The Central Bank of The Bahamas

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QUARTERLY ECONOMIC REVIEW

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REVIEW OF ECONOMIC AND FINANCIAL DEVELOPMENTS

DOMESTIC ECONOMIC DEVELOPMENTS

The pace of economic growth moderated during the second quarter, and was supported by stable gains in construction activity alongside more mild expansion in the tourism sector. Less stimulus was provided by net foreign investment inflows which continue to recede from the peak levels achieved over the past three years. Despite the continuing influence of recent oil price hikes, inflation remained mild. Preliminary estimates for the first 11 months of FY2000/01 suggest a further modest budget surplus, as revenue and expenditure growth were almost evenly paced. Financial sector developments featured a falloff in bank liquidity and further tightening in interest rate spreads as the monetary aggregates contracted, amid slowed but steady expansion in domestic credit. On the external side, the current account deficit was significantly reduced, owing to the conclusion of rebuilding activities following the 1999 hurricane season and a lower level of foreign investment activities. The gap was financed by a corresponding sharply reduced surplus on the capital and financial account, alongside a decline in external reserves.

During the review quarter, excess reserves of the banking system contracted by 17.1% to $51.2 million and were less than half the comparative estimate for 2000, which had reflected the sizeable build-up sustained since 1999 amid higher net foreign currency inflows. Banks' secondary liquidity—as measured by surplus liquid assets—was also moderately lower for the quarter at $51.3 million. In this environment, average interest rates exhibited broad firming, with the weighted average deposit rate higher by 9 basis points at 4.25%; albeit, more concentrated lending in mortgages pulled the weighted average loan rate lower by 13 basis points to 11.74%. Additionally, the average 90-day Treasury bill rate increased by 38 basis points to 1.80%, whereas commercial banks' Prime and the official Discount Rate were unchanged at 6.00% and 5.75%, respectively.

The marginal contraction in the overall measure of money (M3) of 0.1% contrasted with the 2.5% expansion last year, and featured significant moderation in all of the major aggregates. Demand deposit trends switched to a decline of 1.8%, while savings and fixed deposits growth slackened to 1.2% and 0.5% from the year-earlier pace of 2.8% and 1.8%, respectively. Foreign currency deposits were also reduced by 10.6%, while the increase in currency in circulation was nearly five times lower at 1.0%.

Domestic credit growth slackened to 0.9% from 1.7% in second quarter 2000, led by a more than halving in private sector credit expansion to 1.4%, which was largely concentrated in abated growth in consumer and construction sector credit and a reduction in business loans. Mortgage lending, however, continued to register robust growth. For the public sector, the marginal rebound in net credit to Government of 0.1% contrasted with a net repayment of 4.6% last year, while claims on the public corporations declined by a reduced rate of 7.1%.

Preliminary estimates for FY2000/01 through May, indicate an increased budget surplus of $2.1 million to $10.2 million when compared to the same period in FY1999/00. Revenue collections improved by 4.8% to $868.8 million, due principally to a 27.6% gain in non-tax income, while total expenditure rose by 5.4% to $874.0 million. The latter included a 4.9% increase in recurrent outlays and a 57.9% hike in net lending to public corporations, which combined for 92.0% of the total and more than offsetted the 12.9% decline in capital spending. Budgetary financing included net domestic currency borrowings of $15.4 million as against net foreign currency debt repayment of $10.8 million and a modest reduction in short-term liabilities to the banking system. In the context of developments in the final month of the fiscal year, these trends culminated in a $4.5 million (0.3%) increase in the Direct Charge on Government to $1.52 billion. The National Debt, however, contracted by $20.4 million (1.1%) to $1.86 billion as debt guaranteed for the public corporations was appreciably reduced by 6.9%.

Preliminary estimates of tourism activity suggest significantly tempered growth, mainly attributed to continued weakness in the United States economy which principally affected earnings indicators. Led by a levelling-off in cruise visitor volumes for New Providence, total visitor arrivals rose by a sharply reduced 2.3% to 1.14 million visitors vis-à-vis a robust 18.0% increase in 2000. Sluggish growth in sea visitors of 1.3% contrasted with the 31.3% expansion achieved in 2000 when both the number of ships and port calls increased. Air traffic continued to register positive and improved growth of 4.1% from 1.2%, supported by favourable capacity developments in Grand Bahama's hotel sector. Compared to the double digit advances in 2001, revenue indicators were likewise less robust but still positive, with room revenue growth for New Providence—which accounts for a majority share of the market—reduced to 5.6% from 22.5%, due mainly to attenuated gains in average nightly room rates. However, stronger revenue increases were registered in Grand Bahama of 46.6%, as higher room sales accompanied a more than two thirds hike in average nightly room rates.

Construction output strengthened significantly during the review period, with indicators of future investments also improved. Compared to 2000, valuations on new projects started rose by 11.3% to $48.6 million, with lower commercial investments strongly outpaced by the 24% hike in residential activity which were influenced by upscale condominium developments in New Providence and recovering housing demand in Grand Bahama. The value of building completions was approximately doubled at $101.8 million—with over 85% of the increase linked to commercial and industrial projects in Grand Bahama. Amid a stable outlook for domestic housing demand and sharply elevated prospects for foreign sales, the investment outlook was more favourably weighted towards the residential sector. In this regard, the value of building permits granted more than doubled to $200.0 million, broadly outpacing the 9.6% decline in commercial and industrial permits granted to $36.3 million.

Inflation, as measured by the quarterly change in the average Retail Price Index, firmed to 0.9% from 0.2% in 2000, with the most substantive increases recorded in average costs for furniture & household operations (2.6%), recreation & entertainment services (2.3%), food & beverages (1.0%) and transportation & communication (0.7%). However, for the 12 months ended June 2001, average consumer price inflation was virtually stable at 1.5%, with the significantly accelerated uptrend for food & beverage costs (2.1%) partly offset by a reduced firming in the more heavily weighted housing component of the Index (0.2%). Also noteworthy was the halving in the average education costs uptrend to 6.1%, as there were no further programmed increases in tertiary level tuition.

In the external sector, the current account deficit narrowed to an estimated $61.1 million from $161.0 million in 2000. The merchandise trade deficit contracted by 19.6% to $364.4 million, following a 7.1% boost in export receipts and a 21.6% reduction in goods imports vis-à-vis the previous year, when significant rebuilding efforts followed Hurricane Floyd and consumer durables imports rose at a faster pace. Growth in net tourism receipts of 10.7% and decreased payments for foreign construction services combined to boost net invisible receipts by 9.5% to an estimated $493.6 million. This broadly offset higher net income outflows of 31.2% and a one-third reduction in net transfer receipts.

