2008

The Central Bank of The Bahamas
ANNUAL REPORT
& Statement of Accounts
For The Year Ended 31 December, 2008

THE CENTRAL BANK OF THE BAHAMAS

Mission Statement:

To foster an environment of monetary stability
conducive to economic development,
and to ensure a stable and sound financial system.

DIRECTORS AND SENIOR OFFICIALS

At December 31, 2008

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Dr. Duane Sands

Mr. Gregory Cleare

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Rochelle A. Deleveaux – Legal Counsel & Secretary to the Board

Gerard L. Horton – Manager, Exchange Control

John A. Rolle – Manager, Research

Keith T. Jones – Manager, Accounts

Errol L. Bodie – Manager, Information Technology

Ian B. Fernander – Manager, Administration

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April 20, 2009

Dear Prime Minister:

In accordance with Section 30 (1) of the Central Bank of The Bahamas Act, 2000, I have the honour of forwarding to you, on behalf of the Board of Directors, the Annual Report of the Bank for the year 2008. Included with this report is the Annual Statement of Accounts of the Bank for the year.

Respectfully yours,

Wendy M. Craigg
Governor

The Rt. Hon. Hubert A. Ingraham
Prime Minister and Minister of Finance
Office of the Prime Minister
Sir Cecil V. Wallace-Whitfield Center
Cable Beach
Nassau, N.P., Bahamas

Economic and Monetary Review

DOMESTIC ECONOMIC DEVELOPMENTS

Preliminary indications are that domestic economic activity slowed in 2008, with a projected moderate contraction in real GDP, following estimated growth of 2.8% in 2007 and 4.6% in 2006. The accelerated downturn in economic activity over the second half of the year, culminated in a sharp rise in the unemployment rate, to more than 12.0% at end-December from mid-year estimates of 8.7% and 7.9% in May of 2008 and 2007, respectively. Tourism output weakened, amid the intensifying global economic and financial crisis and, in particular, the recession in the United States (see Table 1); and the corresponding slump in foreign investment inflows led to a decline in construction activity. Domestic annual inflation was significantly elevated, as the retail sector adjusted to higher prices on imported fuel and other commodities, including food items. The fiscal situation for the first six months of FY2008/09 revealed moderations in revenue growth and continued increases in expenditure, which underpinned a widening of the Government's estimated deficit. Monetary developments were marked by an overall improvement in average liquidity and a reduction in the financial system's net foreign liabilities, as the pace of credit expansion slowed by more than the abatement in deposit growth. In the external sector, the estimated current account deficit narrowed, mainly reflecting the decrease in payments for foreign construction services and lowered non-oil import demand. Meanwhile, the surplus on the capital and financial account contracted, as a result of the falloff in net private investments.

TABLE 1: Selected Economic Indicators (% Change)

	2005	2006	2007	2008
Real GDP	3.3	4.6	2.8	n/a
Unemployment Rate (actual mid-year)	10.2	7.6	7.9	8.7
Occupied Hotel Room Nights	4.6	(1.9)	(4.4)	(3.3)*
Total Arrivals	(4.5)	(1.0)	(2.7)	(4.5)
Construction Starts - Value	19.6	19.3	(11.4)	n/a
Construction Completions - Value	16.0	12.8	18.3	n/a
Electricity Generation (mwh)	5.5	1.8	n/a	n/a
Retail Price Index	2.0	1.8	2.5	4.5

SOURCE: The Central Bank of The Bahamas - * YTD Sep 08 vs YTD Sep 07

Average monthly free cash balances of domestic banks improved by 22.5% to $234.2 million, although contracting by 13.8% to $164.0 million at end-December 2008, to represent a moderately smaller 2.9% share of Bahamian dollar deposit liabilities. Similarly, the broader surplus liquid assets firmed by 57.8%, for a monthly average of $271.1 million. As banks adopted a more conservative posture against increased credit risks, the weighted average interest rate spread widened by 9 basis points to 7.03%; the average loan rate was boosted by 32 basis points to 10.95%, while the average deposit rate rose by only 23 basis points to 3.92%. The average 90-day Treasury bill rate also increased by 7 basis points to 2.73%; whereas the Central Bank's policy rate and commercial banks' Prime Rate were unchanged at 5.25% and 5.50%, respectively.

Reflecting moderated foreign currency inflows, money supply (M3) expansion slowed to 5.1% from 9.6% in 2007, placing the overall stock at $5,924.0 million. In particular, currency in active circulation contracted by 8.0%, while a broadly based reduction in holdings reversed demand deposit trends to a 0.7% drawdown from an increase of 2.6% in 2007. Gains for savings deposits narrowed to

2.9% from 4.1% in 2007, and for fixed deposit, to 9.0% from 13.1%, the latter partly due to diminished accumulations by businesses and public corporations. Foreign currency deposits also registered a significantly smaller increase of 0.6%, as compared to 25.7% in 2007.

Domestic credit growth decelerated to 6.4% in 2008 from 10.3% a year earlier, for an outstanding stock of $7,909.1 million—corresponding mainly to narrowed expansion in the Bahamian dollar component. Gains in private sector credit were nearly halved to 5.1%, as the rise in consumer debt receded to 6.5% from 10.8% and in residential mortgages, to 11.3% from 13.7%. Other private sector claims, mainly of a commercial nature, contracted by 3.3%. The increase in the banking sector's credit to the public sector moderated slightly to 12.9%, although featuring a sharply narrowed advance in net claims on Government, which was strongly mitigated by a rebound in foreign currency dominated lending to the rest of the public sector.

On the fiscal side, provisional estimates of the Government's budgetary operations indicated that, relative to the same period in FY2007/08, the overall deficit for the first six months of FY2008/09 expanded by $35.8 million (36.0%). In particular, total revenue gains of 1.9% to $621.3 million trailed the 6.7% advance in aggregate expenditure to $756.5 million. The modest 1.8% improvement in tax receipts was primarily attributed to Government's increased fee structure for various business and professional licence fees and the removal of the tax ceiling on property assessments and real estate transactions. However, trade taxes, which contributed to more than half of the total, decreased by 5.9%. Non-tax collections also rose by 2.6%, benefitting from a hike in immigration work permit fees. With regard to expenditures, recurrent outlays expanded by 6.9%, while capital spending declined by 7.8%, despite increased outlays for infrastructural developments. Also, Government's budgetary assistance to public entities grew by 40.8%.

Budgetary financing during the first half of the fiscal year was provided by way of net Bahamian dollar borrowing of $75.0 million and an $11.4 million net increase in foreign currency debt. Inclusive of net financing over the first half of the calendar year, the Direct Charge on Government advanced by 4.9% to $2,763.8 million. Inclusive of a 0.5% rise in Government's contingent liabilities, the National Debt also expanded by 4.2% to $3,200.3 million at end-2008, approximating an estimated 43.4% of GDP compared to 42.4% in 2007.

Tourism indicators suggest a moderate reduction in output during 2008, due to weak stopover and cruise trends. Total visitor arrivals decreased by more than 4.0%, extending last year's contraction of 2.9%. In particular, sea traffic, which comprised nearly 67% of the market, fell by an estimated 3.6% and air passengers weakened by more than 6.0%. Port of entry data showed that visitors to New Providence decreased by over 7.0%, explained by a double digit downturn in the sea segment and a reduction in air passengers of just under 5.0%. A similar pattern was revealed for Grand Bahama, where the overall contraction also exceeded 5.0%, due to a sharp curtailment in air visitors alongside a modest decline in sea arrivals. However, visitors to the Family Islands advanced by almost 3.0%, as a moderate increase in sea traffic offset a slump in the air segment.

Although preliminary data positioned output lower for 2008, hotel sector performance still retained cumulative growth of 5.8% in room revenues through September, due to room pricing gains, as the falloff in room night sales was already notable. However, the improvement was solely attributed to New Providence, where room receipts advanced by 10.6%, contrasting with revenue reductions of 18.7% in Grand Bahama and 6.8% in the Family Islands.

Annual inflation—measured by the change in the average Retail Price Index—accelerated to 4.5% from 2.5% in 2007. The pass-through effects of oil price increases combined with higher food costs significantly impacted domestic electricity, food, fuel, and finished goods costs. The rise in housing costs—the most heavily weighted component of the Index, quickened to 3.5% from 0.5%; the rate of increase in food & beverages nearly doubled to 6.7% and rates in excess of 1.5% were recorded for the other items in the Index.

Indications are that construction output slowed during 2008, as the downturn in tourism-led investments outweighed gains in domestic residential and commercial activity, financed by banks, insurance companies and the Bahamas Mortgage Corporation. Local mortgage loan disbursements for building projects advanced by 10.4% to $381.1 million; outlays for residential construction were higher by 10.6% at $346.2 million and commercial investments by 8.9% at $34.9 million. In tandem, mortgage commitments for new construction and repairs, a leading indicator of future economic activity, increased in number by 34.7% to 1,416, with a corresponding boost in value by 69.8% to $226.3 million. Mortgage financing also benefitted from lowered interest costs, as the corresponding residential and commercial rates softened by 10 and 40 basis points, to an average 8.50% and 8.60%, respectively.

In the external sector, the estimated current account deficit narrowed by 23.8% to $1,001.3 million during 2008. Amid a slowdown in non-oil import demand, which nearly muted the hike in the oil bill, the trade deficit widened marginally by 1.8% to $2,115.6 million. However, the services account surplus improved further, by 14.7% to $1,169.7 million, reflecting a modest curtailment in residents' overseas travel expenditures and a sharp reduction in payments for foreign construction services, given scaled-back activities on major tourism developments. Also noteworthy was the sizeable falloff in the private sector's net interest and dividend remittances, which contributed to a halving in net income outflows, to $114.0 million. Meanwhile, net current transfer receipts were higher by 13.1% at $58.6 million, as increased general government inflows coincided with a reduction in workers' net outward remittances.

On the capital and financial account, the one-fourth curtailment in private foreign investment inflows led to an 8.8% reduction in the estimated surplus, to $899.9 million in 2008. In particular, net real estate purchases decreased by a third to $229.9 million, and net private loan financing was more than halved to $186.0 million. These outweighed the 13.4% increase in net equity supported private developments, to $442.4 million. The public sector's external debt operations reverted to a net capital inflow of $104.4 million; and commercial banks' activities were also reversed to a net short-term inflow of $22.7 million.

FISCAL OPERATIONS

Improvements in revenue performance supported a reduction in the Governments' overall deficit during FY2007/08. However, preliminary indications are that this trend was reversed in the first six months of FY2008/09, as revenue gains were dampened by weakened domestic demand conditions and coincided with a firming in spending growth.

FY2007/08 Performance

Initial data for FY2007/08 revealed a narrowing in the estimated deficit, to $150.8 million from $182.8 million in FY2006/07, although still $25.5 million (20.3%) above the budget estimate. Total expenditures grew by $54.0 million (3.5%) to $1,575.0 million, placing them approximately 2.1% below budget; albeit, including a reduction in net lending to public corporations of 21.6% to $54.1 million. Revenue collections advanced by $85.9 million (6.4%) to $1,424.1 million, but were 4.0% less than projected (see Table 2).

Reflecting gains in most categories, tax receipts, at 89.0% of total revenue, rose by 5.2% to $1,267.3 million, but lagged the budgeted target by 6.2%. Posting a budgetary shortfall of 13.8%, the yield on taxes on international trade and transactions (54.8% of the total) was higher by 4.4%, owing to similar gains in import duties and associated stamp taxes. Although 17.2% below projections, selected taxes on tourism services strengthened by 15.8%, due in part to the improvement in hotel occupancy taxes. Gains in excess of initial targets were achieved for stamp taxes on financial and other transactions (13.3%) and business and professional licence fees (12.8%). However, the increase was curtailed for motor vehicle taxes (13.9%), and unanticipated reductions were registered for property taxes (8.3%) and departure taxes (3.2%).

Non-tax revenue of $156.7 million eclipsed both the previous fiscal year's level by 17.3% and the budgeted forecast by 28.1%. Approximately two-thirds of the flows represented augmented receipts from fines, forfeits and administrative fees (32.3%), outpacing a reduction in income from public enterprises and other sources (11.8%)—which includes property income.

On the expenditure side, recurrent outlays, which represented 85.3% of the total, expanded by

$58.3 million (4.5%) to $1,344.0 million in FY2007/08, but trailed the budget by 3.0%. Outlays for the purchase of goods & services and personal emoluments rose by 6.8% and 2.9%, to $288.7 million and $552.0 million, respectively. Transfer payments grew by 5.1% to $503.3 million, which was 2.4% in excess of budgeted allocations. Consistent with the growth in Government debt, interest payments advanced by 12.6% to $143.1 million, and higher payments to households (pensions and gratuities) and assistance to public corporations boosted subsidies and other transfers by 2.4% to $360.2 million.

Capital expenditures firmed by 6.3% ($10.6 million) to $176.8 million, but were 6.8% less than initial allocations. In particular, capital formation, mainly infrastructure developments, increased by 5.5% to $115.2 million and acquisition of assets, by 8.8% to $56.5 million.

Budgetary financing for FY2007/08 comprised net Bahamian dollar borrowings (mainly bonds) of $137.9 million and net foreign currency loans of $99.7 million, which included proceeds from a US$100.0 million bond issue in April.

2008/2009 Budget

The Budget for FY2008/09, which was approved by Parliament in June 2008, outlined the Government's plans to mitigate the domestic effects of the global economic slowdown, through the acceleration of its public sector capital works programme and the provision of certain tax concessions to relieve escalating food and fuel prices. Tax incentives were also proposed to encourage the "revitalization" of Nassau and the development of key sectors in certain Family Islands.

The Budget projected a 32.2% rise in the deficit and an increase in the deficit to GDP ratio, to 2.5% from 1.7% in FY2007/08. Given the higher net financing requirements, the direct debt to GDP ratio was also projected to firm by 0.5 percentage points to 35.2%.

Revenue generating measures included hikes in immigration work permit fees and annual bank licence fees, in addition to the elimination of the ceiling on real property taxes. The Government also undertook to simplify the trade tax regime by appending the stamp taxes on imports to many of the corresponding import duty rates, and introduced excise taxes from the rationalization and amalgamation of various other duties and stamp levies.

Relative to FY2007/08 targets, revenue and grants are budgeted to grow by 5.7% to $1,569.3 million, and approved expenditures—including net lending to public corporations—increased by 7.8% to $1,735.0 million.

