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QUARTERLY OVERVIEW OF DOMESTIC ECONOMIC DEVELOPMENTS

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This summary is an early release, excerpted from the upcoming issue of the Central Bank's Quarterly Economic Review for the Quarter ended March 2004. The full text of the Economic Review will be released on 27 September 2004.

The Bahamas:

Review of Domestic Economic Developments, Second Quarter 2004

Indications are that the Bahamian economy continued to strengthen during the second quarter of 2004, led by more firmly established tourism expenditure growth. In particular, the improving US economy continued to provide healthy stimulus for stopover visitor gains, while cruise line business rose substantially. Construction output, while poised for a significant pickup in activity during the remainder of 2004, remained sluggish during the second quarter; albeit, with initial signs of increased expenditures on major resort developments planned for New Providence. On the fiscal side, provisional estimates foreshadowed some consolidation in the budget deficit during both the second quarter and the entire Fiscal Year, based on modest revenue growth and curtailment in public sector investments. In the financial sector, stronger net foreign currency inflows supported a rebound in the monetary aggregates which coincided, however, with an upturn in domestic credit. As a result, bank liquidity was marginally reduced but financial institutions' net foreign liabilities decreased and average interest rates softened on both loans and deposits. Despite increased energy costs, average inflation eased during the second quarter as internal cost pressures abated. On the external account, gains in net travel receipts contributed to a reduction in the current account deficit, while a decrease in net private loan and real estate inflows narrowed the estimated surplus on the capital and financial account.

The economic expansion is expected to continue at a healthy pace in the medium term, owing to the upbeat outlook for the United States' economy, the primary market for tourism, and a steady pick up of construction activity connected with major hotel and industrial sector developments. However, damage caused by Hurricane Frances during September 2nd – 4th could disrupt tourism inflows over portions of the third and fourth quarters, particularly in Grand Bahama and the Family Islands. As the impact will be felt during the slowest months of the tourist season, the industry is still expected to experience cumulative growth in 2004 and to resume its robust uptrend in 2005. The economy should experience some offsetting upsurge in construction expenditures on rebuilding activities, with the corresponding balance of payments impact tempered by re-insurance inflows.

During the second quarter, intensified local currency lending curtailed further build-up in bank liquidity, as net free cash balances decreased marginally by 0.5% to $189.6 million and surplus liquid assets by 4.6% to $226.8 million. However, excess balances constituted a larger 4.7% share of Bahamian dollar deposit liabilities compared to 3.4% last year, and liquid assets exceeded the statutory minimum by a greater 34.5% as compared to 24.7% in 2003. Buoyancy in liquidity supported some narrowing in the average interest rate spread on banks' loans and deposits, by 16 basis points to 7.39%; the softening in the weighted average loan rate, by 34 basis points to 11.23%, outpaced the counterpart 18 basis points decrease in the average deposit rate to 3.84%. The average 90-day Treasury bill rate also fell by 23 basis points to 0.71%, while base rates—commercial banks' Prime and the Central Bank Discount Rate—were unchanged at 6.00% and 5.75%, respectively.

During the quarter, the money supply (M3) expanded by 4.1% to $4,355.7 million, reversing the year-earlier contraction of 0.1%. More sizeable gains in business and private individuals' holdings resulted in respective rebounds in demand and fixed deposits of 11.3% and 1.3%, from reductions of 1.1% and 0.3% last year. Also, savings deposit growth firmed to 4.3% from 3.6%, and resident's foreign currency deposits recovered by 5.7%, while growth in currency in active circulation firmed to 4.8%.

Domestic credit also rebounded, on a comparative basis, by 2.0% to $5,144.6 million, following the 2003 decline of 1.4%. After a net repayment of 1.0% in 2003, claims on the private sector rose by 2.0%, with a 1.7% upturn in consumer lending, while improved credit conditions for businesses and productive ventures bolstered the slowed increase in residential mortgages of 3.3%. In the public sector, a revival in net Bahamian dollar borrowing raised the banking sector's net claims on Government by 6.3%, reversing a 3.6% decline in 2003. However, public corporations claims were further reduced by 5.1%.