Less elevated investments in tourism and industrial sector projects underpinned a significant decline in the estimated surplus on the capital and financial account to $10.6 million from $66.4 million in 2000. Net private direct equity investments decreased to $10.1 million from $42.6 million last year, real estate transactions switched to a net outflow of $2.8 million from a net inflow of $48.9 million and net private sector loan proceeds contracted to $2.8 million from $35.7 million last year. The surplus was also constrained by a modestly expanded public sector debt repayment of $7.7 million, although supported by a reversal in the banking sector's net short-term transactions to a $15.9 million inflow from a net outflow of $56.3 million last year.

Fiscal Operations

Provisional estimates for the first eleven months of FY2000/01 indicate tax revenue growth of 5.0% to $879.0 million, marginally outpacing expenditure growth of 4.8% to $868.8 million. Based on this preliminary outcome, Government operations achieved a budgetary surplus of $10.2 million compared to $8.1 million a year earlier.

Revenue

Revenue growth was underpinned by a 3.1% increase in tax collections to $796.1 million, representing 90.6% of total receipts. The non-tax component, which comprised the remainder (9.4%), was also higher by 27.6% at $82.9 million. Property tax collections at $31.9 million, exceeded the year-earlier intake by 6.7%; and business and professional fees grew by 8.3% to $48.9 million, despite declines for both company registration and international business company fees—the latter reflecting some winding down of these investment vehicles following enhancements to the regulatory environment. Meanwhile, selective taxes on tourism increased more incrementally by $0.8 million, and the notable decline in levies on international trade and transactions ($21.8 million) was largely offset by revenue captured in the yet to be classified "other" category, which rose by $42.8 million to $67.6 million.

Under non-tax receipts, the 27.6% gain to $82.9 million included increased income from fines, forfeits and administrative fees ($14.4 million) and an almost threefold hike in revenue from public enterprises ($4.3 million), which more than offset the 6.3% decline in income from other sources.

Expenditure

The 4.8% growth in total expenditure comprised a 4.9% increase in recurrent spending and a 57.9% hike in net lending to public corporations. In a modest offset, however, capital outlays were curtailed by 12.9% to $69.5 million. On a proportional basis, recurrent spending represented a comparatively stable 87.4% of total expenditure, with capital outlays reduced to an 8.0% share relative to an increased 4.6% share for net lending.

The economic classification of recurrent expenditure indicated a 4.9% rise in Government's current consumption, paced by the 17.0% increase in spending on goods and services to $156.4 million. However, the wage bill was stable at $329.0 million, representing 43.3% of recurrent expenditures. Transfer payments also grew by 4.6% to $273.7 million, although interest payments fell by 3.6% to $85.3 million, owing to the comparatively softened interest rate environment and narrower spreads on newly issued debt. Meanwhile, subsidies and other transfers increased by 8.8% to $188.4 million, primarily reflecting flows to the Public Hospital Authority and other autonomous entities.

Government Revenue By Source
YTD - May

	FY 99/00p		FY 00/01p	
	B$M	%	B$M	%
Property tax	29.9	3.6	31.9	3.6
Selective Services tax	36.9	4.4	37.7	4.3
Bus. & Prof. Lic. Fees	45.2	5.4	48.9	5.6
Motor Vehicle tax	13.7	1.6	13.0	1.5
Departure tax	52.7	6.3	52.4	6.0
Import duties	395.7	47.3	366.6	41.7
Stamp tax from imports	89.0	10.6	96.0	10.9
Export tax	12.5	1.5	12.9	1.5
Stamp tax from exports	0.3	- -	- -	- -
Other stamp duty	73.8	8.8	74.7	8.5
Other Tax revenue	24.8	3.0	67.6	7.7
Fines, forfeits. etc.	46.8	5.6	61.3	7.0
Sale of Government Property	0.5	0.1	0.7	0.1
Income	17.6	2.1	20.9	2.4
Other non-tax rev.	- -	- -	- -	- -
Capital Revenue	0.3	- -	0.1	- -
Grants	- -	- -	- -	- -
Less: Refunds	2.5	0.3	5.7	0.6
Total	837.2	100.0	879.0	100.0

By functional classification, the increase in recurrent expenditure was underpinned by higher outlays for education (7.2%) and health (9.7%) of $149.7 million and $128.6 million—respectively, accounting for 19.7% and 16.9% of the total. In addition, spending increased for public order and safety (14.0%) to $91.9 million, defence (4.1%) to $22.3 million and economic services—most notably tourism and air transportation—(10.1%) to $100.0 million. In contrast, outlays were lowered for general administration activities (3.5%) to $117.5 million and for social benefits and services (0.5%) to $54.1 million.

Compared to the first eleven months of FY1999/00, the decrease in capital expenditure featured an $8.9 million drop in spending on defence to $2.1 million, alongside scaled back spending on public works and water supply projects by 7.9% to $25.7 million and a 12.9% decrease in education outlays to $13.5 million. On balance, however, investments were more than two thirds higher for health at $8.5 million, while air transportation benefited from capital improvements of $5.9 million compared to less than $1.0 million last year.

FINANCING AND NATIONAL DEBT

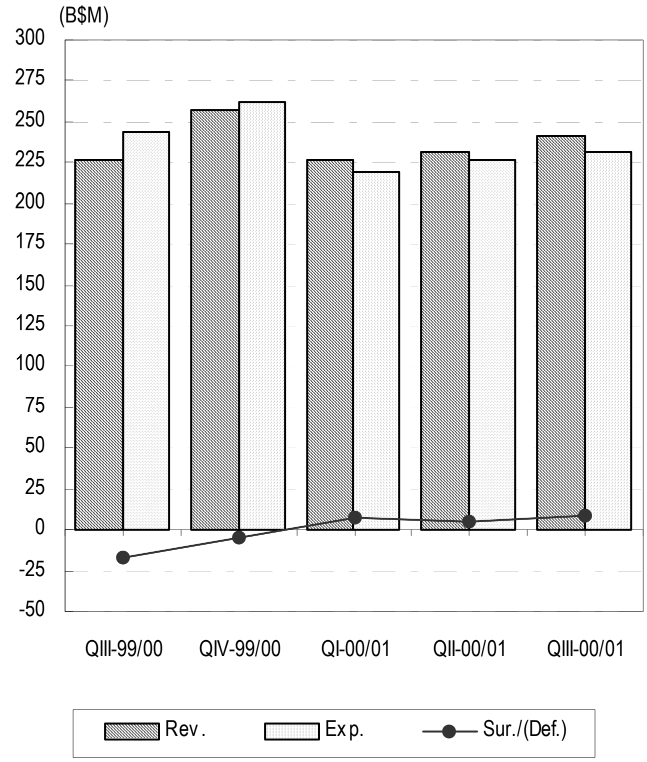
Budgetary financing during the first eleven months of FY2000/01 consisted of a $55.8 million Bahamian dollar bond issue, a $20.0 million Treasury bill issue and $3.0 million in external borrowings. Reflecting significant scheduled bond maturities, debt repayment was considerably higher at $74.3 million vis-à-vis $18.3 million a year earlier. Within this context, Government's short-term position with banks shifted to a net borrowing position of $28.3 million, as against a $34.7 million net repayment in the previous fiscal period.

