2006

The Central Bank of The Bahamas
ANNUAL REPORT
& Statement of Accounts
For The Year Ended 31 December 2006

Mission Statement

To foster an environment of monetary stability
conducive to economic development, and
to ensure a stable and sound financial system

DIRECTORS AND SENIOR OFFICIALS

At December 31, 2006

BOARD OF DIRECTORS

Wendy M. Craigg - Chairman

Mr Warren Rolle

Mr Carleton Williams, CBE

SENIOR OFFICIALS

Wendy M. Craigg - Governor

Bert A. Sherman - Senior Manager

Cecile M. Sherman - Manager, Banking

Sylvia L. Carey - Manager, Human Resources

Cassandra C. Nottage - Manager, Bank Supervision

Rochelle A. Deleveaux - Legal Counsel & Secretary to the Board

Michael D. Foot - Inspector, Banks and Trust Companies

Gerard L. Horton - Manager, Exchange Control

John A. Rolle - Manager, Research

Keith T. Jones - Manager, Accounts

Errol Bodie - Manager, Information Technology

Ian Fernander - Deputy Manager, Administration

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29 March, 2007

Dear Prime Minister:

In accordance with Section 32(1) of the Central Bank of The Bahamas Act, 2000, I have the honour of forwarding to you, on behalf of the Board of Directors, the Annual Report of the Bank for the year 2006. Included with this Report is the Annual Statement of Accounts of the Bank for the year.

Respectfully yours,

Wendy Craigg
Governor

The Rt. Hon. Perry G. Christie
Prime Minister and Minister of Finance
Office of the Prime Minister
Sir Cecil V. Wallace-Whitfield Center
Cable Beach
Nassau, N.P., Bahamas

DOMESTIC ECONOMIC DEVELOPMENTS

Preliminary indications are that the Bahamian economy continued to expand at a healthy pace in 2006, benefiting from steady growth in construction activity, consumer demand and foreign direct investments, while providing opportunities for further gains in employment. However, activity in the tourism sector was relatively subdued in comparison to 2005, amid apparent broad based weakness in the dominant cruise market segment (see Table 1). Despite the surge in international oil prices to record levels in the middle of the year, overall inflation remained low, in line with trends in The Bahamas' major trading partner, the United States. Fiscal consolidation efforts during the first six months of FY2006/07 were supported by strong revenue gains, resulting in a reduction in the overall deficit.

Financial sector developments featured elevated bank credit, which translated into heightened import demand and, alongside oil price hikes, exerted a contractionary influence on both bank liquidity and external reserves. Correspondingly, the external current account deficit widened substantially, but was partially offset by a near-doubling of the surplus on the capital and financial account, linked to expanded net private foreign investments and short-term inflows through the banking sector.

Buoyant credit demand, favoured by a benign interest rate environment and positive economic fundamentals, led to a contraction in bank liquidity by 38.8% to $117.2 million at end-December 2006, to represent a reduced 2.4% of total Bahamian dollar deposit liabilities vis-à-vis 4.2% in 2005. This extended 2005's 29.5% decline in liquidity to $191.5 million. Average monthly liquidity was more than a third lower at $167.0 million, and the broader excess liquid assets weakened by 39.7% to a monthly average of $153.0 million. Competition among local banks influenced some narrowing in the interest rate spread to 6.61%, as average loan rates fell by 37 basis points to 9.97%, while average deposit rates firmed by 14 basis points to 3.36%. Responding to tightening liquidity conditions, the average 90-day Treasury bill rate moved upwards by 73 basis points to 0.87% during 2006, but official rates—commercial banks' prime and the Central Bank's discount rate—were unchanged at 5.50% and 5.25%, respectively.

Reflecting the quickened pace of credit expansion relative to net foreign currency inflows, money supply (M3) growth slowed to 6.5% from 9.2% in 2005—placing the overall stock at $5,145.1 million. Gains in savings deposits and currency in circulation were reduced to 8.1% and 3.5%, from 13.1% and 10.6%, respectively, in 2005. Additionally, demand deposits contracted by 0.3%, whereas more attractive terms supported strengthened growth in fixed deposits of 8.8%.

Demand for bank credit remained strong for the second consecutive year, increasing by

TABLE 1: Selected Economic Indicators (% Change)

	2003	2004	2005	2006
Occupied Hotel Room Nights	(1.4)	3.1	4.6	(1.9)
Total Arrivals	4.3	8.9	0.6	(4.7) *
Construction Starts - Value	(7.0)	(31.8)	82.4	n/a
Construction Completions - Value	(12.7)	1.8	10.7	n/a
Electricity Generation (mwh)	5.4	(0.8)	5.5	1.8
Water Consumption (gals.)	(0.7)	8.3	n/a	n/a
Retail Price Index	3.0	1.2	2.0	1.8

SOURCE: The Central Bank of The Bahamas

* Change is calculated for YTD October 2006 over YTD October 2005

14.3%, compared with 12.9% in 2005. Consumer credit growth firmed by 2.8 percentage points to 14.5%; however, the expansion in mortgages slowed to 16.3% from 17.4% in 2005. In addition, the public sector's combined net liabilities to the banking system advanced by 13.6%, reinforced by the 31.0% upswing in public corporations' credit growth-reflecting in part The Bahamas Electricity Corporation's $100 million bond issue. This was only partly offset by a deceleration in the growth of net credit to Government, to 5.4% from 17.4% a year-earlier.

Preliminary indications are that the Government achieved further progress in fiscal consolidation, as evidenced by a 29.6% reduction in the estimated budget deficit to $50.0 million during the first six months of FY2006/07. A combination of robust growth in imports, improvements in revenue administration and extraordinary receipts, boosted revenue gains by 14.8% to $626.1 million, eclipsing the 9.7% rise in outlays to $676.0 million. Apart from increased international trade collections, the 12.3% hike in tax receipts was largely associated with stamp taxes on a significant property transaction, coupled with administrative-led improvements in property and departure tax yields. Higher fines, forfeits and administrative fees, along with property income supported growth in non-tax revenues of 56.0%. On the expenditure side, recurrent spending firmed by 6.5%, reflecting higher purchases of goods and services, personal emoluments and transfers and subsidies; and the 31.1% hike in capital expenditures was primarily absorbed by asset acquisitions and public works.

Budgetary financing in the amount of $118.5 million was principally sourced from a $100 million domestic bond issue. Amortization payments included $50 million in Bahamian dollars and a further $3.2 million in foreign currency. After accounting for net borrowings of $146.4 million, the Direct Charge on Government rose by 6.6% to $2,381.7 million for calendar year 2006. However, the National Debt increased at a slightly reduced pace of 5.4% to $2,880.7 million, as guaranteed debt of the public sector grew marginally by 0.4%.

On the external account, a substantially higher import bill combined with a marked reduction in net service inflows caused the current account deficit to deteriorate sharply by $623.5 million to $1,476.5 million. Reflecting the rise in oil prices, the merchandise trade deficit worsened by 5.7%, as net oil import payments firmed by 34.6%. These trends were further exacerbated by a near halving in the estimated services account surplus, from $1,115.0 million to $538.3 million, inclusive of a 2.5% decline in net travel receipts to $1,684.2 million. In particular, foreign direct investment (FDI) financed imports of construction services, for ongoing tourism investment projects, increased five-fold to $213.5 million, "other" services outflows, mainly for advertisements, management fees and overseas usage of credit cards, doubled to $626.6 million and outflows associated with insurance services gained 22.8%.

On the capital and financial account, tourism investment-related net inflows underpinned a widening of the surplus, by an estimated $486.3 million (76.8%) to $1,119.4 million. The upturn was primarily by way of net private inflows, which advanced by 22.7% to $692.1 million. Moreover, inflows under the "other investments" category expanded more than three-fold to $509.5 million, inclusive of an upswing in net private loan financing to $370.7 million from $90.6 million in 2005. The public sector recorded a 49.4% reduction in net repayments to $4.3 million, and had outward portfolio investments of $18.8 million.

Tourism data for the first ten months of 2006 indicated a 4.7% decline in total arrivals to 3.9 million, extending last year's drop of 2.3%. The weakness in visitor arrivals was led by a 7.0% decline in cruise volumes, which more than offset the modest 0.5% increase in the long stay air passengers. Port of entry data revealed a similar pattern for New Providence, where the 6.7% drop in arrivals was largely explained by a 11.1% contraction in sea visitors, with air passengers gaining a mere 0.8%. In the Family Islands, the 2.8% downturn in sea visitors contrasted with the 3.3% upturn in air tourists, for a 1.8% decline in total arrivals. By contrast, Grand Bahama's increase in sea arrivals of 0.3% was out-weighed by a 4.3% reduction in air visitors, driving overall arrivals lower by 1.2%.

During 2006, growth in hotel room revenues, an indicator of stopover expenditure, receded to 4.9% from 9.2% in 2005. In New Providence, room revenues advanced by 4.1%, while earnings in Grand Bahama rebounded by 5.5% and for Family Island properties, by 3.2%.

For 2006, average consumer price inflation trended moderately lower to 1.84% from 1.95% in 2005, amid strongly offsetting trends among the major items in the Retail Price Index. Price contractions were recorded for transportation and communication, education and recreation and entertainment services, in contrast to notably higher average price gains for "other goods & services" and food & beverages.

In the construction sector, more moderate growth in residential investments and substantive gains in resort-related commercial projects, boosted construction output in 2006. Indicative of the favourable interest rate and economic environment, total mortgage loan disbursements rose 22.5% in 2006, following on double digit gains for both residential (19.4%) and commercial disbursements (56.1%). In the context of tightening liquidity conditions, mortgage commitments—a more forward looking indicator of construction activity—fell by 22.9% in number and 21.3% in value.

Over the year, the value of outstanding mortgages expanded by 16.0% to $2,503.9 million, with residential mortgages accounting for 91.4% of the total. In terms of lending sources, the majority of mortgages was extended by the banking sector (87.9%), followed by insurance companies (7.4%) and the Bahamas Mortgage Corporation (4.7%).

FISCAL OPERATIONS

A combination of strengthened tax and non-tax receipts outstripped the growth in expenditures, to achieve a contraction in the estimated fiscal deficit during the first half of FY2006/07. This outcome is expected to be sustained over the short-term, based on favourable growth prospects and ongoing efforts to improve revenue administration.

FY2005/06 Performance

Preliminary estimates for FY2005/06 indicated an improvement in Government's fiscal situation as the deficit contracted from $175.5 million in FY2004/05 to $106.1 million, and was approximately $71.2 million (40.2%) under budgeted expectations. Total revenue, which firmed by 17.5% to $1,221.5 million, exceeded the budget by $88.7 million, while total outlays expanded by 9.3% to $1,327.5 million, approximately $17.4 million higher than targeted (see Table 2).

Revenue performance was led by an 18.3% gain in tax collections to $1,094.5 million, which benefited from an almost equivalent rise in import taxes. Earnings on business and professional license fees surpassed FY2004/05's intake by 22.7%, and motor vehicle taxes rose by 12.6%, although falling short of budget estimates by 11.8%. Similarly, departure taxes were 6.8% below budget, but 10.1% ahead of FY2004/05's receipts. Property taxes were marginally higher by 0.2% at $54.7 million, while all other stamp taxes yielded a 19.4% increase, led by gains in the judicial and commercial components. Both the other taxes—which mainly consisted of insurance companies gross premiums—and export taxes rose by 4.0% and 12.3%, respectively. In contrast, tourism taxes fell by 25.2%, reflecting a 56.0% decline in gaming taxes, following the previous year's extraordinary growth linked to the settlement of arrears.

Non-tax receipts of $125.9 million exceeded both the budget target and FY2004/05's outcome by an estimated $21.7 million. Receipts for fines, forfeits and administrative fees advanced by 9.6%, while earnings from the sale of Government property declined by $0.3 million (15.6%) to $1.7 million.

On the expenditure side, recurrent outlays rose by 9.2% to $1,149.6 million for FY2005/06, which represented approximately 86.6% of total expenditure and was 0.3% higher than budget projections. Outlays for both purchases of goods and services and personal emoluments expanded by $23.2 million (11.0%) to $233.7 million, and by $41.6 million (9.2%) to $494.0 million, respectively. Reflecting an 11.7% hike in subsidies and other transfers (mainly to nonprofit institutions), transfer payments moved higher by $31.6 million (8.1%) to $421.9 million.

Capital expenditures firmed by 36.6% to $123.5 million, although 7.1% below budget estimates. Capital formation absorbed $80.8

million of this total, for a gain of 41.3%, while spending for land and other "miscellaneous" asset acquisitions rose by 67.8% and 15.5%, to $14.4 million and $24.3 million, respectively.

Financing for FY2005/06 included Bahamian dollar borrowings of $201.6 million, all of which was obtained through the sale of Government bonds. Debt amortization comprised $57.2 million in Bahamian dollar obligations and $4.9 million in foreign currency.

2006/2007 Budget

The Budget for FY2006/07, which was approved by Parliament in June 2006, was framed within the context of favourable prospects for sustained expansion of the Bahamian economy. These expectations, alongside revenue administration enhancements, reinforced the Government's commitment to progressively minimize the debt-to-GDP ratio to 30.0% and to reduce the GFS deficit from 2.8% of GDP to 1.9% in FY2006/07. Under the expenditure budget, increased outlays were earmarked for the Police, Defense Force, Immigration, Customs Department, the judicial system and for social services, such as education, training, disaster relief, housing and health. Additionally, the budget proposed a reduction of customs duties on hurricane prevention and environmental protection purchases, and articulated the Government's intention to increase outlays for the Urban Renewal Program.

The 2006/07 Budget did not propose any tax increases or new taxes. Instead, the Government undertook to improve the efficiency and effectiveness of the tax collection process through tightening revenue administration, while increasing fees for certain services.

In comparison to FY2005/06 targets, revenue and grant receipts are budgeted to rise by 18.2% to an estimated $1,339.0 million. However, approved expenditure—including net lending to public corporations—is set to grow by 11.8% to $1,464.3 million.

Tax receipts are expected to increase by 16.5% to $1,196.0 million, due to boosted earnings from taxes on international trade and transactions (15.6%), tourism taxes (12.7%), business and professional license fees (11.3%), property taxes (9.5%) and departure taxes (5.4%). Non-tax revenue is budgeted to expand by $31.7 million (30.5%), in anticipation of overall gains from fines, forfeits and administration fees (13.6%), as well as income from other sources (68.9%) which includes property income. Capital revenues are also expected to enlarge the overall revenue position by a further $6.5 million.

Expenditure projections are $153.3 million (12.0%) higher at $1,431.9 million, to which is added the 2.9% hike in provisions for net lending to $32.4 million. Current expenditures are anticipated to grow by $123.9 million (10.8%) to $1,269.6 million. Of this total, personal emoluments, at 43.6%, are set to advance by 9.5%, partly due to pay increase provisions for the public service; and payments for goods and services, at 21.7% of the total, are forecast to rise by 13.0%. Transfer payments are

TABLE 2: Government's Budget (B$'000)

	FY2004/05	FY2005/06		FY2006/07	
	Actual	Approved Estimates	Preliminary Estimates	Approved Estimates	Preliminary[1] Estimates
Government Revenue	1,039,376	1,132,774	1,221,454	1,338,971	626,071
Government Expenditure (i+ii+iii)	1,214,903	1,310,092	1,327,534	1,464,321	676,036
i) Recurrent Expenditure	1,053,095	1,145,691	1,149,582	1,269,560	582,859
ii) Capital Expenditure	90,374	132,901	123,454	162,356	65,499
iii) Net Lending	71,434	31,500	54,498	32,405	27,678
Surplus/(Deficit)	(175,527)	(177,318)	(106,080)	(125,350)	(49,965)

SOURCE: Ministry of Finance

Compiled according to the IMF's Government Finance Statistics Format. 1July - December, 2006 budgeted 11.1% higher at $440.5 million, and include increased allocations for subsidies and transfers to non-profit institutions and non-financial public enterprises. In addition, reflecting the rise in the outstanding debt stock, interest payments are expected to rise by 5.9%.

Capital expenditures for FY2006/07 are targeted to increase by 22.2% to $162.4 million, with allotments for economic services up by 18.4% to $77.5 million; education, by 24.3% to $24.3 million; health, by 5.2% to $13.9 million; defense, by 51.1% to $7.5 million; and general public service, by 27.8 % to $28.9 million.

The overall budget deficit for FY2006/07 at $125.4 million is 29.3% lower than in FY2005/06, and approximately 1.9% of GDP. Local borrowing projections declined by 3.2% to $195.3 million, with an additional $32.7 million to be obtained from external sources. Given scheduled debt servicing and the planned funding profile, the Direct Charge on Government for FY2006/07 is likely to increase by approximately $125.4 million (5.4%) to $2,441.7 million, elevating the National Debt to $2,950.6 million.

First 6 Months of FY2006/07

Budgetary operations for the first six months of FY2006/07 indicated an improvement in the overall position, to a deficit of $50.0 million from $71.0 million in the comparable year-earlier period. This outturn benefited from increased revenue collections, due largely to a combination of enhanced revenue administration and compliance, non-recurring gains, and the general buoyancy in economic activity. Consequently, total receipts expanded by 14.8% to $626.1 million, with both tax and non-tax revenue yields approaching 47.0% of budgeted expectations. On the other hand, total expenditure, inclusive of net lending, rose by 9.7% to $676.0 million, which represented some 46.2% of the budget target and was attributed to growth in purchases of goods and services, personal emoluments and an advance in transfers to the Public Hospitals Authority and households. Capital spending grew by 31.1% to $65.5 million, being concentrated in outlays for public infrastructure works and asset acquisitions.

Accounting for 90.2% of total revenue, tax receipts rose by an estimated 12.3% to $564.5 million, benefiting from higher yields for taxes on international trade, stamp, property and departure taxes. Buoyancy in economic activity combined with ad valorem gains from the rising value of oil imports supported growth in international trade taxes, by 12.1% to $309.0 million, with double digit increases in both import (12.5%) and related stamp (13.7%) taxes. Also to be added to this category is the 25.8% hike in other "miscellaneous" taxes, to $76.0 million, which represent undistributed revenues. Stamp taxes from other activities improved by 18.2%, boosted by a significant private sector share buyback programme. Departure taxes advanced by 12.7% to $32.4 million, and property taxes were up by 18.5% to $29.0 million. Despite the 36.1% contraction in room occupancy taxes to $5.5 million, selective tourism taxes increased by 2.5% to $10.7 million, supported by an almost three-fold hike in gaming taxes to $5.2 million. Motor vehicle taxes moved higher by 2.2% to $7.1 million; however, business and professional license fees declined by 27.3% to $13.0 million, reflecting notable reductions for international business companies' fees, other license fees and general business fees.

Non-tax revenue strengthened by $22.1 million (56.0%) to $61.5 million, led by increases in income from other sources ($10.7 million) as well as fines, forfeits & administrative fees ($11.8 million).

On the expenditure side, recurrent spending, at 86.2% of the total, advanced by $35.7 million (6.5%) to $582.9 million. Personal emoluments (44.9% of the total) rose by 8.1% to $261.9 million; and purchases of goods and services moved up by 9.7% to $103.3 million. Transfer payments were higher by $7.0 million (3.3%), led primarily by a 5.1% hike in subsidies and other transfers, due to an increase in transfers to the Public Hospitals Authority (11.4%), non-financial public enterprises (24.3%) and households (28.2%). In contrast, interest payments declined marginally by 1.2% to $59.2 million.

Capital expenditures grew by $15.5 million (31.1%) to $65.5 million, explained by a 65.2% rise in the acquisition of assets and a 18.5% increase in capital formation. Further, net lending to public entities rose by 45.3% to $27.7 million.

Budgetary financing for the first six months of FY2006/07 included a $100.0 million domestic bond issue, a $15.0 million advance from the Central Bank and $3.5 million in drawings on external loans. Amortization payments comprised $50.0 million to settle Bahamian dollar debt and $3.2 million for foreign currency loans.

During calendar year 2006, the Direct Charge on Government increased by $146.4 million to $2,381.7 million. Bahamian dollar claims, which constituted 87.9% of the total, rose by $144.4 million to $2,093.1 million. By creditor composition, the majority of Bahamian dollar debt was held by public corporations (36.5%), followed by private and institutional investors (32.5%), commercial banks (21.6%), the Central Bank (9.1%) and Other Local Financial Institutions (0.3%).

Government's contingent liabilities increased marginally by 0.4% to $499.1 million in 2006. As a consequence, the National Debt expanded by $148.3 million (5.4%) to $2,880.7 million at end-December 2006, following a $194.7 million (7.7%) increase in 2005.

