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**QUARTERLY OVERVIEW OF DOMESTIC
ECONOMIC DEVELOPMENTS**

SEPTEMBER 2007

This summary is an early release, excerpted from the upcoming issue of the Central Bank's Quarterly Economic Review for the Quarter ended September 2007. The full text of the Economic Review will be released on 16 January, 2008.

The Bahamas

Review of Domestic Economic Developments for Third Quarter 2007

Preliminary information suggest some moderation in the rate of expansion in the Bahamian economy during the third quarter of 2007 as construction investments slackened, although the outturn was supported by tempered growth in consumer demand and a more positive tourism performance. Average consumer price inflation, although stabilized, continued to reflect the past through effects of strengthened global fuel prices. In the fiscal sector, the reversal in the overall position to a deficit, was owing to a combination of higher salary and interest payment outlays and lower revenue collections, following the impact of one-time receipts from an extraordinary transaction last year. Seasonal firming in domestic credit, alongside reduced levels of investment inflows, led to declines in both external reserves and liquidity during the quarter; and a consequent narrowing of the average interest rate spread on bank loans and deposits. On the external side, the estimated deficit on the current account improved, aided by growth in tourist expenditure and a reduction in the merchandise trade deficit. However, sharply tapered direct investment inflows resulted in a significantly lower capital account surplus.

Monetary conditions during the third quarter of 2007 featured a 36.1% fall-off in net free cash balances to \$148.9 million, as the rise in total domestic credit surpassed gains in the overall money supply. Consequently, the ratio of net free cash reserves to total Bahamian dollar deposits fell by 0.8 percentage points over the previous year to 2.8%. Similarly, the broader surplus liquid assets receded by 46.2% to \$122.5 million, which exceeded the statutory minimum by a reduced 14.3%. In this environment, the weighted average interest rate spread contracted by 24 basis points to 6.95 percentage points, as the commercial banks' weighted average loan rate softened by 19 basis points to 10.63%, while the weighted average deposit rate firmed by 5 basis points to 3.68%. With respect to the other key rates, the 90-day Treasury bill rate moved marginally lower to 2.63%, but base rates—commercial banks' prime and the Central Bank's discount rate—were unchanged at 5.50% and 5.25%, respectively.

Reflecting a firming in the foreign currency deposits of residents, the money supply (M3) rebounded by 0.2% to \$5,542.7 million, from a 1.5% contraction a year earlier. In terms of the major components, fixed deposits advanced by 2.4%; however, reductions were noted for saving deposits, demand deposits and currency in circulation of 1.6%, 4.8% and 1.7%, respectively.

Growth in domestic credit eased slightly to 3.0% during the review quarter from 3.6% in the previous year, based primarily on a slower expansion in private sector credit of 3.3%. After falling by 0.9% a year earlier, net claims on the Government expanded by 6.4%, buoyed by the banking system's increased holdings of Government Registered Stocks. In contrast, credit to the public corporations declined by 8.5%.

Fiscal operations resulted in a deficit of \$50.7 million in the first quarter of FY2007/08, in contrast to a \$3.6 million surplus in the corresponding period of FY2006/2007. Total revenue contracted by 10.2% to \$293.6 million in comparison to the previous year, when collections were boosted by extraordinary tax receipts; and total outlays rose by 6.5% to \$344.4 million, primarily on account of higher salaries and interest payments. Capital expenditures, which were largely for infrastructural development projects, rose by 1.0% to \$30.5 million. Financing for the budget deficit consisted of a \$100.0 million Registered Stock issue, \$28.0 million in Treasury bills and external loan drawdowns of \$2.0 million. In terms of the \$21.3 million in debt repayment, \$20.5 million was earmarked for Bahamian dollar obligations, which were predominantly used for the retirement of Registered Stocks. Consequently, over the review quarter, the Direct Charge on Government increased by \$108.7 million (4.5%) to \$2,546.9 million. Taking into account the \$10.4 million decline in Government guaranteed liabilities, National Debt rose by \$98.3 million (3.4%) to \$2,987.3 million, vis-à-vis an \$81.0 million (2.9%) upturn in 2006.

Tourism sector performance improved during the relevant quarter, as evidenced by a 1.7% hike in total

visitor arrivals to an estimated 1.05 million, following last year's 2.8% contraction to 1.04 million. The outturn mainly reflected gains in the long-stay air segment, which expanded by 4.8% in comparison to the 6.9% reduction last year. A more modest increase of 0.2% was noted for the sea component, albeit a turnaround from the previous year's 0.7% decline. Port of entry data showed that visitors to the Grand Bahama market rebounded by 15.1%, after a 25.2% downturn in 2006. Similarly, New Providence's 2.6% gain completely reversed last year's contraction of 9.0%; whereas visitors to the Family Islands fell by 5.8%, following a strong upsurge of 34.2% a year earlier.

Partial indicators suggest some slowing in construction activity during the third quarter, amid weakened tourism-related foreign investment flows and residential building expenditures. Data from banks, insurance companies and the Bahamas Mortgage Corporation revealed that the value of mortgage disbursements during the quarter declined by 23.8% to \$136.7 million, with the major residential component falling by 29.4% to \$116.9 million. The more forward looking indicator, commitments for new construction and repairs, fell by 19.2% in value to \$31.8 million, with residential loan approvals, which accounted for 92.0% of the total, contracting by 18.6% to \$29.3 million. The total value of mortgages outstanding at end-September rose by 11.5% to \$2,712.5 million, with the residential component (91.9%) elevated by 12.4% to \$2,492.0 million and commercial claims up by 2.0% to \$220.5 million.

Inflation, as measured by average changes in the Retail Price Index, stabilized at 2.1% in the third quarter, relative to the same period last year. Although notable price increases were observed for furniture & household operation (7.1%), transportation & communication (2.5%) and education (2.3%), significant offsets were provided by other goods and services, food & beverages and housing—the largest component—which rose at a slower pace of 0.8%, 3.4% and 0.4%, respectively.

During the twelve months to September, average consumer prices advanced by 2.4%, exceeding the 1.6% rise of last year. Higher average costs were registered for "other" goods and services (4.6%), furniture & household operations (4.0%), and food & beverages (3.8%).

An analysis of fuel prices for New Providence revealed a modest 1.4% decline in the average cost of gasoline to \$4.44 per gallon, and a less than one percentage point reduction in the price of diesel to \$3.54 per gallon.

External sector developments featured an improvement in the estimated current account deficit by \$34.1 million to \$491.4 million. In particular, the trade deficit contracted by 8.6% to approximately \$543.5 million, occasioned by reductions in both fuel and non-oil imports. The surplus on the services account also firmed by 2.6% to \$91.9 million, reflecting improvements in net tourism receipts and net inflows from the offshore sector, by 10.7% and 18.6%, respectively.

Indications are that the estimated surplus on the capital and financial account contracted by more than six-fold to \$48.2 million vis-à-vis the same period last year. Net foreign direct investment decreased by \$59.4 million to \$80.3 million, as net equity inflows fell by \$34.2 million to \$63.8 million and net real estate sales declined by \$25.2 million to \$16.6 million. Similarly, owing to a significant reduction in private sector inflows by \$115.3 million to \$7.6 million, and a reversal in commercial bank transactions to a net repayment of \$18.3 million from a net borrowing of \$73.2 million a year earlier, "other investments" recorded a net outflow of \$10.6 million, in contrast to a net inflow of \$197.3 million a year earlier.