Over the second quarter of 2001, the National Debt increased by $3.9 million (0.2%) to $1,861.8 million, compared to a $0.4 million rise to $1,882.3 million the previous year. In particular, the Direct Charge on Government advanced by $13.0 million (0.9%) to $1,523.6 million, to exceed the $9.1 million (2.7%) contraction in the guaranteed debt of the public corporations to $338.3 million.

However, for the fiscal year ended June 2001, the lesser $4.5 million (0.3%) advance in the Direct Charge was eclipsed by a $24.8 million (6.9%) decrease in contingent liabilities. As a result, the National Debt contracted by 1.1%, contrasting with a 3.4% growth in FY1999/00.

As regard the Direct Charge at end-June, Bahamian dollar borrowings—dominated by long-term bonds—represented 91.4% of the total, with the balance in foreign currency. Creditor profile data indicated that public corporations—mainly the National Insurance Board—continued to hold the largest share, although slightly reduced to 42.1%. Commercial banks' share was also lower (27.5%), whereas proportions were boosted for private non-bank investors (21.7%) and the Central Bank (8.7%).

Fiscal Operations



PUBLIC SECTOR FOREIGN CURRENCY DEBT

Foreign currency debt of the public sector contracted over the review quarter by 2.1% to $368.0 million, comprising respective declines in Government and the public corporations' debt of 1.6% and 2.3%. This extended the fiscal year decrease in the foreign currency debt to 7.1%. In line with the decreasing stock, debt servicing during the review period fell by 4.5% to $16.9 million, comprised of an almost equivalent level of principal and interest payments. In proportion to exports of non-factor goods and services, the quarterly debt service ratio increased to 2.4% from 2.2% in the same period last year.

2001/2002 BUDGET HIGHLIGHTS

The Government's budget for FY 2001/02, presented to Parliament on 30 May, 2001 and approved in June, envisaged the achievement of a balanced position, while enhancing the priority areas of Government services, including education, health, public safety, social services and national security. Also noteworthy were provisions for pay increases for nurses and other medical professionals, and for the first of a three-phase general salary review for teachers.

Revenue initiatives announced in the budget included further rationalisation of import duties and measures to improve tax administration, within the context of no new or increased levels of taxation. In particular, the Government reduced duties on a range of products to 35% from previous rates of 40% to 210%. Rates lowered on the upper range softened protective tariffs previously enjoyed by various agricultural products, including pineapples, pigeon peas, canned tomatoes, lemons, limes and cucumbers; and were intended to make these staples more affordable in view of constrained domestic production. Duties were eliminated on imports of grapes, apples and pears. Additionally, the duty rate on certain office equipments and supplies, previously charged at 50%, and for various electronic items and household appliances once dutiable at 45%, was lowered to 35%. The rate on various medical instruments and tools was also reduced to 25% from 35%.

Against this backdrop and relying on an outlook of stable economic growth to support the revenue base, the budget envisioned an overall surplus of $5.8 million for FY2001/02, as compared to the $0.3 million deficit forecasted in the previous year. This expected outcome is premised on a 4.0% projected increase in revenues and grants to $1,029.7 million vis-à-vis a 3.3% hike in approved expenditures to $1,023.9 million.

Meanwhile, the financing plan for FY2001/02 included anticipated borrowings of $83.2 million against debt amortisation of $87.3 million, some 45.3% of which was scheduled in foreign currency. Against this background, the Direct Charge on Government should decline further by $4.1 million to approximately $1,857.7 million by June 2002.

The revenue outlook is tempered by the more moderate growth projections for the Bahamian economy, and the continued sluggish performance of the United States economy. In this context, taxes on international trade and transactions, the largest component of revenue, were projected to post slower growth of 3.6% to $613.0 million, which constituted almost 60% of total expected receipts. In particular, import duties were estimated to increase by 1.4%, stamp taxes on imports by 11.4% and export duties by 17.3%.

Among other tax categories, sustained economic growth and strengthened collection efforts were expected to secure revenue gains from property taxes of 39.4% to $52.6 million, selective taxes on tourism services, 8.6% to $44.7 million, motor vehicle taxes, 5.0% to $18.5 million, departure taxes, 2.4% to $69.7 million, stamp tax on financial and other transactions, 1.7% to $78.1 million and for "other" unclassified taxes, 61.2% to $12.6 million. However, given the recent enhanced legislative regime, business and professional license fees are expected to decline by 10.7% to $50.9 million, with those from IBCs approximately halved to $8.7 million.

Regarding non-tax revenue, the budget forecasted a decline of 11.1% to $77.3 million, largely attributed to a 13.8% falloff in income from fines, forfeits and administrative fees to $54.7 million, a category which posted average annual growth of approximately 3.1% over the past five years. Otherwise, capital revenue was expected to provide new receipts of $5.0 million and grants, a modestly increased $7.3 million.

On the expenditure side, the $33.1 million hike in allocations included growth in recurrent provisions of 3.6% to $893.8 million—to account for 87.3% of the total—with capital allocations also higher by 9.8% at $108.8 million. Conversely, appropriations for net lending to the public corporations were reduced by 26.4% to $21.3 million.

By economic classification, recurrent expenditures comprised a programmed increase in Government consumption of $24.0 million (4.3%), with the salary component higher by 3.9% at $391.3 million—partly corresponding to approved pay increases for teachers and medical professionals. In addition, the allocation for purchases of goods and services rose by 5.1% to $189.0 million.

Allocations for interest bearing transfer payments were reduced by 4.7% to $97.4 million, mainly in line with declining interest rates and debt stock. Subsidies and transfers were apportioned a 5.8% increase to $216.2 million, covering a 4.2% hike in subsidies to $121.8 million, a 12.8% rise in transfers to households—including old age pensions and disability assistance—to $51.2 million and a 12.3% growth in planned assistance to the non-financial public enterprises to $7.2 million. Current transfers to the public corporations, however, are expected to decline by a third to $3.3 million.

