Release Date: 16 March 2005

QUARTERLY OVERVIEW OF DOMESTIC ECONOMIC DEVELOPMENTS

DECEMBER 2004

This summary is an early release, excerpted from the upcoming issue of the Central Bank's Quarterly Economic Review for the Quarter ended December 2004. The full text of the Economic Review will be released on 22 March 2005.

The Bahamas
Review of Domestic Economic Developments for 4th Quarter, 2004

Preliminary indicators suggest that the Bahamian economy continued to expand during the fourth quarter of 2004, as intensification in construction output, partly fuelled by re-insurance inflows, compensated for the capacity constrained decrease in tourism expenditures. Although price trends firmed incrementally, significant moderation was evident in the annual inflation rate. In the fiscal sector, the provisional budget deficit was relatively stable in comparison to the same quarter of the previous fiscal year, signaling broad seasonal recovery in revenue collections that were adversely impacted by Hurricanes Frances and Jeanne in the previous quarter. Financial sector trends featured a robust buildup of the system's net foreign assets and liquidity, amid expansion in the monetary aggregates, in contrast to a decrease in domestic credit. Conditions influenced broad softening in lending rates and some narrowing in average interest spreads on new loans and deposits. On the external side, sizeable reinsurance inflows reduced the deficit on the estimated current account balance, while net private capital and financial flows continued at a significantly strengthened pace.

Robust foreign currency inflows combined with a reduction in Government liabilities to banks boosted net free cash balances by 73.5% to $271.6 million during the quarter—equivalent to an increased 6.5% of the system's Bahamian dollar deposits, compared to 3.4% in 2003. Surplus liquid assets also expanded by 19.6% to $232.8 million, and represented an enlarged 34.4% of the statutory minimum, compared to 25.5% in 2003. As regard interest rates, competitive credit conditions influenced a 47 basis point decrease in banks' weighted average loan rate to 10.84%. The weighted average deposit rate firmed by 7 basis points to 3.75%, resulting in a 54 basis point narrowing in the estimated interest rate spread to 7.09%. The 90-day Treasury bill rate also declined by 71 basis points to 0.25%, while base rates—commercial banks' Prime and the Central Bank's Discount Rate—were unchanged at 6.00% and 5.75%, respectively.

Despite strong support from foreign currency inflows, non-bank participation in the Government's bond issue and financing of public corporations' investment in treasury bills contributed to a slow-down in money supply (M3) growth to 0.5% from 1.2% in the fourth quarter of 2003, placing the stock at $4.4 billion vis-à-vis $4.0 billion in 2003. Demand deposits contracted by 0.3%, following last year's 2.2% increase, while placements by businesses and private individuals elevated savings and fixed deposits growth to 3.4% and 1.2%, from 0.7% each in 2003. The increase in currency in active circulation firmed slightly to 6.9%, however, residents' foreign currency deposits fell by $39.6 million (29.0%), reversing the third quarter 2004 gain. Fixed deposits remained the largest component (54.5%) of the money stock, followed by demand deposits (21.7%) and savings (17.6%).

After the year-earlier increase of 4.5%, domestic credit contracted by 0.6% in the fourth quarter, placing the stock at $5.23 billion. Mainly reflecting the public sector's net repayment, the Bahamian dollar component contracted by 0.4% compared to last year's 1.6% expansion, and foreign currency credit by 1.9%, from a 28.7% increase in 2003. Net claims on Government decreased by 12.6%, reversing an advance of 4.0% in 2003, which reflected non-bank proceeds from the $100 million bond issue and a shift in Treasury bill holdings towards public corporations. Claims on the public corporations also fell by 0.9%, following a 65.3% rise last year when the corporations refinanced $125 million in external multilateral debt. Private sector credit growth steadied at $52.2 million (1.2%), with accelerated increases in residential mortgages (3.5%) and consumer credit (1.7%), but slightly reduced claims for the other components.

Preliminary estimates reveal that the deficit on the Government's operation was marginally higher at $34.6 million during the second quarter of FY2004/05 from to $33.5 million in the same period in FY2003/04. Benefiting from broadly favorable economic conditions, total revenues grew by 9.9%, inclusive of a 9.9% increase in tax receipts to $241.6 million and a 9.7% rise in non-tax revenue to $12.4 million. Total expenditure also rose by 9.1% to $288.8 million, with a 1.9% hike in current spending and more than doubled capital investments, as opposed to a 4.2% decrease in net lending to public enterprises. On the financing side, the Government borrowed $101.8 million, mainly in domestic currency, and repaid $26.1 million, mostly towards Bahamian dollar debt. As a result, the Direct Charge on Government increased by $75.6 million (3.7%) to $2.1 billion. After a 1.2% drop in Government's contingent liabilities, the National Debt rose by $70.6 million (2.9%) to $2.5 billion, culminating in a 5.1% increase for 2004.