While the revenue projections incorporated the anticipated impact of adjustments to the tax system, the Government also realigned some forecasts closer to the realized performance in FY2007/08. Under revenues, projected tax receipts rose by 4.8% to $1,416.6 million. This was due primarily to an anticipated one-third gain in stamp taxes on financial and other transactions

TABLE 2: Government's Budget (B$ Millions)

	FY2005/06	FY2006/07	FY2007/08		FY2008/09	
	Actual	Actual	Approved Estimates	Preliminary Estimates	Approved Estimates	Preliminary[1] Estimates
Government Revenue	1,221	1,338	1,484	1,424	1,569	621
Government Expenditure (i + ii+ iii)	1,327	1,521	1,609	1,575	1,735	756
i) Recurrent Expenditure	1,150	1,286	1,385	1,344	1,484	666
ii) Capital Expenditure	123	166	190	177	189	59
iii) Net Lending	54	69	34	54	62	31
Surplus/(Deficit)	(106)	(183)	(125)	(151)	(166)	(135)

SOURCE: Ministry of Finance
Compiled according to the IMF's Government Finance Statistics Format. [1] July - December, 2008

to $268.0 million—which, while buoyed by the removal of the $35,000 ceiling on amounts payable for real estate transactions, also aligned expectations closer to realized collections in the last two fiscal periods. Meanwhile, the increase in bank licence fees and projected growth in international business companies' activities are forecasted to elevate business and professional licence fees by almost one-third to $112.0 million. Revenue gains are also anticipated for property taxes, of 13.6% to $97.3 million; motor vehicle licensing, of 11.3% to $28.5 million, and departure taxes, of 10.7% to $86.2 million. Conversely, a lowering of expectations, more in line with the realized outturn for FY2007/08, resulted in a projected decline in trade taxes from the previous year's forecast, by 5.4% to $762.3 million; albeit, with a 9.8% gain expected relative to the previous year's outcome. Given a downgraded tourism outlook, the yield on selected services was curtailed by 18.8% to $45.2 million.

While non-tax receipts are projected to expand against the previous year's forecast, by 16.3% to $142.3 million, the intake is still poised to weaken by 9.2% from the FY2007/08 outcome. Reinforced by the hike in immigration fees, fines, forfeits and administrative fees are set to grow by 11.6%—although still down 13.4% from the estimated outturn; and the 27.1% projected gain for income from investment and other sources, represents a likely realized improvement of only 2.8%. Meanwhile, the Budget provided for capital revenues of $10.0 million, a carryover of the uncollected amount from FY2007/08.

Approved expenditures firmed by 6.2% to $1,672.9 million, owing to a 7.1% growth in recurrent allocations to $1,484.2 million and a 0.1% curtailment in the capital budget to $188.7 million. In addition, provisions for net lending to public sector entities rose by 80.5% to $62.2 million, although placing the amount only 14.8% higher than the preliminary estimate for FY2007/08.

Under current expenditure, consumption increased over the previous year's allotment by 6.2% to $949.0 million, with respective planned gains of 5.2% and 7.9% for personal emoluments and purchases of goods & services. Moreover, transfer payment provisions rose by 8.9%, due to a 6.0% expansion in approved subsidies and other transfers to $370.3 million, which included a boost in allocations for social assistance payments, transfers to households (gratuities and pensions) and assistance to non-financial public enterprises. Reflecting the expected growth in Government debt levels, interest payments were budgeted higher by 16.1% at $164.9 million.

Under the capital budget, allocations for infrastructural works were boosted by 21.8% to $147.0 million, targeted primarily for public works and education related projects. In contrast, proposed spending for acquisition of assets was scaled back by 41.1% to $35.1 million, and for capital transfers to non-financial public enterprises, by 42.2% to $5.5 million.

The Budget projected an overall deficit of $165.7 million, which exceeded both the FY2007/08 target and the preliminary estimate, by 32.2% and 9.8%, respectively. This outturn would correspond to a projected 2.5% of GDP. It is anticipated that funding for the deficit will consist of net Bahamian dollar borrowing of $152.2 million and net foreign currency loans of $22.7 million. The Direct Charge on Government is expected to increase by $175.0 million to approximately $2,938.8 million and the National Debt, to an estimated $3.4 billion—corresponding to respective ratios slightly above 38.0% and 45.0% of GDP.

First 6 Months of FY2008/09

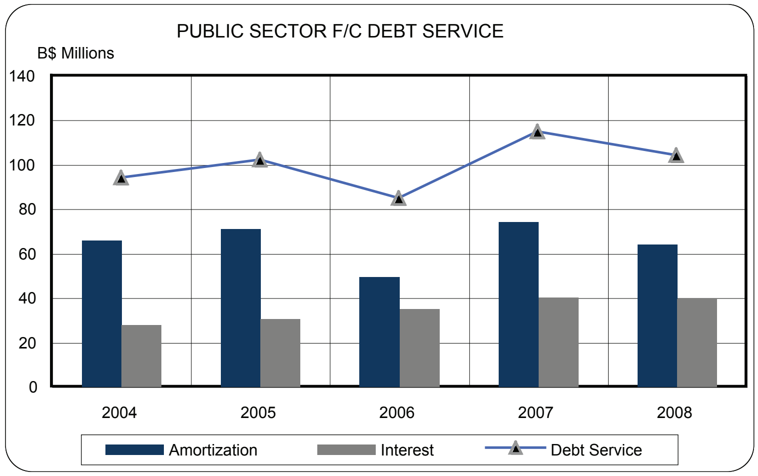
Owing to a sharper than expected slowdown in economic activity, the preliminary outcome for the first six months of FY2008/09 revealed a comparative deterioration in the overall deficit, by 36.0% to $135.2 million. While total revenue recovered by 1.9% to $621.3 million, to approach nearly 40% of the budgeted amount, expenditure recorded accelerated growth of 6.7% to $756.5 million, to approximate 43.6% of the approved target.

On the revenue side, tax receipts, which contributed nearly 91.5% of the total, grew by 1.8% to $568.4 million. Gains were registered for business and professional licence fees (9.6%) and property taxes (3.5%), alongside a more than doubling in amounts recorded under "other" as yet unallocated collections, which partially capture trends in trade taxes. However, the latter was almost fully offset by an estimated 5.9% reduction in taxes on international trade, which represented 54.4% of total receipts. The downturn in tourism contributed to reductions in departure taxes (11.7%) and taxes on tourism services (2.4%); and a decrease was registered for stamp taxes on financial and other activities (4.9%), whereas motor vehicle taxes were flat.

Non-tax revenue was higher by 2.6% at $52.8 million, led by a 3.0% rise in proceeds from fines, forfeits and administrative fees to $49.3 million, mainly corresponding to increases in immigration and work permit charges. Conversely, income from public enterprises and other sources narrowed by 1.7% to $3.1 million; and proceeds from the sale of Government property were reduced by 7.5% to $0.5 million.

The expenditure outcome included a steadied 6.9% expansion in current outlays to $666.0 million, alongside a larger retrenchment in capital spending of 7.8% to $59.0 million––both contrasting with a 40.8% widening in budgetary assistance to public enterprises to $31.5 million.

Under recurrent spending, personal emoluments, which comprised 43.0% of the total, expanded by 4.8% to $286.0 million, and purchases of goods and services rose by 4.2% to $115.0 million. Similarly, transfer payments advanced by 10.6%, with the hike in external liabilities elevating interest payments by 9.3% to $75.6 million. The subsidies and other transfers component also rose by 11.1% to $19.0 million, underpinned by strengthened assistance



to public enterprises and higher pension and gratuity payments.

Capital spending contracted, owing to a 53.3% decrease in acquisitions of assets and a 95.5% reduction in transfers to non-financial public enterprises. However, outlays on capital formation, supporting public infrastructure projects, rose by 12.9%, for 85.2% of the period's investments.

During the first six months of FY2008/09, budgetary financing consisted of a $100.0 million domestic bond issue and external drawings of $15.1 million. Scheduled amortization payments of $28.8 million serviced both Bahamian dollar ($25.0 million) and foreign currency ($3.8 million) obligations.

For calendar year 2008, the Direct Charge on Government increased by $128.3 million (4.9%) to $2,763.8 million. Bahamian dollar claims accounted for 86.1% of the total, gaining $39.5 million (1.7%) to $2,379.4 million. By

Table 3: Public Sector Foreign Currency Debt (B$ Millions)

	2006p	2007p	2008p
A. EXTERNAL DEBT	**334.0**	**326.3**	**430.6**
i) Government	289.2	272.4	383.0
ii) Public Corporations	44.8	53.9	47.6
of which Gov't Guaranteed	44.6	38.8	32.8
B. INTERNAL F/C DEBT	**302.2**	**317.6**	**405.3**
i) Government	5.0	23.2	1.4
ii) Public Corporations	297.2	294.4	403.9
of which Gov't Guaranteed	151.8	90.7	75.7
C. TOTAL F/C DEBT	**636.2**	**643.9**	**835.9**
D. DEBT SERVICE RATIO	**2.7**	**3.4**	**3.0**

SOURCE: Treasury Accounts, Treasury Statistical Printouts and Public Corporations' Quarterly Reports creditor composition, the majority of Bahamian dollar debt was held by private and institutional investors (32.0%), followed by public corporations (30.3%), domestic banks (29.2%) and the Central Bank (8.5%).

With contingent liabilities higher by $2.0 million (0.5%) at $436.5 million in 2008, the National Debt advanced by $130.3 million (4.1%) to $3,200.3 million at end-December. This follows on a year-earlier gain of $182.8 million (6.3%), and approximated 43.4% of GDP, compared to 42.4% at end-2007.

Foreign Currency Debt

During 2008, public sector foreign currency debt rose by $192.0 million (29.8%) to $835.9 million (see Table 3), as new borrowings of $256.2 million exceeded amortization payments of $64.2 million. The public corporations' obligations, which accounted for 54.0% of the total, rose by $103.2 million (29.6%) to $451.5 million; and Government's liabilities increased by $88.8 million (30.0%) to $384.4 million.

The largest share of foreign currency debt was held by commercial banks (47.8%), followed by private capital markets (35.9%), and multilateral institutions and other miscellaneous creditors (16.3%). The average maturity of the debt rose incrementally to in excess of 12 years, with over 98% of the liabilities denominated in US dollars.

Total debt service narrowed by 52.7% to $104.0 million, as amortization payments resettled nearly one-third lower following the $65 million refinancing operations of public corporations during the fourth quarter of 2007. Also, interest charges fell by $0.7 million (1.7%) to $39.7 million. As a result, debt service softened to 3.0% of exports of goods and non-factor services from an adjusted 3.4% in 2007. The ratio of Government's foreign currency debt service to total revenue narrowed to 3.4% from 3.7% last year.

REAL SECTOR

Tourism

Tourism output decreased during 2008, as recessionary conditions in the United States, the primary visitor market, adversely impacted both stopover and cruise activity. Total visitor arrivals fell by more than 4.0%, extending the 2007 decline of 2.9% (see Table 4). Sea arrivals, which accounted for 67.5% of total tourists, declined further by an estimated 3.6% vis-à-vis 4.0% a year ago; while air traffic, which mainly comprised stopover visitors, fell by in excess of 6.0%, relative to the 0.4% contraction in 2007.

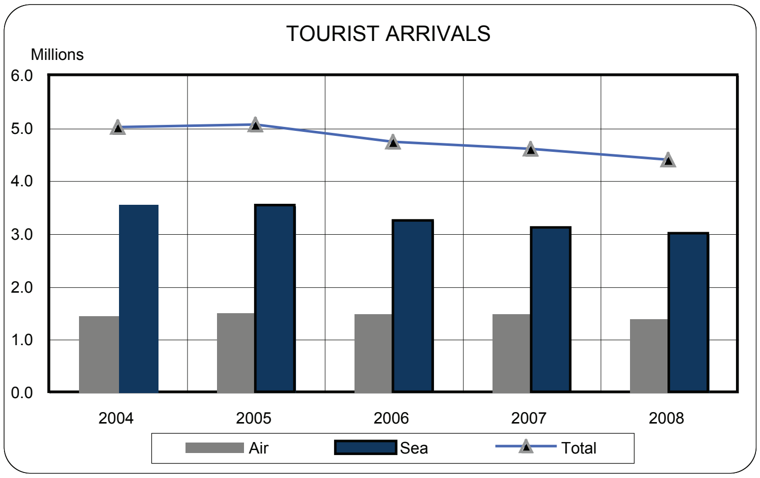
Stopover visitors fell by an estimated 4.3% to 1.46 million in 2008. Tourists from the United States decreased by 6.9% to 1.2 million, to represent a reduced 80.5% share of the total. However, the weakness of the dollar during the first half of the year supported increased travel demand from other major markets. In particular, the Canadian segment recorded an improved performance of 14.6%, corresponding to a 1.3 percentage point rise in market share to 7.9%. Also, European stopovers increased by 7.6%, for a 0.7 percentage point gain in market share to 6.4 %; albeit, visitors from Asia and other countries fell by 0.6%.

Visitor trends weakened broadly across The Bahamas' destination groupings, with total arrivals to New Providence contracting further by almost 8.0%, owing to declines in both air (4.4%) and sea (10%) passengers. Similarly, the weakness in Grand Bahama persisted, with the downswing in excess of 5.0%, based on an approximate double digit decline in air arrivals of 14.0% and a 0.9% loss in sea visitors. In contrast, visitors to the Family Islands recovered by nearly 3.0%, as a moderate uptick in the dominant sea component outpaced a more than 9.0% decline in air traffic (see Table 5).

TABLE 4: Growth in Tourist Arrivals (%)

PORTS OF ENTRY	2006	2007	2008	2008 Mkt. Share
Nassau/Paradise Island	(8.1)	(0.8)	(7.9)	56.8
Grand Bahama	(0.8)	(9.0)	(5.2)	12.7
Rest of Family Islands	17.1	(4.1)	2.7	30.5
TOTAL	**(1.0)**	**(2.9)**	**(4.5)**	**100.0**

SOURCE: The Bahamas Ministry of Tourism



Given the overall softening in visitor trends, estimated tourism output fell marginally during 2008. Following on the marked deterioration in hotel sector business during the second half of the year, and weak indications of bookings for the 2009 winter season, the industry made significant adjustments, with the elimination of some 1,241 jobs. In addition, many retained hotel employees were placed on reduced work hours. To counter the downturn in the sector, promotional activities have been intensified, led by the marketing initiatives of the Ministry of Tourism, which include the subsidization of some airline travel to The Bahamas.

Up through the first nine months of the year, however, stopover earnings were still marginally improved over 2007, with estimated hotel room receipts at major hotel properties higher by 5.8%, owing to the 9.4% appreciation in average room rates. Nevertheless, the industry's slump was evident from the 3.3% fall in room night sales. The New Providence market recorded a 10.6% advance in revenues, buoyed by an 11.7% appreciation in average nightly room rates, which countered a decline in room sales of 0.9%.