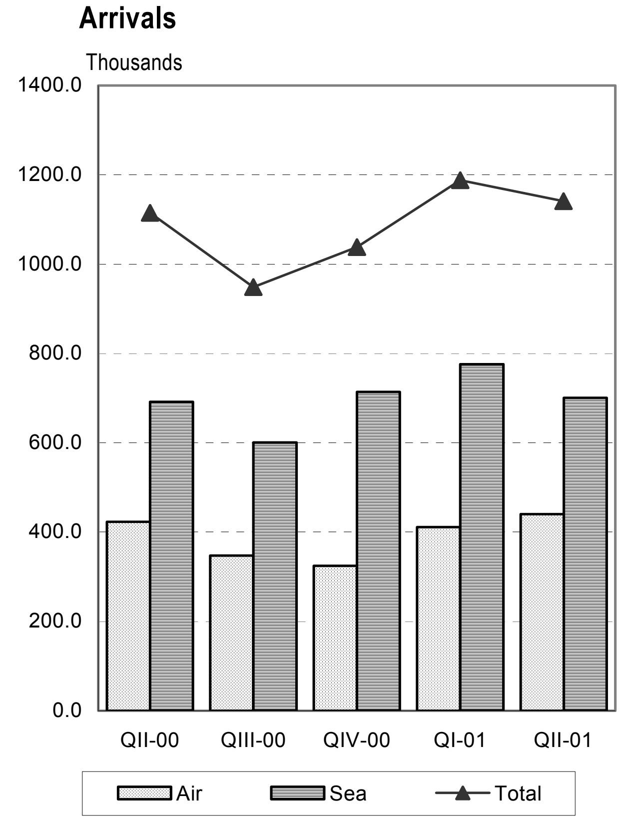
On a functional basis, approved outlays reflected continued priority for general public services, which recorded an 8.1% gain in allocations to $245.4 million (27.4% of the total). The budget for education increased by 5.7% to $188.9 million (21.1%); health, by 4.2% to $148.3 million (16.6%); economic services, by 0.5% to $117.2 million and social benefits and services, by 7.3% to $62.5 million.

The capital budget grew by $9.7 million (9.8%) to $108.8 million, highlighted by a $16.8 million (43.9%) hike in planned outlays for public works and water supply projects to $55.1 million, including $30.2 million for road works in New Providence and the Family Islands and for other Family Island infrastructual development, including hurricane restoration works. Sizeable allocations were earmarked for school construction and refurbishment within education's $20.0 million provision; while health and defence received $11.1 million and $2.0 million, respectively and activities covering general public administration, a combined $14.2 million.

REAL SECTOR

TOURISM

Preliminary data for the second quarter of 2001 underscore significant slowing in tourism sector expenditure growth from the double digit gain posted in the corresponding 2000 period. In particular, weakness in the North American economy primarily constrained stopover pricing gains and cruise visitor demand, with slowing in key indicators most noticeable for New Providence. However, Grand Bahama continued to experience a strong capacity-led recovery in stopover activity.



Total visitor arrivals, which registered a robust 18.0% gain last year, slackened to 2.3% in the second quarter of 2001, for a total of 1.14 million visitors. Growth in the dominant sea arrivals market segment tapered off to 1.3% from last year's 31.3% boost which corresponded to an expansion in cruise line capacity for New Providence and the Family Islands. However, the performance of the more lucrative longer stay air arrivals registered a strengthened gain of 4.1% from 1.2% in 2000.

A breakdown of port of entry data reveals that New Providence experienced the strongest moderation in visitor growth, to 2.8% from a healthy 22.3% advance in the second quarter of 2000. Underlying this was an appreciable slackening in cruise visitor growth to 2.8%, albeit moderated by the 2.7% rebound in air traffic. A similar pattern was also evident in the Family Islands where a significant leveling-off in sea passenger gains to 7.0% curtailed overall visitor growth to 5.3%, eclipsing a marginal 1.6% recovery in air arrivals. In Grand Bahama, double digit—although slightly moderated—growth in air arrivals of 11.1% was offset by a more protracted 11.0%

decline in sea arrivals, for a downturn in total visitors of 2.4%.

Available stopover indicators suggest positive but mixed expenditure performance in New Providence and Grand Bahama. For New Providence, room revenue gains fell sharply to 5.6% from 22.5% last year, with the appreciation in the average room rate almost two-thirds less for $189.92 nightly. Conversely, room revenue growth in Grand Bahama strengthened to 46.6% vis-à-vis 36.3% in 2000, as the average nightly rate increased by 36.1% to $87.88 alongside a 7.7% hike in occupied nights. However, as both markets experienced further capacity growth—although more significant for Grand Bahama—the respective occupancy rates were both lower at 75.9% and 59.8%. Airlift trends mirrored occupied room night sales, with marginal declines in both available and occupied seats for New Providence, but healthy respective increases in both indicators for Grand Bahama of 14.5% and 8.4%.

Construction

Second quarter estimates on construction activity suggest some strengthening in building activity vis-à-vis the same period in 2000, associated to a large extent with resumed investments in upscale residential developments geared toward the second-homes market and domestic first-time buyers, particularly within Grand Bahama.

The value of building projects started during the quarter rose by 11.3% to $48.6 million, with the total number of projects higher by 12.3% at 310 units. Gains were principally noted in residential construction, which increased by 24.0% in value to $43.5 million, alongside a 16.7% boost in the number of units to 294. Conversely, commercial and industrial starts, which were fewer in number by 8 units, declined by $3.5 million (41.0%) in value to $5.0 million.

Total building completions increased by 22.4% to 416 units, while the associated value nearly doubled to $101.8 million. For commercial completions, the number of projects rose by 40.0% to 42, with value surging to $52.3 million from $9.4 million in 2000. Similarly, valuations on residential completions strengthened by more than a third to $49.5 million, gaining 21.0% in number to 374 projects.

Construction Activity
(April-June)

	2000	2001	% Δ
Building Permits			
Number	874	885	1.3
Value (B$M)	151.4	239.4	58.1
Building Starts			
Number	276	310	12.3
Value (B$M)	43.7	48.6	11.3
of which: Residential	35.1	43.5	24.0
Commercial	8.5	5.0	-41.0
Public	--	--	--
Building Completions			
Number	340	416	22.4
Value (B$M)	52.8	101.8	92.7

Indicative of positive future activity, the total number of building permits issued increased by 1.3% to 885 and value appreciated by more than half to $239.5 million. In this regard, residential permits rose in number by 8.9% to 787, with a more than twofold rise in assessed value to $200.0 million. However, commercial and industrial permits issued fell by a third to 97, with value decreasing by a lesser 9.6% to $36.3 million. A single public sector permit was recorded at $3.0 million, as compared to 5 approvals valued at $26.9 million in 2000.

Prices

Based on quarterly changes in the average Retail Price Index, consumer price inflation advanced to 0.9% from 0.2% in the same quarter of 2001, reflecting broad based firming in the indices. The most significant hikes were in average costs for furniture & household operations (2.6%), recreation & entertainment (2.3%), “other” goods & services (1.9%), food & beverages (1.0%), transportation & communication (0.7%) and clothing & footwear (0.6%).

