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QUARTERLY OVERVIEW OF DOMESTIC ECONOMIC DEVELOPMENTS

MARCH 2007

This summary is excerpted from the upcoming issue of the Central Bank's Quarterly Economic Review for the quarter ended March 2007. The full text of the Economic Review is being released concurrently.

The Bahamas
Review of Domestic Economic Developments for First Quarter 2007

Preliminary data suggests that the economy's growth momentum moderated somewhat during the first quarter, as evidenced by a slowing in tourism output and consumer demand. However, key drivers of growth continued to be foreign financed projects in the tourism sector and steady residential construction investments. Price developments were less favourable during the quarter, owing to the pass-through effects of higher commodity prices. The fiscal position for third quarter FY2006/07 featured a widened deficit, as elevated levels of recurrent and capital expenditures completely offset the stamp and realty related led gains in revenue. On the monetary side, the observed consumer led slowdown in credit growth, alongside a strengthening in deposits, reinforced a recovery in bank liquidity from the trough of late 2006, and a corresponding strengthening in external reserves. In the external sector, the estimated widening of the current account deficit reflected the import intensive nature of ongoing foreign direct investment projects on the services account surplus, although significantly offset by related investment inflows.

The banking system's net free cash reserves recovered by $81.1 million (69.2%) to $198.3 million from the $2.5 million (1.3%) downturn a year earlier, and represented a slightly lower 3.9% of Bahamian dollar deposit liabilities. A similar improvement was registered for the broader surplus liquid assets of $112.3 million to $175.4 million, which exceeded the statutory minimum by a relatively stable 21.6% margin and were invested mainly in Government paper. Reflecting the impact of the tight liquidity conditions prevailing into the early weeks of the year, the weighted average interest rate on deposits advanced by 15 basis points to 3.66%, and the weighted average loan rate firmed by 56 basis points to 10.35%. Consequently, the interest rate spread moved higher by 41 basis points to 6.69 percentage points. Moreover, the Treasury bill rate rose by 81 basis points to 2.55%; while the benchmark commercial bank's Prime and the Central Bank's Discount rate remained at 5.50% and 5.25%, respectively.

Increased net inflows of foreign currency, alongside more tempered credit expansion, led to strengthened growth in the monetary aggregates (M3) to 3.5% from 2.2% in 2006, placing the stock higher at $5,323.4 million. Increased interest rate yields prompted extended growth in fixed deposits, to 4.5% from 3.1%, and influenced a corresponding deceleration in demand deposit gains to 0.4% from 1.4%. Saving deposits growth stabilized at 3.5%, whereas the currency component surged by 6.9%, after a marginal 1.5% rise last year.

Easing domestic demand impulses contributed to a slowdown in total credit growth to 0.9% ($60.1 million) from 2.6% ($151.9 million) in 2006, with the expansion in the private sector component more than halved to 1.6% ($90.1 million). Apart from residential mortgages, which grew at a steady 3.3%, accretions to consumer credit slackened to 1.9% and for overdrafts, to 7.8%. Net credit to Government, which fell by 3.3% a year earlier, weakened further by 1.9% and net claims on the rest of the public sector contracted by 4.3%, to reverse last year's 3.7% advance.

On the fiscal side, the overall deficit firmed by $10.8 million to $35.6 million during the review quarter, as the 13.1% gain in revenue was surpassed by the 15.3% growth in expenditure. Tax receipts firmed by 13.0%, buoyed by higher revenue from other stamp taxes and real property taxes, which offset some softening in international trade and tourism related tax receipts. Recurrent spending was 15.5% higher at $334.5 million, owing to increased outlays for wages and salaries, goods and services and transfer payments. Capital expenditures also grew by 15.4% to $36.1 million, reflecting higher spending for infrastructure projects; and net lending to public corporations strengthened by 11.4% to $16.9 million. Budgetary financing included a $50.0 million Registered Stock issue and $1.4 million in external loan drawdowns. Debt amortization payments amounted to $11.3 million, of which $10.5 million went towards servicing Bahamian dollar liabilities and $0.8 million to external debt obligations. Consequently, the Direct Charge on the Government advanced by 1.7% ($40.1 million) to

$2,422.7 million and, inclusive of a 1.5% contraction in public sector debt guaranteed by the Government, the National Debt rose by 1.1% to $2,914.1 million.

Tourism developments were marked by a 0.9% contraction in total visitors during the first quarter, reflecting primarily the continuing impact of intensified competition in the sector. The higher spending air arrivals declined by 5.0%, whereas there was a 1.0% firming in sea tourists. Visitors to New Providence fell by 3.2%, with declines in both air (7.1%) and sea (0.8%) arrivals. A similar pattern was obtained in Grand Bahama, where both air and sea passengers fell by 3.5% and 10.2%, respectively. In a more positive outcome, visitors to the Family Islands strengthened by a further 8.0%, comprising improvements in air (3.8%) and cruise (8.9%) visitors.

Consumer price inflation—as measured by changes in the Retail Price Index— accelerated to 3.1% over the first three months-to-March, from 1.2% in the corresponding quarter of 2006. The global effects of higher oil and other commodity prices influenced significant cost increases for 'other' goods & services, recreation & entertainment services, transportation & communication, medical care & health, and food & beverages. Similar trends were observed for the 12-month period ending March, as average prices firmed to 2.30% from 1.82% in the previous year, occasioned by a marked upturn in costs for 'other' goods & services, food & beverages, medical care & health and recreation & entertainment services.

Preliminary data suggests that growth in construction output moderated during the first quarter, with weakened domestic expenditures mitigated by steady contributions from foreign financed projects. Information provided by banks, insurance companies and The Bahamas Mortgage Corporation revealed reductions in both the number and value of commitments for new construction and repair projects, by 47.8% and 49.2%, respectively. Similarly, total mortgage disbursements fell by 8.3% to $133.8 million, led by weakness in the commercial component which overshadowed improvements in residential disbursements. As a result, growth in total mortgages slowed by 4.7 percentage points to 13.5%, for an end-March balance of $2,564.4 million. Average borrowing costs for both commercial and residential mortgages were marginally higher by 1 basis point each at 9.0% and 8.5%, respectively.

In the external sector, the current account deficit widened by an estimated $41.8 million to $454.9 million during the first quarter. This development reflected a $31.4 million contraction in the surplus on the services account, owing to higher net construction and transportation payments and reduced receipts from tourism activity. Moreover, higher outflows related to income and profit repatriations resulted in an expansion in the deficit on the income account by $13.8 million, while net current transfer receipts retreated by $3.0 million. In contrast, the deficit on the trade account softened by an estimated 1.2% to $520.9 million, as lower fuel imports negated increases in non-oil imports.

The surplus on the capital and financial account rose by an estimated $46.5 million to $308.6 million, mainly on account of a significant increase in private sector investments. Reflective of these developments, direct investment inflows strengthened by $22.0 million to $200.6 million. Moreover, other miscellaneous investment inflows rallied by $32.0 million to $129.4 million, as net inflows to the private sector firmed by $72.2 million to $127.0 million, countering the $40.3 million contraction in domestic banks net inflows to $2.8 million.