TABLE 5: Tourism Statistics

	2006	2007	2008	% Change 2007	% Change 2008
Air Arrivals	1,491,633	1,487,278	1,392,552	(0.3)	(6.4)
Sea Arrivals	3,238,974	3,114,060	3,001,020	(3.9)	(3.6)
Total	4,730,607	4,601,338	4,393,572	(2.7)	(4.5)
Occupied Room Nights*	2,225,939	2,127490	1,923,756	(4.4)	(3.3)
Hotel Occupancy*	68.4%	65.5%	56.8%	(2.9)	(7.3)
Avg. Daily Room Rate (B$)*	167.00	189.20	220.58	13.3	9.4

SOURCE: The Bahamas Ministry of Tourism
*Data for 2008 based on YTD September comparisons.

Conversely, estimated revenues for Grand Bahama and the Family Islands fell by 18.7% and 6.8%, respectively. Grand Bahama's contraction reflected losses in both average nightly room rates (7.2%) and occupied room nights (12.4%); while the Family Island outcome corresponded to a 5.6% decrease in room sales and a 1.3% reduction in nightly room rates.

Prices

Despite the moderation in fuel prices in the latter half of the year, domestic inflation accelerated to 4.5% in 2008 from 2.5% in 2007 (see Table 6), due to the pass-through effects of earlier oil price increases, including a run-up in food costs. The rise in housing costs—the largest weighted component of the Retail Price Index—quickened to 3.5% from 0.5%, and the rate of increase in food & beverages nearly doubled to 6.7%. Costs for "other" goods and services also rose, on average, at a significantly intensified pace of 7.5%; and incrementally firmer average increases were recorded for furniture & household operations (6.8%), medical care & health (5.0%), education (2.6%) and clothing & footwear (1.5%). Meanwhile, more tempered price gains were posted for transport & communications (3.0%) and for recreation & entertainment services (2.5%) costs.

Rapid cost increases in the first nine months of the year occasioned double digit firming in both diesel (40.8%) and gasoline (15.1%) prices, to $4.89 and $4.92 per gallon, respectively in 2008. The fuel surcharge in households' electricity bills, which reached a peak of 24¢ per kilowatt-hour (kWh) in August, closed the year 71.8% above the December 2007 estimate, at 19.2¢ per kWh.

Construction

Construction sector output was subdued in 2008, despite ongoing positive support from domestic residential and commercial investments. The contribution from the foreign sector was significantly less, amid the falloff in foreign investment projects, including a sharp contraction in second homes developments.

On the local front, total domestic mortgage loan disbursements for new construction and building repairs, as reported by banks, insurance companies, and the Bahamas Mortgage Corporation, expanded by 18.8% to $646.5 million. Residential financing rose by 18.2% to $586.9 million, and the commercial component was elevated by 25.8% to $59.6 million. In addition, mortgage commitments for local projects, a forward looking indicator of construction activity, were higher in number by 34.7% at 1,416 and in value, by 69.8% at $226.3 million. Residential approvals increased nearly two-thirds in value to $195.6 million, and commercial commitments more than doubled to $30.7 million.

Lending conditions were favoured by softened average interest rates for both residential and commercial loans, by 10 and 40 basis points, to 8.50% and 8.60%, respectively. For 2008, total mortgages outstanding grew by 8.1% to $3,039.3 million, although below last year's gain of 12.3%. Growth in residential mortgages, which accounted for approximately 92.8% of the total, slowed to 9.3% from 12.9%; albeit, commercial mortgages contracted by 5.4%, to reverse the 2007 expansion of 6.7%. Domestic banks originated the majority of the outstanding loans (89.8%), followed by insurance companies (6.3%) and the Bahamas Mortgage Corporation (3.9%).

TABLE 6: Average Annual Percentage Changes in Retail Price Index

New Providence
(Oct./Nov. 1995 = 100)

Group	Weight	2006	2007	2008
Food & Beverage	138.3	4.68	3.59	6.71
Clothing & Footwear	58.9	1.14	0.87	1.53
Housing	328.2	1.66	0.47	3.51
Furniture & Household Operation	88.7	2.02	5.26	6.78
Medical Care & Health	44.1	1.75	3.01	4.97
Transportation & Communication	148.4	(1.97)	3.72	3.04
Recreation, Entertainment & Services	48.7	(0.15)	3.78	2.53
Education	53.1	(0.44)	2.30	2.62
Other Goods & Services	91.6	6.74	2.80	7.54
ALL ITEMS	**1,000.0**	**1.84**	**2.49**	**4.49**

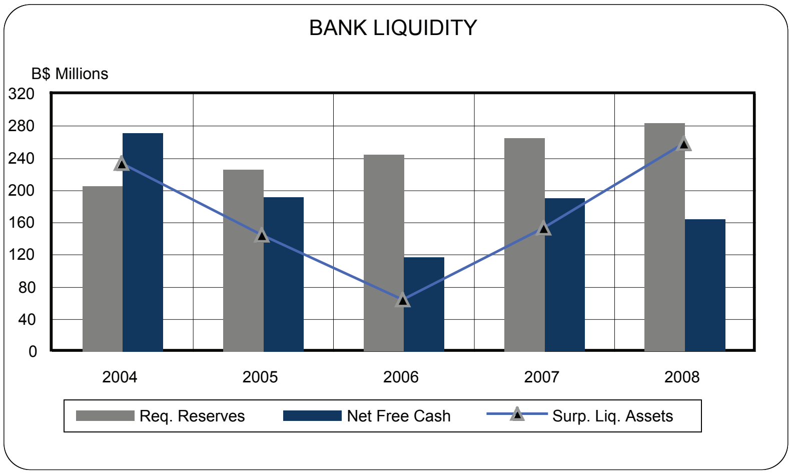
SOURCE: Department of Statistics

MONEY, CREDIT AND INTEREST RATES

Liquidity conditions remained buoyant during 2008, supported by robust net foreign currency inflows, linked mainly to public sector borrowings, and a tempering in private sector credit growth. This reinforced a reduction in the banking system's net foreign liabilities, which included a healthy recovery in the Central Bank's external reserves. However, the downturn in the local economy led to a steady deterioration in banks' credit quality indicators over the year, with the corresponding hike in loans loss provisions contributing to a reduction in overall bank profitability. Meanwhile, the average interest rate spread at domestic banks widened, as firming in the weighted average lending rate outpaced the increase in the corresponding deposit rate.

Liquidity

In 2008, average monthly liquidity, as measured by banks' net free cash balances, rose by 22.5% to $234.2 million. At year-end, balances stood at $164.0 million, compared to $190.1 million a year earlier, which corresponded to a lesser 2.9% of Bahamian dollar deposit liabilities vis-à-vis 3.6% in 2007. Average monthly surplus liquid assets—a broader measure



of liquidity—strengthened by 57.8% to $271.1 million, while the year-end excess improved by 69.4% to $257.3 million. As a result, the excess over the minimum statutory requirement increased to 28.2% from 17.7% in 2007. Peak levels were registered for free cash balances in April of $302.6 million, and in July for surplus liquid assets of $332.5 million. Both measures declined over the second half of the year, amid the seasonal gains in credit expansion.

Foreign Exchange

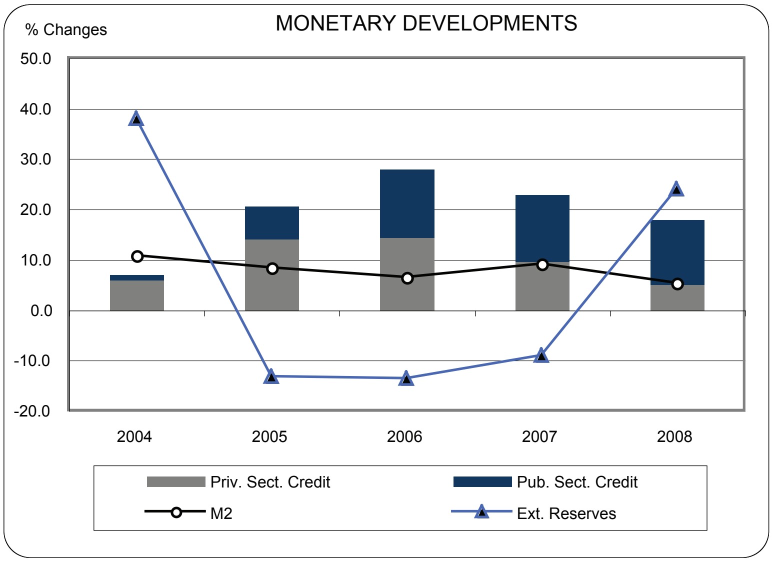
The Central Bank's net foreign currency transactions were mainly influenced by a combination of the slowdown in private sector demand and increased external borrowings by the Government. For 2008, the Bank recorded a net foreign currency purchase of $88.8 million as opposed to a net sale of $69.0 million in 2007, as total purchases widened by 43.0% to $1,017.2 million to outweigh a 19.0% rise in sales to $928.4 million. While the net purchase from commercial banks increased by $6.5 million (3.4%) to $195.7 million, a more significant influence was the rise in the net intake from Government to $240.7 million from $29.7 million, which incorporated proceeds from the US$100 million bond issue in April. In contrast, the net sale to public corporations increased by $59.8 million to $347.7 million, largely owing to the surge in oil import payments (see Table 7).

These developments culminated in a $108.7 million (23.9%) expansion in external reserves to $562.9 million, in contrast to the previous year's contraction of $45.5 million (9.1%). In line with the seasonal pattern, external reserves rose over the first four months, registering a month-end peak of $707.8 million in April. Balances contracted steadily afterwards, for an end-December close corresponding to an estimated 13.4 weeks of non-oil merchandise imports, improved from 10.0 weeks

TABLE 7: Central Bank Foreign Exchange Transactions (B$ Millions)

Period	Commercial Banks Purchases	Commercial Banks Sales	Government Purchases	Government Sales	Other Purchases	Other Sales	Total Purchases	Total Sales	Net Purch/ (Sale)
Qtr.I	202.3	23.6	51.0	42.2	1.3	71.2	254.5	137.0	117.5
Qtr.II	154.3	63.7	45.4	61.3	10.4	72.8	210.1	197.8	12.3
Qtr.III	39.8	148.2	41.7	47.5	1.6	71.1	83.1	266.9	(183.8)
Qtr.IV	76.5	48.1	81.4	38.8	5.4	91.5	163.3	178.4	(15.0)
2007	**472.9**	**283.6**	**219.5**	**189.8**	**18.7**	**306.6**	**711.1**	**780.1**	**(69.0)**
Qtr.I	137.6	51.0	101.4	32.2	51.5	126.0	290.5	209.3	81.3
Qtr.II	140.4	55.6	221.4	86.8	24.4	113.9	386.2	256.3	129.9
Qtr.III	111.2	76.1	66.3	49.8	56.2	137.9	233.8	263.9	(30.0)
Qtr.IV	50.2	60.9	54.9	34.6	1.5	103.5	106.7	199.0	(92.3)
2008	**439.4**	**243.7**	**444.1**	**203.4**	**133.7**	**481.3**	**1,017.2**	**928.4**	**88.8**

SOURCE: The Central Bank of The Bahamas



in 2007. By law, the Central Bank is required to keep, at a minimum, external reserves equivalent to 50.0% of its demand (currency and deposit) liabilities. After discounting the external balances for this amount, "useable" reserves stood at $233.0 million, more than double the $104.5 million recorded in December 2007.

Money Supply

Overall money growth slowed in comparison to 2007, amid more tapered accretions to public corporations' and private sector deposits. Narrow money (M1), which comprises 21.5% of the overall stock, fell by $25.8 million (2.0%), in contrast to a $49.2 million (3.9%) strengthening in 2007. This was due to downturns in both currency in active circulation and demand deposits, of 8.0% and 0.7% respectively, with the latter corresponding to lower holdings by private and institutional depositors and public corporations.

Broad money (M2) expansion slackened to $285.4 million (5.2%) from $451.3 million (9.1%) in 2007. In particular, savings deposit growth abated to 2.9% from 4.1%, while fixed deposit gains narrowed to 9.0% from 13.1%, partly owing to diminished accumulations by businesses and public corporations.

Foreign currency deposits also registered a reduced increase of 0.6%, compared to 25.7% ($40.9 million) in 2007. As a result, overall money (M3) growth moderated to $286.7 million (5.1%) from $492.2 million (9.6%) in 2007, placing the stock at $5,924.0 million.

Inclusive of the Government's placements, residents' total Bahamian dollar deposits at domestic banks totalled $5.6 billion. Fixed balances accounted for the largest share of the total (62.1%), followed by demand (19.8%) and savings (18.1%) deposits. By holder, the largest share of deposits was held by private individuals (58.6%), with the remainder concentrated among business firms (24.3%), the public sector (9.9%), "other" (mainly institutional) depositors (3.9%) and private financial institutions (3.3%). An analysis of deposits by value and number of accounts showed that balances of up to $10,000 constituted 90.7% of the accounts, but only 7.0% of the aggregate value; those valued between $10,000 and $50,000, 6.3% of the contracts and 12.1% of the liabilities; and accounts over $50,000, 80.9% of the aggregate value, yet only 3.0% of the number of accounts.

Domestic Credit

The pace of domestic credit expansion was curtailed to $474.8 million (6.4%) from $691.4 million (10.3%) in 2007, amid a softening in economic activity and as banks responded to the increased incidence of credit risk. The advance in the Bahamian dollar component fell sharply to $449.4 million (6.7%) from $771.4 million (13.0%) in 2007; however, given renewed activity by public corporations, foreign currency credit rebounded by $25.3 million (3.5%) from an $80.0 million (9.8%) reduction a year earlier.

Private sector credit growth, paced at $549.7 million (9.7%) in 2007, abated to $318.4 million (5.1%) in 2008. Personal loans, at a dominant 71.3% of outstanding claims, increased by a reduced $371.1 million (8.0%) compared with $540.0 million (13.2%) in 2007 (see Table 8). A disaggregation of this category revealed that growth in residential mortgages remained relatively robust, although slightly lower at 11.3%; whereas, after double digit hikes of 11.7% in 2005 and 14.5% in 2006, gains in consumer credit

TABLE 8: Flow of Credit In The Financial System (B$ Millions)

	Outstanding as at 2006	Absolute 2007	Changes 2008	Outstanding as at 2008
DESTINATION				
Government (net)	677.0	189.8	57.2	924.0
Central Bank	182.5	149.8	(133.5)	198.8
Domestic Banks	494.5	40.0	190.7	725.2
Rest of Public Sector	397.2	(48.1)	99.2	448.3
Central Bank	8.1	(0.6)	(0.2)	7.3
Domestic Banks	389.1	(47.5)	99.4	441.0
Private Sector	5,668.7	549.7	318.4	6,536.8
FINANCING				
Liabilities	5,145.1	492.2	286.7	5,924.0
Currency	202.1	21.6	(17.9)	205.8
Demand deposits	1,182.1	45.2	(25.5)	1,201.8
Savings deposits	956.9	38.2	29.0	1,024.1
Fixed deposits	2,804.0	387.2	301.1	3,492.3
International reserves	499.8	(45.5)	108.7	562.9
Other net external liabilities ( ) = increase	(754.1)	86.6	(36.2)	(703.8)
Capital and surplus	1,481.9	175.9	209.8	1,867.6
Other (net)	138.5	(64.3)	(50.8)	23.4

SOURCE: The Central Bank of The Bahamas

subsided to 6.5%—almost equivalent to the 2004 rate. However, there was increased reliance on overdraft facilities, which rose strongly by 33.8% ($27.5 million).