Foreign Currency Debt

As Table 3 shows, public sector foreign currency debt grew by $77.2 million (14.0%) to $628.2 million at end-December 2006, reflecting a three-fold rise in drawings to $126.8 million, which outpaced a 30.3% decline in repayments to $49.6 million. Public Corporations' debt, which accounted for 54.1% of the total, rose by $75.2 million (28.4%), following the issuance of a partial foreign currency denominated bond by the electric utility corporation. Government's liabilities—at 45.9% of the total—rose incrementally by $2.0 million (0.7%) to $288.6 million.

Table 3: Public Sector Foreign Currency Debt (B$ Millions)

	2004p	2005p	2006p
A. EXTERNAL DEBT	**342.8**	**335.1**	**329.4**
i) Government	284.6	286.5	287.0
ii) Public Corporations	58.2	48.6	42.4
of which Gov't Guaranteed	53.8	48.0	42.1
B. INTERNAL F/C DEBT	**236.5**	**215.9**	**298.8**
i) Government	-	-	1.6
ii) Public Corporations	236.5	215.9	297.2
of which Gov't Guaranteed	159.1	170.8	151.9
C. TOTAL F/C DEBT	**579.3**	**551.0**	**628.2**
D. DEBT SERVICE RATIO (%)	**3.4**	**3.3**	**2.6**

SOURCE: Treasury Accounts, Treasury Statistical Printouts and Public Corporations' Report

Creditor profile data indicated that the largest share of the foreign currency debt was held by commercial banks (47.6%), followed by private capital markets (35.8%) and multilateral institutions (16.6%). The average maturity of the debt was just under 13 years, with 99.7% of the liabilities denominated in US dollars.

Total debt service contracted by 16.6% to $84.7 million, as the $21.6 million (30.3%) reduction in amortization payments surpassed the $5.0 million (16.4%) rise in interest charges. Taking into consideration exports of goods and non-factor services, the debt service ratio narrowed to 2.7% from 3.3% in 2005; however, the ratio of Government's foreign currency debt service to total revenue was unchanged at 1.9%.

REAL SECTOR

Tourism

Partial data for the tourism sector suggests an overall moderation in output growth during 2006. The improvement in hotel performance was offset by sustained weakness in sea arrivals, as the local cruise industry appeared to be adversely affected by increased competition from other Caribbean and extra-regional markets.

Total visitor arrivals for the first ten months of 2006 fell by 4.7% to 3.9 million, extending the comparative 2.3% decline of 2005. Despite the 2.3% increase in cruise ship calls, sea visitors, the largest segment of the tourist market, decreased by 7.0% to 2.7 million, while air visitors advanced marginally by 0.5% to 1.3 million (see Table 4).

By port of entry, total arrivals to the country's largest hub, New Providence, decreased by 6.7%, reflecting the more significant fall in sea visitors (11.1%) vis-à-vis the

TABLE 4: Tourism Statistics

	2005	2006	% Change 2005	% Change 2006
Air Arrivals	1,514,532	1,276,377 *	4.4	0.5 **
Sea Arrivals	3,521,286	2,653,626 *	(0.5)	(7.0) **
Total	5,035,818	3,930,003	0.6	(4.7) **
Occupied Room Nights	2,270,018	2,225,939	4.6	(1.9)
Hotel Occupancy	70.4%	68.2%	6.1	(2.2)
Avg. Daily Room Rate(B$)	156.56	166.38	4.4	6.3

SOURCE: The Bahamas Ministry of Tourism

* Air and Sea Arrivals are YTD October 2006

** Change is calculated for YTD October 2006 over YTD October 2005

marginal (0.8%) hike in air tourists. Data for the Grand Bahama market indicated a 1.2% decline in overall arrivals, owing primarily to the 4.3% reduction in air visitors, as sea tourists edged upwards by 0.3%. In the Family Islands, the total number of visitors fell by 1.8%, characterized by a 2.8% decline in the larger sea arrival component, which outpaced the 3.3% increase in air visitors (see Table 5).

Hotel indicators for the year highlighted a comparatively weakened revenue performance, as the firming in room rates overshadowed marginal declines in occupancy levels. Total hotel revenue expanded by 4.2%, although significantly below the 9.2% advance of 2005. Average daily room rates increased by 6.3% to $166.38 for the period; however, average room occupancy rates softened by 2.2 percentage points to 68.2%, as available room nights increased, while the growth in air arrivals softened.

In the New Providence market, room revenues advanced by 4.1%, reflecting a 4.5% hike in average daily rates which offset the 0.4% decline in occupied room nights. In addition, hotel earnings in Grand Bahama increased by 5.5%, due to a 14.1% surge in daily room rates. Despite a 13.9% resurgence in available room nights, following the recovery of the island's tourism industry after several major hurricanes over the past few years, the number of room nights sold contracted by 7.5%. With regards to the Family Islands, overall hotel revenues expanded by 3.2%, occasioned by a 9.3% increase in average daily rates, which outpaced the 5.6% contraction in occupied room nights.

The outlook for the sector in 2007 remains relatively positive, owing to expected improvements in the US economy and expansions in the total available room stock. However, indications are that the cruise market will continue to face increased competition in the coming years as the major carriers shift capacity from the Caribbean to Europe and other high major destinations.

TABLE 5: Growth in Tourist Arrivals (%)

PORTS OF ENTRY	2004	2005	2006*	2006* Market Share
Nassau/Paradise Island	12.2	0.7	(6.8)	58.4
Grand Bahama	15.7	(10.7)	(1.2)	13.8
Rest of Family Islands	(0.9)	6.7	(1.8)	27.8
TOTAL	**8.9**	**0.6**	**(4.7)**	**100.0**

SOURCE: The Bahamas Ministry of Tourism

* Change is calculated for YTD October 2006 over YTD October 2005

Prices

Consumer price inflation, as measured by changes in the Average Retail Price Index, moderated to 1.84% from 1.95% in 2005 (See Table 6), reflecting declines in average costs for transport and communications (1.97%), education (0.44%) and recreation and entertainment services (0.15%). Moreover, average cost increases for housing—the most heavily weighted component—and medical care and health slowed by 1.10 and 1.67 percentage points, to 1.66% and 1.75%, respectively. In contrast, average prices strengthened for other goods and services (6.74%), food and beverages (4.68%), furniture and household operations (2.02%), and clothing and footwear (1.14%).

In 2006, the surge in global oil prices resulted in an increase in domestic fuel costs. For New Providence, by end-December, diesel prices were 12.9% higher at $3.32 per gallon, and gasoline prices rose by 11.4% to $4.11 per gallon vis-à-vis 2005. Moreover,

TABLE 6: Average Annual Percentage Changes in Retail Price Index, New Providence

(Oct./Nov. 1995 = 100)

Group	Weight	2005	2006
Food & Beverage	138.3	3.15	4.68
Clothing & Footwear	58.9	(2.22)	1.14
Housing	328.2	2.76	1.66
Furniture & Household Operation	88.7	1.27	2.02
Medical Care & Health	44.1	3.42	1.75
Transportation & Communication	148.4	2.54	(1.97)
Recreation, Entertainment & Services	48.7	0.28	(0.15)
Education	53.1	3.33	(0.44)
Other Goods & Services	91.6	1.89	6.74
ALL ITEMS	1,000.0	1.95	1.84

SOURCE: Department of Statistics

the fuel surcharge added by the Bahamas Electricity Corporation (BEC) rose appreciably by 40.8% to 10.50¢ per kwh in 2006.

Construction

Ongoing resort developments, alongside increased residential and commercial housing investments, reinforced a strengthening in construction output during 2006. These trends are expected to continue throughout 2007, although the momentum will depend on liquidity conditions, and the rate at which approved foreign investments get underway.

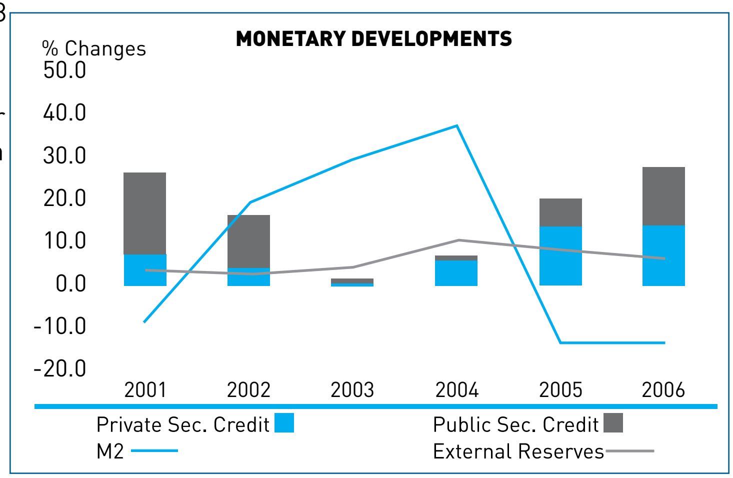
Total domestic mortgage loan disbursements, as reported by banks, insurance companies, and the Bahamas Mortgage Corporation, expanded by 22.5% to $607.9 million—although a portion is used for non—construction related purposes. More specifically, disbursements in the dominant residential sector rose by 19.4% to $543.1 million, while commercial disbursements surged by 56.1% to $64.8 million.

Mortgage commitments for new construction and repairs to existing structures—a more forward looking indicator of construction activity—contracted in number and value, by 22.9% and 21.3%, to 1,451 and $180.3 million, respectively. The residential component weakened by nearly 20.0% to $172.0 million, with a larger 42.9% drop for commercial commitments to $8.4 million.

For the year, mortgages expanded by 16.0% to $2,503.9 million, broadly in line with the increase registered a year earlier. Residential loans, which accounted for approximately 91.4% of the total, grew at a slightly lower rate of 15.9%, while growth in the commercial segment firmed to 16.8% from 13.9% in 2005. By creditor profile, the domestic banking system disbursed the majority of loans (87.9%), followed by insurance companies (7.4%) and the Bahamas Mortgage Corporation (4.7%). The combined average interest rate offered by these entities softened for residential loans by one basis point to 8.3% and for commercial loans by three basis points to 8.9%.

MONEY, CREDIT AND INTEREST RATES

Strong domestic demand, amid



positive economic fundamentals and a relatively low interest rate environment, led to a strengthening in private sector credit throughout 2006, an increase in the net foreign liabilities of the banking system and a corresponding slowing in monetary growth. As a consequence, liquidity conditions tightened, and the weighted average interest rate spread contracted. Meanwhile,

TABLE 7: Central Bank Foreign Exchange Transactions (B$'000)

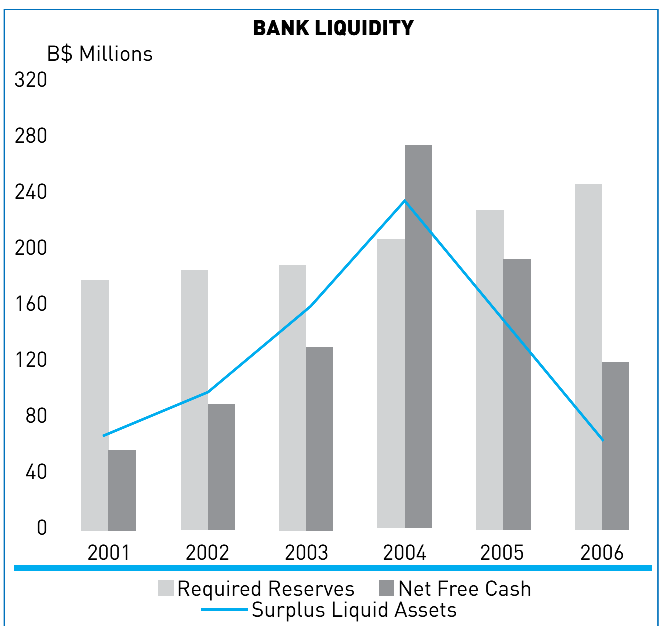
Period	Commercial Bank Purchases	Commercial Bank Sales	Commercial Bank Net Purchase/ (Sale)	Government Purchases	Government Sales	Government Net Purchase/ (Sale)	Other Purchases	Other Sales	Other Net Purchase/ Sale	Total Purchases	Total Sales	Total Net Purchase/ (Sale)
Qtr.I	146,198	83,676	62,522	41,822	24,329	17,493	3,778	35,020	(31,242)	191,798	143,025	48,773
Qtr.II	139,306	77,258	62,048	54,923	48,523	6,400	20,973	57,277	(36,304)	215,202	183,058	32,144
Qtr.III	88,404	148,278	(59,874)	36,579	28,757	7,822	4,946	85,768	(80,822)	129,929	262,803	(132,874)
Qtr.IV	101,277	144,817	(43,540)	45,400	33,279	12,121	5,360	77,971	(72,611)	152,037	256,067	(104,030)
2005	**475,185**	**454,029**	**21,156**	**178,724**	**134,888**	**43,836**	**35,057**	**256,036**	**(220,979)**	**688,966**	**844,953**	**(155,987)**
Qtr.I	163,792	64,209	99,583	48,580	38,842	9,738	6,408	61,502	(55,094)	218,780	164,553	54,227
Qtr.II	114,180	54,676	59,504	44,480	37,151	7,329	5,204	64,625	(59,421)	163,864	156,452	7,412
Qtr.III	54,128	117,553	(63,425)	70,805	30,726	40,079	1,106	85,164	(84,058)	126,039	233,443	(107,404)
Qtr.IV	36,176	82,926	(46,750)	56,895	47,091	9,804	56,864	67,902	(11,038)	149,935	197,919	(47,984)
2006	**368,276**	**319,364**	**48,912**	**220,760**	**153,810**	**66,950**	**69,582**	**279,193**	**(209,611)**	**658,618**	**752,367**	**(93,749)**

SOURCE: The Central Bank of The Bahamas

banks' performance indicators reflected an overall improvement in profitability during 2006, and asset quality indicators remained relatively healthy.

Liquidity

For 2006, average monthly liquidity, as measured by banks' free cash balances, contracted by 35.8% to $167.0 million. After peaking in May at $217.8 million, balances receded to $117.2 million at year-end, and represented a smaller 2.4% share of Bahamian dollar deposit liabilities compared to 4.2% in 2005. A similar pattern was observed for the broader liquid assets, which fell by 56.0% to $63.1 million at end-2006, equivalent to a reduced 7.9% of the statutory minimum vis-à-vis 19.1% in 2005.



Foreign Exchange

Patterns in the Central Bank's foreign exchange transactions reflected a combination of the heightened economic demand impulses, elevated oil payments, public sector foreign currency borrowing activities and several extraordinary transactions. The Bank's net foreign currency sale was reduced by nearly 40% to $93.7 million, based on a 11.0% decline in sales to $752.4 million, and a 4.4% drop in purchases to $658.6 million (see Table 7). The net purchase from commercial banks increased more than two-fold to $48.9 million; purchases and sales were down by nearly one-third to $368.3 million and $319.4 million, respectively. Public Corporations' borrowing proceeds near year's end, offset the earlier increased demands associated with oil payments, for a 5.1% decline in the net sale to these customers to $209.6 million. Moreover, extraordinary foreign currency receipts, associated with a realty transaction, boosted the net purchase from Government by 52.7% to $67.0 million.

As a consequence of these transactions, external reserves contracted by $79.1 million (13.7%) to $499.7 million, extending last year's decline of $89.0 million (13.3%) to $578.8 million. Balances, which averaged $580.2 million over the year, reached a record month-end peak of $665.5 million in May, and declined steadily thereafter to a low of $450.6 million in November, before increasing by $49.1 million in December. At end-2006, reserves were equivalent to an estimated 14.6 weeks of non-oil merchandise imports compared to 18.5 weeks at end-2005. By law, the Central Bank is required to keep, at a minimum, external balances which are equivalent to 50.0% of its demand (currency and deposit) liabilities. After discounting the external balances from this amount, "useable reserves" stood at $201.5 million compared to $257.8 million in 2005.

TABLE 8: Flow of Credit In The Financial System (B$ Millions)

	Outstanding as at 2004	Absolute Changes 2005	Absolute Changes 2006	Outstanding as at 2006
DESTINATION				
Government (net)	547.1	95.4	34.5	677.0
Central Bank	141.9	(19.9)	60.5	182.5
Domestic Banks	405.2	115.3	(26.0)	494.5
Rest of Public Sector	340.7	(37.4)	93.9	397.2
Central Bank	8.6	(0.3)	(0.2)	8.1
Domestic Banks	332.1	(37.1)	94.1	389.1
Private Sector	4,339.4	614.3	715.0	5,668.7
FINANCING				
Liabilities to the private sector & rest of the public sector	4,421.5	408.7	314.9	5,145.1
Currency	176.6	18.7	6.8	202.1
Demand deposits	1,045.7	122.1	14.3	1,182.1
Savings deposits	784.1	101.6	71.2	956.9
Fixed Deposits	2,415.1	166.3	222.6	2,804.0
International reserves	667.8	(89.0)	(79.1)	499.7
Other net external liabilities ( ) = increase	(563.8)	(47.2)	(143.1)	(754.1)
Capital and surplus	1,219.6	83.3	179.0	1,481.9
Other (net)	309.9	(44.1)	(127.3)	138.5

SOURCE: The Central Bank of The Bahamas

Money Supply

Money supply growth slowed in 2006, amid the comparatively strengthened upswing in private sector credit and scaled back net foreign currency inflows. Narrow money (M1), which contributed 24.3% to the overall stock, increased by a modest 0.3% to $1,251.1 million, compared with a 10.0% expansion in 2005. Demand deposits contracted by 0.3%, in contrast to a 9.9% hike in 2005, while accretions to currency in active circulation receded to 3.5% from 10.6% in the previous year.

The expansion in broad money (M2) tapered to $299.9 million (6.4%) from $361.4 million (8.4%) a year-earlier. Reflecting an easing in the accumulation of private sector deposits, savings deposits growth was reduced to $71.5 million (8.1%) from $101.9 million (13.1%) in 2005, and higher returns supported strengthened gains in fixed deposits of 8.8% from 6.1%.

On account of a significant reduction in public corporations' deposits, gains in residents' foreign currency balances slowed by almost a third to $15.0 million (10.4%). As a result, overall money (M3) growth was pegged at $314.9 million (6.5%), for an end-year stock of $5,145.1 million, relative to growth of 9.2% in 2005 and 10.4% in 2004.

Bahamian dollar fixed deposits maintained the largest share of the money stock (54.1%), followed by demand deposits (20.4%) and savings deposits (18.5%), with single digit proportions held by currency in circulation (3.9%) and residents' foreign currency deposits (3.1%). Categorized by holder, private individuals accounted for the major share (58.1%) of Bahamian dollar deposit liabilities. Next were business firms (24.6%), the public sector (9.9%), 'others' (4.8%)—which included institutional investors—and private financial institutions (2.6%).

Based on the value and number of deposit accounts, balances up to $10,000 represented some 90.2% of accounts, but only 8.0% of the aggregate value of deposit liabilities. Placements ranging between $10,000 and $50,000 accounted for an estimated 6.8% of the accounts and 13.5% of the aggregate value. Conversely, balances valued at over $50,000 constituted 78.5% of the total value, but only 3.0% of the aggregate number of accounts.

Domestic Credit

Buoyant consumer demand underpinned an acceleration in domestic credit growth to $843.4 million (14.3%) in 2006, exceeding the $672.3 million (12.9%) advance in 2005. Bahamian dollar credit dominated the uptrend, with a 13.8% hike; while public sector borrowing elevated the growth in foreign currency claims to 17.9%.

The rate of expansion in private sector credit was maintained at 14.4%, boosting the change by approximately $100.7 million to $715.0 million (see Table 8). The Bahamian dollar portion rose by 15.6% relative to 13.1% in 2005; however, foreign currency claims, which increased significantly by 25.2% in 2005, on account of funding associated with the Cable Beach redevelopment project, slackened to a 3.4% gain in 2006.

Growth in personal loans, which represented 72.2% of private claims, was extended to 15.7% from 13.9% in 2005. The housing sector, mainly residential mortgages, continued to be a key driver of bank credit, recording sustained growth of 16.3% ($287.8 million) and absorbing 39.5% of the incremental value and a 29.0% share in overall credit. Consumer credit also registered a double digit gain of 14.5% or $241.5 million vis-à-vis 11.7% in 2005, and personal overdrafts reversed to growth of $23.8 million (44.2%) from a net repayment of $2.6 million a year-earlier.

The rise in consumer credit was broad-based, with net lending notably increased for miscellaneous ($77.0 million) purposes, consolidation of debt ($46.6 million), credit cards ($38.3 million), land purchases ($26.7 million), and private cars and home improvements ($18.5 million each).