For the twelve months through June 2001, average consumer price inflation rose at a more moderate pace of 1.5% as compared to 1.6% in 2000. This primarily reflected a more than halving in the average education cost increase to 6.1%, following phased-in tertiary level tuition hikes in 1999 and 2000. Moderation was also evident in the increases in average costs for housing (0.2%) and clothing and footwear (0.5%), although some offset was provided from stronger advances in the average prices for furniture & household operations (2.2%), medical care & health (2.1%), food & beverages (2.1%), and "other" goods & services (1.8%).

Average Retail Price Index
(Annual % Changes)
JUNE

		2000		2001	
Items	Weight	Index	%	Index	%
Food & Beverages	138.3	107.2	0.4	109.5	2.1
Clothing & Footwear	58.9	106.2	0.7	106.7	0.5
Housing	328.2	102.6	0.5	102.7	0.2
Furn. & Household	88.7	105.1	1.7	107.4	2.2
Med. Care & Health	44.1	107.7	1.9	109.9	2.1
Trans. & Comm.	148.4	101.7	1.5	102.9	1.2
Rec., Enter. & Svcs.	48.7	109.2	1.1	110.3	1.0
Education	53.1	127.1	13.9	134.8	6.1
Other Goods & Svcs.	91.6	102.7	1.6	104.5	1.8
ALL ITEMS	1000.0	105.3	1.6	106.9	1.5

MONEY, CREDIT AND INTEREST RATES

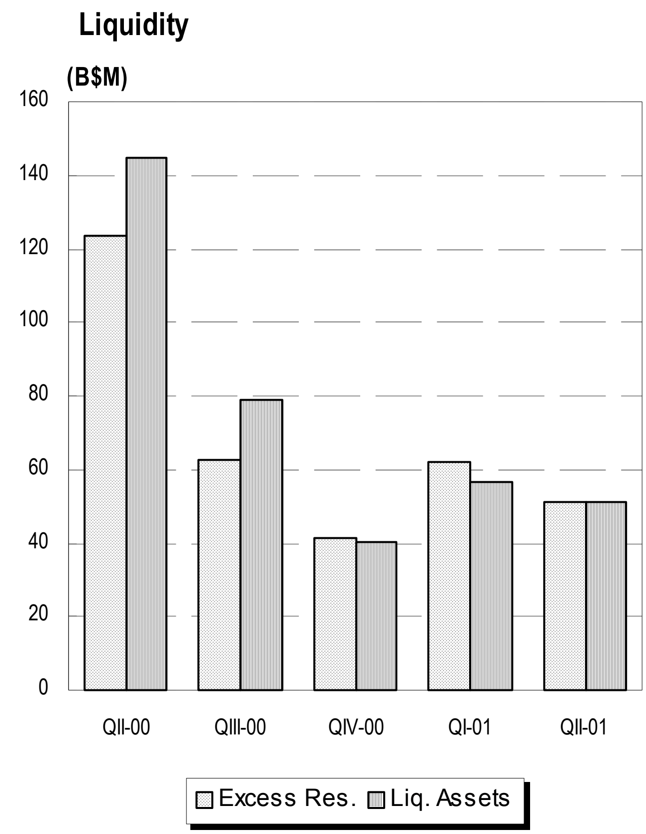
OVERVIEW

Although reduced, continued expansion in domestic credit alongside moderated foreign exchange earnings and net investment inflows, led to a contraction in the monetary aggregates. Given tightening liquidity conditions, average interest rates moved broadly higher, although the average spread on commercial banks' loans and deposits narrowed as comparatively stronger gains in mortgages vis-à-vis consumer lending pulled the weighted average loan rate lower.

Meanwhile, the latest available profitability indicators for the first quarter of 2001 suggest an increase in earnings ratios relative to the same period a year ago, as banks' net interest margins widened.

LIQUIDITY

Free cash reserves of the banking system declined by 17.1% to $51.3 million during the review quarter, to represent a reduced 1.5% of Bahamian dollar deposit liabilities relative to 3.7% in 2000. Banks more broadly defined secondary liquidity—measured by surplus liquid assets—also contracted by 9.2% to $51.3 million, which exceeded the minimum required level by 8.9% in contrast to a 26.8% surplus in June 2000.



DEPOSITS AND MONEY

After advancing by 3.3% in 2000, narrow money supply (M1) contracted by 1.3%. Led by drawdowns in business and public corporations' balances, demand deposits declined by 1.8%, to partly reverse last year's 2.8% advance. Growth in the currency component also narrowed to 1.0% from 5.2% last year.

Broad money (M2) expansion moderated significantly to 0.2% from 2.3% in 2000. A more extended reduction in business balances curtailed accretions to fixed deposits to 0.5% from 1.8% last year, and savings deposit growth was more than halved to 1.2%. A decrease in residents' foreign currency deposits of 10.6% as against growth of 13.2% last year, resulted in the overall money supply (M3) contracting marginally by $3.8 million (0.1%) to $3.64 billion, but contrasting sharply with an $84.8 million (2.5%) gain in 2000. Bahamian dollar fixed deposits remained the largest component of the overall money stock (58.9%), followed by demand deposits (17.5%), savings (17.0%) and currency (4.1%).

An analysis of accounts by depositors and range of value revealed a relatively stable distribution of depositors and account balances. The largest concentration of account holders (91.2%) held average balances of less than $10,000, which constituted 11.2% of aggregate deposits. Conversely, average balances exceeding $50,000 represented 73.5% of all deposits but only a small fraction of depositors (2.6%). In the mid-range, 15.3% of all deposits were held in accounts whose values were between $10,000-$50,000, and corresponded to a disproportionately fewer number of accounts (6.2%).

DOMESTIC CREDIT

Total domestic credit expansion slowed to $41.4 million (0.9%) during the second quarter vis-à-vis $65.7 million (1.7%) a year ago, with private sector credit growth approximately halved to $51.5 million (1.4%). This outcome was largely due to a significant net repayment in business loans, alongside sharply curtailed net construction sector loans and a more than halving in consumer credit growth. However, banks' net mortgage lending continued at a brisk pace of $29.9 million (2.8%), concentrated within the residential sector and representing more than half of the total private sector advance. The bulk of private sector lending was in Bahamian dollars, with ongoing net repayments on foreign currency balances.

A sectoral breakdown of private sector credit indicated that personal loans remained the largest component of the total (62.3%). However, with the halving in consumer lending growth to $14.4 million (1.0%) and continued repayment of overdrafts (8.0%), the net increase in the aggregate narrowed to $48.8 million (2.1%) from $56.4 million (2.8%) in 2000. A moderating influence was also exerted by the sharp decrease in net lending for construction to $1.4 million from $39.4 million last year, and a larger net repayment for entertainment and catering ($15.3 million). Notable decreases were recorded for the miscellaneous category ($16.5 million), professional and other services ($4.1 million), tourism ($2.0 million) and agriculture ($1.2 million). However, net lending was resumed for the distribution sector ($7.2 million).