A further analysis of consumer loans—which account for 34.3% of private sector credit—revealed that the largest expansion occurred for debt consolidation ($98.3 million) and credit cards ($37.4 million), both indicative of elevated financial stress among households. Notable net lending was also registered for land purchases ($18.9 million), home improvement ($8.4 million) and education ($2.5 million), in contrast to net repayments for "miscellaneous" loans ($17.3 million), private cars ($9.4 million), travel ($1.4 million) and furnishings & domestic appliances ($1.2 million).

The other components of private sector credit, mainly representing claims for commercial activities, contracted overall by $51.9 million (3.3%), after a gain of $40.2 million (2.6%) in 2007. Rebounded or larger net lending for "miscellaneous" loans ($21.3 million), professional & other services ($18.4 million), agriculture ($3.7 million) and transport ($3.4 million) were countered by net repayments for tourism ($32.3 million), distribution ($16.8 million), construction ($14.2 million), manufacturing ($11.4 million), private financial institutions ($7.0 million), mining & quarrying ($5.6 million) and fisheries ($0.8 million) (see Table 9).

The increase in the banking sector's net claims on the public sector firmed slightly to 12.9% ($156.4 million) in 2008. In particular, claims on the public corporations rebounded by 28.4% ($99.2 million), following a 12.1% ($48.1 million) contraction in the previous period. This outweighed a significantly tempered advance in net credit to Government of 6.6% ($57.2 million).

Interest Rates

During 2008, the weighted average spread on domestic banks' loans and deposits widened by nine (9) basis points to 7.03%. This corresponded to a 32 basis point increase in the average loan rate to 10.95%, which exceeded the 23 basis point rise in the average deposit rate to 3.92%.

With regard to lending, the largest firming was recorded for consumer loans, of 33 basis points to 13.03%. Similarly, the average residential mortgage and overdrafts rates advanced by 20 and 1 basis point, to 8.36% and 11.45%, respectively. In contrast, the average commercial mortgage rate softened by 3 basis points to 8.72%. For deposits, the average savings rate trended higher by 15 basis points to 2.20%. Buoyed by higher rates for shorter term maturities, the ranges for fixed deposits tightened to 3.70%-4.56% from 3.51%-4.52% in 2007.

TABLE 9: Sectoral Distribution of Bank Credit (B$ Millions)

Sector	2007 $	2007 %	2008 $	2008 %
Agriculture	11.2	0.2	15.0	0.2
Fisheries	10.7	0.2	9.9	0.1
Mining & Quarrying	7.1	0.1	1.5	0.0
Manufacturing	52.5	0.8	41.1	0.6
Distribution	195.4	3.0	178.6	2.6
Tourism	244.8	3.7	212.5	3.0
Entertainment & Catering	47.0	0.7	36.4	0.5
Transport	24.8	0.4	28.2	0.4
Construction	460.2	7.0	446.0	6.4
Government	120.3	1.8	145.8	2.1
Rest of Public Sector	243.9	3.7	343.5	4.9
Private Financial Institutions	27.2	0.4	20.2	0.3
Professional & Other Services	149.6	2.3	168.0	2.4
Personal	4,618.0	70.5	4989.1	71.3
Miscellaneous	340.2	5.2	361.5	5.2
TOTAL	**6,553.0**	**100.0**	**6,997.3**	**100.0**

SOURCE: The Central Bank of The Bahamas

Among other key rates, the average 90-day Treasury bill rate firmed by seven (7) basis points to 2.73%; however, benchmark rates—the Central Bank's Discount Rate and commercial banks' Prime—remained unchanged at 5.25% and 5.50%, respectively.

Net Foreign Assets

As shown in Table 10, the banking system's net foreign liabilities contracted in 2008, by $72.5 million (34.0%) to $140.9 million. In particular, the Government's elevated net external borrowing alongside tempered private sector demand supported a $108.7 million (23.9%) boost in the Central Bank's external reserves to $562.9 million. This outpaced the $36.2 million (5.4%) increase in domestic banks' net foreign liabilities to $703.8 million, earmarked mainly for financing public sector requirements.

Credit Quality

The incidence of loan servicing difficulties among private borrowers, which escalated during the closing months of 2008, underpinned a steady deterioration in domestic banks' credit quality indicators. The total value of private sector loans encountering payment arrears of at least 30 days rose broadly by $235.8 million (44.0%) to $771.8 million, corresponding to an arrears rate of 12.5% relative to 9.4% in 2007 and 7.8% in 2006. Non-performing loans, those with payments past due of more than 90 days and on which banks have stopped accruing interest, rose to 6.1% of the total loan portfolio, up from 4.5% in 2007 and 4.2% in 2006.

The most significant deterioration was in residential mortgages, where the value of the affected facilities rose by more than a third to $364.0 million—equal to a 2.8 percentage point increase in the arrears rate to 13.2%. Consumer loans arrears increased by 39.6% to $240.0 million, representing 10.8% of the respective portfolio, compared to 8.3% in 2007. Similarly, the value of commercial loan arrears escalated to $161.0 million from $94.0 million in 2007, which corresponded to a higher arrears rate of 15.5% vis-à-vis 9.3%.

In response to these trends, domestic banks increased loan provisions by 40.2%, which equates to 2.7% of total claims relative to 2.1% in December 2007. However, the ratio of provisions to non-performing loans fell by 2.0 percentage points to 46.0%.

Bank Profitability

The rise in bad debt provisions, combined with weaker income streams and increased operating costs, led to reduced bank profitability during 2008. The latest data for the twelve-months to September 2008 revealed a comparative decline in estimated net income of $18.4 million (6.0%) to $289.2 million.

Banks' net interest margin improved, but by a reduced amount of $22.1 million (4.9%) to $472.5 million, based on a 2.9% increase in interest income and a 0.2% contraction in interest expense. However, commission and foreign exchange income fell by 14.8% to $30.1 million. In an offset, the operating expenses for the period rose at a moderately firmer pace of 9.5% to $253.1 million, mainly due to the upturn in staffing and occupancy costs. The contribution from "other" income (net of depreciation and bad debt expenses) was lower by 25.2% at $39.7 million, owing to a sharp run-up in provisions for bad debts.

Profitability ratios also softened against average domestic assets, with the net income (return on assets) ratio reduced to 3.31% from 3.81% in 2007. The gross earnings margin fell by 28 basis points to 5.74%, corresponding to the respective 19 and 9 basis point shrinkage in support from the net interest margin, to 5.40%, and in commissions & fee income, to 0.34%. Likewise, the operating cost ratio, relative to average assets, rose by three (3) basis points to 2.89%; while the positive contribution from "other" (net) income decreased by 20 basis points to 0.46%.

TABLE 10: Foreign Asset Position (B$ '000)

	2006	2007	2008
1. THE CENTRAL BANK			
EXTERNAL RESERVES (Beginning of Yr.)	578,796	499,762	454,235
a. SALES TO:			
i) Commercial Banks	319,364	283,612	243,677
ii) Government	152,974	189,815	203,379
iii) Other Customers	282,672	306,637	481,342
Total Sales	755,010	780,064	928,398
b. PURCHASES FROM:			
i) Commercial Banks	368,276	472,878	439,422
ii) Government	220,773	219,508	444,064
iii) Other Customers	68,723	18,717	133,665
Total Purchases	657,772	711,103	1,017,151
c. Reserve Tranche	470	436	(250)
d. SDR Tranche	4	77	(23)
e. Other	17,730	22,921	20,213
INCREASE/(DECREASE)	(79,034)	(45,527)	108,693
EXTERNAL RESERVES (End of Yr.)	499,762	454,235	562,928
2. DOMESTIC BANKS			
NET FOREIGN ASSETS (Beginning of Yr.)	(611,037)	(754,119)	(667,553)
a. Foreign Exchange Transactions	(14,963)	945	2,832
i) Net Purch/(Sale): Central Bank	(48,912)	(189,266)	(195,745)
ii) Net Purch/(Sale): Other Customer	33,949	190,211	198,577
b. Changes in Local Liabilities	696,415	779,296	661,245
c. Changes in Local Assets	839,497	692,730	697,472
INCREASE/(DECREASE) (During Yr.)	(143,082)	86,566	(36,227)
NET FOREIGN ASSETS (End of Yr.)	(754,119)	(667,553)	(703,780)
3. TOTAL NET FOREIGN ASSETS (End of Yr.)	(254,357)	(213,318)	(140,852)

SOURCE: The Central Bank of The Bahamas

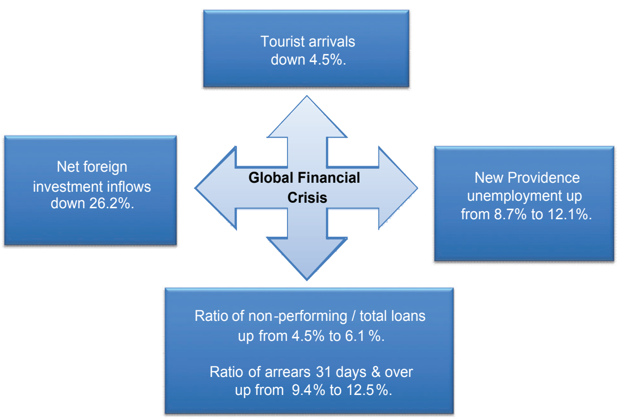
CAPITAL MARKETS DEVELOPMENTS

In line with softened economic trends, domestic equity valuations declined during 2008, with a falloff in trading volume, on an adjusted basis. The Bahamas International Securities Exchange's (BISX) All Share Price Index fell by 17.2% to 1,712.36 points, and the corresponding market capitalization, by 31.7% to $2.7 billion. After adjusting for the significant ownership change in a utilities company, trading volumes on BISX contracted by 3.1% to 4.6 million shares, but the value appreciated by 11.7% to $31.6 million. Companies trading publicly on BISX totalled 24, compared to 19 a year ago—inclusive of 19 common share listings, one preference share listing and four debt tranches. The broader Fidelity Capital Market Limited's Index (Findex)—which captures over-the-counter trading—fell by 11.0% to 834.83 points for the year.

Box I: Monetary Policy Formulation in 2008

During the year, the Central Bank remained focused on providing adequate support for the fixed exchange rate regime and maintaining the stability of the financial system. In this regard, deliberations of the Bank's Monetary Policy Committee were influenced by the global financial crisis and its impact on the Bahamian economy, mainly via the tourism and foreign investment channels. The Committee noted the decline in overall tourism activity, as well as the contraction in foreign direct investment inflows, due to the postponement of a number of tourism investment projects, which led to restrained construction activity and a firming in job losses (see Chart 1).

Chart 1: Domestic Impact of the Global Financial Crisis



Source: Department of Statistics and the Central Bank of the Bahamas

Faced with a worsening economic scenario, the Bank closely monitored the impact of these external shocks on the country's foreign exchange reserves and the performance of key financial sector aggregates in its determination of monetary policy.

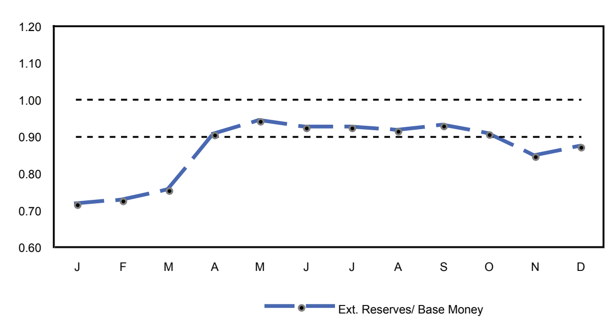
As illustrated in Chart 2, over the year, the principal reserve performance indicator tracked by the Central Bank, the ratio of reserves to base money,[1] remained within the established limits of 90% to 100% for the majority of the review period, with modest deviations occurring in the first and last quarters. In the first six months, tourist receipts were relatively strong and, together with public sector borrowings, boosted external reserves. Consequently, the ratio of reserves to base money rose to its highest level in May. In the following months, despite a reduction in both tourist arrivals and foreign investment inflows, when compared to the same period a year earlier, the usual increase in demand which occurs to support import purchases—particularly in the pre-Christmas period—moderated. As a result, external reserves fell by $111.9 million between June and December compared to a contraction of $188.6 million a year-earlier.

As the downturn deepened, as evidenced by the rise in unemployment, the incidence of loan delinquencies increased among commercial bank consumers, resulting in a steady deterioration in asset quality indicators throughout the year. The Bank continued to monitor these developments closely, and enhanced its dialogue with institutions to ensure adherence to established prudential requirements. In addition, through a number of communications, the Bank encouraged the public to be more conservative in their spending and to avoid excessive increases in their debt levels.

In concert with these measures, the Government introduced a series of measures to stimulate the economy and to provide an increased social safety net for vulnerable groups adversely affected by the crisis. In particular, the Government proposed to accelerate the implementation of several capital projects, such as road improvements and the redevelopment of the Nassau International Airport. As these projects will be financed mainly in foreign currency, it is expected that the projected increase in the fiscal shortfall will not have a significant negative impact on the Central Bank's external reserves.

These policies, taken in their entirety, have focused on ensuring that external reserves remain at sustainable levels and that the financial system is resilient in the face of the financial and economic crisis. Going forward, the Bank will continue to monitor key performance indicators in its determination of future monetary policy.

CHART 2: MONTHLY RATIO OF EXT. RESERVES TO BASE MONEY (2008)



1 The Bank also tracks the ratio of reserves to M2 and the imports in its import reserve cover statistic.

INTERNATIONAL TRADE AND PAYMENTS

During 2008, the estimated current account deficit narrowed by 23.8% to $1,001.3 million, partly reflecting the slowdown in non-oil import demand, scaled-back use of foreign expertise on construction projects and the reduction in private sector income remittances. On the capital side, the curtailment in private foreign investment inflows led to a contraction in the surplus on the capital and financial account, by 8.8% to $899.9 million (see Table 11).

