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QUARTERLY OVERVIEW OF DOMESTIC ECONOMIC DEVELOPMENTS

JUNE 2003

This summary is an early release, excerpted from the upcoming issue of the Central Bank's Quarterly Economic Review for the Quarter ended June 2003. The full text of the Economic Review will be released during the second week in October.

Compared to the first half of 2002, when output was returning to some level of normalcy following the September 11 setback to tourism, the domestic economy strengthened further during 2003. Nevertheless, weak fundamentals in the United States and still dissipating geopolitical tensions prevented a full recovery, relative to output levels attained in the first half of 2001. The nearly flat cumulative position in net foreign investments, also constrained output, particularly vis-à-vis the construction sector; albeit, indications are that both tourism and construction could pick up on a comparative basis in the months ahead.

Amid mild firming in domestic inflation, indications are that the momentum derived from the comparative second quarter output gain was marginal, with the nearly flat position in tourism expenditure, supported only by higher cruise spending vis-à-vis slightly weakened stopover outlays. Tempered mortgage financing suggested softer support for local construction expenditure, although quarterly private foreign investment flows were comparatively strengthened. Meanwhile, the cumulative fiscal position for the 11 months through May indicated modest improvement in revenue collections, which only slightly outpaced constrained expenditure growth, for a small reduction in the budget deficit. Financial sector highlights included a reduction in domestic credit, led by steady weakening in consumer lending, which outpaced the marginal fall-off in the monetary aggregates. In this context, both liquidity and external reserves registered growth. On the external side, the current account deficit was reduced, owing primarily to lessened import pressures. Moreover, a sizeable reversal in short-term flows through the banking sector resulted in a reduced surplus on capital and financial transactions, despite increased net private capital inflows.

Banks' net free cash balances decreased marginally (1.5%) to $127.1 million, remaining below the comparative $143.4 million at the end of the same period in 2002 when net foreign currency inflows to the public sector underpinned a 25.6% increase. With institutions channeling more resources into Government securities, a more sizeable buildup occurred in surplus liquid assets, of 20.2% to $148.3 million, exceeding the statutory minimum by 24.7%, albeit remaining below the year-earlier ratio of 28.9%. Reflecting the composition of lending and policy influenced credit conditions, commercial banks' weighted average loan rate rose by 44 basis points to 12.17% during the quarter and, when combined with a 17 basis point easing in the weighted average deposit rate to 3.86%, caused the loans to deposit rate to widen by 61 basis points to 8.31%. Achieving more convergence towards the average savings rate, the 90-day Treasury bill rate rose by 13 basis points to 2.02%, although base rates—commercial banks' prime and the Central Bank Discount Rate—were unchanged at 6.00% and 5.75%, respectively.

During the quarter, the total money supply (M3) fell by 0.1% to $3,940.9 million, contrasting with the year-earlier advance of 2.3% to $3,889.8 million. In particular, fixed deposit balances contracted by 0.3%, vis-à-vis the previous year's growth of 0.4%; demand deposits fell by 1.1%, reversing last year's 5.6% advance, and residents' foreign currency deposits decreased by 17.4%, partly reflecting foreign currency loan repayments. Conversely, growth in savings deposits firmed incrementally to 3.6%, while expansion in the currency component moderated slightly to 4.6%.

Featuring reductions in claims on both the public and private sectors, domestic credit declined by 1.4% to $4,883.2 million, to contrast with growth of 1.8% to $4,809.2 million in 2002. In particular, after advancing by 11.1% during the second quarter last year, in the context of foreign currency borrowing, net claims on Government decreased by 3.6%. Claims on the public corporations also contracted by 1.1%, following a 0.6% increase in 2002. Meanwhile, accelerated repayment of foreign currency liabilities, caused private sector credit to contract by 1.0%, following a slowed increase of 0.4% last year. Residential mortgage lending was the main growth component, although only marginally higher at 3.9%, while consumer credit contracted further by 0.7%.

