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QUARTERLY OVERVIEW OF DOMESTIC ECONOMIC DEVELOPMENTS

MARCH 2006

This summary is an early release, excerpted from the upcoming issue of the Central Bank's Quarterly Economic Review for the Quarter ended March 2006. The full text of the Economic Review will be released on 07 July 2006.

The Bahamas
Review of Domestic Economic Developments for First Quarter 2006

Preliminary data suggests that the Bahamian economy continued to expand at a healthy pace during the first quarter of 2006. This improvement was attributed to further growth in tourism earnings, robust foreign investment inflows, alongside elevated domestic consumption and investment expenditures that were supported by credit expansion. Sustained increases in international oil prices however, continued to exert upward pressure on domestic inflation. In the fiscal sector, strengthened tax receipts outpaced expenditure increases, resulting in a narrowing in the overall deficit for the third quarter of FY2005/06. Monetary and credit trends featured a continuation of developments observed in previous quarters, with private-sector led acceleration in credit growth contrasting with a seasonally slowed increase in the monetary aggregates and consequently, a less robust buildup in bank liquidity. On the external front, elevated investment outlays, consumer spending and higher fuel costs contributed to a significant widening in the quarterly current account deficit. The correspondingly intensified private foreign investments boosted net capital and financial inflows.

Net free cash reserves of the banking system contracted by $2.5 million (1.3%) to $189.0 million, contrasting with a more marked reduction of $40.2 million (14.8%) last year, which also corresponded to a seasonal reallocation of resources to Government securities. However, this represented a reduced 4.1% of Bahamian dollar deposits, compared to 5.5% in 2005. The broader surplus liquid assets' improvement of $25.9 million (18.1%) to $169.3 million trailed a $30.9 million (13.3%) increase in 2005 and approximated a lower surplus over the statutory minimum of 22.0% versus 38.1% in 2005. Less buoyant liquidity gains caused some firming in the weighted average interest rate on deposits, by 7 basis points to 3.31%, and in the corresponding loan rate, by 26 basis points to 10.25%. As a result, banks' average loan-to-deposit rate spread widened to 6.94% from 6.75%. Similarly, the average 90-day Treasury bill rate increased by 19 basis points to 0.36%. Benchmark rates, commercial banks' Prime and the Central Bank's Discount Rate, remained at their respective 2005 levels of 5.50% and 5.25%.

Reflecting milder growth in deposits held by public corporations and private businesses, expansion in the monetary aggregates (M3) slowed to 2.2% from 4.4% in the first quarter of 2005. Noticeably strengthened build up in fixed deposits of 3.1% vis-à-vis 0.7% last year, contrasted with moderated gains in demand and savings deposits of 1.4% and 3.4%, respectively. Meanwhile, currency in circulation rebounded by 1.5%.

In contrast to deposit trends, domestic credit expansion firmed to $151.9 million (2.6%) from $132.6 million (2.5%) in 2005, for an end-quarter stock of $6,051.4 million. Growth in private sector credit accelerated to $162.0 million (3.3%) from $39.4 million (0.9%), predominantly concentrated in Bahamian dollar claims and attributed to more robust lending under residential mortgages (3.1%) and consumer credit (2.5%). In contrast, banking sector claims on the public sector contracted moderately (1.1%), as net credit to Government decreased by $21.3 million (3.3%), outweighing elevated claims on the public corporations of $11.2 million (3.7%).

Preliminary estimates of the Government's budgetary operations for the third quarter of FY2005/06 indicated a one-third reduction in the overall deficit to $22.2 million from $33.2 million a year earlier. Healthier demand conditions supported improved tax collections of 21.1% to $287.7 million, while non-tax revenues were augmented by 39.9% to $23.5 million. These outpaced total expenditure growth of 16.0%, which included higher recurrent spending of 10.1% to $287.1 million and a doubling in capital outlays to $31.3 million. Similarly, net lending to public corporations rose by 30.9% to $15.1 million. Budgetary financing during the quarter included a $75.0 million Registered Stock issue in January and a $1.8 million drawdown on external loans, partly offset against debt amortization of $20.7 million (mainly on Bahamian dollar obligations). As a result, the Direct Charge on Government rose by $56.1 million (2.5%) to $2,291.4 million. Despite a 2.1% reduction in the contingent liabilities of the public corporations, to $486.8 million, growth in the National Debt consequently firmed to $45.5 million (1.7%) from $12.6 million (0.5%), placing the outstanding stock higher at $2,778.2 million.