TABLE 9: Sectoral Distribution of Bank Credit (B$ Millions)

Sector	2005 $	2005 %	2006 $	2006 %
Agriculture	10.3	0.2	11.3	0.2
Fisheries	14.7	0.3	13.3	0.2
Mining & Quarrying	15.3	0.3	11.2	0.2
Manufacturing	47.4	0.9	51.7	0.9
Distribution	178.7	3.3	217.0	3.6
Tourism	258.6	4.8	253.7	4.2
Entertainment & Catering	63.6	1.2	59.3	1.0
Transport	20.9	0.4	22.9	0.4
Construction	312.8	5.9	412.3	6.8
Government	150.7	2.8	156.3	2.6
Rest of Public Sector	265.8	5.0	268.1	4.4
Private Financial Institutions	20.0	0.4	27.8	0.5
Professional & Other Service	125.5	2.3	156.4	2.6
Personal	3,525.8	66.0	4,078.0	67.2
Miscellaneous	332.6	6.2	332.2	5.5
TOTAL	**5,342.7**	**100.0**	**6,071.3**	**100.0**

SOURCE: The Central Bank of The Bahamas

Other categories of private sector credit registering gains were construction ($99.6 million), distribution ($38.3 million), professional & other services ($30.9 million), private financial institutions ($7.7 million), manufacturing ($4.3 million) and transport ($2.0 million). Conversely, net repayments were posted for tourism ($5.0 million), entertainment & catering ($4.3 million), mining & quarrying ($4.1 million) and fisheries ($1.4 million) (see Table 9).

The banking sector's net claim on the public sector expanded by 13.6% ($128.4 million), as a public corporation's bond issue elevated this sector's credit growth to $93.9 million (31.0%), in contrast to a net repayment of $37.4 million (11.0%) in 2005. However, accretions to net claims on Government slackened to $34.5 million (5.4%) from $95.4 million (17.4%) in 2005.

Interest Rates

Amid more tightened liquidity conditions and competition among commercial banks, the weighted average spread on commercial banks' loan and deposit rates narrowed by 51 basis points to 6.61% for 2006. The weighted average deposit rate firmed by 14 basis points to 3.36%, whereas the counterpart loan rate fell by 37 basis points to 9.97%, reflecting the more competitive lending environment. Further, the average

90-day Treasury bill rate advanced by 73 basis points to 0.87%. However, benchmark rates—the Central Bank's Discount Rate and commercial banks' Prime—held steady at 5.25% and 5.50%, respectively.

On the lending side, the easing in rates was evidenced by a reduction in the average interest rate for consumer loans, by 26 basis points to 11.96%; overdrafts, by 29 basis points to 10.56% and residential mortgages, by 23 basis points to 7.84%. Conversely, the average rate for commercial mortgages rose by 27 basis points to 8.37%. With regards to deposits, the average savings rate fell by 10 basis points to 2.16%, while the average range for fixed deposit rates trended upwards to 3.17% - 4.17% from 3.13% - 3.62% in 2005.

Net Foreign Assets

As Table 10 illustrates, the financial system's net foreign liabilities rose sharply by $222.1 million to $254.4 million during 2006. Public sector borrowings contributed significantly to a $143.1 million (23.4%) hike in domestic banks' net foreign liabilities, to $754.1 million. Additionally, the Central Bank's external reserves declined by $79.0 million (13.7%) to $499.8 million, with the average monthly level 16.9% lower at $580.2 million.

Asset Quality

Quarterly surveys revealed a broadly positive trend in domestic banks' asset quality during 2006, amid robust growth in bank loans of $655.6 million (14.2%). Total arrears as a percentage of banks' total non-Government Guaranteed loans contracted to 7.7% from 8.3% in 2005 and 9.4% in 2004. Loan arrears on residential mortgages also narrowed by 1.6 percentage points to 7.2% of total loans, while consumer loan delinquencies fell by 0.2 percentage points to 8.0%. In contrast, the arrears rate for commercial loans was marginally

TABLE 10: Foreign Asset Positions (B$'000)

	2004	2005	2006
1. THE CENTRAL BANK			
EXTERNAL RESERVES (Beginning of Year)	484,324	667,823	578,796
a. SALES TO:			
i) Commercial Banks	340,996	454,029	319,364
ii) Government	120,115	134,888	153,810
iii) Other Customers	181,002	256,036	279,193
Total Sales	642,113	844,953	752,367
b. PURCHASES FROM:			
i) Commercial Banks	653,569	475,185	368,276
ii) Government	131,069	178,724	220,760
iii) Other Customers	13,971	35,057	69,582
Total Purchases	798,609	688,966	658,618
c. Reserve Tranche	441	(775)	470
d. SDR Tranche	13	(21)	4
e. Other	26,549	67,756	14,241
INCREASE/(DECREASE)	183,499	(89,027)	(79,034)
EXTERNAL RESERVES (End of Year)	667,823	578,796	499,762
2. DOMESTIC BANKS			
NET FOREIGN ASSETS (Beginning of Year)	(628,060)	(563,483)	(611,037)
a. Foreign Exchange Transactions	(3,740)	(3,996)	(14,963)
i) Net Purchase/(Sale): Central Bank	(312,573)	(21,156)	(48,912)
ii) Net Purchase/(Sale): Others	308,833	17,160	33,949
b. Changes in Local Liabilities	488,862	581,662	696,415
c. Changes in Local Assets	424,285	629,216	839,497
INCREASE/(DECREASE) (During Year)	64,577	(47,554)	(143,082)
NET FOREIGN ASSETS (End of Year)	(563,483)	(611,037)	(754,119)
3. TOTAL NET FOREIGN ASSETS (End of year)	104,340	(32,241)	(254,357)

SOURCE: The Central Bank of The Bahamas

Box 1: Monetary Policy During 2006

The Monetary Policy Committee (MPC) was established by the incumbent Governor in 1980 to promote efficiency and transparency in the formulation and conduct of monetary policy, and to ensure a well-organized decision-making process. The MPC also formulates recommendations for the Government on fiscal and Exchange Control matters, and reviews banking supervision issues as they impact the domestic financial system. The MPC is chaired by the Governor and its membership includes several department heads. While the Governor is ultimately responsible for the policies promulgated by the Bank, the Committee formally assists this process, and credibility is ensured by the consensus nature of decisions acted upon by the Governor.

During 2006, the MPC actively monitored economic developments, along with indicators of domestic credit, liquidity and loan quality, to ensure that the evolution of these trends was consistent with financial sector and overall macroeconomic stability. Given the continued strong growth in credit and the consequent fall-off in liquidity levels, the Bank, on several occasions, communicated to the banking community, the need for credit restraint and strict adherence to guidelines regarding equity requirements and other prudential norms.

During the year, the Bank worked closely with the Bahamas International Securities Exchange (BISX) and the Government, to develop a framework for the listing of Bahamas Government Registered Stock (BGRS) on BISX, as well as the migration of secondary market transactions of BGRS from the Bank to the Exchange. In addition, the Bank and relevant Government ministries, coordinated efforts aimed at bringing money transmission businesses (MTBs) under the regulatory and supervisory responsibility of the Central Bank.

The MPC continued to monitor developments in the Payments System Modernization Initiative, relative to the Automated Clearing House (ACH) project and the work of the commercial banks' ACH Task Force, as it sought to progress to the next stage of the ongoing modernization of the domestic payments system.

During 2006, the MPC remained consistent in its efforts to share with the banking community and the general public, information utilized by the Committee in the formulation of monetary policy. This was achieved chiefly through the publication of its Monthly Economic and Financial Developments Reports, which cover data and analysis on selected trends monitored by the Bank.

increased by 0.6 percentage points to 8.1%.

The ratio of non-performing loans—those with payments 90 days or more past due—to total loans, narrowed slightly to 4.2% from 4.5% in 2005. Reflecting the conservative posture of the banking system, total loan loss provisions firmed by $27.5 million (30.8%) to $117.1 million, exceeding the $1.7 million (1.9%) rise in 2005, and with the ratio to total loans higher at 2.3% from 2.0%. Provisions, as a percentage of non-performing loans, also advanced to 54.2% from 44.9% last year.

Bank Profitability

Bank profitability was buoyed by the heightened level of economic activity and sustained growth in credit. For the four quarters through September 2006, net income increased by $72.6 million (35.6%) to $276.2 million, appreciably higher than the $12.1 million (6.3%) rise in the comparative 2005 period. Despite the modest narrowing in the effective interest rate spread on Bahamian dollar loans and deposits, to 6.35% from 6.43%, the rapid growth in the total value of loans relative to deposits resulted in the net interest margin widening by $79.5 million (23.9%) to $411.6 million. Commission and foreign exchange income was on par with the previous year's $27.9 million; however, higher staff and occupancy expenses boosted operating costs by $19.4 million (9.8%), tempering growth in the net earnings margin to $60.1 million (37.0%). "Other" income, net of depreciation and bad debt expenses, improved by $12.4 million (30.2%) to $53.6 million. This development occurred despite the boost in the loan-loss provisions relative to impaired loan servicing, which resulted in bad debt expenses expanding by $6.1 million (25.2%) to $30.2 million. Additionally, depreciation costs were relatively stable at $12.1 million.

Expressed as a proportion of average balance sheet assets, the net income ratio (return on assets) firmed to 3.90% from 3.09% in 2005. The gross earnings margin, the combined ratio of net interest income and commissions and fee income, widened by 74 basis points to 6.20%, and the operating cost ratio firmed by 6 basis points to 3.06%. Moreover, the other income (net of depreciation and other non-cash expenses) ratio was higher by 12 basis points at 0.75%.

PAYMENT AND SETTLEMENT DEVELOPMENTS

Real Time Gross Settlement (RTGS) Transactions

The Bahamas Real Time Gross Settlement system facilitates the real time processing of high value and time critical payments between financial institutions and their customers, by reducing the risk associated with manual or delayed payments settlement. This system has been in place since May 2004 and facilitates, among other transactions, customer payments, inter-bank payments and cheque clearing.

For 2006, the total volume and value of transactions from the clearing banks and the Central Bank increased by 65% and 19% to 31,438 and $9.3 billion, respectively.

Automated Clearing House (ACH)

Plans are underway for the implementation of an Automated Clearing House (ACH) system, which is an electronic funds transfer system that allows inter-bank clearing of retail payments for participating depository financial institutions. The Clearing Banks Association (CBA) established a Task Force to oversee the implementation of this system, and during 2006 solicited and reviewed proposals from several vendors for software and hardware solutions. It is expected that the ACH would be deployed in the local economy during 2007.

Cash

In The Bahamas, cash remains a very important method of making payment. Of the $318.4 million in currency in circulation at end-2006, the value held in active circulation by the public was $202.1 million, an increase of 3.5%. Currency in active circulation as a percentage of M2 was 4.1%.

Cheques

Cheques are an important and popular payment media, especially with the advent of cheque guarantee cards, which offer a measure of security to merchants who accept this type of payment. In 2006, the total number of cheques cleared was 3,982,332, with a value of $8.7 billion compared to 3,947,218 valued at $7.8 billion in 2005. Over the ten year period 1997-2006, the number of cheques which cleared through the banking system increased by 25.6%.

Direct Debits/Credits

Several institutions have implemented pre-authorized debits which are mainly used to pay insurance premiums, utility bills and credit cards. In addition, direct credits are basically used for salary or wage payments. Commercial banks accommodate this service by allowing their clients to send a soft or hard copy of the pay sheet, which is then inputted and a fee charged by the bank. The clients' account would then either be directly debited or charged through a cheque issued.

Credit Cards

Presently, local commercial banks issue credit cards under the brand names of Visa and MasterCard, and there is also in use a Bahamian dollar denominated card, SunCard, which was first introduced in 1984.

Since 2000, the number of cards issued has increased by 16.5% to 111,166 in 2005. The level of debt outstanding indicates the increasing popularity of this method of payment. From an outstanding $60.0 million in 1996, the value of credit card debt increased to $226.4 million at end-2006.

On-Line Banking

The majority of commercial banks offer this fee-based service to their clients. Presently, online banking facilities offer limited payment options, basically being used to pay utility bills, make credit card payments and transfers between clients' accounts.

Retailer and Pre-Paid Cards

There is only one retail card in operation which was issued by a gas station and commercial bank and operated on a Card Four Hundred System. The limits on the card range from $300-$5000. Presently, there are two pre-paid cards in circulation, one which was launched by the Bahamas Telecommunications Corporation (BTC) and the other by Indigo Networks, a private company. These cards can be used to make local and international calls. They can be purchased with dollar values of $5, $10 and $20.

OTHER FINANCIAL SECTOR DEVELOPMENTS

Indicators of banking, insurance and investment fund activity, suggest that the financial sector experienced favourable balance sheet trends and stable employment conditions during 2006. However, domestic capital market activity was somewhat subdued, recording a depreciation in the value of shares traded.

Banking Sector

The number of banks and trust companies licensed to operate within or from within The Bahamas was reduced by 2 to 248 during 2006. Reflecting merger and reorganization activities of many institutions to meet the challenges of a more competitive environment, the number of public licensees was reduced by 6 to 143. However, restricted and non-active operations increased by 4 to 105.

In adherence to the physical presence requirement of 2004[1], 215 licensees operated through physical presence at end-2006, compared to 205 at end-2005. Another 33 institutions continued under restricted management arrangements approved by the Central Bank and 3 were still in transition.

Insurance Sector

Based on the latest available data from the Office of Registrar of Insurance Companies, for 2005, the domestic insurance sector experienced steady growth. The number of licensed insurance operations in The Bahamas rose by 15 to 205 at end-2006, while the number of companies operating in the domestic sector increased by 1 to 10. Domestic brokers and agents and external operators totaled 99 and 10, respectively.

Securities Industry

The Securities Commission reported an increase in the number of active investment (mutual) funds operating from within The Bahamas, to 725 in 2006 from 699 in 2005, with a corresponding 17.0% growth in the value of assets under management to $205.0 billion. Based on the structure introduced under the Investment Funds Act 2003, which superseded the Mutual Funds Act 1995, the majority of the active mutual funds were registered as professional (293), followed by recognized foreign funds (169), standard (138) and Specific Mandate Alternative Regulatory Test (SMART) (125) funds.

Capital Markets

Domestic capital market activity was somewhat subdued during 2006, with trading volumes slightly higher, while values declined compared to 2005. The volume of securities traded on the Bahamas International Securities Exchange (BISX) rose by 4.4% to 7.1 million shares; however, these shares were, on average, lower priced, resulting in the total value of transactions declining by 25.1% to $27.5 million. In other developments, Kerzner International's Bahamian Depository Receipts (BDRS) were repurchased at a price of $8.09 per BDR share, an improvement over the initial list price of $5.14 per share. The benchmark BISX All Share Price Index appreciated by 24.1% to 1,676.2 points, extending the year-earlier gain of 30.0%. Valuation represented in the broader Fidelity Capital Market Limited's Index (Findex)-which captures over-the-counter trading-grew by 34.5% to 742.2 points, up from 28.4% to 551.9 points in 2005. In addition, the market capitalization on BISX rose by 20.8% to $3.2 billion.

The total number of publicly traded companies on the Exchange remained at 19. Inclusive of over-the-counter instruments and mutual funds, the total number of securities trading locally increased by 1 to 28 due to the addition of the mutual fund, Fidelity Prime Income Fund Limited. Meanwhile, the number of over-the-counter securities was unchanged at 4.

INTERNATIONAL TRADE AND PAYMENTS

Provisional balance of payment data showed a sizeable deterioration in the current account deficit, by $729.5 million to $1,582.5 million in 2006, primarily on account of elevated oil prices, increased consumer demand and outflows associated with the various ongoing foreign investment projects. The services account surplus also tapered off, due in part to boosted payments for construction services and a softening in net travel receipts. Investment income outflows expanded, while net current transfer receipts narrowed. However, these outflows were significantly offset by corresponding financing inflows which enlarged the capital account surplus (see Table 11).

The merchandise trade deficit widened by an estimated $105.6 million (5.7%) to $1,955.7 million, impacted by the hike in global oil prices, particularly in the first half of the year, which boosted the oil import bill by 34.6% to $705.8 million. Gains occurred across all product categories as, on average, the price per barrel of propane gas advanced by 18.8% to $56.58; motor gas, by 19.1% to $89.78; aviation gas, by 15.9% to $147.06; jet fuel, by 13.7% to $86.55; bunker "C", by 28.7% to $32.46; and gas oil, by 13.3% to $80.92. Non-oil merchandise imports rose by 2.3% to $1,915.2 million; however, goods exports (inclusive of goods procured in ports of foreign

1 As at 30 June 2004, except for special managed arrangements approved by the Central Bank, all remaining licensees were required to meet the physical presence requirements, inclusive of a minimum level of dedicated staffing and record keeping within The Bahamas.

TABLE 11: Balance of Payments Summary (B$ Millions)	2004p	2005p	2006p
I) CURRENT ACCOUNT	(305.3)	(853.2)	1,582.5
i) Merchandise Trade (net)	(1,427.5)	(1,850.2)	(1,955.7)
Exports	477.4	549.0	668.4
Imports	1,904.9	2,399.2	2,624.1
ii) Services (net)	1,012.7	1,115.0	538.3
Travel	1,568.9	1,727.6	1,684.2
Transportation	(249.3)	(312.9)	(288.5)
Other	(306.9)	(299.7)	(857.4)
iii) Income (net)	(141.3)	(203.3)	(217.9)
Compensation of Employees	(63.3)	(73.2)	(92.8)
Investment Income	(78.0)	(130.1)	(125.1)
iv) Current Transfers (net)	250.8	85.3	52.8
Government	59.7	59.1	59.1
Private	191.1	26.2	(6.3)
II) CAPITAL AND FINANCIAL ACCOUNT	479.8	633.2	1,119.3
i) Capital Account (Transfers)	(47.9)	(60.4)	(63.5)
ii) Financial Account	527.7	693.6	1,182.8
1. Direct Investment	442.9	563.9	692.1
2. Portfolio Investment	—	—	(18.8)
3. Other Investment	84.8	129.7	509.5
Central Gov't Long Term Capital Flow (net)	(3.9)	1.2	1.9
Other Public Sector Capital	(16.8)	(9.7)	(6.2)
Banks	(64.6)	47.6	143.1
Other	170.1	90.6	370.7
III) NET ERRORS AND OMISSIONS	9.1	131.0	383.9
IV) CHANGES IN EXTERNAL RESERVES ( ) = increase	(183.6)	89.0	79.0

SOURCE: The Central Bank of The Bahamas

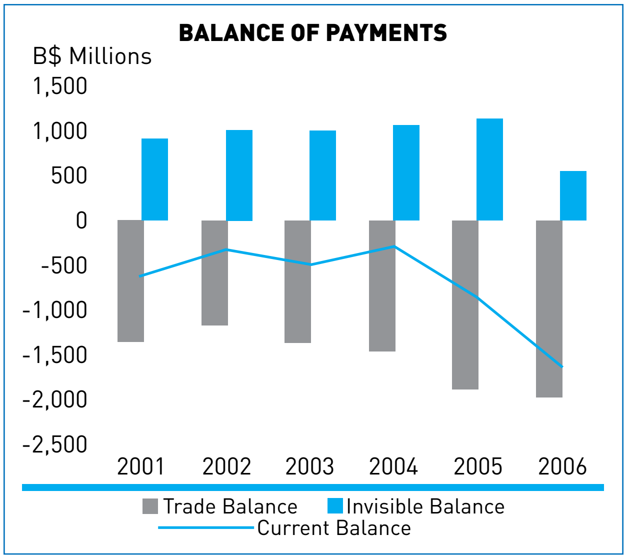
carriers) were higher by 21.7% at $668.4 million.

The estimated services account surplus narrowed by $576.8 million (51.7%) to $538.3 million, in contrast to a 10.1% firming in 2005. Buoyed by increased payments related to various tourism-investment projects, construction services outflows increased more than five-fold, to $213.5 million from $40.7 million in 2005, and other related service outflows more than doubled to $626.6 million. Net travel receipts decreased by an estimated 2.5% to $1,684.2 million, amid the weakness in tourism output. Outflows connected to royalty & license fees and Government services rose by 10.2% and 35.6% to $17.7 million and $68.4 million, respectively, and net insurance service outflows, by 22.8% to $119.3 million. Conversely, the sustained recovery in the offshore sector boosted net inflows from offshore companies' local expenses, by 27.0% to $188.1 million. Net outflows for transportation services contracted by 7.8% to an estimated $288.5 million.

