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QUARTERLY OVERVIEW OF DOMESTIC ECONOMIC DEVELOPMENTS

DECEMBER 2003

This summary is an early release, excerpted from the upcoming issue of the Central Bank's Quarterly Economic Review for the Quarter ended December 2003. The full text of the Economic Review will be released on March 29 2004.

The Bahamas
Review of Domestic Economic Developments for 4th Quarter, 2003

Preliminary indicators suggest mild strengthening in the Bahamian economy during the fourth quarter of 2003, in comparison to the same period in 2002 and the comparative weakening which occurred in the third quarter. Increased cruise visitor volumes and appreciated stop-over pricing underpinned healthy tourism expenditure growth. The performance, while positively linked to the sustained expansion in the United States' economy, remained constrained by the slowed pace of improvement in US labour markets, where productivity gains, as opposed to increased payrolls, continued to allow firms to accommodate output expansion needs. As US employment conditions strengthen and the households' financial position improve, expenditures on recreation and travel are also expected to firm, with favourable consequences for The Bahamas' tourist sector in 2004. Forward looking indicators for construction also underscored stronger prospects for 2004, mainly backed by proposed foreign investments in the hotel sector. However, fourth quarter investments were weaker than in 2002 owing to reduced growth in residential mortgages.

Constrained by economic conditions and reflecting elevated spending requirements, the fiscal situation featured a marked widening in the estimated budget deficit during the second quarter of FY2003/04. In the financial sector, stronger public sector led expansion in credit, relative to monetary growth, underpinned a seasonal abatement in bank liquidity, which otherwise remained buoyant; and an increase in the system's net foreign liabilities. In this context and amid the Central Bank's continued restriction on increases in financial institutions' Bahamian dollar loans, there was some narrowing in average interest spreads. While inflation estimates for the December quarter indicated some softening in consumer price pressures during the fourth quarter, firming in the annual inflation rate continued, linked to a combination of domestic and external pressures. On the external side, increased net imports and reduced net service inflows caused some widening in the estimated current account deficit, while the capital and financial surplus declined, owing to abated net private sector foreign investment inflows.

Banks' accommodation of increased private sector currency needs, associated with seasonal retail spending caused net free cash balances to contract by 7.2% to $128.9 million during the quarter. However, overall liquidity remained more buoyant than the previous year's close of $88.9 million, and was equivalent to an increased 3.4% of Bahamian dollar deposits, compared to 2.4% in 2002. With banks also reducing holdings of Treasury bills, broader surplus liquid assets declined, on a seasonal basis, by 11.6% to $156.7 million, which still represented an enlarged 25.5% of the statutory minimum as compared to a 16.6% excess in 2002. Buoyant liquidity conditions and the continuation of the Central Bank's tight credit stance influenced a 5 basis points easing in commercial banks' weighted average loan rate to 12.10%. Corresponding deposit rates firmed by 19 basis points to 4.00%, resulting in a 24 basis points narrowing in the estimated interest rate spread on loans and deposits to 8.10%. The 90-day Treasury bill rate also declined by 29 basis points to 1.45%, while base rates—Commercial Banks' Prime and the Central Bank's Discount Rate—were unchanged at 6.00% and 5.75%, respectively.

Led by a recovery in private sector balances, the money supply (M3) expanded by 1.2% to $4.0 billion during the fourth quarter, after contracting by 0.7% to $3.8 billion in 2002. In a turnaround, demand deposits grew by 2.2%, following last year's 3.1% decline, and savings and fixed deposits each rose by 0.7%, as opposed to respective declines of 1.5% and 0.1% in 2002. Meanwhile, growth in the currency component nearly doubled to 6.2% and residents' foreign currency deposits recovered slightly by 0.2%. Fixed deposits remained the largest component (57.8%) in money, followed by demand (18.7%) and savings deposits (17.0%); and approximately three-quarters of all deposits were concentrated in accounts with average balances in excess of $50,000.

After the year-earlier increase of 1.0%, domestic credit expansion accelerated to 4.9%, placing the stock at $4.99 billion. Mainly reflecting the Government's net financing needs, growth in Bahamian dollar credit was nearly three-fold higher at $83.1 million (2.0%), while refinancing of the public corporations' external debt underpinned a 28.7% run-up in domestic foreign currency credit. In particular, net claims on Government increased by 4.0% following a 4.8% net repayment in 2002, while the banking sector's claims on the public corporations rose by $147.3 million (65.3%), with approximately 94.2% denominated in foreign currency. Conversely, private sector credit growth almost steadied at $66.1 million (1.6%), with a slowed increase in residential mortgages lending (2.7%) and a further net repayment of consumer credit (0.7%), outweighed by increases and, in some cases, resumed net lending for some other private sector activities, including distribution and construction.