Signs of some stabilization emerged on the fiscal front, with the comparative deficit for the first eleven months of FY2003/04 slightly narrowed, by 0.8% to $85.6 million. Partly underpinned by improved economic conditions, revenue collections rose by 5.4% to $867.6 million, maintaining pace with growth in total expenditures of 4.8% to $953.2 million. Revenue gains were largely impacted by $15.0 million in capital receipts, following the sale of Government equity investments in the capital markets, while the increase in tax receipts narrowed to 2.5% from 4.9% last year. On the spending side, current outlays rose by 7.1% to $867.6 million, exceeding both the 14.6% reduction in investments and the 14.2% decrease in net lending to the public corporations. Budgetary financing for the eleven months through May 2004 included net borrowings of $20.3 million in Bahamian dollars and $68.7 million in foreign currency. Taking account of June's transactions, the Direct Charge on Government rose by $2.0 million (0.1%) during the quarter, culminating in a narrowed $88.9 million (4.7%) advance to $1,943.4 million during FY2003/04. Government guaranteed debt decreased by $21.0 million (4.9%) during the quarter, while increasing by $22.9 million (6.0%) to $408.1 million for the Fiscal Year. As a result, the National Debt was reduced by $19.0 million (0.8%) to $2,350.3 million during the quarter, and registered a tapered rise of $111.8 million (5.0%) for the Fiscal Year vis-à-vis $154.2 million (7.4%) in the comparative period a year ago.

Rising hotel occupancy levels and a strong upsurge in cruise activity sustained robust tourism expenditure growth during the second quarter. Visitor growth quickened to 18.7% from 5.5% last year, for 1.4 million arrivals. Gains in both air and sea traffic exceeded year-earlier advances, at 9.8% and 23.2% from 2.3% and 7.2%, respectively. Broad-base improvement included the cruise-led 21.5% surge in visitors to New Providence, a 26.0% recovery in arrivals to Grand Bahama and a steady 10.0% uptrend in the Family Islands. On the expenditure side, double digit growth in the cruise sector was accompanied by healthy stopover inflows, mainly boosted by increased hotel occupancy. Quarterly data for New Providence revealed a 4.9% rise in estimated room expenditures, attributed to a similar hike in occupied room nights, while in the first two months of the quarter, Grand Bahama recorded a strong revenue improvement of 37.1% for similar reasons. In the Family Islands, room revenue gains of 6.6% during April and May were mainly supported by the 11.9% appreciation in the average nightly room rate, which countered some softening in total room night sales.

Although construction expenditures remained subdued during the second quarter of 2004, the reduced mortgage financing of local housing developments was offset by a pickup in commercial outlays, including the start of work on the Atlantis Phase III expansion on Paradise Island. Mortgage data from banks, insurance companies, and the Bahamas Mortgage Corporation indicate that, compared to last year, the estimated value of commitments for new construction and building repairs decreased by 12.8% to $19.5 million. A more than two-thirds falloff in commercial commitments outweighed a 2.4% rise in residential loan approvals, which still represented the bulk of the total (92.1%). Although only partially indicative of actual construction activity, also containing equity-based drawdown for other purposes, mortgage disbursements rose by 5.6% to $75.7 million, with higher outlays against commercial loans exceeding the reduction in residential advances. Meanwhile, average interest rates were incrementally more favourable on both residential and commercial borrowing, at 8.8% and 9.4% compared to 8.9% and 9.6% respectively, during the second quarter of 2003.

Inflation, as measured by the quarterly change in the average Retail Price Index, eased to 0.2% during the second quarter from 0.4% in 2003, mainly influenced by stable housing costs, a smaller rise in transportation & communications costs and a marginal decrease in average education costs. On a 12-month basis, inflation moderated to 1.8% through June from 2.8% in 2003. Significantly slowed average price gains for recreation & entertainment services, furniture & household operations, education and "other" unclassified goods & services, countered the sharp run-up in average costs for medical care & health services (10.6%) and the fuel-related rise in transportation & communications costs.

In the external sector, the quarter's current account deficit narrowed to an estimated $68.7 million from $83.3 million in 2003. Stronger import demand exceeded the improvement in export receipts, broadening the trade deficit by 8.6% to an estimated $334.5 million. This was more than offset by the 14.4% widening in the services surplus, led by a 15.3% upswing in tourism-related net travel inflows. Also, reduced profit repatriations lowered net income remittances by 15.8% to $33.7 million, outweighing the increase in net transfer payments of 7.4% to $19.5 million.

The capital and financial surplus narrowed to $4.1 million from $41.8 million in 2003, with net private foreign investment inflows approximately halved to $57.5 million. Although net direct equity inflows strengthened to $56.1 million from $11.5 million, net real estate sales softened to $2.1 million from $30.8 million and a net private loan financing repayment of $0.8 million was recorded, contrasting with net financing of $69.6 million last year. The financial outcome also included a reduction in the public sector's net external debt repayment to $3.7 million from $3.9 million and a decrease in net short-term outflows through the banking system to $40.8 million from $58.8 million.