On the income account, net factor remittance outflows grew by an estimated $14.6 million (7.2%) to $217.8 million, owing primarily to higher net labour income remittance outflows, which increased by 26.8% to $92.8 million. However, net outflows of investment income declined by 3.9% to $125.1 million, as profit repatriations for banks and other private sector companies fell by 4.5% to $132.5 million. Meanwhile, the net inflows for official transactions decreased by $1.3 million to $7.5 million.

Net current transfer receipts fell by $32.5 million (38.1%) to $52.8 million, occasioned by a reversal in "Other sectors" transfers, which moved from an increase of $26.9 million to a contraction of $6.3 million in 2006. Among the major categories, inflows from other "miscellaneous" transfers contracted by $35.8 million to $1.2 million, which overshadowed the 30.6% decline in net workers remittances to $7.5 million.

The capital and financial account surplus widened by $486.3 million to $1,119.4 million in 2006, occasioned by higher investment



inflows from both direct and other investment activities. Net inflows in the financial account advanced to $1,182.9 million from $693.5 million a year earlier, as net direct investment inflows firmed by 22.7% to $692.1 million, associated with a 37.0% expansion in equity investments and a three-fold increase in other "miscellaneous" investments to $509.5 million. The significant rise in "other investment" inflows was largely the result of increased net loan receipts from other private investments of $280.2 million to $370.7 million, as well as growth in short-term capital inflows through the domestic banking system, to $143.1 million from $47.6 million in 2005. Meanwhile, the public sector registered an almost 50% reduction in net repayments to $4.3 million, while portfolio investment outflows for the year amounted to $18.8 million, via the investment window created under the 2006 exchange control liberalization measures.

Adjusting for possible errors and omissions, the overall payments balance, as reflected in changes in the Central Bank's external reserves, was in deficit by $79.0 million — a $9.9 million improvement over 2005's contraction.

INTERNATIONAL ECONOMIC DEVELOPMENTS

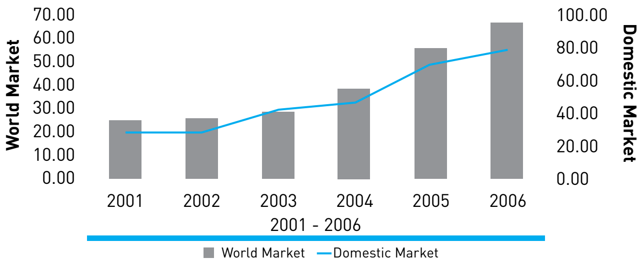
Despite the adverse impact of high oil prices and rising geopolitical tensions, the global economy proved to be resilient in 2006. The International Monetary Fund (IMF) estimated that world output rose briskly by 5.1% in 2006, up from 4.3% in 2005. However, as high rates of growth absorbed spare capacity, inflationary pressures emerged, and major central banks responded by tightening monetary policy. In currency markets, investors' concerns over the United State's deteriorating current account and debt positions, combined with higher interest rates in several major markets, led to a depreciation of the United States dollar against most major currencies during the year. However, these concerns did not appear to extend to the financial markets, as investors' focus on economic growth and positive statements from the Federal Reserve Board regarding its inflation outlook, resulted in the majority of the developed markets recording average price gains.

Economic activity in the United States expanded by 3.3% in 2006, an improvement over the 3.2% rise in 2005, and was occasioned by an acceleration in inventory investments, exports, nonresidential building and Government spending, which moderated the downturn in the residential housing market. After beginning the year at a brisk rate of growth of 5.6%, the momentum decelerated notably to 2.6% in the second quarter and further to 2.0% in the third quarter — led by a cooling housing market and more modest consumer spending. However, real GDP growth rebounded marginally in the final quarter to 2.2%, as consumer spending was supported by strong employment gains and accelerating wage growth. Recording its fastest pace in more than a decade, China's real output advanced by 10.7% vis-à-vis 10.4% in 2005, largely fuelled by a manufacturing boom, soaring exports and domestic investment activity. Supported by robust domestic demand, especially in investment, alongside sustained global expansion and strong export performance, the rate of output growth in the euro area accelerated to 2.7% from 1.4% in 2005, with the expansion in the zone's largest economy, Germany, advancing to 2.8%. Robust services activity was the main contributor to the upturn in output growth in the United Kingdom, to 2.7% from 1.8% in 2005. Anchored by strong exports and business investments, Japan's GDP expanded by an estimated 2.7%. Accelerated economic activity was also noted in the developing economies, as real output increased by an estimated 0.4 percentage points to 7.0% in 2006. Among developing countries, Africa's real GDP growth

Box 2: Oil Price Developments in The Bahamas in 2006

The Bahamas like many other countries imports all of the fuel used for local consumption. Therefore, the demand driven upward spiral in world crude oil prices, which commenced in 2001, has had a considerable impact on the local economy and was exacerbated in 2006. More specifically, there has been a significant expansion in the domestic economy's oil import bill, leading to a rise in fuel prices at the pump, an increase in electricity surcharges and a deterioration in the country's merchandise trade deficit. However, the rise in prices positively impacted Government's ad-valorem tax revenue from refined fuel products; while the effect on inflation was benign due to the relatively minor weight applied to fuel items in the Consumer Price Index (CPI).

FIGURE 1: World and Domestic Market Oil Prices
(US$ Per Barrel)

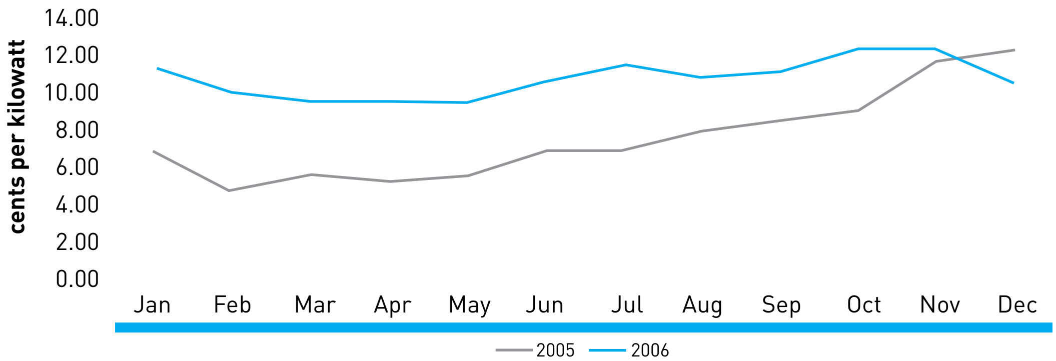


SOURCE: Bloomberg and The Central Bank of The Bahamas

For 2006, the world markets' average price per barrel of imported crude oil rose by 19.6% to $66.55 per barrel from $55.63 per barrel in 2005-peaking at $72.44 per barrel at end-June 2006. A similar pattern was observed for the domestic market when, after adjusting for transportation, duties and other local costs, the average price per barrel of refined fuel products advanced by 14.6% to $78.70 for 2006 from $68.70 in 2005 (See Figure 1).

Consequently, these cost increases for bulk fuel products had pass-through effects on consumers, as average prices at the pump for gasoline increased by 51¢ to $4.12 per gallon in 2006. Similarly diesel prices, which recorded an average value of $2.94 per gallon for 2005, were elevated to $3.32 per gallon in 2006.

FIGURE 2: Bahamas Electricity Corporation Fuel Surcharge
(Cents Per KWH)



SOURCE: The Bahamas Electricity Corporation

The surge in energy prices in 2006 predictably also fed through into the cost of electricity, since fuel is one of the inputs in electricity generation. Information from the Bahamas Electricity Corporation (BEC) showed that the fuel surcharge, which averaged 7.46¢ in 2005, rose to 10.50¢ in 2006 (see Figure 2).

The persistent rise in imported refined fuel costs and volumes has exacerbated the merchandise trade deficit. Information for 2006 showed that the volume of locally consumed fuel products rose by 18.3% to 9.0 million barrels in 2006, compared to 7.6 million barrels in 2005. Meanwhile, the corresponding value grew by 34.6% to $705.8 million, although below the 43.5% hike to $524.3 million in 2005.

Based on ad-valorem gains, oil price hikes have had a positive effect on Government's revenue. Provisional data from the Bahamas Customs Department showed that total revenue receipts from fuel imports grew by 17.7% to $106.7 million for FY2005/06, an increase over the 11.5% growth to $90.6 million recorded in FY2004/05. In terms of the major categories, Government's revenue from duty on fuel imports-which contributes over 80% of revenue from this category-amounted to $77.4 million at the end of FY2004/05, and grew by 12.5% to $87.0 million during FY2005/06. Associated stamp taxes rose by 48.0% to $19.2 million for FY2005/06, while earnings from bonding taxes almost doubled to $0.5 million.

Outlook for 2007

According to the International Monetary Fund's (IMF) latest "World Economic Outlook" for September 2006, rising geopolitical tensions in the Middle East and robust growth in emerging market economies such as China, are some of the developments expected to impact crude oil prices in 2007. Consequently, the IMF projects that oil prices will remain high, above $70.00 by the end of 2007.

was maintained at a strong pace of 5.4%, owing to a combination of higher export earnings, favourable international prices and markedly increased foreign direct investment (FDI) flows. Economic activity slowed marginally both in Central and Eastern Europe and in developing Asia, to 5.3% and 8.7%, respectively; but increased for the Western Hemisphere, to 4.8% from 4.3% in 2005. Heightened demand for oil resulted in slightly elevated output growth in the Middle East of 5.8% for 2006.

During the review year, labour market conditions improved in most of the major economies, buoyed by the advance in economic activity. As a result, the average unemployment rate in developed countries contracted to 5.6% from 6.1% in 2005. Despite experiencing a slowdown in its growth momentum in the second half of the year, the average jobless rate in the United States fell to a five-year low of 4.6% from 5.1% in 2005, with job gains concentrated in the professional and business services, health care, food services and mining categories. In China, the jobless rate declined marginally by 0.1 percentage points to 4.1%. For the euro area, the unemployment rate improved significantly to 7.8% from 8.6% in 2005, with the rates in the two largest economies, Germany and France, moderating to 8.4% and 9.0%, respectively. Despite the expansion in output, the United Kingdom's unemployment rate advanced to 5.5% from 5.1%; however, Japan's unemployment rate fell by 0.3 percentage points to 4.1%.

Surging oil prices fueled inflationary pressures in several major economies during 2006. In the United States, average consumer price inflation firmed by 2.5% relative to 3.4% in 2005, while China's inflation rate decreased by 0.4 percentage points to 1.5%. In the euro area, consumer prices advanced by 1.9%, 0.4 percentage points lower than in 2005, and still within the ECB's 2.0% threshold. Germany and France recorded inflation rates of 1.4% and 1.7%, respectively. Reflecting the impact of higher gas, electricity and food prices, inflation in the United Kingdom rose by more than 1 percentage point to 3.0%, the highest annual rate in over a decade. A combination of solid domestic demand and the pass-through effects of earlier increases in energy prices ended Japan's seven year deflationary cycle, as average prices rose by 3.0%, compared to a decline of 3.0% a year ago.

Global commodity prices expanded for the fifth consecutive year, with gains occurring in most major raw material prices. Increased demand for crude oil from countries such as the United States and China, combined with tight global production, ratcheted up prices in the first half of the year, when average costs rose by 28% to a high of $74.24 per barrel. Thereafter, indications of increased supply, alongside a reduction in geopolitical tensions, resulted in prices easing to $60.79 per barrel by year-end. Non-fuel primary commodities also rose, on average, by 22.1% in 2006. Investors' interest in gold as a hedge against record oil prices was evidenced by the 23.2% hike in gold prices to $636.70 per troy ounce. Silver prices also appreciated strongly by 46.3% to $12.90 per troy ounce.

On the monetary front, concerns over rising prices in several major economies prompted central banks to raise their policy rates during 2006. Citing the high level of resource utilization and sustained inflationary pressures, the United States Federal Reserve Board retained its tightening bias, raising its target policy rates four times during the first six months of the year. At end-July, the federal funds and discount rates were higher by one percentage point each at 5.25% and 6.25%, respectively. Thereafter, the Board paused the tightening cycle, as the downturn in the housing market and moderation in commodity prices caused inflationary pressures to abate. In a bid to curtail inflation below the targeted rate of 2.0%, the European Central Bank raised its main policy rate, on five occasions, by a cumulative 1.25 percentage points to 3.5%. Limited spare capacity, alongside rapid credit growth and higher prices, led the Bank of England to boost its benchmark repo rate, to 5.0% at end-December from 4.5% at the start of the year. Faced with rising prices, the Bank of Japan, for the first time since 2001, also raised its discount rate from negligible levels to 0.25 per cent in July—shifting from an expansionary monetary posture, which aimed to inject liquidity into the financial system. The massive build-up in liquidity, occasioned by a burgeoning balance of payments surplus, caused the Peoples Bank of China to be very active in the market in 2006. The Bank moved to increase the reserve requirements of deposit taking institutions by an aggregate of one percentage point to 9.0%, and effected upward adjustments of 0.28 percentage points to both the benchmark one-year deposit and lending rates, to 2.52% and 6.12%, respectively.

During 2006, currency markets were marked by a significant depreciation in the United States' Dollar against other major currencies, owing to concerns over that country's deteriorating current account position, as well as the increasing attractiveness of other currencies as interest rate differentials were compressed. The dollar recorded its most significant depreciation against the pound sterling, falling by 12.0% to £0.51 as the latter benefited from strong merger and acquisition flows and a recovery in the housing market. Against the Euro, the dollar fell in value by 10.2% to €0.76; and by 7.2% against the Swiss Franc to CHF1.22. The dollar's 3.3% depreciation against the Chinese Yuan coincided with intensified lobbying in the US for the Yuan to move more freely against other currencies, while the persistent low interest rate environment in Japan resulted in the dollar rising by 1.1% against the Japanese Yen to ¥119.07.

Preliminary data suggests that the fiscal situation in several major economies improved in 2006. Benefiting from the robust growth performance, the United States' fiscal deficit to GDP ratio contracted to an estimated 3.1% from 3.8% in 2005. In Europe, the fiscal deficit of the United Kingdom and the Euro Zone are both estimated to have narrowed by 0.1 percentage points to 3.2% and 2.0% of GDP, respectively. Asian economies also witnessed improvements in their fiscal accounts. Japan's balance was reduced by 0.4 percentage points to 5.2% of GDP, and China by 0.1 percentage point to 1.2% of GDP.

Steady growth in the global economy, relatively benign inflation and stable interest rates continued to fuel solid gains in most of the major indices in 2006, with the Morgan Stanley All Country World Index, a measure of global trends, rising by 22.6% to 198.63 points. In the United States, the Dow Jones Industrial Average (DJIA) rallied by 19.1% to 12,463.2 points, while the S&P 500 Index rose 15.8% to 1,428.4 points. European equity markets performed strongly, with Germany's DAX up 22.0% to 6,596.9 points. France's CAC-40 Index also gained 17.5% to 5,541.8 points, the United Kingdom's FTSE 100 Index, by 10.7% to 6,220.8 points, and Japan's Nikkei-225, 6.9% to 17,225.8 points. However, the best performance was seen in China, where the benchmark Shanghai Composite Index, which tracks Yuan backed A shares and hard currency B shares, soared by 130% to 2,675.47.

Reflecting the higher level of oil prices and increased imports from emerging markets, the majority of the current account balances of developed countries deteriorated during the year. The United States' current account deficit expanded to an estimated 6.6% of GDP from 6.4% in 2005. Initial indications are that the United Kingdom's current account deficit deteriorated marginally by 0.2 percentage points to 2.4% of GDP. In the euro area, preliminary data suggests that a deficit of 0.1% of GDP was recorded in 2006, compared to a zero balance in 2005; however Germany's current account surplus firmed by 0.1 percentage point to 4.2%. With regards to Asia, the estimated surplus on Japan's current account accumulated to 3.7% of GDP, slightly higher than the previous year's ratio, while a continued strong export performance resulted in China maintaining a current account surplus of 7.2% of GDP in 2006.

At its 14th Annual meeting held in Singapore in September 2006, the International Monetary (IMF) and Financial Committee of the Board of Governors of the IMF, highlighted the need to reform its quota and voice programme. The Committee therefore resolved to increase quotas for certain countries, in an effort to realign quota shares with members' relative positions in the world economy. It also proposed an enhancement to the participation and voice of low-income countries. These reforms were set out in a comprehensive document to the Board of Governors, which is expected to be implemented in time for the 2008 Annual Meetings. In its deliberations, the Committee expressed its satisfaction with the expected robust growth in the global economy in 2007, but also cited its concern over potential risks such as spiraling inflation, volatile and increasing oil prices and the spread of protectionism. The Committee further indicated that the focus of the IMF should be centered on addressing these challenges in order to reduce imbalances and sustain economic growth. Among the issues addressed by the Committee were the resurgence of the emerging market economies; the need for countries to work to achieve the Millennium Development Goals, the concern over the suspension of the World Trade Organisation's (WTO) negotiations and the provision of Debt Relief to two countries under the HIPIC Initiative[2]. The group also called for closer coordination between the IMF and the Financial Action Task Force with regards to promoting anti-money laundering and terrorism financing standards. In concluding its discussions, the Committee stated that it would work to improve the level of cooperation, and separation of duties between the IMF and the World Bank.

2 Highly Indebted Poor Country Initiative

BANKING

Currency Operations

The Central Bank of The Bahamas, through the Currency Division of the Banking Department, has responsibility for all aspects of the country's currency management—covering the design, minting and printing of currency needed to maintain adequate stock balances. An important aspect of the Division's daily efforts involve examining the quality of the currency available to the public, to determine whether it should be reissued or destroyed, and recording all movements of currency into and out of circulation.

In an ongoing effort to upgrade the security of Bahamian banknotes, through leveraging technological improvements, the Bank introduced into circulation its newly designed $20 and $50 banknotes during the second half of 2006. These new notes represented the second and third denominations in the CRISP (Counterfeit Resistant Integrated Security Product) family. The Bank will continue to phase into circulation other denominations in the coming years, with the CRISP $5 banknote planned for 2007.

At end-2006, Bahamas currency in circulation totaled $318.4 million, an increase of 5.73% over 2005. Banknotes are issued in denominations of $0.50, $1, $3, $5, $10, $20, $50, and $100, with a circulation value of $302.3 million at end-December 2006. Coins in circulation stood at approximately $16.1 million.

Currency in Circulation (B$ Millions)

Year	Notes	Coins	Currency
2005	286.2	14.9	301.1
2006	302.3	16.1	318.4
% Change	5.6	7.9	5.7

Foreign Exchange Transactions

During the year, the Central Bank's buying and selling rates for U.S. dollars from/to commercial banks were unchanged at US$1.00 = B$1.00 and US$1.00 = B$1.0025, respectively, and at par for cash transactions. Foreign exchange rates for the quotation of Pound Sterling were obtained each business day from the international market at 9:00 a.m. and 11:30 a.m. and at other appropriate intervals, depending on the dollar value of transactions and market volatility. For Pound Sterling sales, the Central Bank maintained the policy of adding a commission of 0.5% to the mid-rate.

The highest and lowest Pound Sterling/Bahamian Dollar rates employed by the Bank during 2006 were as follows:-

	Buying	Selling	Date Employed
Highest	1.9782	1.9893	December 4, 2006
Lowest	1.7275	1.7361	April 3, 2006

Relations with Public Sector

The Central Bank is the official registrar and transfer agent for Bahamas Government Registered Stocks, Treasury bills, debt securities issued by the Bahamas Development Bank, Bahamas Mortgage Corporation, the Clifton Heritage Authority and the Bridge Authority. Responsibilities include activities related to the issuance, redemption, and transfer of these securities.

For Treasury bills, the statutory ceiling on the maximum amount Government is permitted to borrow is capped at 25 percent of the lesser of ordinary revenues, as provided in the most recent approved budgetary estimates, or

TABLE 12: Bahamas Government Treasury Bills

	2004	2005	2006
Bills Outstanding (B$M)	**179.4**	**192.5**	**192.5**
Average Pricing			
Tender Rate (%)	99.85	99.85	98.81
Discount Rate (%)	0.32	0.35	3.00
Re-discount Rate (%)	0.82	0.85	3.50

Source: The Central Bank of The Bahamas

the average revenue for the latest three years of audited accounts tabled in Parliament. Treasury bills outstanding were unchanged at $192.5 million (see Table 12) in 2006, with the largest proportion held by public corporations (67.5%), followed by the Central Bank (27.3%) and then commercial banks (5.2%). In 2006, the Bank rediscounted $124.6 million in Treasury bills from commercial banks, and average prices trended upwards in line with tightened liquidity conditions.

