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QUARTERLY OVERVIEW OF DOMESTIC ECONOMIC DEVELOPMENTS, MARCH 2003

The following summary is extracted from the analysis of economic developments in the Central Bank's Quarterly Economic Review for the period ended March 2003. The full text of the Economic Review will be released on July 23, 2003.

Provisional estimates for the first three months of 2003 signal some improvement in domestic economic activity in The Bahamas, following significant weakness during the same period in 2002. Tourism output was sustained by recovered stopover pricing and marginally improved visitor volumes, while construction continued to experience steady support from domestic residential mortgage lending. On the pricing front, insurance premium adjustments caused marginal firming in consumer price inflation. Stable revenue intake against sizeable spending increases, linked mainly to the provision of budgetary assistance to public corporations, contributed to a marked increase in the Government's overall budget deficit for the third quarter of the fiscal year. In the financial sector, elevated seasonal foreign currency inflows, in the context of further moderation in domestic credit expansion, supported a stronger build-up in the monetary aggregates, more buoyant liquidity and a reduction in the system's net foreign liabilities. On the external account, reduced net factor income outflows and payments for foreign services provided for a small increase in the estimated current account surplus; albeit, net private foreign investments were reduced on the capital and financial account.

In the context of the continued policy constraints on banks' domestic currency lending and robust seasonal foreign currency inflows, net free cash balances of the banking system expanded by 45.1% to $129.0 million, corresponding to an enlarged 3.5% share of Bahamian dollar deposit liabilities as compared to 3.2% at end-March 2002. With institutions holding higher liquid balances with the Central Bank, the broader surplus liquid assets also rose by 26.3% to $123.4 million, exceeding the statutory minimum by 20.6% versus 18.1% in 2002. Despite these trends, there was firming in the weighted average interest rates in both loans and deposits, by 55 and 12 basis points, to 11.73% and 4.03%, respectively, resulting in a 43 basis points widening in the average spread to 7.70%. The average 90-day Treasury bill rate, however, decreased by 13 basis points to 1.89%, while benchmark interest rates—Central Bank's Discount Rate and commercial banks' Prime—were maintained at 5.75% and 6.00%, respectively.

Reflecting the upswing in private sector foreign currency inflows, monetary expansion (M3) during the quarter strengthened to 2.9% from 2.3%, for an overall stock of $3.95 billion. Demand deposits' growth accelerated to 8.3% from 3.5% in 2002, partly owing to public corporations' transfers from fixed balances, and residents' foreign currency deposits rose by approximately one-third, reflecting some repositioning to meet scheduled debt repayments. These outpaced moderated growth in savings and fixed deposits, of 2.7% and 0.5% vis-à-vis 4.1% and 2.2%, respectively in 2002. Meanwhile, currency in active circulation contracted further by 4.0%.

With private sector demand restrained amid lending restrictions, domestic credit expansion narrowed to 0.2% for an end-March total of $4.95 billion, and trailed respective gains of 1.0% and 2.2% in the corresponding periods of 2002 and 2001. The outcome only incorporated accelerated credit expansion within the public sector, at 5.8% as compared to 1.3% in 2002. In particular, net credit to Government rebounded by $45.4 million (7.0%) to contrast with the sharply moderated increase in claims on public corporations of 2.4% vis-à-vis 26.7% in 2002 when proceeds from foreign currency borrowing repaid short-term lending provided to the Government during the fourth quarter of 2001. Private sector credit, which contracted by 1.0%, extended the 2002 weakening trend, when growth slowed to 1.0% from 2.4%. While lending for residential mortgages recorded the most notable uptrend (2.7%), it was offset by a reduction (2.6%) in lending, on balance, for other private sector activities including consumer loans.

Estimates of the fiscal performance for Fiscal Year 2002/03 suggest a widening in the overall deficit, to $45.7 million from $2.5 million in the same period in FY2001/02. In contrast to almost unchanged revenue collections of $218.8 million, total expenditure rose by 20.0% to $264.6 million, under the impact of an appreciable hike in budgetary support to public sector entities. Capital spending, however, was cut by $5.9 million (26.7%), partially offsetting the $12.8 million (5.7%) upswing in recurrent outlays. Budgetary financing during the review quarter included significant short-term funding from the local banking sector, alongside a 0.6% reduction in the Direct Charge to $1,793.9 million, consequent on a net domestic debt repayment of $11.0 million. Following a 2.2% decrease in the guaranteed liabilities of the public corporations to $393.1 million, the National Debt contracted by $19.7 million (0.9%) to $2,187.3 million. This contrasted with an expansion of 0.8% to $1,977.8 million in 2002.

Tourism output improved during the first three months of 2003, with firming in stopover pricing outweighing weak trends in visitor volume. Softening in US travel demand, as a result of fears related to the war in Iraq, lowered growth in visitor arrivals to 1.1% from 3.0%, for a first quarter count of 1.2 million. Of particular note, however, was the 0.3% upturn in air arrivals, the primary source for stopover expenditure, from a 5.8% contraction in 2002. Conversely, cruise visitor growth slowed sharply to 1.4% from 7.5% in 2002, and was largely sustained by continued gains in Family Island arrivals. Led by appreciated pricing in New Providence, preliminary indicators for the first two months of the year suggest a 9.8% upturn in hotel room revenues, reinforced principally by the strengthened 9.5% boost in the average nightly room rate to $175.08, and a 0.3% gain in the volume of visitor nights sold, on account of Grand Bahama's increased capacity. As regards the March performance, feedback from the hotel industry suggests that, although room night sales declined during the immediate period surrounding the war in Iraq, pricing was still appreciated, thereby limiting the total extent of expenditure loss.

Based on changes in the average Retail Price Index, consumer price inflation accelerated to 1.4% during the March quarter, from 0.5% in 2002. Heightened average price gains were recorded for "other" goods & services (10.9%) and medical care & health (5.6%), related to boosts in life premiums on health insurance policies, and for recreation & entertainment services (3.8%). These occurred alongside more subdued increases in most other categories, and a decline in average costs for food & beverages, furniture & household operations and clothing & footwear. On an annual basis through March, average inflation firmed slightly to 2.4% from 2.3% in 2002. Accelerated advances in average costs for furniture & household operations, recreation & entertainment services, medical care & health, and "other" non-categorized goods and services were almost offset by softened or reduced average costs on the remaining components in the Index.

For the external sector, preliminary estimates for the March 2003 quarter indicate a marginal increase in the current account surplus to $6.0 million from $0.7 million. Appreciated oil prices reinforced a widening in the merchandise trade deficit by 13.2% to $296.6 million, but were more than countered by a 9.2% improvement in the services surplus to $296.8 million, and a one-third decrease in net factor income outflows to $30.9 million. Net transfer receipts were also slightly higher at $13.0 million.

The capital and financial account registered an estimated deficit of $68.8 million in contrast to the 2002 surplus of $89.7 million. Short-term flows through the banking system were reversed to a net outflow of $76.9 million from a net inflow of $40.9 million in 2002. In addition, net private equity inflows narrowed to $9.5 million from $34.0 million; net real estate sales, to $3.9 million from $9.9 million, and net private loan receipts, to $10.7 million from $18.6 million. The public sector's net external debt repayment increased to $6.9 million from $5.1 million.