Indications are that tourism output decreased in the fourth quarter, as visitor capacity was constrained by property and infrastructure damages, on which repairs commenced in Grand Bahama and the Family Islands. After gaining 9.9% in 2003, total visitor arrivals fell by 1.5% to 1.1 million in the final quarter. The year's results were still upbeat, however, with a further 8.9% growth in arrivals vis-à-vis 4.3% in 2003. For the quarter, air arrivals fell by 9.7%, while sea arrivals recorded a small increase of 1.7%—both following respective advances of 5.4% and 11.7% in the corresponding quarter of 2003. Not significantly affected by the hurricanes, New Providence, with two-thirds of all visitors, experienced robust visitor growth of 14.5%, supported by gains in both the air (4.0%) and sea (19.5%) components. The Grand Bahama market, responsible for 10.0% of the quarter's arrivals, recorded a contraction of 26.7%, encompassing a sharp decrease in air arrivals (54.8%) and a moderate falloff in sea traffic (4.6%). In the Family Islands, arrivals contracted by 21.9%, reflecting modest softening in air arrivals (6.4%) and a sharp decrease in sea traffic (24.1%).

When compared to the same period the previous year, construction sector output gained further momentum during the fourth quarter, as hurricane rebuilding efforts intensified and residential mortgage lending strengthened. A continuation of these trends is expected to sustain stimulus to the sector in the short- and medium terms, augmented by foreign investment activities. Although only partially financing building activities, residential mortgage disbursements by local banks, insurance companies and the Bahamas Mortgage Corporation increased by 7.7% to $85.6 million during the fourth quarter. Commercial disbursements also rose by 21.4% to $5.1 million. Regarding forward looking indicators, the value of mortgage commitments for new housing construction and repairs more than doubled to $44.6 million, overshadowing a softening in commercial loan approvals to $1.5 million from $5.5 million in 2003. Financing conditions for borrowers remained favourable, as evident from the approximately stable average interest rate of 9.6% for commercial mortgages, and the 20 basis points softening in residential mortgage rates to 8.8%.

Consumer price inflation, based on quarterly variations in the average Retail Price Index, rose to 0.6% in the final quarter of 2004 from 0.2% in the corresponding period last year. Despite a decline in the most heavily weighted housing component, a larger advance was recorded in average costs for medical care & health, along with an upturn in the quarterly indexes for transport & communications and clothing & footwear items. The annual inflation rate through December eased broadly to 0.9% from 3.0% in 2003, owing to tempered increases in medical care & health, and furniture & household costs, alongside a reduction in average costs for housing, recreation & entertainment services and 'other' goods & services, which all trended upwards at a faster pace in 2003.

In the external sector, the current account deficit narrowed sharply to an estimated $20.7 million from $157.5 million in the same period in 2003. An escalation in the oil bill increased the merchandise trade deficit by 6.0% to $341.3 million. Despite an 18.7% drop in net travel receipts, the services account surplus expanded to an estimated $393.3 million from $200.9 million, largely owing to the $179.4 million in net insurance inflows from a more normal seasonal outflow of $28.4 million last year. Net income outflows also decreased by 23.2% to $35.7 million while current transfer receipts firmed to $14.1 million from $10.1 million.

Estimated transactions on the capital and financial account registered an enlarged surplus of $107.5 million compared to $46.2 million in the fourth quarter of 2003. Leading this result was a more than doubling in net private capital inflows, mainly in tourism and infrastructure developments. Net private equity inflows were boosted to $68.5 million from $24.6 million and net loan financing extended to $69.2 million from $22.1 million. These more than offset net outflows under real estate transactions of $6.4 million, following an inflow of $15.3 million in the previous year. In the absence of any significant net external debt refinancing, the public sector debt repayments stood at $1.0 million compared with $123.0

million last year. The banking sector recorded a short-term capital outflow of $4.0 million as opposed to the $119.6 million net receipt in 2003, which supported the public sector's refinancing activity.