During 2006, the outstanding value of Bahamas Government Registered Stocks increased by 9.6% to $1,829.9 million (see Table 13). The Bank arranged three issues totaling $226.6 million, and redeemed a scheduled $65.7 million. Bonds issued during 2006 were maintained at the upper maturity limit of 20 years, with the effective cost continuing to decline, due solely to a moderation in the highest rate by 25 basis points, as the lowest rate offered was stable at 0.03125% above prime.

The value of Bridge Authority bonds outstanding was unchanged at $28.0 million, bearing a maturity range of 2014 - 2029. Variable yields on bonds are between the Nassau Prime Rate of 5.500% plus 1.000% - 1.625%, per annum.

Section 19 of the Central Bank of The Bahamas Act, 2000 mandates that banks maintain "Statutory Reserves" against their Bahamian dollar deposit liabilities. Since being established in 1974, the reserve ratio has remained at 5.0%, with a minimum of 80% to be held in deposit balances at the Central Bank. In line with accretions to the Bahamian dollar deposit base, required reserves firmed by 7.7% to $200.4 million at end-2006. However, the combination of robust credit growth, higher oil prices and extraordinary outflows led to a tightening in liquidity conditions—with excess reserves contracting by 55.2% to $65.3 million. The latter represented a reduced 26% of the banks' deposits held at the Central Bank compared to 50.9% in 2005.

Banks maintain balances at the Central Bank to facilitate their cheque clearing arrangements, which continue to be managed by the Central Bank. The volume of cheques processed in 2006 increased by 0.9% to 4.0 million, with an 11.5% hike in the associated value to $8,710.4 million. During the year, the Bank continued to use the Society Worldwide Interbank Financial Telecommunication (SWIFT) network to transmit high speed messages relative to international business.

Financial System Upgrade

In an on-going effort to ensure the efficiency of its treasury management operations, in 2006, the Central Bank commissioned and installed a system designed by the United States software development firm, MIMICS. The software has facilitated the provision of real-time information related to the Bank's correspondent account balances, general ledger balances, interest computations, deposit placements, and semi-straight through foreign exchange transactions processing.

Investment Currency Market (ICM)

Through the Banking Department, the Bank continued to provide residents with investment dollars via the mechanism of the ICM to facilitate, among other things, overseas purchases of shares/securities and real estate. On January 16, 2006, as part of approved Exchange Control liberalization measures, the Bank adjusted the premium bid and offer rates, from 20% and 25% to 10% and 12.5%, respectively. The ICM, which opened the year with a balance of $2,701,479.57, recorded purchases of $3,289,038.67 and sales of $328,182.31, resulting in a closing balance of $5,662,335.93 at end-December, 2006. The hike in purchases mainly reflected investors' desire to take advantage of the window of opportunity through end-March 2006, to liquidate transactions at the old rate.

EXCHANGE CONTROL

During the year, the Exchange Control Department continued its efforts to process applications for exchange control transactions and to monitor the economy's demand for foreign exchange. In January 2006, the Department succeeded in implementing earlier approved measures, dealing with the liberalisation of the Exchange Control regime. These measures were principally concerned with adjustments to capital account transactions, and necessitated ongoing collaborations with key stakeholders and practitioners such as BISX and licensed brokers, to fine-tune the modalities for full implementation of the announced

Table 13: Bahamas Government Registered Stocks (B$ Millions)

	2005	2006
Outstanding (Beginning of year)	1,552.6	1,669.0
Add: New Issues	181.4	226.6
Less: Maturities	65.0	65.7
Outstanding (End of year)	**1,669.0**	**1,829.9**
Interest Yield		
Variable Rates (Prime + Add-On)		
Prime	5.50%	5.50%
Add-On	0.03125% - 1.50%	0.03125% - 1.25%
Fixed Rates	5.75% - 10.50%	5.75% - 9.00%
Maturity Range	2005 - 2025	2006 - 2026

Source: The Central Bank of The Bahamas

measures. The Department also remained proactive in its efforts to identify areas for possible further liberalization and incorporated revisions to procedures which would serve to increase the efficiency of the system.

As part of the ongoing interfacing with Authorized Dealers, the Department engaged several banks in discussions on issues related to the operation of debit card programmes. The consultations were aimed at rationalizing existing programmes, to ensure uniform operational standards, and the Bank reaffirmed its commitment to a continued review of these programmes.

Another area of focus for the Department related to money transfer services, given the heightened interest among both local and foreign investors in providing these services in The Bahamas. Currently, these services are provided either under the umbrella of authorized dealers e.g. Western Union and Money Gram, or as stand alone facilities, which seek to utilize the services of a commercial bank to effect the necessary currency conversion. In the context of the latter, the Exchange Control Department worked closely with a single operator to establish guidelines for its activities and made available the necessary foreign exchange approvals. The Department also worked with regulatory counterparts, to further define the framework for regulation of money transfer businesses.

During 2006, representatives from Exchange Control, in collaboration with officers from the Research Department, met with principals of several major investment projects in The Bahamas, in order to develop an efficient reporting regime for related capital inflows into the economy.

At end-2006, the number of Authorized Dealers and Authorized Agents operating domestically stood at eight (8) and fifteen (15), respectively[3].

RESEARCH

During 2006, the Research Department remained focused in its mandate of collecting, analysing and disseminating economic data, for the purpose of informing policy decisions and providing timely information to the public. A number of research projects were also undertaken, as part of the Department's ongoing attempt to explore pertinent economic issues which affect the local economy.

The Department completed research work on a number of topics for the 2006 Research Agenda, including a study entitled, "The Implications of Credit Growth for Countries' Foreign Exchange Reserves", which was presented at the 38th Annual Caribbean Center for Monetary Studies Conference, held in Barbados. Other research papers presented at the Department's Round Table discussion series examined Grand Bahama's recovery and restoration following hurricanes Frances and Jeanne, inflation in The Bahamas, and fiscal and monetary policy coordination in The Bahamas. Further analysis of domestic policy issues, such as fiscal and debt sustainability versus growth in The Bahamas and the impact of monetary policy on real sector development, were also examined during the year.

Throughout 2006, the Department provided feedback to the Bank's Monetary Policy Committee (MPC), internal units, as well as various external agencies, on a number of issues. In particular, ongoing technical

3 See the Central Bank's website, www.centralbankbahamas.com for list of Authorized Dealers and Authorized Agents.

assistance was given to the MPC via regular reviews of policy initiatives and updates of money and credit trends.

The Department published several surveys during the review period, including the 2005 Financial Sector Survey, which appeared in the March 2006 issue of the Quarterly Economic Review and the survey of Private Pension Funds in The Bahamas for 2004, which was released in the September 2006 Quarterly Economic Review. The Department, through a number of initiatives, continued to strengthen its data collection and compilation capabilities. To this end, officers from the Department of Statistics conducted a workshop, which outlined the key elements of the System of National Accounts for The Bahamas. Additionally, a statistical workshop was held to provide a comprehensive overview of the latest version of the Commonwealth Secretariat's Debt Management Software (CSDRMS).

The Department sustained its efforts to improve its reporting processes in 2006, with particular attention given to the prospect of implementing an online reporting system for financial institutions. Meanwhile, a website re-development project was undertaken during the year, which sought to achieve enhanced website functionality and improved efficiency in the receipt of financial institutions' data, inclusive of statutory reports, and the dissemination of vital information, most notably, the Department's core Quarterly Economic Review, Quarterly Statistical Digest and Annual Report publications.

Several officers from the Department participated in regional and international training programs during the year, which focused on monetary policy operations, financial programming and policy, debt management and the impact of fiscal policy in the economy.

In 2007, key areas for development are anticipated to be in the fields of research writing, and the Department expects to leverage the use of technology to improve efficiency in the areas of statistical compilation, reporting, and analysis.

BANK SUPERVISION

During 2006, the Bank Supervision Department (BSD) focused its activities on enhanced regulatory effectiveness, while continuing to perform core functions of licensing, policy formulation and supervision of banks and trust companies in The Bahamas. To this end, the Department emphasized:

- an examination programme

TABLE 14: Banks and Trust Companies Licensed in The Bahamas

	PUBLIC			RESTRICTED			NON-ACTIVE			
	B&T	**B**	**T**	**B&T**	**B**	**T(Nom)**	**B&T**	**B**	**T**	**TOTAL**
December 2005	82	48	19	4	3	84	5	3	2	250
Add Licenses issued in 2006	1	1	0	0	0	8	0	0	0	10
Less Licenses revoked in 2006	3	2	0	0	2	4	0	0	1	12
Sub Totals	80	47	19	4	1	88	5	3	1	248
Licenses upgraded or downgraded	1	-4	0	0	2	-2	0	1	2	0
December 2006	81	43	19	4	3	86	5	4	3	248

B=Bank, T=Trust, T(Nom)=Nominee Trust

Note: Gross License Fees during 2006 amounted to approximately $7.590 million.

Source: The Central Bank of The Bahamas

targeted to assess licensees' compliance with relevant statutory and regulatory requirements, set prudential norms, AML/CFT requirements, corporate governance frameworks and overall safety and soundness indicators. Particular attention was paid to banks which are active in the domestic market, due to the operational implications for domestic financial stability.

- publication of new guidelines and policy documents, in particular guidelines on the external auditors of licensees and the management of country risk;
- deepening co-operative ties with local regulators via the Group of Financial Sector Regulators (GFSR);
- enhanced co-operation with foreign regulators and responding to requests for information from overseas regulators in a timely and efficient manner; and
- further training and development of staff.

Licensing Activity and Physical Presence Policy

For 2006, the number of bank and trust company licences fell by two to 248 (see Table 14).

During the year, ten (10) new licences were granted. However, continuing merger and rationalization activity among existing banks and the closure of a few remaining "managed" banks which had chosen not to take up a physical presence in The Bahamas[4] more than outweighed the effect of this on the aggregate numbers.

Of the 248 remaining licensees, 215 operated through physical presence compared to 213 in 2005; 33 maintained restrictive management arrangements approved by the Central Bank and consistent with good international practice[5],compared to 42 in 2005.

On-site Examinations

Having substantially completed the verification of licensees' compliance with physical presence requirements in 2005, on-site examinations during 2006 focused almost exclusively on licensees' safety & soundness. Thirty-eight (38) examinations were conducted compared to thirty-nine (39) in 2005 (see Table 15).

The wider safety and soundness examinations indicate ongoing improvement in licensees' systems and controls. Weaknesses and deficiencies were identified and recommendations requiring corrective actions were discussed with senior management and subsequently communicated to the banks' board of directors and management in the Report of Examination. A reasonable timeline was provided for licensees to respond, on an ongoing basis, to the Report of Examination and to indicate the corrective actions taken to address all outstanding issues satisfactorily.

The number of full-time on-site examiners stood at eight (8) at end-2006. Their efforts were supplemented by the secondment of eleven (11) staff from the off-site supervision units, further evidencing the Department's commitment to ensuring that off-site supervision staff develop the full range of skills to take increasingly active roles in the conduct and leadership of examinations.

Other Domestic Supervisory Actions

The Supervisory Units of the Department continued to carry out comprehensive analysis and assessments of the ongoing financial positions of active banks and trust companies. The ability of licensees to operate as going concerns and their compliance

TABLE 15: Onsite Examinations Conducted (2004-2006)

	2004	2005	2006
Examinations			
Licensees (physical presence)	24	4	27
Managed Banks[1]	0	24	2
Domestic Licensees	2	4	2
Follow-up /Special focus examinations	6	7	7
Total	**32**	**39**	**38**
Reports			
Finalized Reports	23	41	40
Reports in Progress	6	4	2
Total	**29**	**45**	**42**
Follow-up Examinations Required	**5**	**3**	**0**

[1] Represents licenses recently converted to physical presence

Source: The Central Bank of The Bahamas

4 See Central Bank of The Bahamas 2004 Annual Report (page 34), for a detailed discussion of the "physical presence" requirement.
5 These types of licensees have restricted licences and/or are branches of banks originating from G10 countries.

with the Bank's requirements regarding liquidity, solvency, risk and management, were investigated and appraised.

The Bank Supervision Department reviewed and recommended approval of the appointment of 155 directors and 56 senior officers, who were deemed to possess the necessary credentials and the appropriate experience to execute their responsibilities. Eighty-two meetings were held with licensees to discuss prudential issues during the year. The total number of courtesy visits paid by licensees to the Department stood at 30.

The Department remained vigilant in its practice of collecting and disseminating information on instances of attempted fraud or questionable activities brought to its attention by certain institutions, the public, or other regulatory agencies. The Bank's website is regularly updated with warning notices to the public, providing timely information on suspected fraudulent schemes and entities purporting to be banks or trust companies. Consequently, five new warning notices were posted in 2006. To assist the Department in its information dissemination effort, the Attorney General's Office and other Government and public sector authorities are routinely advised of these matters.

During 2006, the Inspector continued to use quarterly letters as an avenue for ensuring ongoing dialogue between the Bank and licensees on developments relating to their operations, new guidelines for consultation, issuance of guidelines and regulations as well as other pertinent issues. Licensees have become accustomed to these letters as a means through which they are kept abreast of general issues, which affect the industry and require their input.

TABLE 16: Issued Guidelines

	Document	Final Issue Date
1	Guidelines on the Appointment of External Auditors of Licensees and the Relationship Between the Central Bank and External Auditors of Licensees	6th September 2006
2	Guidelines on Electronic Banking	6th June 2006
3	A Guide to the Central Bank's Ladder of Supervisory	13th April 2006
4	Guidelines for the Establishment or Acquisition of Overseas Branches, Subsidiaries and Representative	11th April 2006
5	Country Risk Management Guidelines	11th April 2006

Source: The Central Bank of The Bahamas

The Department maintained an ambitious work programme to strengthen its prudential regulations and provide clear guidance to licensees of the Bank's Basel Core Principles Self-Assessment and the Module II Assessment of The Bahamas, conducted by the IMF in 2002.

Watch List Committee

The Watch List Committee within the Bank Supervision Department, which meets on a monthly basis, continued to identify and monitor high-risk licensees, placing specific emphasis on ensuring that the safety and soundness of these licensees is restored in a timely manner. The action plan for the watch list remained the blueprint for the Committee in its effort to monitor the progress made in addressing the specified recommendations. The number of licensees on the watch list was significantly reduced during the course of the year.

New Guidelines

The Department's policy work programme to enhance prudential regulations and to provide clear guidance to licensees continued apace in 2006, as five new guidelines were finalized and issued (see Table 16).

The Guidelines on the Appointment of External Auditors of Licensees and the Relationship between the Central Bank and External Auditors of its Licensees ("External Auditors Guidelines") received much attention and comment, particularly from the audit community. The guidelines outline criteria by which the Central Bank assesses the fit and proper status for the appointment of new auditors by licensees. The guidelines also set out parameters for reporting and dialogue between licensees' external auditors and the Central Bank, with a view that such exchanges would further enhance supervisory oversight and monitoring. Extensive discussions were undertaken with the external auditors via the Auditors Advisory Committee (AAC) and industry participants, prior to the issuance of the guidelines.

In recognition of the inherent

risks associated with the offering of electronic banking services by licensees and the emergence of accompanying technology related issues, the Department disseminated Guidelines for Electronic Banking. These guidelines set out the Central Bank's approach to the supervision of licensees' e-banking services and provided licensees with guidance on general principles for risk management of e-banking. The guidelines also introduced various types of internet financial services and provided suggestions for customer education and security in e-banking.

The Department's commitment to a transparent approach to bank supervision was further evidenced by the issuance of a document entitled "A Guide to the Central Bank's Ladder of Supervisory Intervention". This guide outlines the procedures the Department follows in instances where there are significant breaches of policies by a licensee or where the operations of a licensee raises concerns regarding its viability, safety or soundness. The guide also summarizes the measures which may be taken by the Central Bank for non-compliance by a licensee to applicable legislation, regulations, guidelines, directives and general prudential norms.

The Guidelines for the Establishment or Acquisition of Overseas Branches, Subsidiaries and Representative Offices outline the major considerations of the Central Bank in assessing applications for overseas branches, subsidiaries and representative offices and the information required in support of such applications.

Sound country risk management is an important component of the licensees' overall risk management framework. To this end, Country Risk Guidelines were issued, which aimed at assisting licensees in establishing internal structures, policies and procedures for the sound management of country risk.

A key tenet of the Department's policy programme is a commitment to a transparent and consultative approach to policy development with licensees and other stakeholders. Industry participation is viewed as an integral component in the development of supervisory policies. During the year, the Department issued two consultation papers for industry comment (see Table 17).

Non-Executive Directors

A Consultation Paper on the Guidelines for Independent Non-Executive Directors (INEDs) was issued in 2006, as a follow-up to the workshops held by the Inspector of Banks and Trust Companies with Resident Non-Executive Directors (RNEDs) in 2005, which examined issues faced by RNEDs. This initiative was in keeping with the Bank's ongoing practice to enhance communication and improve relationships with licensees and industry participants.

The Guidelines specify elements that constitute independence, outline activities that INEDs are prohibited from performing as they might lead to a conflict of interest, and identify and discuss issues that may influence the effectiveness of INEDs on the licensees' Board of Directors. The Guidelines also clarify the expectations of the Bank in relation to independent non-executive directors of licensees and certain functions of their boards.

Substantial industry feedback and comments were received and reviewed by the Policy Unit and where appropriate, changes were incorporated. The Department expects to issue the finished guidelines during the first quarter of 2007.

Business Continuity

The Department believes effective business continuity planning will assist in improving the safety and soundness of licensees by allowing them to manage disasters when they occur and to recover from disasters within a shorter period. Consequently, guidelines on business continuity were issued for industry consultation during the year. The draft guidelines set out the Central Bank's supervisory approach to business continuity planning and the sound practices which the Central Bank expects its licensee to take into consideration. The draft guidelines are consistent with the Joint Forum's High-level principles for business continuity issued in August 2006, as well as international guidelines and prudential standards. The implementation of the proposed guidelines in early 2007, is expected to offer systemic benefits to The Bahamas as a financial centre, by improving the jurisdiction's resilience to major operational disruptions. All final guidelines and consultation papers

TABLE 17: Consultation Papers

	Document	Date Released	Final Date for Comments
1	The Guidelines for Independent Non-Executive Directors	3rd August 2006	6th November 2006
2	The Business Continuity	6th November 2006	28th February 2007

Source: The Central Bank of The Bahamas

are published in their entirety on the Central Bank's web site.

The Banks and Trust Companies (Licence Application) (Amendment) Regulations, 2006

During the year, the Department proposed amendments to the Banks and Trust Companies (Licence Application) Regulations, 2002. This initiative was implemented in an effort to reduce the compliance burden, where appropriate, on prospective licensees and improve the application process for directorship and the acquisition of shares of the Central Bank's licensees. Under these amendments, applicants who seek to acquire shareholdings in licensees of 10% or less, will not have to submit the customary detailed net worth statement previously required. Instead, applicants will now be required to submit concise net worth statements, signed by a certified professional accountant, which indicate that the individual's net worth at the date of the statement is at least five (5) times the value of the share capital to be acquired. The draft regulations also enable an individual who was previously approved to serve as a director on the board of a parent company domiciled in a Zone A country, to submit, in lieu of two character references, a letter of good standing in support of an application to serve as a director for its subsidiary/branch in The Bahamas.

Private Trust Companies

Other legislative enhancements provide ongoing support for the international competitiveness of The Bahamas as a leading financial centre including legislation relating to Private Trust Companies (PTC). Private Trust Companies may not conduct business with the public, and are often used by wealthy families as part of their asset management structure, with the Board of Directors comprising relatives of the settlor. The PTC is exempt from the full range of licensing requirements, otherwise applicable to trust companies operating within and from within The Bahamas. However, there are requirements that must be met annually to maintain the exempt status and the Bank has retained the right to conduct an on-site examination of PTCs, should the need arise. Further, the Registered Representative is mandated to carry out proper due diligence on shareholders and beneficiaries in accordance with the provisions of the Financial Transaction Reporting Act and PTCs are mandated to submit annually to their Registered Representative a certification that stipulates that the company continues to qualify as a PTC. The Registered Representative is also required to obtain from the directors of each PTC, for which they provide services, a duly completed Compliance Certificate on or before 31st December of each year. The Compliance Certificate is required to state that:

a) the company continues to qualify as a PTC;
b) all officers and directors associated with the company continue to be fit and proper persons; and
c) the company continues to comply with all applicable requirements.

