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QUARTERLY OVERVIEW OF DOMESTIC ECONOMIC DEVELOPMENTS

DECEMBER 2005

This summary is an early release, excerpted from the upcoming issue of the Central Bank's Quarterly Economic Review for the Quarter ended December 2005. The full text of the Economic Review will be released on 8 May 2006.

The Bahamas
Review of Domestic Economic Developments for 4th Quarter, 2005

Indications are that the growth momentum was maintained during the fourth quarter of 2005, amid a moderate inflationary environment, as tourism activity benefited from an upswing in both room revenues and visitor arrivals and construction output improved. In the fiscal sector, the preliminary budget deficit widened in comparison to the same quarter of the previous fiscal year, as import tax led gains in revenue receipts were offset by rising expenditures. Monetary developments featured robust growth in domestic credit which outstripped the expansion in the monetary aggregates, leading to contractions in both liquidity and external reserves. Apart from the generally improved economic conditions, credit trends were influenced by some softening in lending rates. On the external side, higher oil prices combined with elevated domestic demand resulted in an expansion in the estimated external current account deficit, while net capital and financial inflows weakened in the context of a significant reduction in other private inflows.

Owing to strengthened private sector credit, net free cash reserves of the banking system contracted by 32.5% to $191.5 million during the fourth quarter, accounting for a smaller 4.2% share of Bahamian dollar deposit liabilities compared to 6.5% last year. Reflecting higher minimum requirements, due to increases in deposits, the broader surplus liquid assets narrowed by 40.8% to $143.4 million, resulting in a reduction in the excess over the statutory minimum to 19.1% from 34.3% in the previous year. Given continued buoyant liquidity conditions, domestic banks' weighted average interest rates softened on loans, by 70 basis points to 9.99%, but firmed moderately for deposits, by 13 basis points to 3.24%, for an 83 basis point reduction in the average spread to 6.75%. The average 90-day Treasury bill rate decreased by 8 basis points to 0.17%, while benchmark interest rates—Central Bank's Discount Rate and commercial banks' Prime Rate—were unchanged at 5.25% and 5.50%, respectively.

Growth in business and private individuals' deposits reinforced a strengthened 3.4% expansion in the money supply (M3), placing the overall stock at $4.83 billion. Demand deposits firmed by 5.7%, after contracting by 0.3% last year, while fixed deposits grew further by 1.7%. Gains in currency in active circulation were approximately halved at 3.4%, but were maintained for savings deposits at 3.4%.

Domestic credit expanded by $275.3 million (4.9%), in contrast to the year-earlier contraction of $29.7 million (0.6%). Contributing to this outcome was an 11.7% ($67.4 million) increase in net credit to Government. Further, private sector credit registered growth of 4.3%, following an advance of 1.2% in the previous year. The Bahamian dollar component firmed by 4.4%, up from 1.5% in 2004 and foreign currency grew by 3.3% in contrast to a 1.5% decline a year earlier. Residential mortgage and consumer credit rose by 4.5% and 4.6%, respectively, while personal overdrafts contracted further by 8.4%. Moreover, claims on the public corporations, which fell by 0.9% in 2004, expanded by 0.7% in 2005.

On the fiscal side, preliminary estimates indicated that the deficit on Government's budgetary operations widened to $50.9 million for the second quarter of FY2005/06 from $36.6 million in the year-earlier period. Total revenue rose by 8.3% to $273.0 million, comprising a 4.5% growth in tax receipts to $250.9 million, a $9.1million rise in non-tax revenue to $21.1 million and grants totaling $1.0 million. However, total expenditure also expanded by 12.2% to $323.9 million, with a 17.0% hike in current outlays to $286.1 million, and a 44.1% increase in capital investments to $23.6 million. In contrast, net lending to public enterprises contracted by almost 50% to $14.3 million. On the financing side, Government borrowed mainly from local sources in the form of short-term advances from commercial banks. A much smaller portion was derived from external creditors, while repayments, which went mainly towards retiring Bahamian dollar debt, totaled $11.1 million. Consequently, the Direct Charge on Government declined by

0.4% to $2,234.5 million over the previous quarter. With Government's contingent liabilities lower by 0.5%, the National Debt decreased by 0.4% to $2,731.9 million compared to the previous quarter, but registered an increase of $194.2 million (7.7%) over 2004.