Distribution of Bank Credit By Sector
End-June

	2000		2001	
	B$M	%	B$M	%
Agriculture	11.1	0.3	7.5	0.2
Fisheries	6.3	0.2	6.5	0.2
Mining & Quarry	16.0	0.4	23.3	0.6
Manufacturing	68.3	1.9	65.5	1.7
Distribution	171.2	4.8	222.8	5.6
Tourism	219.9	6.2	219.9	5.5
Enter. & Catering	20.5	0.6	27.1	0.7
Transport	52.7	1.5	68.5	1.7
Public Corps.	133.1	3.7	124.4	3.1
Construction	283.	8.0	310.	7.9
Government	66.4	1.9	79.2	2.0
Private Financial	3.4	0.1	26.1	0.7
Prof. & Other Ser.	124.7	3.5	126.1	3.2
Personal	2177.9	61.3	2463.0	62.3
Miscellaneous	198.2	5.6	181.3	4.6
TOTAL	3552.7	100.0	3951.6	100.0

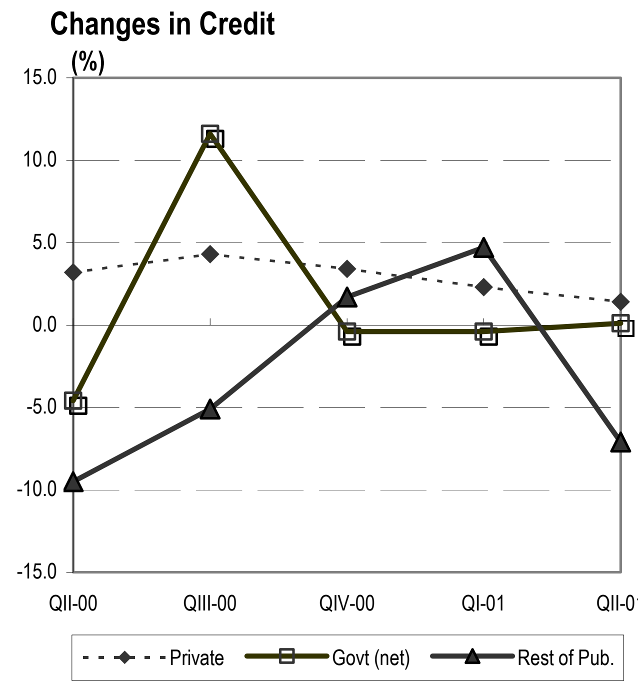
Under consumer credit, the major moderating influences included the more than halved reduction in net lending for miscellaneous purposes ($9.3 million) and land purchases ($2.3 million), alongside decreased net flows for travel, debt consolidation and home improvement at less than $2.0 million, on average. Debt for private cars was also reduced ($3.7 million), whereas credit card debt advanced by $2.3 million in comparison to a small decline in 2000.

Weaker than expected revenue performance influenced a nearly unchanged quarterly position in net credit to Government vis-à-vis the year-earlier net repayment of $22.1 million (4.6%). Although claims on the rest of the public sector fell further by $10.6 million (7.1%), this was approximately one third less than in 2000.

COMMERCIAL BANKS

For the review quarter, growth in commercial banks' net lending to the private sector abated to 1.3% from 3.1% in 2000, which contrasted with a marginal decline in deposit liabilities to the sector of 0.3% vis-à-vis a 1.2% increase in 2000. The reduction in net credit to Government narrowed to 1.5% from 5.9% last year, and the net repayment by public corporations was also moderately decreased to 7.3%, with growth in their respective deposits curtailed to 4.0%. As result of these and other developments, commercial banks' net foreign liabilities increased over the quarter by 0.8%.

On a proportional basis, commercial banks' held 97.8% of total banking sector deposits, which were mainly owed to the private sector (88.8%) and concentrated in accounts valued in excess of $50,000 (73.3%). A breakdown of deposits by contractual categories revealed that fixed balances maintained the largest share (61.1%), followed by demand (21.2%) and savings (17.7%) deposits.



OTHER LOCAL FINANCIAL INSTITUTIONS

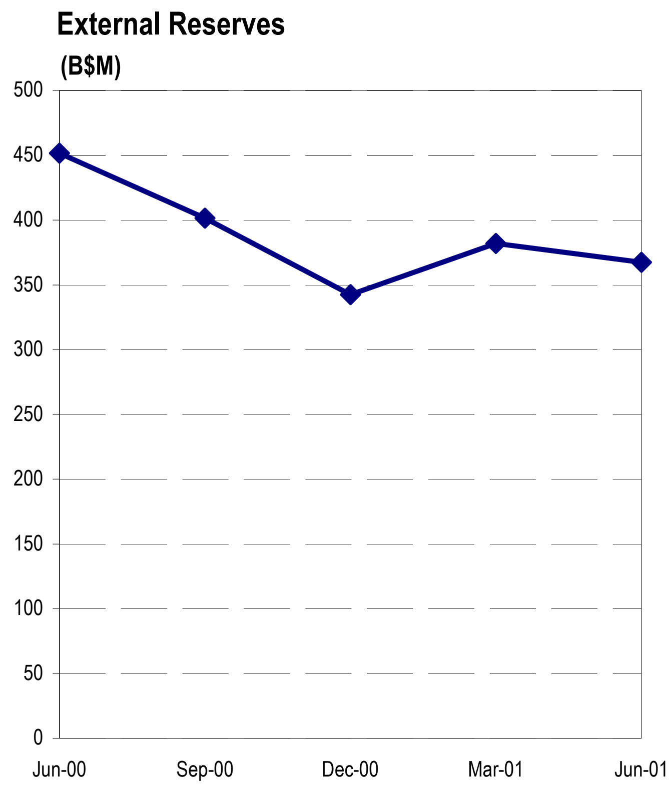
The OLFIs reported a decrease in private sector deposits of 3.8%, following a robust 17.9% growth last year. Continued, albeit moderately reduced credit growth of 3.6% was recorded to the sector, which was largely accommodated by a halving in net foreign assets.

A broader analysis of the OLFIs' deposit liabilities showed that 88.5% were held in fixed maturities; 7.8% in demand balances and 3.7% in savings deposits. As regard credit, mortgages represented 85.8% of the total, increasing over the review period by 4.6% to $99.7 million.

CENTRAL BANK

During the second quarter, the Central Bank's net claim on Government rose by $6.3 million (5.9%), reflecting an increase in holdings of Government paper. Moderated foreign inflows, combined with steady domestic demand, led to a broadening in the quarterly falloff in external reserves to $14.6 million (3.8%) from $1.3 million (0.3%) last year. This placed the stock some $84.3 million below the June 2000 level at $367.4 million.