Reflecting some stabilization in economic trends, preliminary indications are that the fiscal deficit in the first eleven months of FY2002/03 narrowed to $86.6 million from $94.2 million in the comparative period in FY2001/02. With a 4.9% improvement in tax receipts, total revenue rose by 4.1% to $823.5 million, but in absolute terms remained below expenditures, which rose by 2.8% to $910.1 million. In respect of the latter, current outlays increased by 4.1% to $810.0 million and net lending to the public corporations intensified by 41.0% to $34.6 million, partially offset by a reduction in capital expenditures of 20.9% to $65.4 million. Budgetary financing during the eleven months included a net borrowing of $157.4 million in Bahamian dollars and $22.0 million in foreign currency. Taking June into account, the

Direct Charge on Government increased by $61.3 million (3.4%) during the quarter and by $178.2 million (10.6%) for the fiscal year, to $1,854.6 million. The comparative FY2001/02 advance was moderately lower at $156.5 million (10.3%) to $1,676.5 million. Meanwhile, a $9.0 million (2.3%) decline in Government guaranteed borrowings to $388.7 million, produced a quarterly increase in the National Debt of $52.3 million (2.4%) and capped a 12-month growth of $159.0 million (7.6%) to $2,243.4 million. This contrasted with a more accelerated uptrend of $196.1 million (10.4%) to $2,084.4 million in FY2001/02, which was associated with contingent liabilities.

In the tourism sector, visitor volumes for the June quarter of 2003 strengthened by 5.5% to 1,185,188, reversing the 1.8% decrease posted in 2002. Sea arrivals growth was extended to 7.2% from 4.1% in 2002 and air visitors, which comprised the higher value-added stopover segment, rebounded by 2.3% from an 11.3% fall-off in 2002. Visitor expenditure growth was almost flat, with modest cruise spending contrasting with weakened stopover outlays. In particular, indications are that estimated hotel room revenues dipped by 0.3% vis-à-vis 2002. The only positive contribution was appreciated average room rate pricing, at $167.12 per night, as compared to $163.14 in 2002. Instead, average hotel occupancy was lower at 62.6% from 66.9% last year, as occupied room nights decreased by 2.7%, while available capacity increased by 4.1%. As to the distribution of the revenue performance, marginal growth in New Providence (1.4%) and a stable outturn for the Family Islands were offset by a more sizeable falloff in receipts on Grand Bahama (12.4%).

Inflation, measured by quarterly changes in the average Retail Price Index, rose to 0.4% from 0.1% in the comparable 2002 period, led by rebounded costs for transport & communication and resumed increases under housing. For the 12-month period through June 2003, average inflation advanced to 2.8% from 2.2%, comprising firmer uptrends in average costs for recreation & entertainment services (8.5%); miscellaneous goods & services, (8.8%); furniture & household operation expenses (6.9%) and medical care & health costs (4.4%). However, more tempered increases were registered in average costs for food & beverages (1.0%), transport & communication (0.6%) and housing (0.3%).

In line with the reduction in valuation on both residential and commercial building permits granted last year, indications are that construction output softened during the opening months of 2003, relative to stabilized expenditures in 2002. Data on mortgage lending from banks, the Bahamas Mortgage Corporation and insurance companies indicated a general slowing in second quarter financing for domestic building activity, with commitments for residential mortgages for new construction, rehabilitation and additions contracted to $18.5 million from last year's $21.4 million. Similar commercial mortgage commitments also slackened, to $5.7 million from $14.5 million. Meanwhile, the average interest rate on new residential mortgages was marginally lower at 8.9% but slightly higher for commercial mortgages at 9.6%, vis-à-vis the same period in 2002.

In the external sector, the current account deficit narrowed to an estimated $28.0 million from $108.0 million in the same quarter last year. In particular, the estimated merchandise trade deficit decreased to $279.2 million from $345.7 million in 2002, with non-oil and oil imports reduced by 12.6% and 13.3% respectively, to exceed the 9.2% reduction in exports. Net invisible inflows increased by 6.9% to $278.1 million, mainly due to reduced net outflows for external services, alongside the 0.9% increase in net travel receipts. In addition, net foreign income remittances narrowed to $38.4 million from $71.8 million in 2002, led by the reduction in profit remittances by banks and private businesses. Net current transfer receipts were almost halved to $8.3 million, mirroring a net decrease in general government inflows.

On the capital and financial account, the estimated surplus narrowed to $16.1 million from $91.0 million, with the $58.8 million short-term outflow through the banking system contrasting with the $51.5 million net inflow in 2002, which was associated with foreign currency lending to Government. However, net private foreign investment inflows were moderately increased, with growth in net loan inflows rising to $56.9 million from $31.1 million, and more than offsetting the reduction in direct equity (36.6%) and real estate inflows (19.1%) to a combined $28.2 million from $38.2 million in 2002. In addition, outflows stemming from the public sector's net external debt repayment narrowed to $2.9 million from last year's $23.4 million.