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QUARTERLY OVERVIEW OF DOMESTIC ECONOMIC DEVELOPMENTS

SEPTEMBER 2004

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

The Bahamas:

Review of Domestic Economic Developments, Third Quarter 2004

Preliminary indicators suggest some contraction in domestic output during the third quarter of 2004, as the September Hurricanes, Frances and Jeanne, negatively impacted tourism performance. As the more severely impacted northern economies of Grand Bahama and Abaco are only expected to gradually recover over the rest of 2004, indications are that the overall loss of output during September to December could exceed $200 million, to which would be added the economic costs associated with property and infrastructure damage. The falloff in economic activity, in combination with a broad-based spending increase, resulted in a widening in the Government's overall budget deficit for the first quarter of FY2004/05. Construction indicators suggested fairly stable quarterly expenditures compared to the same quarter last year, with robust residential investments nearly offset by ongoing sluggishness in commercial outlays. Financial sector developments featured more normalized seasonal trends, with a strong upturn in domestic credit outweighing marginally increased deposit growth and contributing to reductions in otherwise buoyant liquidity and net foreign assets. Oil pressures, although masked in the softening domestic inflation trends, combined with the net reduction in tourism receipts for an increase in the external current account deficit. Meanwhile, net capital and financial transactions switched to small outflow, in response to a decline in net private foreign investments and the resumed net repayment of public sector external debt.

As the banking sector accommodated an elevated level of domestic credit demand, net free cash reserves of the sector were lowered by $33.0 million (17.4%) to $156.6 million during the third quarter, still representing a more buoyant 3.9% of Bahamian dollar deposit liabilities, compared to 3.7% last year. Broader surplus liquid assets also receded by $32.3 million (14.2%) to $194.6 million, albeit continuing to exceed the required minimum by a stable 29.5% when compared to the same period last year. Buoyant liquidity conditions contributed to a decline in the weighted average interest rate on deposits by a further 9 basis points to 3.67% during the quarter, while the boost in consumer lending underpinned a 4 basis point increase in the corresponding loan rate to 11.33%. Consequently, the average loan-deposit spread widened by 13 basis points to 7.66%. Similar to deposit trends, the average 90-day Treasury bill rate softened by 42 basis points to 0.29%; however, benchmark rates, commercial banks' Prime rate and the Central Bank's Discount rate, remained at their respective July 1999 levels of 6.00% and 5.75%.

Money supply (M3) growth strengthened to 1.0% from 0.4%, placing the stock at $4.4 billion relative to $4.0 billion in 2003. The uptrend was associated with a 26.6% rise in residents' foreign currency deposits, following a 2.5% decline in 2003 and firmer Bahamian dollar savings deposits growth of 1.2%, compared with 0.5% last year. The expansion in demand deposits moderated to 1.3% from 3.0%, and the falloff in fixed deposits increased to 0.7%, linked to non-bank investments in the Government's $100 million Registered Stock issued in July. Currency in active circulation also rebounded by 2.7%, after a 3.1% reduction in 2003.

Domestic credit recovered, on a seasonal basis, by $109.3 million (2.1%) in the third quarter of 2004, to $5.25 billion, contrasting with the year earlier contraction of $124.9 million (2.6%). Of particular note was the 4.9% net upturn in claims on the public sector, dominated by the Bahamian dollar-led $47.8 million (8.3%) increase in net credit to Government, which declined by $184.4 million (27.5%) last year, following the application of proceeds from the $200 million external bond issue in July 2003. Growth in private sector claims was incrementally higher at 1.5%, as the personal component, featuring accelerated increases in both consumer credit (2.3%) and residential mortgages (2.9%), contrasted with a net repayment of claims on businesses and other private sector activity.

In the fiscal sector, estimates for the first quarter of FY2004/05 indicate that the overall deficit expanded to $49.2 million from $19.6 million in the corresponding FY2003/04 period. Hurricane related losses suffered in September constrained growth in tax collections to 0.4%, and overall revenue consequently fell by 3.0% to $210.9 million, reinforced by a near halving in the non-tax component (46.6%). Conversely, the increase in outlays was broad-base, with recurrent expenditure elevated by 8.1% to $240.6 million; capital outlays, by 29.6% to $10.4 million and net lending to public corporations, by 40.8% to $9.0 million. Budgetary financing for the first quarter of FY2004/05 included a $100 million Registered Stock issue in July, versus principal repayment, mostly on the domestic debt, of $14.5 million. As a consequence, the Direct Charge on Government rose by 4.4% to $2,027.6 million, which outweighed the $11.3 million (2.6%) reduction in Government's Contingent Liabilities to $416.8 million. As a consequence, the National Debt was higher by 3.1% at $2,444.4 million, outpacing the comparative 2.6% uptrend to $2,301.7 million at end-September 2003.