The underlying foreign exchange transactions were dominated by increased net foreign currency demand by the public sector which boosted the Bank's net foreign currency sale to $17.6 million from $5.2 million in the same period a year ago. In particular, the 16.1% hike in the net purchase from commercial banks to $30.1 million was completely offset by a more than 50.0% growth in the net sale to the public sector to $47.7 million, partly corresponding to equipment upgrades for the telecommunications company.



INTEREST RATES

Consistent with the tightening in liquidity, commercial banks interest rates trended higher during the quarter, with the weighted average deposit rate rising by 9 basis points to 4.25%. Given the dominance of mortgages on the lending side, the weighted average loan rate declined by 13 basis points to 11.74%, and resulted in a 22-basis point reduction in the average loan-to-deposit interest rate spread to 7.49%.

The firming in average deposit rates was led by a 50 basis point increase in the rate on fixed placements of more than one year, with the average band on fixed deposits rates moving higher to 4.20%-5.03% from 4.12%-4.67% in the previous quarter. Conversely, the average savings rate declined slightly by 2 basis points to 2.68%.

On the lending side, the respective average residential and commercial mortgage rates advanced by 15 and 56 basis points, to 9.09% and 9.15%. The average rate on overdrafts was also 43 basis points higher at 10.85%, with a more modest 5 basis points rise in the average consumer loans rate to 13.69%.

Benchmark rates, commercial banks' Prime and the Central Bank Discount Rate, remained unchanged at 6.00% and 5.75%, respectively. However, the average 90-day Treasury bill rate advanced further by 38 basis points to 1.80%.

BANK PROFITABILITY

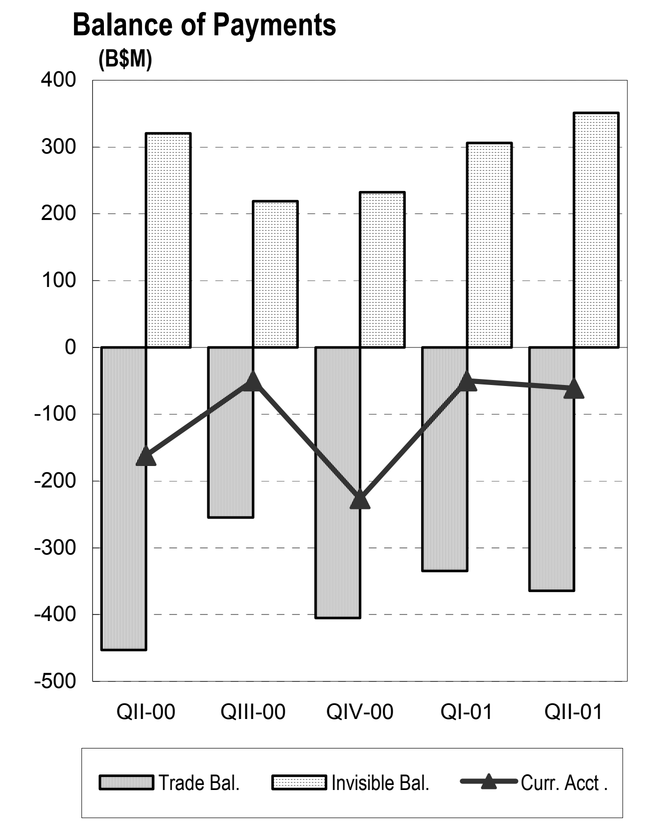
In the context of 2000's significantly expanded private sector credit base and the slowed accretions to the deposit base, banks' net income rose significantly by $11.2 million (38.4%) vis-à-vis the corresponding period in 2000. The gross earnings margin widened by 24.8% to $79.8 million, reflecting a 22.2% boost in net interest income. Commission and forex exchange income also rose by 55.3%, which represented 5.8% of banks' gross income. In contrast, the advance in staffing and other operating costs trailed at a more modest 10.5%.

This improved outcome in income also boosted profitability ratios relative to average asset, with the net interest margin ratio advancing to 5.98% and broadly offsetting a firming in the operating cost ratio to 3.61%. A 19 basis point increase in the commission and foreign exchange income ratio to 0.64% more than countered the 7 basis point reduction in the 'other' net income ratio to 0.35%, which was primarily linked to an increase in bad debt provisions. Within this context, the net income (return on assets) ratio improved to 3.36% from 2.62%.

INTERNATIONAL TRADE AND PAYMENTS

Provisional estimates for the second quarter of 2001 indicate a notable reduction in the current account deficit, to $61.1 million from last year's $161.6 million when hurricane rebuilding efforts and more significant levels of foreign investment projects exerted greater upward pressure on domestic demand. In a comparatively less expansionary environment, the merchandise trade deficit contracted by 19.6%, while a further growth in net tourism receipts helped augment the surplus on the services account by 9.5%.

The estimated merchandise trade deficit narrowed appreciably by 19.6% to $364.4 million. Non-oil imports fell by 21.6% to $321.9 million and, reinforced by the



7.1% boost in estimated exports to $122.3 million, more than offset the 9.2% hike in the oil bill to $73.7 million. Oil payments continued to reflect recent global price hikes, with increases almost broadly based across categories. The per barrel cost of aviation gas was higher by 22.6% at $89.63; jet fuel, by 6.7% at $36.38; motor gas, by 5.3% at $44.15; gas oil, by 3.3% at $31.04 and propane fuel, by 2.0% at $29.46. By exception, the per barrel price of bunker 'c' fuel declined by an estimated 6.3% to $21.33.

The surplus on the services account widened by an estimated 9.5% to $351.2 million, due largely to a 10.7% gain in net tourism receipts to $493.6 million, which partly benefited from reduced overseas expenditures by residents. A positive contribution was also derived from a three-quarter reduction in net outflows for construction services, in line with the completion of major hotel sector projects, as well as contracted outflows for transportation services (9.0%) and "other' services (15.2%)—the latter inclusive of royalty and credit card payments. Conversely, net external payments for insurance services quadrupled to $31.2 million and outflows for government services more than doubled to $23.1 million. Inflows associated with offshore companies' local operations fell 56.3% to $13.2 million, corresponding to significant rationalization of industrial activities in Grand Bahama.

Under the income account, net outflows expanded by 31.2% to $58.2 million. In particular, net repatriation of investment income—which represented more than three quarters of the total—increased by 39.7%, attributed in large measure to the 69.7% increase in net profit remittances by non-financial private companies. Net official interest inflows were marginally reduced to $1.6 million, and expatriate workers' net income remittances were almost unchanged at $10.7 million.

Net current transfer inflows decreased by a third to $10.3 million, as public sector net receipts fell by 26.3% to $11.8 million. Conversely, net private sector outflows—including workers' remittances and other transfers—rose marginally to $1.5 million.