The estimated trade deficit widened marginally by 1.8% to $2,115.6 million, after a 3.6% increase in 2007. Reflecting the slowdown in consumer demand, the non-oil deficit improved by 17.5% to $1,355.6 million, although the surge in international oil prices in the first half of 2008 enlarged the fuel bill by 37.9% to $1,061.1 million. Double digits gains were registered for all the major oil product categories. The per barrel price of propane gas increased by 17.5% to $74.8; motor gas, by 26.3% to $114.97; aviation gas, by 27.0% to $162.17; jet fuel, by 35.2% to $137.50; bunker 'C', by 56.6% to $90.33 and gas oil, by 51.0% to $123.8

The surplus on the services account improved further by an estimated 14.7% to $1,169.7 million. Net travel receipts firmed by 2.2% to $1,848.6 million, as residents' overseas travel expenditures adjusted downwards amid the general weakening in economic conditions, and paced ahead of the estimated decrease in tourism inflows. The surplus also benefited from a decline in "other" net external payments of 18.5% to $433.9 million, owing to a significant abatement in payments for foreign construction services, associated with scaled-back tourism-related developments. The net payment for insurance services fell by 1.1% to $105.9 million, while reduced payments for freight and port charges contracted net transportation outflows by 4.5% to $301.7 million; and net inflows for offshore companies' local expense firmed by 4.1% to $218.9 million. However, the net outflows for Government rose by 25.6% to $56.3 million.

Net income outflows were approximately halved to $114.0 million. In particular, net repatriation of labour income narrowed by 30.7% to $58.7 million. Additionally, net investment income remittances decreased by almost two-thirds to $55.3 million, as the significant reduction in net interest and dividend outflows by non-bank entities, outweighed elevated profit remittances by commercial banks. The public sector's interest earned on the external reserves, net of external debt costs, narrowed to $2.1 million from $7.5 million in 2007, owing to the coincidence of a decrease in the Central Bank's income and higher interest payments by Government.

Net current transfers were boosted by 13.1% to $58.6 million, as net inflows for general government rose by 7.5% to $65.5 million, while net workers' remittances fell by 21.2% to $8.1 million.

The estimated surplus on the capital and financial account narrowed by $86.6 million (8.8%) to $899.9 million. Migrants' net capital transfers rose by 0.8% to $76.3 million, but continued to be dominated by the surplus on the financial account, which decreased by $86.1 million (8.1%) to $976.2 million. In particular, net private investment inflows fell by a quarter to $858.3 million, owing to a one-third reduction in net real estate purchases to $229.9 million and in net loan proceeds, to $186.0 million from $417.4 million in 2007. These surpassed the 13.4% increase in net equity inflows to $442.4 million. Private residents' net portfolio outflow increased two-fold to $9.2 million.

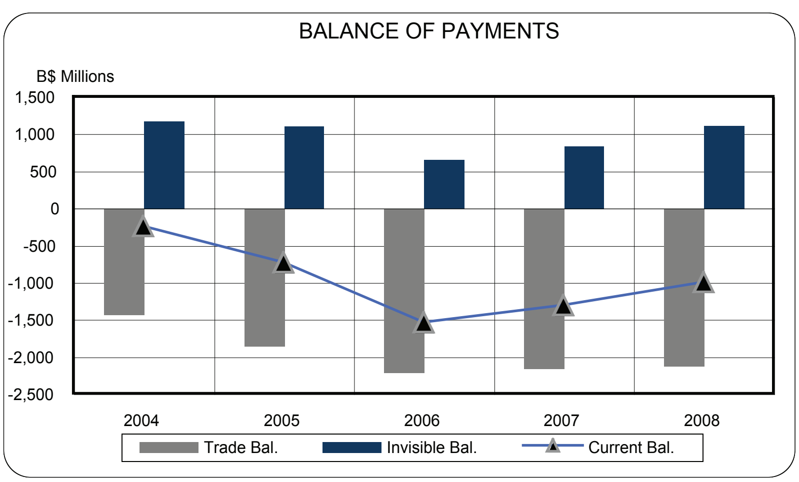


TABLE 11: Balance of Payments Summary (B$ Millions)

	2006p	2007p	2008p
I) CURRENT ACCOUNT	(1,373.9)	(1,314.5)	(1,001.3)
i) Merchandise Trade (net)	(2,033.1)	(2,154.4)	(2,115.6)
Exports	694.2	801.9	953.1
Imports	2,727.3	2,956.3	3,068.6
ii) Services (net)	825.2	1,019.7	1,169.7
Travel	1,671.2	1,809.8	1,848.6
Transportation	(301.1)	(315.7)	(301.7)
Other	(544.9)	(474.4)	(377.2)
iii) Income (net)	(218.0)	(231.6)	(114.0)
Compensation of Employees	(92.8)	(84.7)	(58.7)
Investment Income	(125.2)	(146.9)	(55.3)
iv) Current Transfers (net)	52.0	51.8	58.6
Government	58.3	60.9	65.5
Private	(6.3)	(9.1)	(6.9)
II) CAPITAL AND FINANCIAL ACCOUNT	1,216.7	986.6	899.9
i) Capital Account (Transfers)	(63.5)	(75.7)	(76.3)
ii) Financial Account	1,280.2	1,062.3	976.2
1. Direct Investment	706.4	746.2	672.3
2. Portfolio Investment	(18.8)	(8.3)	(9.2)
3. Other Investment	592.6	324.4	313.1
Central Gov't.	2.7	(15.4)	110.6
Other Public Sector	(6.2)	9.0	(6.2)
Banks	143.1	(86.6)	22.7
Other	453.0	417.4	186.0
III) NET ERRORS AND OMISSIONS	78.2	282.4	210.1
IV) CHANGE IN EXTERNAL RESERVES ( ) = increase	79.0	45.5	(108.7)

SOURCE: The Central Bank of The Bahamas

The public sector's external debt transactions, which were dominated by the Government's bond issue, featured a net borrowing of $104.4 million as compared to the $6.4 million net repayment in 2007. Similarly, the commercial banks' position was reversed, to a $22.7 million increase in net external liabilities, following a net decrease of $86.6 million in 2007.

After adjusting for net errors and omissions, the overall balance, which corresponds to the change in the Central Bank's external reserves, reverted to a surplus of $108.7 million from a deficit of $45.5 million in 2007.

INTERNATIONAL ECONOMIC DEVELOPMENTS

The global financial crisis, which originated with the collapse of the sub-prime market in the United States in 2007, intensified during 2008, triggering a global economic recession, with rising unemployment and mounting consumer and business uncertainty outweighing the benefits of retreating inflation. As a result, the IMF estimates that world economic growth moderated to 3.4% in 2008 from 5.2% in 2007, characterized by a significant slowdown in international trade growth. Average global inflation began to ease towards the close of the year, as fuel and commodity prices softened, mainly in response to declining demand fundamentals. In the major economies, both monetary and fiscal policies became aggressively expansionary, in a bid to jumpstart tight credit markets and stimulate a recovery in aggregate demand. The limited success of these interventions underlined the persistent volatility of the major stock markets, which declined sharply during the year, shifting investment demand towards the relative safety of US government debt and precious metals. Consequently, the United States Dollar rallied strongly against several major currencies, and gold prices firmed to near historic levels. Oil and other commodity prices, however, fell significantly over the year, reflecting the sharp decline in consumer demand.

In the advanced economies, real GDP growth slackened to an estimated 1.0% from 2.7% in 2007. Revised assessments suggest that the United States entered a recession in December 2007, with real output growth lower at 1.1%

in 2008 from 2.0% in 2007, and notwithstanding the final period's annualized contraction of 6.2%. Despite the fiscal stimulus payments to households in the spring, the economy continued to be plagued by declines in personal consumption expenditures, exports, and residential investments. Amid a deterioration in the banking sector, which led to tightened liquidity and credit conditions, the United Kingdom also lapsed into a recession in the latter half of 2008, as output contracted by 0.6% and 1.5% in the third and fourth quarters. Consequently, the estimated annualized expansion in real output narrowed to less than 1.0%, from 3.0% in 2007. Recessionary conditions were also experienced in the euro zone, especially in the second half of 2008, as lower levels of consumption expenditure and investments occasioned a contraction in real GDP, by 0.2% in the third quarter and by 1.5% in the final three months of the year. The decreased demand stimulus in the United States and Europe underpinned weakness in Japanese exports and industrial production, contributing to continued output decline over the last three quarters of the year and a 0.7% falloff for 2008, after growth of 2.4% in 2007.

Although China maintained a healthy growth momentum, estimated at 9.0% in 2008, this was a notable slowing from the 13.0% achieved in 2007, mainly reflecting weakened export growth, amid deteriorated overseas demand conditions. In Latin-America and the Caribbean, the expansionary pace weakened to an estimated 4.6% from 5.7% in 2007, with the Caribbean mainly impacted by a slowdown in tourism demand.

During 2008, the average unemployment rate in the advanced economies trended upwards to 6.0% from 5.1% in 2007, as the increased spate of bankruptcies and growing economic uncertainty, forced companies to downsize their workforces. In the United States, the unemployment rate rose by 2.2 percentage points to 7.2%, as private and public entities shed approximately 1.9 million workers, with the majority of job losses concentrated in the construction, manufacturing and service sectors. After a 1.4 million increase in the number of unemployed, the euro zone's unemployment rate moved higher by 0.8 percentage points to 8.0% in 2008, with Spain experiencing a 5.4 percentage point hike to 14.4%, the highest among member states. The United Kingdom's jobless rate was extended to 6.3% from 5.2% a year earlier, with the majority of the redundancies occurring in the manufacturing, hospitality and financial services sectors. China's unemployment rate edged up to 4.2% from 4.0%, as demand for exports fell significantly over the year; while Japan's rate rose by 0.6 percentage points to 4.4%, reflecting declines in both exports and business investments.

As demand conditions weakened, food and energy prices moderated strongly during the second half of the year, contributing to a lowering in average inflation in the advanced economies. In the United States, escalating energy costs elevated average consumer price inflation to a peak of 5.6% in July; thereafter, pressures eased, as fuel prices declined sharply in the face of softened domestic demand, bringing the annual rate lower at 0.1% at end-2008 from 4.1% in 2007—the smallest annual increase since 1954. Similarly, inflation in the euro zone was nearly halved to 1.6% in 2008, with rates in both France and Germany, the two largest economies, tapered by 2 percentage points to 1.2% and 1.1%, respectively. In Japan, price instability was fuelled by surging commodity prices, which resulted in inflation rising as high as 2.3% in the first seven months of the year. However, owing to subsequently declining commodity prices and weakening economic activity, inflation softened, on a year-on-year basis, to 0.4% from 0.7% in 2007. Conversely, higher costs for food and housing contributed to firming in China's consumer price inflation, to 5.9% in 2008 from 4.8% in 2007. Average inflation in the United Kingdom also advanced, by 1.0 percentage point to 3.1%, with price gains concentrated in the housing & household services and food & beverages areas.

The general uptrend in global commodity prices, which persisted for six consecutive years, was significantly reversed in 2008. Over the first half of the year, the per barrel price of oil trended upwards to an end-June peak of $147.50, as markets adjusted pricing to offset the declining US dollar, rising demand from emerging economies and political tensions, which restricted supplies. Amid the ensuing global economic crisis, slump in demand

and the recovery of the dollar, the price of crude oil collapsed, to end the year at $39.53 per barrel—58.4% lower than at end-2007. During the year, investors sought to increase their holdings of relatively "safe" assets, such as gold, as a hedge against the turbulence in the financial markets, resulting in an increase in prices, by 5.8% to $882.05 per troy ounce. In contrast, silver prices declined by 23.0% to $11.39 per troy ounce.

Faced with significant downside risks to economic growth, major central banks implemented aggressive, and sometimes coordinated, monetary measures, aimed at restoring stability to the financial markets and stimulating a recovery in demand. These supplemented more than $2 trillion in fiscal stimulus from OECD countries and China, which included tax reductions, significant guarantees of bank deposits and efforts to recapitalize weak and failing financial institutions. In the United States, the Federal Reserve (Fed) swiftly loosened monetary policy, cutting the federal funds rate six (6) times and the discount rate on eight (8) separate occasions. By year's end, the target federal funds rate reached an historic low, in the range of 0%-0.25%, and the discount rate settled at 0.50% compared to the respective end-2007 levels of 3.00% and 3.50%. The Fed also intensified its liquidity support to credit markets, injecting almost $1 trillion into domestic financial markets during the year.

Elsewhere, in a bid to restore the flow of credit and temper the downside risks to the United Kingdom's economy, the Bank of England lowered its bank rate, by a total of 3.5 percentage points to 2.00% by end-December. Similarly, in the second half of the year, the European Central Bank switched from an anti-inflationary to an expansionary posture, cutting its main policy rates by a total of 1.25 percentage points by year's end. In Japan, where interest rates were already at low levels relative to other advanced countries, the central bank reduced its overnight call rate, for the first time in seven years, from 0.5% to 0.3% in October; and followed up with another decrease in December, to a target of virtually zero. The People's Bank of China's posture also shifted from tightening in the first half of the year to accommodation in the second half, reducing commercial banks' reserve requirement ratio by 2 percentage points to 15.5% and the central bank's benchmark lending and excess deposits rates, by 2.16 and 1.89 percentage points to 5.31% and 2.25%, respectively.

During 2008, currency market developments were swayed by the rapid deterioration in financial markets during the second half of the year, which ignited a resurgence in the attractiveness of relatively safe US Dollar denominated assets. On an annual basis, the US dollar therefore rallied by 26.3% against the British pound to £1.43; relative to the Canadian dollar, by 22.2% to CDN$1.22; and vis-à-vis the euro, by 4.2% to €1.40. After declining by 12.4% against the Swiss Franc in the first quarter of 2008, the dollar partially recovered, to check the annual decline at 5.6%, to CHF1.07. Conversely, amid preliminary indications that the Asian financial sector was not as severely affected as other regions, the dollar depreciated by 18.8% against the Japanese yen to a 13-year low of ¥90.68, and by 6.5% value vis-á-vis the Chinese currency, to 6.83 yuan.

As investors responded to reports of sharp declines in corporate earnings, ongoing bankruptcies in the financial sector and government-sponsored bailouts of a number of large firms, global stock market indices exhibited significant volatility during 2008. The Morgan Stanley All Country World Index, a measure of global stock prices, fell by 43.4% over the year to 117.21 points by December-end. In the United States, the S&P 500 index slumped by 40.2% to 903.3 points and the Dow Jones Industrial Average (DJIA), by 33.8% to 8,776.39 points, the lowest levels recorded since 2003. Similarly, in Europe, France's CAC 40 index plummeted by 42.7% to 3,217.97 points; Germany's DAX index, by 40.4% to 4,810.20 points and the United Kingdom's FTSE 100 index, by 31.3% to 4,434.17 points. In Japan, the NIKKEI 225 closed near a 26 year low, off by 42.1% to 8,859.56 points; while China's Shanghai SE Composite index receded by 65.4% to 1,820.80 points.

