CENTRAL BANK OF THE BAHAMAS
1974-2024

Prepared for Delivery for the CFA Society (Bahamas), Investment Dinner
Nassau, The Bahamas
18 April 2024

An Economic Update
Remarks by Governor John A Rolle

INTRODUCTION

A very special thank you to the CFA Society for inviting me to make this presentation. The outline of my presentation will cover recent developments in the Bahamian economy, particularly from the perspective of the recovery from the COVID-19 pandemic. I will touch on some important aspects of recent domestic monetary and financial sector trends, fiscal sector developments, and the real sector—focusing on tourism. I will also share assessments on the outlook and briefly discuss some impactful policies and reforms on the Central Bank's work agenda.

ASSESSING THE LOCAL INVESTMENT ENVIRONMENT

As financial analysts and investment professionals, we are supposed to be able to make overall assessments about the health and prospects for the economy and to use that information to guide decisions on investments in both the public and private sectors. In that respect, I would say objectively that The Bahamas is still a strong investment prospect. I believe that we are significantly under-mobilised in domestic private sector investments, particularly given the potential to extract and retain more returns from various input activities in the tourism industry. Significant private capital also exists that can fund the transfer of more investments and assets off the public sector's balance sheet—subject, of course, to the policy preferences that the government might have regarding privatisation and public-private partnerships.

In addition, increased direct investments in public debt are a viable prospect. Public sector borrowing requirements are significantly receding from the pandemic highs, which means that investors should be thinking more actively about how they can reduce reinvestment risk rather than what is often a misplaced assumption of being over-exposed to Bahamian sovereign risk. From a domestic versus external rebalancing perspective, the system does not have the capacity to shift all of its unused liquidity into foreign-currency denominated assets. Even the levels of exchange control liberalisation that the Central Bank has already undertaken, only represents a gradual around-the-edges approach to relaxing capital controls that will not fully absorb potentially displaced liquidity. When the opportunity arises, the Central Bank will also sell off more of its holdings of government debt to absorb private sector liquidity, but this is unlikely to close off all of the medium-term overhang. Channelling more of these resources into the private sector is, therefore, critical from both a liquidity management perspective and as a means for supporting growth and development.

Of course, our assessment also has to be tempered by potential downside risks, to which I will return later in the presentation.

OUR ECONOMY

Growth and Employment

Turning to the economy, our recent experience has been characterised by the very sharp contraction in output during the COVID-19 shutdown, combined with the 2019 losses from Hurricane Dorian, and an equally strong rebound. During 2023, the economy finally regained the output levels it had before the pandemic. However, with the recovery part of growth completed, the economy is demonstrating convergence, once more, to its longer-term rate of potential growth, which is still less than two percent per annum. Employment is likewise still recovering to its prepandemic level. The unemployment rate is already comparably lower, however, the headcount employment in 2023 was still less than in 2019, with the labour force participation rate still lagging this period as well.

The economy's recovery mirrored what was happening in tourism, where, in the case of stopover activity, headcount gains (for both vacation rentals and resort properties) also occurred, alongside average price appreciation.

Tourism

The Central Bank tracked tourism recovery against the monthly seasonal performance of the best months, which preceded both Hurricane Dorian and COVID-19. By the middle of 2022, month-over-month cruise traffic had regained its prepandemic levels and arrivals continued to grow subsequently. In the stopover segment, this crossover point started around the third quarter of 2022. However, there has not been any consistent uptrend in the numbers since then. That said, there is a potential for additional boost in business, once more accommodations capacity is added or returned to the industry.

We should also note that for the last four months or so, there has been some divergence between the vacation rental and hotel segments, with the volume of vacation rental stays slightly reduced, even while hotel stays expanded. For context though, vacation rental business was exceptionally strong and more vibrant than that of resort stay, over most of the postpandemic period. These trends would, therefore, have to be observed closer before any strong conclusions are made.