In the fiscal sector, the estimated deficit for the second quarter of FY2003/04 widened to $36.2 million from $5.0 million in the same period in FY2002/03, with weakness in revenue collections occurring alongside increased expenditure obligations. Constrained by economic conditions, total revenues fell by 6.0%, with decreases in import duties and tourism related taxes causing a 5.8% decline in tax receipts to $206.9 million; and non-tax revenue decreased by 8.0% to $21.7 million. However, total expenditures rose by 6.6% to $264.8 million, including a 7.4% hike in current spending partly linked to retroactive salary increases. This, and slightly elevated net lending to public enterprises, outweighed the 7.2% falloff in capital investments. Budgetary financing during the period featured new borrowings of $34.4 million, mainly in the form of local currency advances from the Central Bank, alongside debt repayment–predominantly domestic currency--of $24.5 million. As a result, the Direct Charge on Government increased by $9.8 million (0.5%) to $1,939.6 million. After a $27.8 million (7.0%) rise in Governments' guaranteed borrowings to $426.5 million, the National Debt rose by 1.6% to $2,366.0 million, culminating in a 7.1% increase in the stock for 2003.

Building on the 2002 recovery, tourism output improved further during the fourth quarter, underpinned by steady growth in cruise visitors and continued pricing gains in the stopover market. Total visitor arrivals strengthened further by 10.0% to 1.127 million, relative to the 10.9% gain posted in 2002. Sea visitor growth, which encompasses the cruise segment, advanced to 11.7% from 7.8%, while air arrivals recorded a more tempered increase of 5.4%, following a 19.4% recovery in 2002. As regard major destination groupings, New Providence's 9.7% rebound in sea traffic supported a 6.7% recovery in total arrivals. Both cruise and stopover gains underpinned the more accelerated growth in visitors to Grand Bahama of 19.5%, and the Family Islands' steady gain in traffic of 12.3%. As regard expenditure indicators, in addition to increased activity in the cruise segment, the Ministry of Tourism's survey of major hotel properties in The Bahamas suggest that, in the stopover segment, estimated room revenues increased by 12.2% during the period. A 3.6% increase in total room night sales was accompanied by an 8.4% appreciation in average nightly room rates to $158.70.

While the outlook for construction was favoured by approved investment projects and increased commitments under domestic mortgage financing, the quarter's output was weaker than in 2002. Indications are that foreign investment inflows fell below the previous year's level, while total disbursements of local residential and commercial mortgages decreased. Although also encompassing equity loans, which finance non-construction expenditures, total mortgage disbursements by banks, insurance companies and the Bahamas Mortgage Corporation decreased by 13.8% to $78.4 million during the fourth quarter, corresponding mainly to reduced financing of housing investments (14.9%) which represented 95% of the total. However, forward looking indicators were encouraging, as the number of mortgage commitments for new construction and repairs of residential and commercial structures rose by 51.2% to 313, with total value increased by 11.6% to $26.9 million. The bulk of the latter ($21.4 million) represented residential commitments, compared to $17.4 million in 2002. Indicative financing costs however, suggested a 30 basis point firming in average interest rates on residential mortgages, to 9.0% vis-à-vis 2002, as compared to a 30 basis point easing in the corresponding commercial rate to 9.5%.

Consumer price inflation, based on quarterly variations in the average Retail Price Index, was comparatively abated to 0.2% from 0.9% in the fourth quarter of 2002. Despite accelerated cost increases, most notably for education and food & beverages, estimated costs for housing, the most heavily weighted component, was approximately unchanged; and only incrementally abated changes registered for most other components of the Index. However, the annual inflation rate rose to 3.0% from 2.2% in 2002, led by firmer increases in average costs for recreation and entertainment services (9.8%) and furniture & household operations (9.8%). These were strongly mitigated by the abatement in average education cost increases to 1.1%, after a tuition-led hike of 12.9% in 2002.

In the external sector, the estimated current account deficit expanded by 31.3% to $157.7 million during the fourth quarter. Reduced exports caused the merchandise trade deficit to widen to $321.9 million from $309.7 million while, despite slightly improved net tourism receipts, the services account surplus declined to $200.7 million from $215.6 million in the previous year, owing to increased net outflows for other external services. Additional pressure was also exerted from growth in net factor income outflows to $46.5 million from $30.8 million in the previous year.

Estimated net capital and financial inflows receded to $34.8 million from $95.6 million in the fourth quarter of 2002. Most notable was the more than one-third reduction in net private direct investments, owing to decreased net equity inflows to $14.7 million from $24.3 million, which overshadowed expanded net real estate inflows of $15.3 million vis-à-vis $12.7 million in 2002. Net private loan financing also declined to $22.1 million from $24.4 million the previous year. Meanwhile, the public sector featured a significant net external debt repayment of $123.0 million relative to a net drawdown of $5.2 million last year, mainly resulting from the $120.0 million refinancing of the electricity corporation's multilateral debt. This correspondingly explained the expanded net short-term inflow through the banking system of $118.1 million, compared to $32.6 million in 2002.