The slowdown in global economic growth and the surge in oil prices had mixed effects on the major economies' trade balances. For the United States, the trade deficit narrowed by $23.2 billion to $677.1 billion, as the 12.0% increase in exports of goods and services outpaced a 7.4% expansion in imports. Led by improvement in the surplus on services trade, which negated the deterioration in the goods deficit, the United Kingdom's trade deficit contracted by just over 1% to £46.1 billion in 2008. For the euro area, the trade balance switched to a record deficit of €32.1 billion from a surplus of €15.8 billion in 2007, owing to the softness in exports and the high cost of imported fuel. Despite a slowdown in export growth, in the latter half of the year, China's trade surplus improved by 12.5% to US$295.5 billion in 2008; albeit, balances started to shrink in the closing months of the year. Meanwhile, Japan experienced a reduction in exports, for the first time in 7 years, which sharply contracted the goods and services surplus, by 81.7% to ¥18.0 trillion in 2008.

The eighteenth meeting of the International Monetary and Financial Committee (IMFC) of the Board of Governors of the International Monetary Fund was held on October 11, 2008, in Washington D.C. During its deliberations, the Committee acknowledged that the spread of the financial crisis across advanced and developing countries necessitated the implementation of bold and coordinated policy actions. The Committee asserted that, in this regard, the IMF was mandated and ably positioned to foster multilateral cooperation between countries in devising policy responses, and to provide emergency funding for the restoration of global monetary and financial stability.

OPERATIONS

GOVERNANCE

The Board of Directors of the Central Bank, which is chaired by the Governor, is responsible for the policy and general administration of the Bank. Changes to the Central Bank Act, 2000 (CBBA) in 2008, expanded the number of non-executive directors on the Board, to four from two. As mandated by statute, the Board met monthly during the year.

In July 2008, the Bank welcomed the reappointment of Mr. Gregory Cleare and the appointments of Mr. Lennox McCartney and Dr. Duane Sands as external Directors. The Bank extends its gratitude to Mr. Vincent Vanderpool-Wallace, who served as a Director prior to his appointment in 2008 as a Senator and Minister of Tourism and Aviation.

The Bank's Management Committee, which is chaired by the Governor, meets weekly to deliberate on matters pertaining to the Bank's core functions, as well as general operational issues. The Management Committee is complimented by other committees, including the Monetary Policy Committee (MPC), the Policy Advisory Committee, the Pension Administrative Committee, and the Investment Committee. These committees provide for participation of staff across the institution and assist the Bank in meeting its mandate.

The MPC continued carrying out its function of promoting efficiency and transparency in the formulation and conduct of monetary policy and ensuring a well-organized decision making process. As part of its remit, the MPC formulated recommendations for the Government on fiscal and exchange control matters, and reviewed supervisory issues as they impact the domestic financial system. The MPC is chaired by the Governor and its membership includes the Deputy Governor, the Inspector of Banks and Trust companies and several department heads. While the Governor is ultimately responsible for the policies promulgated by the Bank, the Committee formally assists in this process and credibility is ensured by the consensus nature of decisions acted upon by the Governor.

As provided for in the Central Bank's Retirement Plan, the Pension Administrative Committee is appointed by the Bank, through the action of the Board, to administer the Plan in accordance with the established terms. The Committee, which is chaired by the Deputy Governor, meets at least quarterly and among its responsibilities are ensuring the annual conduct of an actuarial valuation and the auditing of the financial statements of the Plan and reporting to the Board on the financial position of the Fund.

The Investment Committee is delegated authority by the Governor for management of the internal portion of the Bank's external reserves. Chaired by the Deputy Governor, the Committee comprises Heads of the Banking and Accounts Departments and two other persons appointed jointly by the Governor and Deputy Governor. The Committee meets every week to review, among other referred matters, recommendations from the Banking Department for deployment of available funds for investment.

The Policy Advisory Committee (PAC) comprises the Governor (Chair), the Inspector of Banks and Trust Companies, the Manager, Bank Supervision Department, the Chief Examiner, the Legal Counsel, and the head of the Policy Unit (Deputy Manager, Policy) of the Bank Supervision Department. The PAC meets monthly to review and approve supervisory and regulatory policies and procedures applicable to banks and trust companies, private trust companies and money transmission businesses.

In defining its objectives and goals, the Bank made significant progress in drafting a Strategic Plan, intended to provide a coherent framework to guide the Bank's operations and support activities over the next five years, 2009-2013. The Plan will take account of identified challenges and changes in the Bank's external and internal environment, and address issues identified in the recent enterprise risk assessment exercise. It is being prepared through a Bank-wide effort, involving the participation of all departments and units, as well as input from key stakeholders.

RISK MANAGEMENT

During the year, the Bank continued to monitor its activities and improve controls to mitigate its risks. As a means of identifying, measuring and mitigating the principal risks facing the institution, the Bank engaged an outside consultant to undertake an enterprise risk assessment. The output will be used to align the Bank's internal audit plan going forward, as well as inform the activities to be covered in the Strategic Plan.

In the area of business continuity, the Board also approved the undertaking of a business continuity gap assessment, with a view to ensuring that a comprehensive programme was in place to provide for continuity in critical Bank operations.

With a view to strengthening the Bank's internal audit function, draft Internal Audit and Audit Committee Charters were prepared and approved by the Board of Directors.

INTERNAL AUDIT

Internal audit remains a vital activity in the Bank's efforts to ensure the appropriateness of its business operations and adequacy of controls. Key operational areas, including currency, external reserve management and correspondent bank account reconciliations, were monitored and reviewed.

To strengthen this function, the Bank retained the services of an accounting firm to provide support services, inclusive of the development and documentation of an internal audit policies and procedures manual, and drafting of audit plans, based on the recently completed risk assessment exercise.

PREMISES

The Bank strives to maintain the adequacy and safety of its facilities, inclusive of its historical properties (Balcony House, Verandah House and Great House), through an ongoing programme of upkeep and maintenance. Presently, the Balcony House Museum is operated in collaboration with the Antiquities Monuments and Museums Corporation, and the Verandah House is being used by the Bahamas Institute of Financial Services. Among projects undertaken during the year to improve facilities were an upgrade of the air conditioning system in the main building, and an engineering assessment of the Bank's electrical systems.

CURRENCY, BANKING SERVICES, AND PAYMENT SYSTEMS

Currency Operations

The Central Bank is responsible for maintaining the stock of Bahamian dollar notes and coins. This includes the design, minting, and printing of currency; the issuance and redemption of banknotes and the issuance of coins. Bank notes have a face value of $0.50, $1, $3, $5, $10, $20, $50 and $100, and coins are most commonly circulated as 1¢, 5¢, 10¢, 15¢ and 25¢.

Consistent with the slowdown in transactions growth, both the value of the Central Bank's total currency liabilities and amounts held in active circulation by the public contracted during the year, by 3.1% and 8.0%, to $323.6 million and $205.8 million, respectively. On an average monthly basis, currency in circulation fell by 2.0% to $207.7 million and was equivalent to an estimated and relatively stable 2.8% of GDP.

In keeping with its ongoing commitment to enhance banknote security and maintain the integrity of the currency, the Bank introduced in December 2008, the newly designed $1 banknote––the fifth denomination in the CRISP (Counterfeit Resistant Integrated Security Product) series of banknotes. The Bank also remained active in promoting public understanding regarding counterfeit detection and banknote authentication, partly through the delivery of training sessions to retailers and other cash handlers.

Foreign Exchange Transactions

The Bank's buying and selling rates for U.S. dollars from/to commercial banks were unchanged at US$1.00 = B$1.00 and US$1.00 = B$1.0025, respectively, and at par for cash transactions. Foreign exchange rates for the quotation of Pound Sterling were obtained

Table 12: Bahamas Government Treasury Bills (B$ Millions)

	End-2006	End-2007	End-2008
Bills Outstanding	**192.5**	**230.5**	**230.5**
Average Price			
Tender Rate (%)	98.81	98.81	98.87
Discount Rate (%)	3.00	3.04	2.92
Re-discount Rate (%)	3.50	3.54	3.42

Source: The Central Bank of The Bahamas

each business day from the international market at 9:00 a.m. and 11:30 a.m. and at other appropriate intervals, depending on the value of transactions and market volatility. For Sterling sales, the Central Bank maintained the policy of adding a commission of one-half of one percent to the mid-rate.

The highest bid and offer of Pound Sterling/Bahamian dollar rates of 2.0336 and 2.0438 were employed on March 13 and the lowest of 1.4407 and 1.4479, on December 30.

Relations with the Public Sector

In its role as the official registrar and transfer agent, the Bank continued to oversee and facilitate the issuance, redemption and servicing of Bahamas Government Registered Stocks and Treasury bills, together with debt securities of the Bahamas Development Bank, Bahamas Mortgage Corporation, the Bridge Authority and the Clifton Heritage Authority.

The statutory ceiling on the maximum borrowing by Government by way of Treasury bills, is capped at 25 percent of the lesser of ordinary revenues, as provided in the most recent approved budgetary estimates or the average revenue for the latest three years of audited accounts tabled in Parliament. Treasury bills outstanding were unchanged at $230.5 million in 2008 (see Table 12), with the largest proportion being held by commercial banks (78.4%), followed by public corporations (18.8%) and the Central Bank (2.8%). During the year, the Bank rediscounted $50.0 million in Treasury bills from commercial banks. The average tender rate (on rollover maturities) rose marginally by six (6) basis points to 98.87%, which corresponded to a 12 basis point lowering in the average discount rate to 2.92%.

During 2008, the outstanding value of Bahamas Government Registered Stocks (bonds) increased by 2.0% to $2,071.7 million (see Table 13). The Bank, as Registrar, arranged one bond issue totaling $100.0 million, and redeemed a scheduled $60.0 million. New issues featured a maximum maturity limit of 29 years and stable effective coupon rates at spreads of 0.03125% to 1.25% above commercial banks' Prime Rate.

Bridge Authority bonds outstanding at $28.0 million, featured maturities ranging from 2014 – 2029 and variable yields of Prime plus a margin of 1.000% - 1.625% per annum. Similarly, the value of Clifton Heritage Authority bonds outstanding was unchanged at $24.0 million, to mature between 2020 and 2035. Variable yields on these issues are Prime plus a margin of 0.2500% - 0.7500% per annum.

Relations with Banks

In accordance with Section 19 of the Central Bank of The Bahamas Act 2000, banks are required to

Table 13: Bahamas Government Registered Stocks (B$ Millions)

	2007	2008
Outstanding (Beginning of yr)	**1,829.9**	**2,031.7**
Add: New Issues	261.8	100.0
Less: Maturities	60.0	60.0
Outstanding (End of year)	**2,031.7**	**2,071.7**
Interest Yield		
Variable Rates (Prime + Add-On)		
Prime	5.50%	5.50%
Add-On	0.03125% - 1.25%	0.03125% - 1.25%
Fixed Rates	5.75% - 9.00%	6.00% - 9.00%
Maturity Range	2008 - 2037	2009 - 2038

Source: The Central Bank of The Bahamas

maintain "Statutory Reserves" against their Bahamian dollar deposit liabilities. Since being established in 1974, the reserve ratio has remained at 5.0%, with a minimum 80% to be held in deposit balances at the Central Bank. In line with growth in the Bahamian dollar deposit base, required reserves increased by 7.3% to $232.4 million. Banks' excess balances at end-December 2008 stood at $120.2 million, representing 37.4% of their total deposits held with the Central Bank, a decline of 5.6 percentage points from 2007. Institutions also maintained balances to facilitate cheque clearing arrangements, which continued to be managed by the Central Bank.

Dormant Accounts Administration

Section 20 of the Bank and Trust Companies Regulations Act (BTCRA) provides for transfer to the Central Bank of balances held on dormant accounts, defined as deposit accounts in respect of which "no transaction has taken place, or no statement of account has been requested or no written acknowledgement has been received from the customer, during a period of seven years". During 2008, the Central Bank received a total of $5.1 million in dormant funds from banks and processed approximately $0.3 million in claims. To improve the efficiency of the administrative process, the Bank introduced the Dormant Accounts Web Reporting System (DARS) during the final quarter of 2008, which provides a fully automated reporting interface between licensees and the Dormant Account System.

Payment Systems

In promoting efficiency in settling domestic payments, the Bank, since May 2004, has operated the Bahamas Interbank Settlement System (BISS), which accommodates real time gross settlement of high value and time critical payments between clearing banks and their customers. During 2008, the total volume of large-value transactions settled through the BISS rose by 26.1% to 45,459, corresponding to a 17.8% increase in value to $10.1 billion. Partly reflecting some shift in large value settlements through the BISS, as well as the increased usage of ATM and debit card facilities, the volume of retail cheques cleared among banks fell by 3.7% to 3.78 million, with the value lower by $0.1 billion (1.1%) at $8.6 billion.

During 2008, further progress was made towards the implementation of the Automated Clearing House (ACH) system. Prior to launch, which is expected to occur in the first half of 2009, participating banks were engaged in the requisite user acceptance testing phase, securing the readiness of the infrastructure, and completing the preparation of various corporate governance documentation. The Bank participated actively in the various committees established to facilitate the implementation of the ACH project. These included the Legal Requirements Working Group, which reviewed and made recommendations on the constitutive documents and commercial agreements; the Operations Working Group, tasked with regularizing operational readiness within the respective institutions, and the Rules and Standards Committee, responsible for setting standards in accordance with international best practices for the settlement of cheques and electronic payments. Once operational, the ACH will change the modalities for cheque clearing and local money transfers, decreasing processing time and reducing costs, to the benefit of clearing banks, merchants and the general public.

The Central Bank also continued its efforts towards strengthening the governance framework for payments systems in The Bahamas. The Bank commenced efforts towards the establishment of a Payments Unit that will oversee responsibilities for regulating and establishing policy guidelines for payment systems operating in The Bahamas. With the assistance of a payments expert, the Bank made substantial progress in developing a draft bill that will enhance its oversight of the payments system and, among other things, codify existing provisions for the finality of payments outlined in the Bahamas Inter-Bank Settlement System's (BISS) Service Provision Agreement, and the BISS Procedures and BISS High Value Rules.

EXCHANGE CONTROL ARRANGEMENTS

During 2008, the Bank continued to support the management of foreign exchange reserves and to oversee the capital account liberalization programme launched in early 2006. The latter included activities in the non-sponsored Bahamian Depository Receipt (BDR) Programme, under which residents may purchase domestic investments, backed by foreign securities, through local BISX-licensed broker/dealers. Two licensed broker/dealers participated in this arrangement and accessed foreign exchange allotments totalling $10.80 million. Being the first full year of the programme, the total drawdown exceeded the $4.17 million availed of during its commencement in the fourth quarter of 2007. Another facet of the broad liberalization programme permitted the National Insurance Board to have overseas investments. The Board purchased US$12.5 million during 2008, bringing the total accessed to date to just over $40.0 million.