The regulatory regime for a PTC is designed to ensure high standards of business conduct, professionalism and competence for PTCs, while offering an appropriate level of regulatory oversight given the limited activities of such companies. An important feature of this new legislation is that Registered Representatives are limited to licensees of the Central Bank or Financial And Corporate Service Providers (FCSPs) approved by the Governor to undertake such business with the condition that they are prohibited from conducting any other line of business. Such FCSPs must undergo a vigorous vetting process before approval is granted.

Basel I Status

The Central Bank, under the provisions of the Banks and Trust Companies Regulation Act 2000, mandates capital standards for licensees that are consistent with the Basel Capital Accord. In 1992, The Bahamas implemented the 1988 Basel Capital Accord (Basel I) which currently applies to over 100 licensees which hold banking as well as banking and trust licences. Since the implementation date, the Central Bank has actively applied the standards prescribed under Basel I with respect to credit risk as a part of its capital adequacy framework.

In 2006, the Department conducted an in-house study, using licensees' 2005 audited statements, to determine the average level of capitalization for public banking entities. The study revealed that the average capital risk-weighted ratio for this jurisdiction was 27%, well above the 8% minimum Basel requirement. This largely reflects the liability driven nature of international/offshore banking in The Bahamas, coupled with the requirement by the Central Bank that a portion of a bank's balance sheet be diversified in high quality and liquid financial instruments, which attract low risk weights.

The Department is committed to advancing the implementation, in 2007, of the amendments to Basel I relating to Market Risk and Netting Arrangements, as this is seen as a prerequisite for the eventual implementation of Basel II. Accordingly, the Central Bank has engaged special assistance from the Caribbean Regional Technical Assistance Centre (CARTAC), to conduct two-weeks of intensive sessions on Market Risk with a group of technical staff within the Bank Supervision Department in early 2007. These sessions are intended to place specific emphasis on the practicality of the draft Market Risk Guideline in the Bahamian context. A Market Risk Committee has been formed with the main objective of working through some of the practical issues to ensure that the draft policy guideline is fine-tuned and clearly articulates the Central Bank's approach for implementation, before the draft is exposed for public comment.

While the Basel Committee offers a choice between two broad methodologies for the calculation of the capital charge for market risk (i.e. the Standardized Approach and the Internal Risk Management Models Approach), it is envisaged that the Central Bank will opt to use the less sophisticated standardized approach. Earlier studies by the Department have indicated that a relatively small number of licensees would be obliged to comply with such provisions and only 25 of the international offshore licensees have more than 10% of their on and off-balance sheet assets in a form subject to market risk.

Update on Basel II

On 4 July 2006, the Basel Committee issued a comprehensive version of the Basel II Framework[6], which represents a compilation of the June 2004 Basel II Framework, the elements of the 1998 Accord that were not revised during the Basel II process, the 1996 Amendment to the Capital Accord to Incorporate Market Risks and the 2005 paper on the Application of Basel II to Trading Activities and the Treatment of Double Default Effects. The Department has targeted implementation of the new Accord by 2010.

Given that Basel II is intended to improve regulatory capital requirements, especially for large complex banking groups, the Department recognizes the need to ensure that it exercises national discretion, where possible, to ensure that the Basel II framework is tailored to fit the banking system within this jurisdiction. It is expected that licensees will be allowed to use a range of approaches as appropriate to their size, complexity of operations and unique character, while

TABLE 18: Projected Basel II Plan for 2007

Drafting and Issuance of the following guidelines:	
PILLAR I	— Market Risk Guidelines — Operational Risk Guidelines
PILLAR II	Risk Based Supervision Guidelines
PILLAR III	Revision of the Minimum Disclosure Guidelines to incorporate all elements of Pillar III

Source: The Central Bank of The Bahamas

6 See www.bis.org/publ/bcbs128.htm

also taking into account the approaches of their parent banks, where applicable. However, it is envisaged that stand-alone banking licensees, which are solely incorporated in The Bahamas and for whom the Central Bank is the home regulator, would opt to adopt the simplified and standardized approaches in the short term.

The Department will, in due course, produce its road map and timelines for the implementation of the Basel II capital accord as well as publish the way it hopes to address matters that are left to national discretion under the Accord. In the interim, the Department intends to release revised policy guidelines that will complement its Basel II strategy in relation to the three pillars under the new Accord (see Table 18).

IMF Information Dissemination and Monitoring Initiative

During 2006, The Bahamas participated in the pilot phase of the IMF's information dissemination and monitoring initiative for international and offshore financial centres. The overriding benefit of centres such as The Bahamas participating in this exercise relates to the fact that it would enhance the level of transparency and improve the availability of financial sector data internationally. The Bahamas provided the IMF with a comprehensive set of financial sector data covering banking, insurance, investment funds, company and trust service providers and other relevant economic indicators. The Department coordinated The Bahamas' response with the aid of the Securities Commission, the Office of the Registrar of Insurance Companies and the Inspector of Financial and Corporate Services Providers. It is the IMF's intention that the informational and dissemination framework would increase the transparency of activities in the international and offshore financial centers through the dissemination of a minimum set of information.

Regulatory Co-operation in The Bahamas

During the year, the Group of Financial Service Regulators (GFSR)[7] continued to work closely together, under the chairmanship of Mr Hillary Deveaux, Executive Director of the Securities Commission. The GFSR met eight times in 2006, and one recurring item for these meetings was work designed to meet overseas regulatory requests for co-operation on a timely and effective basis.

Update on Regulatory Reform

The Financial Services Regulatory Reform Commission, which was established in 2005 under the chairmanship of the Minister of State for Finance[8] continued to work on the options for consolidating the various regulatory agencies within the financial services industry. It is expected that once proposals have been approved by Cabinet, a Consultation Paper will be published for wider debate.

Combating Money Laundering & Terrorist Financing

In 2006, members of the BSD along with the Legal Unit participated in a committee established by the Attorney General to prepare for the Caribbean Financial Action Task Force's (CFATF) mutual evaluation exercise. More specifically, this assessment represented the third review of the laws and practices of The Bahamas for compliance with the Financial Action Task Force (FATF) 40 recommendations on Money Laundering and Nine Special Recommendations on the Financing of Terrorism. The committee comprised staff from the Attorney General's Office, the Ministry of Financial Services and Investments, Customs, the Police, the Gaming Board, the Compliance Commission, the Financial Intelligence Unit and Financial Sector Regulators. CFATF examiners, led by experts from the CFATF Secretariat, conducted the mutual evaluation of The Bahamas from May 22 to June 2, 2006. Various Bank staff were also actively involved in providing comments on several drafts of the CFATF report issued after the evaluation and attended the CFATF's October 2006 plenary, where The Bahamas' report was initially discussed. The CFATF's mutual evaluations normally take place once every four years and are carried out by the member states of the CFATF.

It is expected that the final CFATF Report will be finalized during the summer of 2007 and, in line with normal CFATF policy, will be available for release on the CFATF's website.

7 The GFSR comprises the Central Bank, Securities Commission, Registrar of Insurance, Compliance Commission, the Inspector of Financial & Corporate Service Providers and the Director of Societies.

8 See page 36 of the Central Bank of The Bahamas' Annual Report 2005.

TABLE 19: Requests for Cooperation from Foreign Regulatory Authorities in 2006			
Country	**No. of Requests**	**Completed**	**Outstanding***
British Virgin Islands	2	2	
St. Lucia	1	1	
Trinidad & Tobago	3	3	
United States	5	2	3
Panama	3	3	
Guernsey	2	2	
Canada	4	3	1
Guyana	1	1	
El Salvador	1	1	
Jersey	1	1	
Italy	1	1	
Barbados	1	1	
Mauritius	1	1	
Netherlands	1	1	
Belize	1	1	
Cayman Islands	1	1	
Ecuador	1	1	
Nigeria	1	1	
Peru	1	—	1
Colombia	1	1	

Source: The Central Bank of The Bahamas
Note * In these cases, data has been provided but additional "follow-up" is required and requests were still being processed at year end.

International Regulatory Co-operation

Foreign bank regulators continued to conduct, in person or through agents, on-site examinations of Bahamian licensees owned by banks in their respective countries. Such examinations are allowed, with strict protection of Bahamian confidentiality laws, for the purpose of consolidated supervision. Banking regulators from Panama and Switzerland were among those who took advantage of these provisions. The Central Bank is currently negotiating a Memoranda of Understanding covering co-operation with the Office of the Superintendent of Financial Institutions (OSFI), Canada, the Qatar Central Bank and the Central Bank of Argentina.

The Central Bank also co-operated with other foreign regulators receiving and responding to 33 various regulatory requests from 14 countries (see Table 19). This compares with 33 requests from 20 countries in 2005.

In a number of cases, the Central Bank, relying on its broader powers, dealt with requests which had originally been received by the Securities Commission (the Commission's powers have since been augmented by statute in early 2007). The majority of requests came from North American regulators and related to queries for information arising out of cases of insider trading or market manipulation, which were under investigation. A number of Central Bank licensees and other entities cooperated under the Central Bank's powers, as set out in the Central Bank of The Bahamas Act, 2000.

Letters to Home Regulators

In 2006, the Inspector continued annual communication with the home regulators of licensees, which was initiated in May 2005. Letters were sent to the United States' Federal Reserve Board as well as the French, Swiss, British, Brazilian, and Spanish regulators amongst others. The annual letters continued to provide the home regulators with an overview of the operations of subsidiaries or branches. The home regulators were also encouraged to give their comments on the condition of the parent and its operations. This initiative served as a meaningful avenue to boost home-host regulator relationships and maintain the lines of communication between the Central Bank and home regulators.

Membership in International and Regional Bodies

The Bank continues to participate in discussions relating to regional and cross-border bank supervision issues. The Bank Supervision Department currently maintains active membership or actively participates, as part of the Bahamian contingent, in several international and regional bodies. A number of the Department's staff also serve on various technical working groups and committees within these organisations.

Human Resources and Training

The Department's staff complement at year's end totaled 60. Staff training has continued to be an important priority and in 2006, management, senior officers and junior staff again benefited from specialized training provided by the Financial Stability Institute, the Caribbean Group of Banking Supervisors, the Federal Reserve Board, and the Association of Supervisors of Banks of the Americas. Bank Supervision staff attended sixteen overseas training workshops, seminars and courses covering such subjects as Supervisory Review - implementing Pillar II, Market Risk, Quantitative Analysis and Stress Testing, Bank Analysis and Examination, and Money Transmission Services. The Department also received training from the US Treasury Department in the areas of money laundering and market risk. An extensive programme of internal and external speakers at seminars for staff was also arranged.

In-house training sessions continued with a full slate of speakers covering such topics as Trust Administration, Private Trust Companies, Fraud, Liquidation, and Banking Risks. Moreover, a three-month secondment programme to local banking and trust institutions was reintroduced in 2006. The aim of this training is to expose staff to, inter alia, the licensees' internal risk management processes, internal controls and procedures regarding credit risk management. Market and Liquidity Risk Management are targeted areas for 2007. Consequently, three mid-level staff are expected to participate in these programmes during the year.

An innovation this year was the acquisition of licences for the web-based training provided by the Financial Stability Institute based in Basel, Switzerland. This constitutes a highly flexible and cost-effective source of training for BSD staff.

Management and senior staff members were afforded several opportunities to network with their international and regional colleagues as they attended the Offshore Group of Banking Supervisors' Meeting, the International Conference of Banking Supervisors, the High Level Meeting of the Association of Supervisors of Banks of the Americas, the Caribbean Group of Banking Supervisors' Annual Plenary, the Caribbean Financial Action Task Force Meetings/ Assessor Training Workshop and the FATF Assessor Training Workshop.

During the last quarter of the year, the Department's senior staff, along with the Bank's Legal Counsel, organized a working session to update and brief licensees on the amendments to the banking laws and the anti-money laundering framework.

Work Agenda for 2007

During 2007, the Department intends to focus on the following issues and projects, in addition to fulfilling its mandate with respect to the regulation and supervision of its licensees:

- Implementation of the Market Risk component of Basel I and preparatory work towards the eventual implementation of Basel II.
- Involvement of industry participants, professionals and stakeholders in policy making and initiatives.
- Maintenance of regular contact and interaction with the directors and management of each individual licensee.
- Continued off-site analysis and focused on-site examinations to assess and confirm the overall safety and soundness of licensees.
- Ongoing review and continued updating of the regulatory framework and the Department's supervisory processes and procedures to ensure that they remain consistent with international and local standards and developments.
- Ongoing training and development of staff to further equip them in the field of bank supervision.

Deposit Insurance Corporation

The Deposit Insurance Corporation (DIC) is a strategic component of the prudential regulation and supervision of the domestic banking sector, providing coverage to fourteen (14) member institutions in 2006. The DIC insures Bahamian dollar deposits up to a maximum of $50,000 to any single depositor in each member institution. Member institutions do not hold any equity position in the DIC.

The DIC assesses member institutions an annual premium equal to one-twentieth of one percent of the sum of an amount equal to the average of those deposits insured by the DIC as of March 31 and September 30, in the immediately preceding premium year. Based on average total insurable Bahamian dollar deposits in banks of $4.0 billion during 2005 as compared to $3.7 billion in 2004, premiums levied and collected in 2006 amounted to $2.0 million compared to $1.8 million in 2005. At end-2006, the accumulated assets of the Fund stood at $7.7 million compared with $4.9 million in 2005.

The DIC invests in Bahamas Government Registered Stocks (BGRS) and earns interest rates tied to the Nassau Prime Rate. Investments at year-end 2006 amounted to $6.4 million compared to $3.7 million in 2005.

INFORMATION TECHNOLOGY

With the Bank's continued reliance on information technology for communication and workflow, significant efforts were made by the Department during the year to improve the security, efficiency, and reliability of the IT infrastructure. In this vein, in 2006, the Computer Department was officially renamed the Information Technology (IT) Department and the Bank engaged the services of a new IT Manager.

During the year, the IT Department audited and restructured its communications and infrastructure platforms by installing state of the art technology to increase efficiency and reliability. The Department continued to improve its security monitoring system, by enforcing standards and best practice methodologies. In addition, the reporting and data gathering processes were evaluated in an effort to introduce web facing strategies.

Upgrades were also made to the Lotus Domino servers, the Bank's core accounting solution, as well as enhancements to other operational systems. The Department also worked along with the Administration Department on the Bank's overall Business Continuity Plan and will in 2007, seek to substantially enhance the Bank's overall Disaster Recovery capabilities.

LEGAL UNIT

During 2006, the Legal Unit continued to fulfill its mandate as advisor to the Bank on legal matters relating to the Bank's operations and administration.

Litigation

In legal developments, on 13th March 2006, the Privy Council issued a judgment dismissing the appeal of Suisse Security Bank and Trust Limited (SSBT) from the judgement of The Bahamas Court of Appeal, which dismissed the appeal of SSBT from the judgement of the Hon. Mr. Justice Davis in the Supreme Court which dismissed the appeal of SSBT from the decision of Mr. Julian Francis (the former Governor of the Central Bank), revoking the banking and trust licence of SSBT. The Privy Council's judgement in the SSBT appeal was a landmark decision for The Bahamas, being the first case of its kind brought under the Banks and Trust Companies Regulation Act, 2000, against the revocation Order of a Governor of the Central Bank. Further, on 13th November 2006, the Hon. Mr. Justice Stephen Isaacs Ordered that SSBT be wound up and that Mr. Raymond Winder be appointed Official Liquidator of SSBT.[9]

Implementation of International Standards

With respect to implementation of international standards, the Unit, in consultation with the private sector, developed recommendations on steps required to implement the Financial Action Task Force's Special Recommendation VII (SR VII) on wire transfers. The FATF required countries to implement its terms by the end of 2006. However, most countries are seeking to implement SR VII in early 2007.

Amendments to Regulatory Statutes

The Banks and Trust Companies Regulation Act, 2000 and the Central Bank of The Bahamas Act, 2000 were amended by Parliament following extensive work by the Legal Unit in consultation with the private sector in drafting several pieces of legislation to facilitate the Bank's supervision of private trust companies. The legislative amendments and developments are as follows:

- The Banks and Trust Companies Regulation (Amendment) Act, 2006
- Central Bank of The Bahamas (Amendment) Act, 2006
- The Bank and Trust Companies (Private Trust Companies) Regulations, 2007

9 A copy of the Privy Council's judgment dismissing SSBT's appeal may be found on the court's website at www.privy-council.org.uk.

Training Sessions

Apart from playing an integral role in The Bahamas' assessment exercise by the CFATF, the Legal Unit's staff participated in training sessions offered by the CFATF and IMF/World Bank which related to the use of the FATF's 2005 Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) Methodology. A member of staff subsequently participated as an examiner in a mutual evaluation of a CFATF member state.

The Legal Unit's staff made presentations at seminars for Bank staff on the interpretation of various statutes relevant to the work of the Bank and the legislative framework for the operation of private trust companies in The Bahamas.

The Legal Unit, together with the Financial Intelligence Unit, hosted a seminar for Bank staff on suspicious transactions reporting. Presentations were also made at a seminar organized by the Bank Supervision Department, to update licencees on amendments to the banking laws and proposed changes to the jurisdiction's anti-money laundering framework.

INTERNAL AUDIT UNIT

During 2006, activities of the Internal Audit Unit focused on ensuring that key operational areas, were monitored on a continuous basis.

As part of its ongoing monitoring activities, the Internal audit Unit reviewed key operational areas, including the currency operations and external reserves management activities of the Banking Department and the reconciliation of major correspondent bank accounts prepared by the Accounts Department. Other key audits undertaken, included reviews of staff loans, numismatic coins, advances to Government and the MIMICS system.

During the year, members of the Unit participated in overseas seminars, which were conducted by the Institute of Internal Auditors and centered on operational and financial auditing techniques.

In 2007, the Unit will continue to use risk based auditing techniques to assess crucial areas of the Bank's operations and strengthen internal controls. The Unit will also conduct a follow-up audit, which will examine developments relating to Dormant Account activity, following its migration to the MIMICS system.

ADMINISTRATION

Maintenance, Improvements and Facilities Management

In 2006, the Administration Department continued to provide oversight for the Bank's various capital projects, which included refurbishments and repairs to the exterior and interior of the Main Bank Building; enhancements to the Bank's Gallery, and the installation of of a 5,000 gallon underground fuel tank, which supplies the new 600 kilowatt generator.

The Administration Department, in collaboration with the Antiquities, Monuments and Museums Corporation, also supervised major refurbishment of the Balcony House Museum during the year and upgrades to the Great House (Cafeteria) and Verandah House.

Business Continuity, Disaster Preparedness and Managed Systems

Over the year, the Bank engaged the services of external Business Continuity consultants and completed an Enterprise Incident Management Plan. Several systems were developed or enhanced to assist the Department in administering the Dorman Accounts and the procurement and payment process.

Logistical Support and Events Coordination

The Administration Department provided logistical and event coordination support for the Bank's conferences, meetings, and local in-house training in 2006, including the Counterfeit Detection Seminar and the U.S. Department of Treasury's Anti-Money Laundering and Market Risk Seminar, the Annual Fun Run/Walk, and the staff picnic.

Public Relations

In conjunction with the National Art Gallery of The Bahamas, the Bank co-hosted an Art Teachers Workshop and Symposium. The Bank hosted its 23rd Annual Art Competition and Exhibition in November, which boasted a noticeable improvement in the quality of work presented, as well as participation in the High School Category. There were a total of six (6) other shows exhibited in the Gallery during 2006.

ADMINISTRATION

THE BOARD

In 2006, the Board of Directors comprised Governor Wendy Craigg as Chair and two external Directors - Mr. Carleton Williams MBE, a retired businessman, who has been a member since 2001, and Mr. Warren Rolle, a retired public officer, who was appointed in 2006.

OVERSEAS MEETINGS AND CONFERENCES

During the year, Governor Craigg's attendance at overseas meetings included the semi-annual meetings of the CARICOM Central Bank Governors, in May and November, annual meetings of the Bank of England and the Bank for International Settlements in June and the IMF/World Bank annual meetings held in Singapore, during September. In April, Governor Craigg also participated in a CARTAC Steering Committee Meeting held in Jamaica.

STAFF TRAINING, DEVELOPMENT AND RELATIONS

One of the main priorities of the Bank during the course of the year was the completion of the Job Evaluation and Organizational & Compensation Review Exercise, for which consultants were re-engaged in 2005. The Bank also commenced negotiations with the Union of Central Bankers for a new Industrial Agreement.