Tourism activities were underpinned by an upsurge in available room nights and hotel occupancy levels. Following a contraction of 1.5% in the fourth quarter of 2004, total arrivals to The Bahamas advanced by 15.0% to 1.3 million during the review quarter. Air traffic rose by 15.5% to 329,142 visitors, to reverse last year's fall-off of 9.6%, and sea arrivals growth strengthened to 14.8% from 1.7%. New Providence, which received 56.6% of the quarter's arrivals, recorded a contraction in traffic of 3.2%, primarily due to an 8.9% decrease in the more dominant sea component which offset the 10.7% growth in air arrivals. However, Grand Bahama experienced a 36.2% rebound in visitors, based on equally strong performance of both categories of visitors. A similar pattern was observed for arrivals to the Family Islands, where a marked expansion in cruise traffic supported a 59.5% upturn in visitors. With regards to earning indicators, estimated hotel room revenue rebounded by 17.4% from a 9.1% downturn in 2004, and the average hotel occupancy rate firmed to 62.0% from 59.0% in the comparative 2004 period. Room night sales were correspondingly higher by 24.5%, recovering from the 15.5% decline a year ago. However, the overall average nightly room rates contracted by 5.7% to $138.60, based on price softening in New Providence.

Indications are that output in the construction sector continued to benefit from foreign investment in tourism related projects and strong domestic commercial and residential mortgage lending activity. The value of mortgage disbursements for the fourth quarter rose by a combined 51.9% to $136.7 million, the majority of which was earmarked for residential developments. Similarly, commitments for new construction and repairs increased by 43.3% to $61.6 million, with residential loan approvals representing 90.4% of the total. Based on these developments, outstanding mortgages grew by 15.9% to $2,159.4 million over the comparative quarter in 2004, with the residential component higher by 16.1% at $1,975.0 million and the commercial component by 13.9% at $184.4 million. Meanwhile, both segments benefited from reduced interest rates to 8.5% and 8.8% from 8.8% and 9.6%, respectively.

Measured by quarterly changes in the average Retail Price Index, consumer price inflation firmed to 1.85% in the fourth quarter from 1.27% in the comparable 2004 period, as broad based cost increases offset decreases for recreation & entertainment and clothing & footwear. For 2005, average inflation firmed to 2.2% from 1.0% in the previous year, led by price gains in the medical care & health, food & beverages, education and housing categories.

On the external sector, the estimated current account deficit widened to $218.1 million from $32.1 million in the fourth quarter of 2004, which had included sizeable insurance settlements associated with the September 2004 hurricanes. In particular, higher oil prices and strengthened domestic demand caused a deterioration in the merchandise trade deficit by 25.2% to $471.1 million. More buoyant tourism activities supported an improvement in the estimated services account surplus which expanded to $222.7 million from $171.8 million. Buoyed by banking sector income receipts, net income transactions resulted in a net inflow of $21.6 million in contrast to a $37.3 million net outflow in the year-earlier period. Net current transfer receipts, which increased to $208.1 million last year owing to insurance inflows, tapered off to $8.7 million.

The estimated surplus on the capital and financial account narrowed to $83.3 million from $112.6 million in 2004, led by a 53.5% reduction in other investment inflows to $29.8 million. Net direct investment inflows steadied at $66.7 million, while the banking system's transactions were reversed to a net inflow of $16.9 million. Other private net loan inflows decreased to $12.6 million from $71.3 million, and there was a modest $0.3 million rise in the external liabilities of the public sector in contrast to a net external debt repayment of $2.9 million in 2004.