On a more real-time basis, the Central Bank also tracks the economy's performance against the measured foreign exchange inflows and outflows through the banking sector. Although these fluctuated significantly during the pandemic, overall volatility was less than in tourism because The Bahamas had more stable contributions from foreign investments and financial services. Private sector foreign currency flows substantially completed its rebound in 2021 and were more than fully recovered in 2022. In 2023, inflows changed little in comparison to 2022. This was the first signal to the Central Bank of the extent to which real GDP growth would have moderated in 2023.

I will return to the foreign exchange market in a while when we speak about the external reserves.

First, some words about inflation and the public finances.

Inflation

The inflation rate in The Bahamas spiked after 2020, similar to what has been the experience in other countries. This was largely due to supply chain issues as well as higher oil prices spurred by geopolitical tensions. Since then, inflation has moderated significantly but it is a result of the imported experience rather than any domestic policies. The main concern of The Bahamas around inflation is that international interest rates have had to rise significantly to bring consumer prices under control, and therefore, the cost of international capital has increased. Likewise, the government's cost of borrowing has risen.

Public Finances

The public finances bear more scars from the pandemic than any other sector of our economy because of the government's efforts, which were concentrated on stabilisation of basic incomes. At the height of the pandemic the government's revenue contracted sharply, while it was necessary to increase social assistance payments. The deficits decreased in each successive year since the pandemic, as revenues recovered, and the resulting consolidation is expected to continue. Beyond this point, however, it is the directed efforts of fiscal policies that matter for how swiftly consolidation will occur over the medium-term and how swiftly the public debt burden will subside.

Overall, public debt to GDP has increased, compared to the prepandemic levels. With the nominal GDP levels fully recovered, though, we have the clearest indicator of the pandemic's impact—as the debt ratios were artificially inflated a bit higher in 2020 and 2021, given the compressed level of the GDP in those years. It does not matter which measure of the public debt is used; the trends are similar.

Bank Liquidity and Domestic Credit

Turning to the financial sector, excess liquidity in the banking system expanded on average over the last decade and remains high. For the Central Bank, it is an indicator of the potential for credit expansion and to an important extent, the potential for net foreign exchange outflows. While there is considerable room to accommodate liquidity drawdown for credit and other purposes, the Central Bank also believes that some of this has to be sterilised from the system because the foreign reserves cannot fully absorb the full impact of a drawdown. This is why we continue to emphasise the importance of selling off Central Bank holdings of government securities to soak up some of this liquidity. It has also been recommended that the Central Bank should issue its own interest-bearing securities to the market. While the bank is open to this idea, the timing for this is still not yet ideal because it cannot be allowed to displace the adjustment that is still occurring in the government bond markets.

But, the liquidity picture also reflects a persistent, subdued trend in commercial bank lending to the private sector. We expect a very moderate uptick in such lending in 2024, partly in line with some of the accommodating monetary policies that the Central Bank has introduced, including less rigid down payment requirements now for both mortgages and consumer lending. In addition, banks and credit unions have begun to use the Credit Bureau, which is expected to support better lending decisions and, therefore, a more confident approach to lending over the medium-term. More favourable credit prospects also reflect the continuing reduction in average loan delinquencies, which are now approaching the lowest point they have been in more than a decade and a half.

The most recent ebb in bank lending to the private sector was during 2020-2022. Since then, the moderate growth has benefitted commercial lending the most. We expect to see all three categories of lending expand in 2024.

External Reserves

The expectations around the adequacy of the foreign reserves guide the Central Bank's medium-term posture on capital account liberalisation and the extent to which bank lending is either accommodated or discouraged. External reserves have increased relative to where they were prepandemic; we believe that there is moderate scope to drawdown on balances as added import spending is stimulated from the drawdown in bank liquidity.

In absolute terms, the reserves expanded since 2017, and the Central Bank has continued to maintain a high coverage of the reserves to the Central Bank's currency liabilities. At times through 2022, the coverage was more than 100 percent. Since then, we have averaged in the 90 percent range. By law, the lowest this ratio must be is at least 50 percent, relative to all local currency issued and any deposits placed at the Central Bank by financial institutions, the public sector, and other eligible depositors. The external reserves measures are also still above the prepandemic levels when assessed in terms of months of average imports.