On the capital and financial account, the conclusion of major hotel and industrial sector investment projects in Grand Bahama influenced a sizeable reduction in the estimated surplus, to $10.6 million from $66.4 million in the comparative 2000 period. Although net outflows for migrant workers widened to $7.7 million from $3.2 million, the dominant factor was the contraction in net financial inflows to $18.3 million from $69.6 million in 2000.

Disaggregation of the financial account revealed a decline in net foreign direct investment inflows to an estimated $7.2 million vis-à-vis a more robust $91.5 million last year. This corresponded to reduced net equity investments of $10.1 million as compared to $42.6 million in 2000, and a reversal in real estate transactions to a net outflow of $2.8 million from $48.9 million in 2000. Additionally, net private sector loan receipts narrowed to $2.8 million from $35.7 million, and the public sector's net debt repayment increased to $7.7 million from $1.3 million in 2000. In a moderating trend, however, short-term capital flows through the banking system were reversed to a $15.9 million inflow from a net outflow of $56.3 million a year ago.

Consequent upon these developments, and adjusting for possible errors and omissions, the overall payments balance was in deficit by $14.6 million relative to the $1.3 million surplus achieved in the year earlier period.

International Economic Developments

Persistent weakness in the United States economy exerted a larger than expected drag on global economic activity during the second quarter, with no improvement expected before the end of the year. Within this environment, monetary policy remained broadly accommodative but curtailed to some degree by concerns over possible inflationary repercussions. Although labour market conditions remained broadly tight, signs of some unraveling were beginning to emerge in the outlook for business hirings over the remainder of the year, in line with a general slump in corporate earnings. Meanwhile, currency markets recorded mixed movements in major exchange rates against the United States dollar, albeit most major bourses managed to experience some modest recovery in equity prices. On the external front, weak global demand contributed to the deteriorated positions in the current account balances of most major industrial countries.

According to preliminary estimates, second quarter output growth in the major economies was generally weaker than forecast. The United States economy recorded its worst outturn in eight years, with estimated GDP growth revised downward to an anemic 0.2% annualized rate vis-à-vis first quarter growth of 1.3%. With consumer spending remaining surprisingly resilient, much of the overall weakness in the second quarter continued to emanate from companies cutting back sharply on their investments in plant and equipment in the face of weak sales and plunging profits. Similarly, in the United Kingdom the annualised rate of output growth fell to its lowest level in more than two years, of 1.2% from 2.0% in the first quarter, as tourism activity slumped because of the foot-and-mouth disease crisis and manufacturing output continued to decline amid an erosion in export demand.

The euro area, particularly Germany, also recorded more sluggish real expansion—estimated at less than 2.0% for the quarter. Conditions were characterised by falling business confidence and an easing in domestic demand in the context of diminished real income growth. Meanwhile, Japan continued to be plagued by falling exports, contracting manufacturing output and consumer price deflation. The annualised contraction in real output growth of 3.2% extended the first quarter decline of 0.8%.

Although labour market conditions remained tight, a less expansionary position was signaled for corporate hiring over the rest of the year, in the wake of the global slowdown. The United States jobless rate increased to 4.5% from the previous quarter's 4.2%, as a deteriorated earnings outlook prompted significant layoffs in the manufacturing sector. In Japan, labour market demand declined in line with reduced industrial sector activity and a renewed round of corporate restructuring, pushing the average unemployment rate to a record high of 5.0% by July from 4.8% in the first quarter. Employment conditions remained tight in the United Kingdom, where the jobless rate was estimated at 4.9% for the three months to May. For the euro area, the jobless rate is expected to be little improved from the 8.4% of the first quarter.

Inflation trends were mixed in the major countries during the second quarter. For the United States, a strong dollar supported declining import prices and stemmed the advance in average consumer prices to 3.7% from a 4.0% spike in the first quarter. Consumer price deflation persisted in Japan, although stabilized at the previous quarter's 0.3%, owing partly to cheaper imported substitute products. By contrast, the surge in meat and other food prices associated with foot-and-mouth disease and other livestock maladies, pushed inflation within the euro zone higher to 4.4% from an estimated 2.0% in the first quarter, and in the United Kingdom, to 2.3% from 1.2% in the first quarter.

In commodity markets, the spot price of gold rose by 1.7% over the quarter to average $267.92 per fine troy ounce. The per barrel price of crude oil moved marginally lower to $25.56 from $25.90 in the previous quarter, with OPEC's production quotas unchanged over the period.

Currency markets featured mixed movements in major exchange rates, with mild fluctuations posted against the United States dollar. In particular, the dollar recorded gains against the pound sterling of 1.4% to £0.71 and by 1.8% against the euro to €1.16, amid persistent capital outflows from the euro zone. Conversely, the dollar depreciated against the Japanese Yen by 0.9% to ¥124.41 and by 3.8% vis-à-vis the Canadian dollar to C$1.52.

Equity prices on the major stock markets rebounded modestly during the second quarter, after sharply depressed movements in the first quarter of 2001. In the

United States, the technology laden Nasdaq Composite index recovered by 15.5% to 2,125 points, while the Dow Jones Industrial Average rose 7.0% to 10,566 points and the broader Standard & Poor's 500 index gained 5.7% to 1,226 points. The United Kingdom's FTSE 100 index was almost unchanged at 5,638 points after five consecutive quarters of decline, while Germany's Xetra Dax rallied 2.4% to 5,972 points. In the only major decline of the quarter, Japan's Nikkei-225 index lost 2.5% to close at 12,680 points.

Weak short-term prospects for the global economy motivated additional monetary policy accommodation in most of the major industrial countries. Although the Bank of Japan had less scope for interest rate easing, an accommodating stance was maintained in support of boosted financial sector liquidity. In the United States, the Federal Reserve lowered the official discount rate by a further 75 basis points, as it aggressively sought to stimulate the U.S. economy. Similarly, the Bank of England reduced its repurchase rate twice during the quarter to 5.25% from 5.75% at end-March and, despite rising inflation, the European Central Bank cut its refinancing rate by 25 basis points to 4.50% during May.

In the external sector, most major economies recorded deteriorated movements in their respective current account balances, stemming mainly from sluggish export performance. However, estimates of the United States' trade deficit indicated a 4.0% narrowing to an annualised $349.1 billion at end-June, as the falloff in exports was outpaced by decreased imports. For the United Kingdom, a significant downturn in export growth, reflecting weaker demand from both the United States and Europe, extended the external deficit beyond the previous quarter's $43.4 billion; and Japan's external surplus narrowed further from the $101.5 billion recorded in the previous quarter. In the Euro area, the trade surplus also declined considerably from an estimated $17.2 billion in the first quarter.

STATISTICAL APPENDIX

(Tables 1-16)

STATISTICAL APPENDIX

The following symbols and conventions are used throughout this report:

1. **n.a. not available**
2. **-- nil**
3. **p provisional**
4. **Due to rounding, the sum of separate items may differ from the totals.**