Based on continued pricing gains in the hotel sector and positive stopover visitor trends, indications are that tourism output was further expanded during the first quarter of 2006. Relative to a contraction of 3.3% last year, quarterly visitor arrivals decreased further by 4.5%, to an estimated 1.3 million visitors—a development demarcated by a more sizeable reduction in sea arrivals of 8.0%. However, air traffic rebounded by 3.9% from a 4.1% falloff last year. By port of entry, New Providence welcomed fewer visitors (6.5%), due to a downturn in sea arrivals, which offset a slight firming in air traffic. Fewer sea visitors, relative to a marginal gain in air arrivals, also caused a further decline in Family Islands arrivals (6.8%), while cruise-based improvements supported overall visitor growth for Grand Bahama (10.1%). As for earnings indicators, available data for the first quarter of 2006 reveal that hotel room night sales at major properties throughout The Bahamas increased by 4.9%, in contrast to a 6.7% softening in the same period last year. As this outpaced a 3.7% boost in available inventory, average room occupancy rates firmed to 76.2% from 75.3% in the same period last year. In the context of room revenue gains of 7.94%, the average nightly room rate at major properties also appreciated further by 2.9% to $183.00.

Construction output continued to be supported by robust foreign and domestic investments, with the latter further stimulated by lower interest rates and increased mortgage lending. Data from domestic lenders, inclusive of banks, insurance companies and the Bahamas Mortgage Corporation, indicate that quarterly disbursements against residential mortgages, which are correlated with housing investments, rose by 30.1% to $106.8 million, while similar flows against commercial loans were almost seven-fold higher at $27.2 million. More forward looking, mortgage financing commitments for new construction and repairs rose by 26.5% to $59.6 million, mostly geared towards residential construction (98.1%). Amid these robust trends, total mortgages outstanding grew on a 12-month basis by 16.9% to $2,235.4 million at end-March, with residential claims higher by 16.5% at $2,035.4 million and commercial loans, by $21.5% at $200.0 million. As regards financing costs, average interest rates were approximately stable relative to the previous quarter at 8.4% and 8.9% respectively, for residential and commercial loans, but lower relative to the year-earlier estimates of 8.6%.and 9.5%.

Inflation, as measured by the quarterly change in the average Retail Price Index, softened to 1.2% from 1.7% in the first quarter of 2005. Upturns in average costs for food & beverages items, housing, furniture & household operations and clothing were cushioned by milder advances or softening in most of the other components in the Index. However, energy and other cost pressures were more dominant in the annual trends, as average inflation for the twelve months ending March firmed to 2.0% from 1.1% in 2005. Of particular note was the accelerated increase of 2.8% in average housing costs, the largest component of the Index, owing to the higher fuel surcharge in electricity costs. Intensified price increases were also noted for food & beverages, furnishing & household items and education.

External sector developments were characterized by a significant expansion in the current account deficit to an estimated $273.4 million from $41.1 million during the first quarter of 2005. In particular, the continued rise in investment expenditures, domestic consumption and the sustained increases in oil prices, boosted the merchandise trade deficit by 22.3% to $440.9 million. Meanwhile, the surplus on the services account contracted by 46.2% to $173.1 million, owing to a sizeable expansion in net outflows for foreign construction services. More supportive of the current account, net income outflows were more than halved to $21.9 million; however, net current transfer receipts fell by approximately two-thirds to $16.2 million, with trends more normalized following last years' inflows related to the 2004 hurricane season re-insurance claim settlements.

The estimated capital and financial account surplus improved to $249.5 million from $127.7 million in 2005, led by a 31.7% increase in net private investments. Despite reduced net loan financing at $66.1 million from $71.6 million last year, net private equity inflows strengthened to $101.7 million from $71.3 million; and net foreign real estate purchases, to $52.4 million from $24.3 million. Investments were also supported by net short-term capital inflows through domestic banks of $43.0 million, a reversal from a net outflow of $25.3 million last year.