Another important development around foreign reserves is the net source of the inflows. These have reverted to being from the private sector, after the government's foreign currency operations provided an overall net contribution from 2020 through 2022. However, we should also caution against any entrenched view that the government sector has propped up the reserves. Whenever it has happened in the past, it has been transitory and only during short periods to smooth out private sector shortfalls. From 2019 to the present, only one-third of the total accumulation in the reserves was of a net public sector origin.

Economic Outlook and Risks

Now, turning to the economic outlook, growth is expected to continue in 2024, but at a pace that is more moderated and closer to the average rate at which the economy has a capacity to expand over the medium-term. Potential real growth, barring negative or positive shocks, is still under two percent for The Bahamas. That still translates into more than $0.5 billion in net value added each year, factoring replacement capital easily, more than $1.0 billion in gross new activity each year. This growth will continue to generate employment, notably from tourism and investment related activities, with construction manifesting the outward impact of investments. It is expected that fiscal consolidation trends will continue to be further supported, inflation will continue to abate, credit delinquency rates will reduce further, and domestic credit will expand moderately faster than in 2023. The domestic credit trend also means that external reserves are likely to contract further in 2024, which is not a significant concern for the Central Bank, given the levels that currently exist in the system.

The economic downside risks though are always present and, for the most part, outside of the direct control of The Bahamas. I have already mentioned the increased cost of capital imposed on the economy from the elevated international interest rates, which are part of the effort to bring inflation quickly under control. But, this could also potentially weigh upon tourism demand. The global economy is also vulnerable to negative effects of the ongoing wars and conflicts in the Middle-East and Ukraine. Also, climate related, The Bahamas is under threat of more frequent and more destructive hurricanes that could setback the fiscal consolidation momentum.

Taken together, this means that monetary policies, which have a leaning towards credit expansion and careful, gradual liberalisation of exchange control, always have to retain some precautionary buffers, which allows the economy to adequately weather shocks.

IMPACTFUL POLICIES TO BOOST GROWTH AND RESILIENCE

At the same time, our domestic policies have to target how to make the economy more resilient and how to increase its average growth potential. Although a considerable amount of this will be the work of the fiscal authorities, the Central Bank also has a role, particularly around how the robustness of financial sector contributes.

The credit bureau and soon-to-be-introduced moveable collateral assets registry are both very important structural reforms to increase the ease of access to financing. In addition, it is imperative to better outfit The Bahamas to exploit the digital channels for accessing financial services. This would reduce the existing inefficiencies of providing services across a scattered archipelago and the discriminatory outcomes that limit the supply of services in the Family Islands. The Central Bank believes that SandDollar and other innovations will help to provide these channels through which access can be strengthened. In addition, we are crafting a more comprehensive policy framework on financial inclusion, which will be recommended to the government this year that would educate and incentivise Bahamians to take more control of their personal finances. It is also convincing that The Bahamas will need to strengthen consumer financial protection systems and, again, the Central Bank is working to develop proposals to tackle issues that are relevant for consumers and which could also have a bearing on financial inclusion.

CONCLUSIONS

To conclude, as started, I trust that investment professionals will take note that there is still an untapped potential to increase the productive use of private capital in The Bahamas. As well, there is still sound space to invest in public sector instruments, mindful that fiscal consolidation could reduce the relative absorptive capacity for such funds in the future. The pandemic did scar the public finances but it also underscored that there are very important safeguards built into our monetary policy regime. Though it is not often spoken of—even this evening—please be assured that the economy also has tremendous capacity to fund any strenuous correction in the public finances if those triggers ever needed to be pulled. Nevertheless, we have to embrace more reforms on all levels to ensure prudent and productive use of resources, make our economy more resilient, growth prospects stronger, and financial services both more efficient and inclusive.

19 April 2024 ■