The Investment Currency Market (ICM), which provides residents with foreign currency at a premium to facilitate overseas investments, registered moderate activity during 2008. From a revised opening balance of $6,047,249.45, the ICM recorded sales of $1,398,452.37 and no purchases, to end the year at $4,648,797.08. Since the 16th January 2006, the premium bid and offer rates were reduced to 10.0% and 12.5%, respectively.

Several projects aimed at improving operational efficiency in the administration of exchange controls were either initiated or progressed during the year. Content management facilities were added to the Lotus Notes system, to provide for the electronic imaging, storage and retrieval of correspondence information, and have assisted with expediting the processing of customer requests. Significant progress was also made towards preparing user-friendly guides and brochures, to enhance public awareness of Exchange Control policies and procedures, as a means of achieving completeness in application submissions.

A task force, made up of representatives from the Central Bank and commercial banks, resumed work towards streamlining the administrative regime for matters dealt with under delegated authority by the banks. The streamlined process will involve the eventual elimination of the EI forms used by the public in applying for foreign currency at the banks, and the corresponding electronic capture and reporting of this transactional data to the Central Bank.
At end-2008, the number of Authorized Dealers (commercial banks) and Authorized Agents operating domestically stood at eight (8) and fifteen (15), respectively. The list of institutions is published on the Central Bank's website.

ECONOMIC ANALYSIS, STATISTICS AND RESEARCH

Bank staff continued to analyze economic and financial developments in The Bahamas and abroad, providing key input into the monetary policy process through the preparation of the Monthly Economic Financial Development Report (MEFD) as well as other policy briefs for the Monetary Policy Committee (MPC).

In support of its monetary policy process, the Bank collected, analysed and disseminated a wide variety of monetary, fiscal, and other economic statistics by way of its Quarterly Economic Reviews, Quarterly Statistical Digests and Annual Report. To broaden quantitative analysis of domestic economic conditions, the Bank commenced work on designing surveys to capture business and consumer sentiments. These are expected to be launched in 2009.

Efforts to support the development of research skills included staff presentation of studies on a wide range of topics at three in-house roundtable forums. A total of eleven papers were presented in-house during the year, while a twelfth paper was presented at the 39th Annual Regional Monetary Studies Conference, organized by the Caribbean Centre for Money and Finance, and held in St. Kitts and Nevis in November. Additionally, the study entitled, "Monetary & Financial Stability: Issues for CARICOM Economies in the Domestic Sector", was published in the Journal of "Business, Finance & Economics in Emerging Economies". Staff also produced the second edition of the annual Working Paper Series, which provided a compilation of research papers and briefs completed during the year, and advanced work on its macroeconomic forecasting framework.

PRUDENTIAL SUPERVISION AND REGULATION

Overview

During 2008, the Bank complied with its mandate to license and supervise banks and trust companies, money transmission businesses and private trust companies, while ensuring their safety and soundness, and the stability of the financial system. The work agenda was carved out against the backdrop of the rapid evolution in international regulatory standards, as exemplified by the global implementation of the new capital adequacy framework (Basel II), and the escalating global financial crisis, and centered on three over-arching objectives:

- building a flexible legal and regulatory framework that enables licensees to provide a full and competitive array of financial services;
- strengthening the safety and soundness of the banking and financial system; and
- strengthening and improving the effectiveness of supervisory resources.

Asset Quality of Domestic Banks

In 2008, the Bank continued to gather and receive aggregated data, including detailed monthly reports on commercial banks' loan quality and loss provisions, which informed the decision-making of the Monetary Policy Committee (MPC) and remained an important part of the scope of on-site examinations. As economic conditions worsened, an enhanced monitoring regime was implemented, which included increased contacts with the commercial banks and, in December, implementation of a more in-depth quarterly reporting framework for credit risks. Comprehensive discussions were also held with senior management, to become apprised of banks' evolving credit control frameworks amid a more difficult economic environment. Domestic banks were also placed on the on-site examination schedule for 2009, for in-depth reviews of credit, liquidity and funding operations.

Licensing Activity and Physical Presence Policy

During 2008, the number of bank and trust licensees rose by 26, from 245 to 271 (see Table 14). The Central Bank approved 42 nominee trust licences and 16 licences were revoked. Of the 271 licensees, 241 operated through physical presence, compared to 214 in 2007. In addition, 30 licensees, being branch operations originating in predominantly G-10 countries, maintained approved restrictive management arrangements as compared to 31 in 2007. During 2008, the Governor approved the registration of thirty-one (31) Private Trust Companies (PTCs), compared with 7 in 2007. Four (4) additional licensees of the Bank advised of their intention to act as Registered Representatives of

TABLE 14: Banks and Trust Companies Licensed in The Bahamas

	PUBLIC			RESTRICTED			NON-ACTIVE			
	B&T	**B**	**T**	**B&T**	**B**	**T(Nom)**	**B&T**	**B**	**T**	**TOTAL**
December 2007	79	41	18	3	3	89	5	4	3	245
Add Licenses issued in 2008	0	0	0	0	0	42	0	0	0	42
Less Licenses revoked in 2008	3	2	1	1	0	7	0	0	2	16
Sub Totals	**76**	**39**	**17**	**2**	**3**	**124**	**5**	**4**	**1**	**271**
Licenses upgraded or downgraded	-1	-1	1	0	0	1	0	0	0	0
December 2008	**75**	**38**	**18**	**2**	**3**	**125**	**5**	**4**	**1**	**271**

B=Bank, T=Trust, T(Nom)=Nominee Trust
Note: Gross license fees during 2008 amounted to approximately $9.87 million.

Source: The Central Bank of The Bahamas

Box II: Impact of Global Financial Markets Turmoil on the Bahamian Banking Sector

During the second half the year, the Central Bank undertook a detailed assessment of the impact of the global financial market crisis on domestic and international banks in The Bahamas. Licensees were requested to provide details of any direct and/or indirect exposures to the sub-prime mortgage market; a quantification of both the licensees' and clients' on and off balance sheet exposures (including derivatives) to major international investment banks; and knowledge of any exposure or development that was likely to materially affect their operations in The Bahamas.

The submissions indicated that, at end-December, both domestic and offshore banks had limited exposure to failed or distressed financial institutions. In the few cases where losses were identified and crystallized, the capital resources of the firms and their parents were sufficient to maintain licensees above the minimum level of capital required by the Central Bank.

Given the Exchange Control regulations, the domestic banks did not have an external balance sheet exposure to the crisis. However, their Bahamian dollar operations have been impacted by the consequential downturn in the local economy, which has affected many borrowers' ability to repay loans. The Central Bank's preliminary assessment indicates, nevertheless, that the system has an adequate capital buffer to withstand the expected rise in non-performing loans over the next 12 to 18 months.

As to the international banking sector, although anecdotal evidence suggests that there has been some reduction in funds under management, in line with the downturn in the global wealth management industry, the effect on the profits of these firms has not fully been assessed. However, a number of structural elements have limited the negative impact of developments on the international sector. These include the fee-based business models for managing client assets or booking transactions originated by other group entities; comfort in the parent firms' ability to inject additional capital, where required; and the largely non-discretionary nature of the firms' mandates for managing assets. As U.S. and European governments coordinated efforts to recapitalize important and systemically distressed firms, this affected a number of banks with Bahamas affiliates and has provided considerable stability to the sector.

PTCs, increasing the number to nine. Additionally, the Governor approved two Financial and Corporate Service Providers to act as Registered Representatives, with the total now standing at four.

With regard to non-bank Money Transmission Businesses (MTBs), for which the Bank assumed regulatory and supervisory responsibility during the year, the Governor granted one additional licence to a service provider, bringing the total number to two.

On-site Examination Programme

Over the past decade, the regulatory framework of The Bahamas has been strengthened to meet and combat the challenges posed by money laundering and the financing of terrorism. Given the importance of AML/KYC/CFT compliance for The Bahamas, a series of limited scope examinations of a sample of commercial banks were conducted in early 2008. Based on those special examinations, the commercial banks were found, in large measure, to be operating in compliance with their statutory requirements. However, the exercise highlighted several common issues, which will be discussed with the banks at a roundtable scheduled for early 2009. The best practices emanating from the special scope examinations and from the discussions at the roundtable will, in due course, inform a guidance note on implementing the Central Bank's AML/KYC/CFT guidelines.

In addition to the limited scope inspections, the broader focus of examinations during 2008 targeted safety and soundness (licensees flagged for routine full examinations as per internal risk rating), corporate governance and risk management. The safety and soundness examinations continued to indicate overall improvement in licensees' systems and controls, and that licensees were implementing the corrective actions required from previous examinations.

The focus on large banking operations reduced the number of on-site examinations year on year, to 56 in 2008 from 77 in 2007 (see Table 15). These included all seven of the domestic commercial banks and several major international banks. As a result, 19 Reports of Examinations (covering 42 examinations mostly of groups) were issued, while eight reports were in the final stages of drafting.

The Bank, meanwhile, commenced joint examinations with the Securities Commission of The Bahamas during April 2008 and, over the course of the year, five such examinations were conducted. A review of this process is ongoing and is expected to focus on identifying greater synergies between the Bank's and the Commission's on-site examinations methodologies and processes.

To address the challenges of prioritizing and focusing on the most material risks of licensees, the Bank commenced efforts to introduce an enhanced unified risk assessment of their operations. The liquidity, credit and funding examination templates were up-dated and will be instituted in credit and liquidity reviews of commercial banks in early 2009. Reputational risks reviews have also been scheduled for offshore licensees.

In the final quarter of 2008, a review was commenced of the on-site examination processes, towards developing a more consistent approach to reviewing firms' reporting of examinations; improving the timeliness in submitting reports to licensees; and prioritising the recommended follow up actions of licensees, based on the level of inherent risks and quality of risk management processes. This process will be piloted in the first round of examinations in 2009.

TABLE 15: Onsite Examinations Conducted

	2006	2007	2008
Examinations			
Domestic Licensees	2	3	7
Other Licensees	29	75	45
Follow-up /Special focus examinations	7	2	4
Total	**38**	**80**	**56**
Reports			
Finalized Reports	40	41	19
Reports in Progress	2	5	8
Total	**42**	**46**	**27**

Source: The Central Bank of The Bahamas

An exercise was also embarked upon towards revising the On-site Examination Manual, to ensure that supervisors and examiners have comprehensive and up-to-date templates which reflect the full legal requirements within The Bahamas and operational practices consistent with international best standards. In the first instance, work will focus on ensuring that practices in reviewing KYC/AML/CFT and credit risk management processes are in line with evolving international best practices and standards.

Domestic and International Regulatory Cooperation

Domestic and international cooperation with other regulatory bodies remains an important feature of the Central Bank's work programme. On the local level, the Bank is actively involved in the work of the Group of Financial Sector Regulators (GFSR), which comprises the six domestic regulators for banks and trust companies, the securities industry, insurance companies, credit unions and financial & corporate service providers. The Financial Intelligence Unit and Attorney General's office also participate regularly in the GFSR meetings. Currently, sub-committees of the GFSR are completing work on money lending businesses and a review of the statutory provisions to require the electronic publication of licensees' annual financial reports. The GFSR is also examining developing guidelines to establish periods of restriction

TABLE 16: Requests for Cooperation from Foreign Regulatory Authorities in 2008

Country	No. of Requests	Completed	Outstanding*
British Virgin Islands	2	2	-
Turks & Caicos Islands	1	-	1
Total Requests	3	2	1

Source: The Central Bank of The Bahamas
Note * in these cases, data has been provided, but additional "follow-up" is required and requests were still being processed at year end.

for persons who have been prohibited by one or more regulators from providing regulated financial services or performing functions related to the provision of such services, because of either regulatory breaches or failures to satisfy established fit and proper criteria.

At the regional level, the Bank's banking supervision senior management maintained The Bahamas' involvement in the Caribbean Group of Banking Supervisors' (CGBS), which, among other things, focused during 2008 on the need to develop coordinated cross-border mechanisms to address financial sector crises. It is envisaged that a Memorandum of Understanding (MOU) between supervisors, central banks and Ministries of Finance in the Caribbean region on cross-border financial stability will be prepared mirroring EU arrangements; and that an MOU to cover the exchange of information related to financial stability will be pursued between the Caribbean and the Canadian supervisor (OSFI), a key home regulator for the major systemically important banks in the region. The Bank itself signed a bilateral MOU with OSFI in 2006.

The Central Bank also continued to cooperate with other international regulators on the exchange of information concerning its licensees. In 2008, the Bank received and responded to three information requests from authorities in two British Dependent territories (see Table 16), compared to 18 requests from 11 countries in 2007.

The Bank remains actively involved in the ongoing national effort to ensure that The Bahamas' Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) regime is consistent with international best practices.

Current Issues in Bank Supervision

The turmoil in international financial markets during 2007/2008 caused the G7 Finance Ministers and Central Bank Governors to commission work analyzing the underlying causes and weaknesses that eroded markets. The end objective was to assist in identifying changes in the regulatory framework to strengthen firms' resilience to crises. The findings of the review were encapsulated in the Financial Stability Forum (FSF) Report of April 2008, which considered two sets of measures directed at a wide range of actors in the financial and private sectors, including banks, securities firms, insurance companies, credit rating agencies, accountants, supervisors and international organizations. These were measures to support the re-pricing of risk and to rebuild confidence and measures to enhance the ongoing stability of the system. Key areas that are especially relevant to banking supervisors in The Bahamas include the following:

- The capital requirements for certain complex products have been too low and have not considered the need for capital to vary throughout the business cycle, particularly during downturns. Shortfalls in risk management arrangements were a significant contributor to the losses. Basel II provides a coherent framework to capture these qualitative aspects, and encompasses through the Pillar II framework, a perspective on capital, which looks at the entire business cycle.
- Shortfalls were identified in the stress testing frameworks for management of capital and liquidity.
- Market discipline did not prevent a build up of risks, in large measure because of inadequate disclosures on financial statements.
- Supervisors, including central banks, need to take additional steps to translate their analysis into actions that effectively mitigate risk; devote more attention to the systemically important institutions and maintain sufficient resources to carry out effective supervision.

- Supervisory cooperation between regulators ought to increase, encompassing the use of colleges of regulators to unify the supervision of financial conglomerates, and the setting of common prudential standards.

The recent events have also highlighted weaknesses in international arrangements for cross-border crisis management that need to be addressed, and that would clarify and strengthen national and cross-border arrangements for dealing with weak banks.

The Bank's program of development work for 2009 in the banking supervision area, which is now detailed in the proposed Strategic Plan, seeks to address the relevant issues identified in the FSF report as well as to strengthen The Bahamas' position as a stable and reputable offshore financial centre. Two key pieces of development work which address these concerns are the implementation of the risk-based supervisory framework and implementation of the Basel II capital adequacy framework.