The Bank's commitment to capacity building within its workforce was again demonstrated by its sponsorship of a significant number of employees in domestic and international training programmes, as well as their attendance at meetings and conferences held locally and overseas. In addition to local and international training programmes, staff of the Bank participated in 17 in-house training and development workshops and seminars, inclusive of the annual Induction Training Course. The Bank also launched its first Corporate Wellness Programme. Self-initiated continuing education programme enrolments have been consistent throughout the year. Presently, 45 employees benefit from tuition reimbursement and subsidies under the Staff Training Incentive Programme.

Four employees are currently enrolled in full-time programmes under the Bank's In-Service Awards Programme—two at the College of The Bahamas, one at McGill University and one at the American University. At the Annual Long Service Awards Presentation Ceremony in January, several employees who had attained either thirty, twenty or ten years of service, were recognised.

STAFF COMPLEMENT

As at 31 December 2006, the staff complement stood at 234, inclusive of 213 permanent and 21 contractual employees. A total of eighteen (18) employees were hired during the year, while seventeen (17) employees separated from the Bank, including five (5) whose employment contracts terminated, eleven (11) who resigned and one (1) who retired.

PUBLIC RELATIONS

In addition to maintaining linkages with local educational institutions through its Annual Art Exhibition and Competition, the Bank facilitated field visits, presentations and work experience activities for primary and high school students during 2006. The Bank also hosted five schools, inclusive of two from Grand Bahama and Andros, to field trips and provided work experience for students from four high schools in New Providence.

ACKNOWLEDGEMENT

The Board of Directors extends its sincere appreciation to all employees for their continued dedication and service during the past year.

MANAGEMENT'S REPORT

The Central Bank of The Bahamas' Financial Statements for the year ended December 31, 2006 along with comparative figures for 2005, are shown on pages 45 to 75.

Total assets of the Bank declined by $37.3 million (4.88%), mainly on account of a $79.0 million (13.65%) reduction in external assets to $499.8 million. The latter comprised a $54.79 million (37.68%) reduction in foreign currency deposits, and a decrease in marketable securities of $24.7 million (5.82%). Property, plant and equipment grew by $0.55 million (3.94%).

The Bank's total liabilities declined by $40.6 million (6.16%), led by a $41.4 million (6.42%) contraction in demand liabilities. In particular, deposits by Bahamas Government agencies decreased by $27.4 million (50.85%), and deposits by commercial banks by $35.3 million (12.32%). Some offset was provided by the $17.3 million (5.73%) hike in total currency in circulation.

Lower yields on foreign assets, combined with the decrease in average reserve holdings, resulted in a $2.05 million (5.83%) reduction in operating income to $33.2 million. With expenses down by $0.78 million (2.89%) to $26.2 million, there was an overall decrease in profits from operations of $1.28 million (15.48%) to $6.97 million.

The Central Bank of The Bahamas

FINANCIAL STATEMENTS

31 December 2006

PricewaterhouseCoopers
Providence House
East Hill Street
P. O. Box N-3910
Nassau, The Bahamas

PKF
Pannell House
44 Elizabeth Avenue
P. O. Box N-8335
Nassau, The Bahamas

INDEPENDENT AUDITORS' REPORT

To the Directors of the Central Bank of The Bahamas

Report on the Financial Statements

We have audited the accompanying financial statements of the Central Bank of The Bahamas, which comprise the balance sheet as of 31 December 2006, and the income statement, statement of changes in equity and reserves and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and the Central Bank of The Bahamas Act, 2000. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

PricewaterhouseCoopers **PKF**

Opinion

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Central Bank of The Bahamas as of 31 December 2006, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards and the Central Bank of The Bahamas Act, 2000.

PricewaterhouseCoopers

Chartered Accountants

Nassau, Bahamas
29 March, 2007

PKF

Chartered Accountants

Nassau, Bahamas
29 March, 2007

THE CENTRAL BANK OF THE BAHAMAS

BALANCE SHEET AS AT 31 DECEMBER 2006

(Amounts expressed in Bahamian dollars)

	Notes	2006 $	2005 $ (Note 31)
ASSETS			
PROPERTY, PLANT AND EQUIPMENT	4	14,604,933	14,051,923
EXTERNAL ASSETS			
Foreign currency deposits	5	90,606,867	145,398,558
Marketable securities issued or guaranteed by foreign governments	6	399,723,705	424,440,384
International Monetary Fund:	7		
Bahamas reserve tranche		9,418,568	8,948,165
Special drawing rights		13,350	9,333
		499,762,490	578,796,440
OTHER ASSETS			
Bahamas Mortgage Corporation bonds	8	301,079	302,182
Advances to the Bahamas Government	9	63,037,758	77,762,052
Bahamas Government registered stocks	10	77,594,632	73,835,823
Loans to Bahamas Government agency	11	7,050,504	7,327,715
The Bridge Authority bonds	12	761,269	756,450
Clifton Heritage Authority bonds	13	638,075	-
Bahamas Government Treasury bills	14	52,400,690	-
Receivables and other accounts		10,386,449	10,988,074
		212,170,456	170,972,296
Total Assets		**726,537,879**	**763,820,659**

The notes on pages 53 to 75 form an integral part of these financial statements.

THE CENTRAL BANK OF THE BAHAMAS

BALANCE SHEET AS AT 31 DECEMBER 2006

(Amounts expressed in Bahamian dollars)

(Continued)

	Notes	2006 $	2005 $ (Note 31)
LIABILITIES, EQUITY AND RESERVES			
DEMAND LIABILITIES			
Notes in circulation		302,373,357	286,291,928
Coins in circulation		16,064,232	14,892,693
Deposits by commercial banks	15	250,960,623	286,229,823
Deposits by the Bahamas Government and Bahamas Government agencies		26,441,541	53,792,324
Deposits by international agencies	16	546,936	782,706
Payables and other accounts		3,338,072	2,778,365
Provision for payment into the Consolidated Fund	18	3,618,000	-
		603,342,761	644,767,839
OTHER LIABILITIES			
International Monetary Fund allocation of special drawing rights	17	15,485,607	14,694,938
EQUITY AND RESERVES			
Authorized and fully paid capital		3,000,000	3,000,000
Exchange equalization account	18	227,294	154,046
Contingency reserve	18	750,000	750,000
Other reserves	18	13,758,811	13,758,811
General reserves	18	89,973,406	86,695,025
		107,709,511	104,357,882
Total Liabilities and Reserves		**726,537,879**	**763,820,659**

The financial statements were approved by the board of directors and authorized for issue on 29 March 2007, and are signed on its behalf by:

Wendy Craigg

Governor

Director

The notes on pages 53 to 75 form an integral part of these financial statements.

THE CENTRAL BANK OF THE BAHAMAS

INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2006

(Amounts expressed in Bahamian dollars)

	Notes	2006 $	2005 $
INCOME	19	33,192,437	35,249,180
EXPENSES	20	(26,222,808)	(27,003,204)
NET PROFIT FOR THE YEAR		**6,969,629**	**8,245,976**

The notes on pages 53 to 75 form an integral part of these financial statements.

THE CENTRAL BANK OF THE BAHAMAS

STATEMENT OF CHANGES IN EQUITY AND RESERVES

FOR THE YEAR ENDED 31 DECEMBER 2006

(Amounts expressed in Bahamian dollars)

	Authorized and fully paid capital	Exchange equalisation account	Contingency reserve	Other reserves	General reserves	Total
	$	**$**	**$**	**$**	**$**	**$**
Balance at 1 January 2005	3,000,000	(237,893)	750,000	13,758,811	78,840,988	96,111,906
Net profit for the year	—	—	—	—	8,245,976	8,245,976
Transfer of unrealized exchange gains	—	391,939	—	—	(391,939)	—
Balance at 31 December 2005	3,000,000	154,046	750,000	13,758,811	86,695,025	104,357,882
Net profit for the year	—	—	—	—	6,969,629	6,969,629
Transfer to Consolidated Fund	—	—	—	—	(3,618,000)	(3,618,000)
Transfer of unrealized exchange gains	—	73,248	—	—	(73,248)	—
Balance at 31 December 2006	3,000,000	227,294	750,000	13,758,811	89,973,406	107,709,511

The notes on pages 53 to 75 form an integral part of these financial statements.

THE CENTRAL BANK OF THE BAHAMAS

CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2006

(Amounts expressed in Bahamian dollars)

	Notes	2006 $	2005 $ (Note 31)
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net profit for the year		6,969,629	8,245,976
Adjustments for non-cash items:			
Amortization of premiums on marketable securities	6	3,724,902	6,014,680
Depreciation	4	1,608,253	1,675,362
(Loss)/gain on sale of property, plant and equipment		16,225	(31,567)
Interest income	19	(31,421,837)	(32,721,196)
Interest expense	20	550,976	389,461
Net cash used in operating activities before changes in operating assets and liabilities		(18,551,852)	(16,427,284)
(Increase)/decrease in operating assets:			
International Monetary Fund – Special Drawing Rights		294,223	(470,820)
Receivables and other accounts		596,186	(768,962)
(Decrease)/increase in operating liabilities:			
Notes in circulation		16,081,429	45,051,184
Coins in circulation		1,171,539	853,115
Deposits by commercial banks		(35,269,200)	(97,445,263)
Deposits by the Bahamas Government and Bahamas Government agencies		(27,350,783)	(41,526,759)
Deposits by international agencies		(235,770)	27,082
Payables and other accounts		559,707	(462,137)
Net cash used in operating activities		(62,704,521)	(111,169,844)

The notes on pages 53 to 75 form an integral part of these financial statements.

THE CENTRAL BANK OF THE BAHAMAS

CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2006

(Amounts expressed in Bahamian dollars)

(Continued)

	Notes	2006 $	2005 $ (Note 31)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of marketable securities	6	(30,000,000)	(110,000,000)
Proceeds from maturities of marketable securities	6	50,000,000	27,000,000
Purchases of property, plant and equipment	4	(2,215,423)	(2,907,842)
Proceeds from sale of property, plant and equipment		37,935	51,455
Advances repaid by/(made to) Bahamas Government		15,000,000	(5,969,000)
Purchase of the Bridge Authority bonds	12	(5,100)	(55,300)
Purchases of Bahamas Government registered stocks	10	(24,518,400)	(112,244,300)
Proceeds from sales and maturities of Bahamas Government registered stocks	10	20,846,200	118,066,300
Repayments of loan by Bahamas Government agency		275,000	275,000
Purchase of Clifton Heritage Authority bonds	13	(633,700)	-
Purchase of Bahamas Government Treasury bills	14	(52,214,845)	-
Interest received		31,864,673	32,659,316
Net cash provided by (used in) investing activities		8,436,340	(53,124,371)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Payment to the Consolidated Fund		-	(1,000,000)
Interest paid		(528,950)	(389,461)
Net cash used in financing activities		(528,950)	(1,389,461)
Net decrease in cash and cash equivalents		**(54,797,131)**	**(165,683,676)**
Cash and cash equivalents at beginning of the year		145,447,275	311,130,951
Cash and cash equivalents at end of the year		**90,650,144**	**145,447,275**
Cash and cash equivalents comprise the following:			
Foreign currency deposits		90,606,867	145,398,558
Cash on hand (included in receivables and other accounts)		43,277	48,717
		90,650,144	**145,447,275**

The notes on pages 53 to 75 form an integral part of these financial statements.

1. INCORPORATION AND ACTIVITIES

The Central Bank of The Bahamas (the Bank) was established under the Central Bank of The Bahamas Act Chapter 321, and was continued under the Central Bank of The Bahamas Act, 2000 (the Act). Its main place of business is located at Frederick Street, Nassau, Bahamas. The Bank's principal business is the provision of central banking facilities for the Commonwealth of The Bahamas. In accordance with the Act, it is the duty of the Bank to promote and maintain monetary stability, credit and balance of payments conditions conducive to the orderly development of the Bahamian economy.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

(a) Basis of preparation

The Bank's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and the Central Bank of The Bahamas Act, 2000. The financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets.

The preparation of the financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Bank's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 3.

The application of amendments to published accounting standards and interpretations that became effective 1 January 2006 did not result in substantial changes to the Bank's accounting policies. With the exception of the new disclosure requirements of IFRS 7 *Financial Instruments: Disclosures,* and amendments to IAS 1 *Presentation of Financial Statements* regarding capital disclosures, that became effective 1 January 2007, the application of new standards and interpretations issued but not yet effective will not have a material impact on the Bank's financial statements in the period of initial application. On adoption, IFRS 7 will supersede IAS 30 and the disclosure requirements of IAS 32.

(b) Revenue and expense recognition

Revenues and expenses are recognized on the accrual basis.

(c) Foreign currency translation

(i) Functional currency and presentation currency

Items included in the financial statements are measured using the currency of the primary economic environment in which the Bank operates (the functional currency), the Bahamian dollar. The financial statements are presented in Bahamian dollars, which is the Bank's functional and presentation currency.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(c) Foreign currency translation (Continued)

(ii) Transactions and balances

Transactions in currencies other than Bahamian dollars are converted at the rates of exchange ruling at the time of the transactions. Balances in currencies other than Bahamian dollars at the balance sheet date are converted at the closing rate of exchange prevailing at the balance sheet date.

The net change in the Bank's assets and liabilities arising from movements in currency exchange rates is included in the income statement and, in accordance with Sections 32(2)(a) and 32(2)(b) of the Act, the unrealized portion is transferred to an exchange equalization account.

(d) Property, plant and equipment

Property, plant and equipment are recorded at cost less accumulated depreciation. Depreciation is provided in equal annual instalments so as to write off the cost of assets, other than land, over their estimated useful lives. The following rates are used:

Buildings & renovations	2% - 20% p.a.
Office equipment	20% - 33% p.a.
Computer software	33% - 50% p.a.
Office furniture & fittings	20% p.a.
Other fixed assets	20% - 33% p.a.

(e) Financial assets

The Bank classifies its financial assets in the following categories: loans and receivables; held-to-maturity investments and available-for-sale financial assets. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its investments at initial recognition and re-evaluates this designation at every reporting date.

(i) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than: (a) those that the Bank intends to sell immediately or in the short term; (b) those that the Bank upon initial recognition designates are available-for-sale; or (c) those for which the Bank as holder may not recover substantially all of its initial investment, other than because of credit deterioration.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Financial assets (Continued)

(i) Loans and receivables (Continued)

Advances to the Bahamas Government

The advances to the Bahamas Government are classified as loans and receivables originated by the Bank and not held-for-trading. These loans, which are payable on demand, are stated at amortized cost, less any provision for impairment.

Loans to Bahamas Government agency

The loans to Bahamas Government agency are classified as loans and receivables originated by the Bank and not held-for-trading. These loans, which have a fixed maturity period, are measured at amortized cost, using the effective interest rate method, less any provision for impairment.

(ii) Held-to-maturity financial assets

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank's management has the positive intention and ability to hold to maturity. If the Bank were to sell other than an insignificant amount of held-to-maturity assets, the entire category would be reclassified as available-for-sale.

Marketable securities issued or guaranteed by foreign governments

Marketable securities issued or guaranteed by foreign governments are classified as held-to-maturity investments, and are stated at amortized cost using the effective interest rate method. Such investments are subject to review for impairments.

(iii) Available-for-sale financial assets

Available-for-sale investments are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Financial assets (Continued)

(iii) Available-for-sale financial assets (Continued)

Bahamas Mortgage Corporation bonds
Bahamas Mortgage Corporation bonds are classified as available-for-sale investments and are stated at fair value.

Bahamas Government registered stocks
Bahamas Government registered stocks are classified as available-for-sale investments and are stated at fair value.

The Bridge Authority bonds
The Bridge Authority bonds are classified as available-for-sale investments and are stated at fair value.

Regular-way purchases and sales of financial assets categorized as held-to-maturity and available-for-sale are recognized on the trade-date—that is the date on which the Bank commits to purchase or sell the asset.

Financial assets are initially recognized at fair value plus transaction costs for all available-for-sale financial assets. Financial assets are derecognized when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all risks and rewards of ownership.

Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognized directly in equity, until the financial asset is derecognized or impaired. At this time, the cumulative gain or loss previously recognized in equity is recognized in the income statement. However, interest calculated using the effective interest rate method for investments classified as available-for-sale is recognized in the income statement.

The fair values of quoted investments in active markets are based on current bid prices.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(f) Impairment of assets

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount. The amount of the impairment for assets carried at amortized cost is calculated as the difference between the assets carrying amount and the present value of expected future cash flows discounted at the financial instrument's original effective interest rate.

If in a subsequent period, the amount of the impairment decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment is decreased and the decrease is recognized in the income statement.

(g) Numismatic coins

Numismatic coins, which are specially minted or packaged as collectors' items and are not issued for monetary purposes are not included in coins in circulation. Any profit or loss arising from the sale of these coins is included in the income statement.

(h) Retirement benefit costs

The Bank's retirement plan is a contributory defined benefit plan with participants being permanent employees who join the Bank prior to age 55. The cost of providing such benefits is determined using the projected unit credit method, with actuarial valuations being carried out at each balance sheet date. Actuarial gains and losses which exceed 10% of the greater of the present value of the Bank's pension obligations and the fair value of the plan's assets are amortized over the expected average remaining working lives of the participating employees. Past service cost is recognized immediately to the extent that the benefits are already vested, and otherwise is amortized on a straight-line basis over the average period until the amended benefits become vested.

The amount recognized in the balance sheet represents the present value of the defined benefit obligation as adjusted for the unrecognized actuarial gains and losses and unrecognized past service costs, and reduced by the fair value of plan assets. Any asset arising as a result of this calculation is limited to the unrecognized actuarial losses and past service cost plus the present value of available refunds and reductions in future contributions to the plan.

(i) Fiduciary items

No account is taken in these financial statements of assets held or liabilities incurred by the Bank in a fiduciary capacity.

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and based on historical experience and other factors including expectations of future events that are believed to be reasonable under the circumstances. Such accounting estimates and judgments are disclosed in Notes 2 (f) and 2 (h).

4. PROPERTY, PLANT AND EQUIPMENT

	Land	Buildings & renovations	Office equipment	Computer software	Office Furniture & fittings	Other fixed assets	Total
	$	$	$	$	$	$	$
COST							
At 1 January 2006	2,452,938	11,702,455	8,240,950	6,050,206	3,006,725	392,556	31,845,830
Additions	—	472,548	1,268,483	331,720	71,557	71,115	2,215,423
Disposals	—	—	(67,502)	—	—	—	(67,502)
At 31 December 2006	2,452,938	12,175,003	9,441,931	6,381,926	3,078,282	463,671	33,993,751
ACCUMULATED DEPRECIATION							
At 1 January 2006	—	3,860,066	5,149,255	5,922,808	2,602,292	259,486	17,793,907
Charge for the year	—	325,443	746,097	294,889	195,366	46,458	1,608,253
Disposal	—	—	—	—	(13,342)	—	(13,342)
At 31 December 2006	—	4,185,509	5,895,352	6,217,697	2,784,316	305,944	19,388,818
NET BOOK VALUE							
At 31 December 2006	2,452,938	7,989,494	3,546,579	164,229	293,966	157,727	14,604,933

	Land	Buildings & renovations	Office equipment	Computer software	Office Furniture & fittings	Other fixed assets	Total
	$	$	$	$	$	$	$
COST							
At 1 January 2005	2,452,938	11,549,614	5,857,794	5,956,599	2,850,992	486,870	29,154,807
Additions	—	152,841	2,403,156	93,607	155,733	102,505	2,907,842
Disposals	—	—	(20,000)	—	—	(196,819)	(216,819)
At 31 December 2005	2,452,938	11,702,455	8,240,950	6,050,206	3,006,725	392,556	31,845,830

4. PROPERTY, PLANT AND EQUIPMENT (Continued)

	Land	Buildings & renovations	Office equipment	Computer software	Office Furniture & fittings	Other fixed assets	Total
	$	$	$	$	$	$	$
ACCUMULATED DEPRECIATION							
At 1 January 2005	—	3,593,583	4,852,938	5,060,453	2,409,000	399,502	16,315,476
Charge for the year	—	266,483	316,317	862,355	193,292	36,915	1,675,362
Disposals	—	—	(20,000)	—	—	(176,931)	(196,931)
At 31 December 2005	—	3,860,066	5,149,255	5,922,808	2,602,292	259,486	17,793,907
NET BOOK VALUE							
At 31 December 2005	2,452,938	7,842,389	3,091,695	127,398	404,433	133,070	14,051,923

5. EXTERNAL ASSETS

External assets comprise those assets defined by Section 18(1) of the Act. The Act also requires that the value of external assets shall not at any time be less than 50% of the value of the aggregate of the notes and coins in circulation and other demand liabilities of the Bank. At the year-end, external assets represented approximately 82.83% (2005: 89.77%) of such liabilities.