Lost hotel sector business in September contributed to a reduction in tourism output during the third quarter. In particular, the sharp drop-off in September traffic (40.3%) mitigated the robust (17.8%) growth for July and August, and curtailed total arrivals gains at 3.9%, for 1.1 million visitors. This was still above last year's 1.2% increase, reflecting the significant underlying growth occurring in cruise line capacity to The Bahamas. Despite a 40.3% decline in September, the strong 24.8% uptrend in the first two months of the quarter supported growth in sea traffic of 8.2%. Stopover weakness was underscored by a 5.3% quarterly downturn in air arrivals, after the September decline of 48.2% erased modest growth of 4.4% for July and August. Port of entry statistics revealed visitor increases for all destinations, with New Providence's gains (2.7%) sustained by growth in sea arrivals. Despite markedly weakened air traffic (19.0%), Grand Bahama recorded a cruise-led overall growth of 14.7%, while the 0.7% rise for the Family Islands continued to be sustained by stopover traffic.

Construction sector output was relatively stable, with residential activity providing the bulk of industry support. Albeit, the outlook significantly improved, owing both to expenditures related to hurricane repairs and the anticipated upsurge in hotel sector investments. Data from mortgage lending institutions suggested less disparity in the quarterly domestic investments compared to last year, as mortgage disbursements, although incorporating some non-construction financing, contracted marginally by 0.4%. Commercial drawdowns declined by one-fifth to $4.2 million, while residential payouts were approximately stable at $79.5 million. On a forward looking basis, the number of mortgage commitments for new construction and repairs rose by 50.2% to 412 during the third quarter, with the corresponding value increased by 56.0% to $46.9 million. Most of the approvals (392) were for housing projects, valued almost three-fold higher at $43.7 million. However, the number of commercial commitments was more than two-thirds lower (6) and valued at $1.6 million as opposed to $4.2 million last year. Average interest costs on residential mortgages softened by 30 basis points to 8.8% vis-à-vis 2003, as opposed to a stable 9.6% for commercial loans.

Quarterly inflation, as measured by the average change in the Retail Price Index, moderated to 0.1% from 0.4% in the same period in 2003. Average cost declines for housing (the most heavily weighted component) and clothing & footwear items, were accompanied by stable average quarterly prices for medical care & health; and marginally tempered increases for food & beverages and transport & communication. Inflation in the 12-months through September 2004 slowed to 1.2% from 3.0% in 2003, reflecting a decline in average costs for recreation entertainment & services and more abated price increases for housing, furniture & household operations and "other" goods & services. Conversely, annual price pressures increased for food & beverages, medical care & health, education and clothing & footwear.

In the external sector, the current account deficit widened to $214.3 million from $168.8 million in the third quarter of 2003. The trade deficit rose to $316.5 million from $294.8 million, with estimated exports growth of $12.6 million (11.3%) outweighed by an oil price driven $47.0 million (11.5%) hike in merchandise imports. In addition, the services surplus narrowed by 4.2% to $155.6 million, led by a 4.2% reduction in net travel receipts. Meanwhile, net income outflows rose by 10.8% to $48.6 million and net current transfer receipts firmed incrementally to $7.7 million.

The capital and financial account balance switched to an overall deficit of $20.7 million from a surplus of $202.7 million in the corresponding period of 2003. The financial position, which underpinned this outcome, recorded a net outflow of $9.7 million as opposed to a net inflow of $211.3 million last year. With last year's developments dominated by inflows from the Government's external bond issue, the public sector recorded a net external debt repayment of $2.7 million in 2004, in contrast to the net borrowing of $193.3 million in 2003. The latter repaid some $125 million in domestic foreign currency debt owed and contributed to a larger net outflow through the banking system of $87.1 million last year, as opposed to the current period's $19.2 million. Net private foreign investments also retreated, with a net loan repayment of $3.5 million recorded following last year's net inflow of $49.6 million. Also, there was a net outflow under real estate of $4.4 million relative to a net inflow of $29.9 million in 2003, and a moderately reduced net direct equity injection of $20.1 million.