6. MARKETABLE SECURITIES ISSUED OR GUARANTEED BY FOREIGN GOVERNMENTS

Section 18(1) of the Act requires that marketable securities issued or guaranteed by foreign governments, which mature beyond 5 years, shall at no time constitute more than 30% in value of the Bank's external assets. At 31 December 2006, marketable securities held by the Bank, which mature after 5 years, constituted 11.00% (2005: 12.24%) of the Bank's external assets.

6. MARKETABLE SECURITIES ISSUED OR GUARANTEED BY FOREIGN GOVERNMENTS (Continued)

The movement in marketable securities is as follows:

	2006	2005
	$	$
At beginning of year	419,134,652	342,149,332
Purchases	30,000,000	110,000,000
Redemptions	(50,000,000)	(27,000,000)
Amortization of premium	(3,724,902)	(6,014,680)
End of year	**395,409,750**	**419,134,652**
Add: Accrued interest	4,313,955	5,305,732
	399,723,705	**424,440,384**

The maturity of the marketable securities is as follows:

	2006	2005
	$	$
Within 1 year	45,391,263	55,790,312
1 to 5 years	299,342,813	297,785,442
After 5 years	54,989,629	70,864,630
	399,723,705	**424,440,384**

The market value of these securities at the balance sheet date was $386,366,849. These securities bear interest at rates per annum varying between 2.62% and 6.50% (2005: 2.62% and 5.0%).

7. INTERNATIONAL MONETARY FUND

Bahamas Reserve Tranche

The International Monetary Fund (IMF) reserve tranche represents the amount by which The Bahamas' quota of Special Drawing Rights (SDR) with the IMF exceeds subscription payments as noted below:

7. INTERNATIONAL MONETARY FUND (Continued)

	2006 SDR (millions)	$	2005 SDR (millions)	$
Quota	130.3	196,023,565	130.3	186,233,923
Subscription payments in promissory notes	(119.3)	(179,422,681)	(119.4)	(170,667,244)
Subscription payments in currency	(4.7)	(7,182,316)	(4.6)	(6,618,514)
Reserve tranche	**6.3**	**9,418,568**	**6.3**	**8,948,165**

The reserve tranche was purchased from the Government of The Bahamas in 1976.

Subsequent to that purchase, the Bank has funded 25% of each increase in the IMF subscriptions of The Bahamas by issuing interest-free promissory notes which are payable on demand. In the opinion of the Directors, it is not probable that an outflow of resources employing economic benefits will be required to settle these promissory notes, which total $49,632,139 (2005: $51,393,581). Consequently, this amount is regarded as a contingent liability and is not recognized in the Bank's balance sheet.

Special Drawing Rights

This amount represents SDR holdings with the IMF, is repayable on demand and bears interest at rates per annum varying from 4.31% to 5.48% (2005: 2.22% to 3.03%).

8. BAHAMAS MORTGAGE CORPORATION BONDS

These bonds bear interest at a rate of 2.00% (2005: 2.00%) per annum below the Prime rate and mature as noted below:

	2006 $	2005 $
Up to 1 year	301,079	—
Between 2-3 years	—	302,182
	301,079	**302,182**

The bonds are carried at a face amount of $300,000 as at 31 December 2006 (2005: $300,000) plus accrued interest.

9. ADVANCES TO THE BAHAMAS GOVERNMENT

Sections 28(3) and 28(4) of the Act require that advances to the Government, which may be outstanding at any one time, shall not exceed 10% of either the annual average ordinary revenue of the Government over the three preceding years for which the accounts have been laid before Parliament or the estimated ordinary revenue of the Government for the year, whichever is the less.

At the balance sheet date, advances to the Government approximated 6.00% (2005: 10.00%) of the lesser of such revenues. Of those advances $19,000,000 (2005: $34,000,000) bear interest at a rate per annum of 1.09% (2005: 1.09%) and $5,969,000 (2005: $5,969,000) bear interest at a rate per annum of 0.08% (2005:0.08%). The remaining advances were interest free during both 2006 and 2005. The advances are repayable on demand.

The movement in the advances to the Bahamas Government is as follows:

	2006 $	2005 $
At beginning of year	76,987,608	71,018,608
Additions	—	5,969,000
Repayments	(15,000,000)	—
End of year	**61,987,608**	**76,987,608**
Add: Accrued interest	1,050,150	774,444
	63,037,758	**77,762,052**

10. BAHAMAS GOVERNMENT REGISTERED STOCKS

Section 29(1)(c) of the Act requires that the total amount of Government issued or guaranteed securities held at any time by the Bank which mature beyond five years after their date of issue shall not exceed 20% of the demand liabilities of the Bank. At the balance sheet date, Bahamas Government Registered Stocks held by the Bank which mature beyond five years after their date of issue was approximately 12.86% (2005: 11.45%) of such liabilities.

The Act further requires that any holdings of Government issued or guaranteed securities should not have maturities extending beyond 20 years from the date of their acquisition. The Bank held no such securities maturing beyond 20 years at either 31 December 2006 or 2005.

10. BAHAMAS GOVERNMENT REGISTERED STOCKS (Continued)

The movement in Bahamas Government registered stocks is as follows:

	2006 $	2005 $
At beginning of year	72,694,600	78,516,600
Purchases	24,518,400	112,244,300
Redemptions/maturities	(20,846,200)	(118,066,300)
End of year	**76,366,800**	**72,694,600**
Add: Accrued interest	1,227,832	1,141,223
End of year	**77,594,632**	**73,835,823**

Bahamas Government registered stocks bear interest at rates per annum ranging between 5.60% and 6.75% (2005: 5.60% and 6.75%) and mature as noted below:

	2006 $	2005 $
1 to 5 years	—	100
More than 5 years	77,594,632	73,835,723
	77,594,632	**73,835,823**

11. LOANS TO BAHAMAS GOVERNMENT AGENCY

This balance is comprised of three loan facilities made available to a Government agency in accordance with Section 29(l) (f) of the Act.

The movement in loans to Bahamas Government Agency is as follows:

	2006 $	2005 $
At beginning of year	7,300,000	7,575,000
Repayments	(275,000)	(275,000)
End of year	**7,025,000**	**7,300,000**
Add: Accrued interest	25,504	27,715
	7,050,504	**7,327,715**

11. LOANS TO BAHAMAS GOVERNMENT AGENCY (Continued)

The advances bear interest at the rate of 2.00% per annum (2005: 2.00%) and mature as noted below:

	2006 $	2005 $
More than 5 years	**7,050,504**	**7,327,715**

12. THE BRIDGE AUTHORITY BONDS

These bonds bear interest at rates ranging from 1.00% to 1.50% (2005: 1.00% to 1.50%) per annum over the Prime rate.

The movement and maturity for the Bridge Authority bonds, is as follows:

	2006 $	2005 $
At beginning of year	743,300	688,000
Purchases	5,100	55,300
End of year	**748,400**	**743,300**
Add: Accrued interest	12,869	13,150
	761,269	**756,450**
More than 5 years	**761,269**	**756,450**

13. CLIFTON HERITAGE AUTHORITY BONDS

The Bank is the registrar for the Clifton Heritage Authority bonds guaranteed by the Bahamas Government. The total allotment of the bonds is $24,000,000. The maturity dates are as follows:

Maturity dates	Interest rates	Principal Amount $
Due on 20 May 2025	1/2% per annum above Prime rate	8,000,000
Due on 20 May 2030	5/8% per annum above Prime rate	8,000,000
Due on 20 May 2035	3/4% per annum above Prime rate	8,000,000
		24,000,000

As at 31 December 2006, the Bank has holdings of these bonds totaling $633,700 (2005: $Nil) plus accrued interest of $4,375 (2005: $Nil).

14. BAHAMAS GOVERNMENT TREASURY BILLS

As at 31 December 2006, the Bank has holdings of Bahamas Government Treasury bills totaling $52,214,845 (2005: $Nil) plus accrued interest of $185,845 (2005: $Nil) that mature between 1 April 2007 and 2 August 2007 and which are discounted at rates per annum varying from 0.375% to 0.63%.

15. DEPOSITS BY COMMERCIAL BANKS

Deposits by commercial banks consist of current account balances deposited as statutory reserves in accordance with Section 19 of the Act.

The present level of the statutory reserves applicable to commercial banks is 5.00% of the total Bahamian dollar deposit liabilities, of which at least 4.00% must be placed on deposit with the Bank. These deposits are interest free and are repayable on demand subject to maintenance of minimum balances required by the Act.

16. DEPOSITS BY INTERNATIONAL AGENCIES

The Bank is designated as the fiscal agency for the Commonwealth of The Bahamas. Deposits by international agencies include deposits in Bahamian currency by the World Bank, the International Monetary Fund, the Inter-American Development Bank, the Caribbean Development Bank and the Commission of the European Development Fund. These deposits are interest free and are repayable on demand.

17. INTERNATIONAL MONETARY FUND ALLOCATION OF SPECIAL DRAWING RIGHTS

In accordance with a resolution of the Board of Governors of the IMF, effective 11 December 1978, The Bahamas became a participant in the Special Drawing Rights Department of the IMF, receiving a total allocation of SDR10,230,000 between 1979 and 1981. The Special Drawing Rights allocation bore interest during the year at rates per annum varying between 4.31% and 5.48% (2005: 2.22% and 3.03%) with accrued interest of $95,576 (2005: $73,550) and is repayable on demand.

18. RESERVES

a. Exchange equalization account – Under the terms of Sections 32(2)(a) and 32(2)(b) of the Act, this account represents the net unrealized profits or losses arising from the revaluation of foreign currency assets and liabilities of the Bank at the balance sheet date.

b. Contingency reserve – This reserve is maintained in accordance with the provisions of Section 7(1) of the Act.

18. RESERVES (Continued)

c. Other reserves – In accordance with the provisions of Section 7(1) of the Act, the Bank has determined that there will be no transfer from other reserves to general reserves. In 2006 and 2005 an amount of $Nil was transferred from other reserves to general reserves.

d. General reserves – Section 7(2) of the Act requires that at the end of any year where the amount in the general reserves exceed twice the authorized capital of the Bank or 15% of its demand liabilities, whichever is greater, the excess shall be paid to the Consolidated Fund unless the Minister of Finance determines otherwise.

The balance of the general reserves at the year end amounted to $93,591,406 (2005: $86,695,025) equivalent to 15.51% (2005: 13.45%) of demand liabilities prior to a provision of $3,618,000 (2005: $Nil) to be paid into the Consolidated Fund.

19. INCOME

	2006 $	2005 $
Interest income	31,421,837	32,721,196
Exchange gain	73,248	391,939
Other operating income	1,697,352	2,136,045
	33,192,437	**35,249,180**

20. EXPENSES

	2006 $	2005 $
General & administrative expenses	13,015,732	12,892,737
Staff costs	11,047,847	11,432,394
Depreciation expense	1,608,253	1,675,362
Loss on bank loans	-	613,250
Interest expense	550,976	389,461
	26,222,808	**27,003,204**

21. THE DEPOSIT INSURANCE CORPORATION

In accordance with Section 5(1) of the Protection of Depositors Act, 1999, the Bank has made an initial capital contribution of $500,000 representing 100% of the paid-up portion of the capital of The Deposit Insurance Corporation. This Corporation was established to manage The Deposit Insurance Fund, which was established to protect funds deposited with member institutions.

In the opinion of the Directors, the Bank does not have the power to govern the financial and operating policies of The Deposit Insurance Corporation so as to attain benefits from its activities. Consequently, The Deposit Insurance Corporation is not treated as a subsidiary in these financial statements.

Additionally, the Directors do not consider that the investment in The Deposit Insurance Corporation will be recoverable, and consequently the Bank has made a full provision against this investment.

22. COMMITMENTS

The Bank is committed to rent office space under an operating lease. The Bank is committed to the following future payments under the lease agreement:

Year	**$**
2007	331,260
2008	289,408
2009	267,540
2010	89,180

23. CONCENTRATIONS OF ASSETS AND LIABILITIES

The Bank has the following concentrations of assets and liabilities:

EXTERNAL ASSETS	**2006**	**2005**
	%	%
Geographic Region		
North America	99.97	96.76
Europe	–	0.44
Other	0.03	2.8
Industry		
Financial Sector	100.00	100.00

OTHER ASSETS	**2006**	**2005**
	%	%
Geographic Region		
Bahamas	100.00	100.00
Industry		
Government Sector	100.00	100.00

DEMAND LIABILITIES	**2006**	**2005**
	%	**%**
Geographic Region		
Bahamas	99.99	99.88
Other	0.01	0.12
Industry		
Financial Sector	100.00	100.00

OTHER LIABILITIES	**2006**	**2005**
	%	**%**
Geographic Region		
International Agencies	100.00	100.00
Industry		
Financial Sector	100.00	100.00

24. RELATED-PARTY TRANSACTIONS

The Bank could be regarded as related to state corporations such as Bahamas Electricity Corporation (BEC) and National Insurance Board (NIB). However, the only transactions that the Bank has with such related entities are purely on commercial terms.

The Bank provides certain services to the Government of The Bahamas in accordance with its mandate under sections 26 to 28 of the Act. These balances have not been disclosed.

The Bank's senior management personnel are regarded to be its only key management personnel.

The following transactions were carried out with related parties:

a. **Compensation:**	**2006** **$**	**2005** **$**
Salaries and other short-term employee benefits	1,394,686	1,017,462
Termination benefits	—	198,871
	1,394,686	**1,216,333**

b. **Loans:**	**2006** **$**	**2005** **$**
Beginning of the year	874,577	971,883
Loans advanced during the year	32,900	30,000
Loans repayment received	(160,174)	(127,306)
End of year	**747,303**	**874,577**

25. CONTINGENT LIABILITIES

The Bank is party to a number of asserted and unasserted claims in the normal course of business, including a number from a former licensee, which are at varying stages of the judicial process. The Bank is vigorously defending all such claims and is of the opinion that the outcome, which cannot presently be determined, will not adversely affect its operations and financial statements.

26. OFF BALANCE SHEET ITEMS

The Bank has off balance sheet items totalling $37,657,946 (2005: $34,235,008). These items, which are held in a fiduciary capacity, comprise bank balances and corresponding offsetting account liabilities in respect of dormant retail customer accounts of $37,657,946 (2005: $34,235,008) and a sinking fund of $Nil (2005: $Nil).

Certain dormant retail customer accounts, which are received in foreign currencies, are invested in the same currency. These currencies are converted to Bahamian dollars at the rate of exchange prevailing at the date of accepting their funds, and listed as a memorandum account in the trial balance. Foreign currency deposits are repaid by liquidating investments in the same currency, which does not involve currency conversion.

27. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Directors consider that, with the exception of marketable securities issued or guaranteed by foreign governments, all of the Bank's financial assets and liabilities are carried at amounts approximating their fair value. The market value of those marketable securities is as stated in Note 6.

28. MATURITIES OF FINANCIAL INSTRUMENTS

Except as otherwise disclosed in Notes 6 to 15, the Bank's significant financial assets and liabilities mature within one year of the balance sheet date.

29. FINANCIAL RISK MANAGEMENT

The Bank's activities expose it to a variety of financial risks and those activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is core to the financial business, and the operational risks are an inevitable consequence of being in business. The Bank's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effects on the Bank's financial performance.

The Bank's risk management policies are designed to identify and analyse these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The Bank regularly reviews its risk management policies and systems to reflect changes in markets, products and emerging best practices.

29. FINANCIAL RISK MANAGEMENT (Continued)

Risk management is carried out by the investment and monetary policy committees under policies approved by the Board of Directors. The committees identify, evaluate and hedge financial risks in close co-operation with the Bank's operating units. The Board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk and financial instruments.

The most important types of risks are credit risk, market risk, liquidity risk and other operational risk. Market risk includes currency risk and interest rate risk.

Credit risk

The Bank takes on exposure to credit risk, which is the risk that counterparty will cause a financial loss for the Bank by failing to discharge an obligation. Significant changes in the economy, or in the health of a particular segment that represents a concentration in the Bank's portfolio, could result in losses that are different from those provided for at the balance sheet date. Credit exposures arise principally in loans and advances, debt securities and other bills in the Bank's asset portfolio. The credit risk management and control are monitored by the investment committee which reports to the Board of Directors regularly.

The Directors do not consider that the Bank is exposed to any significant credit risk because its financial assets consist primarily of cash and securities issued or guaranteed by either foreign governments or the Bahamas Government.

Market risk

The Bank takes on exposure to market risk, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads, foreign exchange rates and equity prices. The Bank's exposure to market risk is from its financial investment portfolios.

The market risks arising from the Bank's activities are monitored by the investment and monetary policy committees. These committees submit regular reports to the Board of Directors and operating units.

29. FINANCIAL RISK MANAGEMENT (Continued)

Foreign exchange risk

The Bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

The Bank's exposure to foreign exchange risk is largely limited by the fact that fluctuations in the prevailing foreign currency exchange rates are for the account of the Bahamas Government under the terms of Sections 32(2)(a) and 32(2)(b) of the Act.

Interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Bank takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may reduce losses in the event that unexpected movements arise. The level of mismatch of interest rate repricing that may be undertaken by the Bank is monitored frequently by the investment and monetary policy committees.

Except as otherwise stated in Notes 6 to 15, the Bank's financial assets and liabilities do not carry any exposure to interest rate risk.

Liquidity risk

Liquidity risk is the risk that the Bank is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. The consequence may be the failure to meet obligations to repay depositors and fulfil commitments to lend.

The Bank manages its foreign liquidity risks through appropriate structuring of its foreign investment portfolios to ensure that the maturity profiles of foreign assets sufficiently match those of foreign commitments. This is monitored and managed on a regular basis by the investment and monetary policy committees. In addition, the Bank's foreign investment portfolio comprises mainly short-term, highly liquid investment instruments.

29. FINANCIAL RISK MANAGEMENT (Continued)

Liquidity risk management process

The Bank's liquidity management process, as carried out within the Bank includes:

- day-to-day funding, managed by monitoring future cash flows to ensure that requirements can be met. This includes replenishment of funds as they mature or funds that are borrowed by customers. The Bank maintains an active presence in global money markets to enable this to happen;
- maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow;
- monitoring balance sheet liquidity ratios against internal and regulatory requirements; and
- managing the concentration and profile of debt and financial instrument maturities.

30. CONTRIBUTORY DEFINED BENEFIT PLAN

The movement in the contributory defined benefit obligation over the year is as follows:

	2006	**2005**
	$	**$**
Current service cost	1,435,571	1,387,025
Interest cost	1,601,617	1,725,546
Contributions by plan participants	344,995	340,017
Actuarial gains	510,854	2,920,710
Benefits paid	(979,556)	(1,282,943)
End of the year	**2,913,481**	**5,090,355**

30. CONTRIBUTORY DEFINED BENEFIT PLAN (Continued)

The amount recognized as an asset in the balance sheet in respect of the Bank's contributory defined benefit plan is as follows:

	2006 $	2005 $
Present value of funded obligations	(28,012,384)	(26,465,605)
Fair value of plan assets	34,218,125	32,094,290
	6,205,741	5,628,685
Unrecognized actuarial gains	(3,336,723)	(2,818,111)
Net assets calculated in accordance with paragraph 54 of International Accounting Standard 19	**2,869,018**	**2,810,574**

The expense recognized in the income statement in respect of the Bank's contributory defined benefit plan is as follows:

	2006 $	2005 $
Current service cost	1,090,576	1,047,008
Interest cost	1,601,617	1,725,546
Expected return on plan assets	(2,087,072)	(2,122,890)
	605,121	**649,664**

Movements in the net assets recorded in the balance sheet are as follows:

	2006 $	2005 $
Net assets at beginning of the year	2,810,574	2,945,078
Net expense recognized in the income statement	(605,121)	(649,664)
Employer contributions	663,565	515,160
Net assets at end of the year	**2,869,018**	**2,810,574**

30. CONTRIBUTORY DEFINED BENEFIT PLAN (Continued)

Principal actuarial assumptions used at the balance sheet date are as follows:

	2006	**2005**
Discount rate	6.00%	6.25%
Expected return on plan assets	6.50%	7.00%
Expected rate of salary increase at age 18	9.00%	9.00%
Expected rate of salary increase at age 59	2.00%	2.00%
Average expected remaining working lives of employees (years)	19.00	19.00

The actual return on plan assets during the year was $2,094,830 (2005: $1,981,172).

31. CORRESPONDING FIGURES

The corresponding figures for accrued interest in the balance sheet, cash flow statement and notes to the financial statements have been reclassified to conform with the presentation adopted for the current year.

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