Development and Implementation of a Risk-based Framework

In the last quarter of 2008, the Bank commenced the development of a risk-based supervision framework (RBF), building on the current regime of internal risk rating of licensees. This is a more robust and proactive supervisory approach, that will allow the Central Bank to better assess licensees ability to identify, measure, monitor and control risks. Each licensee will be re-assessed using the risk-rating system and supervisory resources will be allocated accordingly. The RBF will permit a systematic and continuous assessment of licensees. It will spotlight where problems exist or are likely to emerge among licensees, and lead to a prioritization of on-site examinations and other supervisory reviews, for optimal allocation of supervisory resources. It will also allow the Central Bank to initiate more timely interventions and to vary the intensity of supervisory actions, in line with institutions' perceived risk profiles.

Implementation of Basel II in The Bahamas

In light of the demanding resource intensive requirements needed for the implementation of the risk-based supervisory framework and market risk assessments—both important precursors to implementation of Basel II—the Central Bank intends to refocus work on full Basel II implementation in 2010. In 2009, the work effort will concentrate on concluding the Market Risk component of Basel I, updating the 2007 self-assessment against the Basel Core Principles, and undertaking a consideration of the areas of national discretion under the Basel II capital adequacy framework.

Other Issues to Receive Special Attention in 2009

Financial Stability: The Bank plans to develop further its capabilities to conduct comprehensive stress tests, to identify structural vulnerabilities and overall exposures in the financial system that could lead to systemic problems.

End to end-review of the Bank Supervision Department: In order to ensure a more efficient and effective supervisory process, the Bank engaged the services of an external consultant to conduct an end-to-end review of the structure, procedures and processes of the Bank Supervision Department. The findings from the review will be used to inform new supervisory approaches being pursued by the Bank.

Commercial Bank Unit: In line with the implementation of a risk-based framework, plans are underway to restructure the operations of the Bank Supervision Department, for more effective use of resources, including establishment of a Commercial Bank Unit. The Unit will focus on the critical oversight of the domestic banking operations, integrating the onsite and offsite supervision of these licensees.

Authorizations Unit: In the first half of 2009, an Authorizations Unit (to include the existing Administration Unit) will be established to oversee the daily non-supervisory functions of the Bank Supervision Department, including routine correspondence with licensees, processing of new licence applications and managing statistical and other databases. This will enhance the efficiency of remaining operations by allowing the technical staff to focus on the core functions of the Department—on-site and off-site analysis.

New Guidelines and Regulatory/Legislative Developments

Under its obligation to ensure that

the legal framework for the prudential regulation and supervision of banks and trust companies in The Bahamas and the guidance issued remains relevant and current, the Bank finalized and issued two new and four revised guidelines (see Table 17). In addition, several legislative initiatives affecting the banking sector were concluded.

During February 2008, the Bank published a *Guide on the Central Bank's On-site Examination Process*, to promote awareness and enhance the transparency of the examination process for licensees and other interested parties. The document should be read in conjunction with the Central Bank's soon to be published Risk-Based Supervision Framework.

To streamline the regulation and supervision of money transmission businesses (MTBs), the Government transferred to the Central Bank, responsibility for the regulation and supervision of money transmission businesses. This change was effected through enactment of the Banks and Trust Companies Regulation (Amendment) Act, 2008, the Central Bank of The Bahamas (Amendment) Act, 2008, along with the accompanying Banks and Trust Companies (Money Transmission Business) Regulations, 2008. Further to this, the Bank issued a complementary policy document entitled *General Information and Application Guidelines for Non-Bank Money Transmission Service Providers and Non-Bank Money Transmission Agents*.

During the year, a review was completed of the *Corporate Governance Guidelines* and *Business Continuity Guidelines*. With respect to the Corporate Governance Guidelines, the Bank decided to employ a less prescriptive approach to the number of mandated board meetings, leaving it up to individual licensees, based on individual risk circumstances. Additionally, the *Guidelines for Independent Non-Executive Directors* was subsumed into the Corporate Governance Guidelines to create a single comprehensive document dealing with the matrix of governance issues.

At the completion of the review of the Business Continuity Guidelines, a decision was taken to no longer require firms to submit their Business Continuity Plans (BCP) for review and approval. Instead, licensees are now required to notify the Central Bank that they have a plan in place, and identify the senior management personnel responsible for the plan. Banks were also encouraged to seek legal opinion to ensure that their BCPs comply with Bahamian law, particularly with respect to the preservation of client confidentiality. In addition, Boards of Directors are required to include a statement in the Annual Corporate Governance Certificate, confirming their satisfaction that the recovery strategies adopted were still valid, and that the BCP management teams and/or an independent party had properly tested the plan during the period.

Three other legislative matters affecting the banking sector were concluded in 2008. The *Banks and Trust Companies (Licence Application) Amendments Regulations 2008* were finalized and entered into force in May 2008. With these amendments, individuals subscribing to less than ten percent of a licensee's share capital need only submit a statement certifying individual net worth to be at least five times the value of the share capital of the entity. Additionally, once approved by home country regulators in any of the Zone A countries, individuals will be allowed to serve as directors in a subsidiary or branch in The Bahamas, without having to provide further character references. The *Banks and Trust Companies Regulation (Amendment to Third*

TABLE 17: Issued Guidelines

	Document	Final Issue Date
1	A Guide to the Central Bank's On-site Examination Process	14th February 2008
2	General Information and Application Guidelines for Non-Bank Money Transmission Service Providers and Non-Bank Money Transmission Agents	8th July 2008
3	Revised Corporate Governance Guidelines	23rd July 2008
4	Revised Business Continuity Guidelines	14th October 2008

Source: The Central Bank of The Bahamas

Schedule) Regulations 2008, was also enacted, revising the licence fee schedule for banks and trust companies; and changes were introduced to the Central Bank of The Bahamas Act, 2000, to clarify the Bank's powers to impose administrative fines on licensees found to be in breach of statutory reserve and liquid asset ratio requirements.

Apart from this, work also continued on drafting amendments to the BTCRA, aimed at strengthening the regulatory oversight of licensees, including broadening the Bank's enforcement powers. In 2009, the Bank plans to develop a comprehensive framework to address violations in prudential and regulatory norms by financial institutions. Under existing arrangements, the Bank's tools for ensuring compliance are limited and involve (in certain circumstances) the need for an application to the courts before a penalty is applied. Changes to this process would fully align The Bahamas with principle 23 of the Basel Core Principles for Banking Supervision, and increase the Bank's array of compliance tools.

Consultation Papers

During the year, the Bank issued two consultation papers (see Table 18). Draft *Guidelines on the Management of Interest Rate Risk* was issued in the second quarter of 2008. These outlined the key elements of prudent interest rate risk management, consistent with the Basel Committee on Banking Supervision's paper on the *Principles for the Management and Supervision of Interest Rate Risk,* published in July 2004. The draft included the minimum policies and procedures that licensees should have in place, as part of the overall corporate governance process and risk management programme, to manage interest rate risk present in their business activities. The Department proposed that the Guidelines apply only, as appropriate, to licensees engaged in business activities that would give rise to interest rate risks. Implementation of the Guidelines, incorporating the comment and feedback from the industry, is planned for 2009.

In the area of combating money laundering and terrorist financing, a consultation document on additional proposed revisions to the *Guidelines on the Prevention of Money Laundering & Countering the Financing of Terrorism ("the AML/CFT Guidelines")* was issued in October 2005. Revisions to these Guidelines were initially issued for consultation in November 2007, following the mutual evaluation of the anti-money laundering and combating the financing of terrorism regime of The Bahamas conducted by the Caribbean Financial Action Task Force ("CFATF") during May and June 2006. These additional revisions to the Guidelines were drafted in anticipation of the changes to the AML/CFT legislation and the implementation of new Wire Transfers Regulations which are expected to be enacted in early 2009. These proposed amendments seek to enhance compliance of The Bahamas with the Financial Action Task Force's (FATF) Special Recommendation VII (dealing with wire transfers), as recommended by the CFATF in its Mutual Evaluation Report on The Bahamas, published in December 2007 and to remedy identified deficiencies in The Bahamas' AML/CFT regime. They also took account of comments received on the consultation draft published on the Central Bank's website in November 2007.

TABLE 18: Consultation Papers

	Consultation Paper	Date Released	Final Date for Comments
1	Consultation Paper on Guidelines on the Management of Interest Rate Risk	17th April 2008	16th May 2008
2	Amendments to the Central Bank of The Bahamas Guidelines for Licensees on the Prevention of Money Laundering & Countering the Financing of Terrorism	18th December 2008	18th February 2009

Source: The Central Bank of The Bahamas

Deposit Insurance Corporation (DIC)

The Central Bank has statutory responsibility to oversee the deposit insurance fund for Bahamian dollar deposits in the banking system. The DIC insures Bahamian dollar deposits up to a maximum of $50,000.00 to any single depositor in each of its 13 member institutions, which do not hold any equity position in the corporation.

The DIC assesses depository institutions at an annual premium equal to one-twentieth of one percent (0.05%) of deposits, averaged over March 31 and September 30 of the preceding year. Based on average total insurable Bahamian dollar deposits in banks of $4.7 billion during 2007, relative to $4.4 billion in 2006, premiums levied and collected in 2008 amounted to $2.4 million compared to $2.2 million in 2007. The accumulated assets of the Fund rose to $13.2 million from $10.2 million at end-2007. Of this amount, holdings of Bahamas Government Registered Stocks (BGRS) totaled $11.4 million compared to $8.7 million a year earlier.

INFORMATION TECHNOLOGY

Information Technology continued to play an enabling role in enhancing the efficiency of the Bank's business processes. During 2008, the Bank strengthened the IT infrastructure by concluding major upgrades to ease the expansion of services and accommodate the hosting of the Bahamas Automated Clearing House (ACH) secondary IT systems, and to simplify systems management, monitoring and security. Upgrades were also carried out to aging workstations and servers.

To strengthen the IT corporate governance framework, the Bank, with the assistance of external consultants, drafted an IT Security Policy and a compendium of related procedural documents which the Bank intends to finalize and implement in early 2009.

The Bank continued to progress its plans towards the eventual implementation of the proposed Online Reporting and Information Management System (ORIMS) solution, a system that will more effectively capture, store and report data from the Bank's reporting constituents. The vendor selection process is expected to be concluded before the end of the first half of 2009.

Following the successful implementation of a document imaging solution in the Exchange Control, and Bank Supervision Departments, the initiative was extended to include the Accounts, Banking, Administration and IT Departments.

Work continued on automating operational processes and included completing a Stock Room Inventory management solution, enhancements to the Bank's JD Edwards and Procurement Management systems, and deployment of a number of solutions for cheque scanning and printing in preparation for the introduction of the ACH.

STAFF TRAINING AND DEVELOPMENT

Through ongoing training initiatives, the Bank continued to provide opportunities—in-house, as well as locally and internationally—for employees to develop their professional and technical skills. During the year, fifty-seven (57) employees participated in local training events, fifty-nine (59) attended local meetings or conferences, thirty-one (31) travelled to overseas training courses/seminars and twenty-eight (28) participated in overseas meetings and conferences.

In the Research Department, staff training efforts focused on strengthening skills in the areas of economic analysis, forecasting and statistical compilation methodologies. Staff participated in an in-house economic and research writing workshop, and attended various regional and international conferences and workshops which addressed data compilation issues, aspects of open market operations, and financial programming and forecasting.

Staff of the Legal Unit attended seminars and workshops on varied subjects, such as the Capital Markets Workshop on Understanding and Combating Unregulated Investment Schemes hosted by CARTAC, the Mutual Evaluators Training Workshop, hosted by the Caribbean Financial Action Taskforce (CARTAC) and the NACHA Payments Conference. They also participated in seminars, both locally and internationally, on the prevention of money laundering and terrorist financing, Basel II and operational risks, and revisions to domestic trust laws. Presentations were made by Legal Unit staff at a number of in-house seminars and for industry participants on the regulation of non-bank money transmission businesses.

In the important area of banking supervision, staff benefited from overseas and local training workshops, courses and seminars in the areas of risk focused supervision, credit analysis, bank examination and analysis, operational risk, coaching and leadership techniques and regulatory issues. In-house training sessions continued with local industry experts and staff presenting topics of interest and relevance to this area of work. Management and senior staff also participated in several international forums and working groups addressing current supervisory issues and challenges. Going forward, the Bank's training program in this area will concentrate primarily on credit risk analysis, bank examination and analysis, advanced risk management and the components of Basel II. A strong emphasis will remain on in-house training and on courses and seminars offered by other agencies both locally and overseas.

STAFF COMPLEMENT AND RELATIONS

As at 31 December 2008, the staff complement stood at 231, inclusive of 214 permanent and 17 contractual employees. Separations from the Bank included the death of one employee, six (6) resignations, three (3) retirements and one (1) non-renewal of contract. In addition to filling two key position vacancies—Inspector of Banks and Trust Companies and Chief Security Officer—the Bank added nine (9) other persons to its complement. The Bank again recognized long-serving employees at its Annual Awards Presentation Ceremony in January, when four employees received thirty-year awards, six, twenty-year awards and seven, ten-year awards.

COMMUNITY RELATIONS AND OUTREACH

The Bank continued to demonstrate its support of local educational institutions and hosted a number of school visits and work experience students. With a view to encouraging students to pursue a career in central banking, the Bank participated in the Bahamas Financial Services Board's (BFSB) Annual Careers Fair, which was co-hosted by the Ministry of Education.

The Bank's Annual Art Competition and Exhibition marked its 25th anniversary during 2008. This competition is a staple in local art calendars and has recorded steady growth since its inception; while also providing an important avenue for young aspiring artists to showcase their talents.

FINANCIAL HIGHLIGHTS

The Central Bank's financial statements for the year ended December 31, 2008 along with comparative figures for 2007 are shown on pages 42 to 76 of this Report.

Although total assets declined by $34.9 million (4.2%), external assets improved by $108.7 million (23.9%) to $562.9 million, with new investments concentrated in deposits with banks. Domestic assets, however, were reduced by $142.2 million (38.4%), primarily explained by a reduction in holdings of Government Treasury bills, to $6.4 million from $144.1 million in 2007. Property, plant and equipment declined by $1.4 million (9.3%) to $13.2 million.

On the liabilities side, there was a $35.3 million (5.0%) contraction in demand liabilities. The currency component was lower by $10.4 million (3.1%), deposits by commercial banks, by $17.7 million (5.2%) and Government agencies, by $11.5 million (44.3%).

The reduction in the operating income was curtailed to $1.3 million (3.8%), as gains in interest on domestic securities ($1.5 million or 25.2%) mitigated the $2.8 million (11.5%) drop in interest on foreign investment which was linked to significantly lower yields. Boosted by currency production outlays, expenses were up by $2.9 million (12.1%), resulting in a reduction in the net profit for 2008 by $4.2 million (37.6%) to $7.0 million.

ACKNOWLEDGMENT

The Board of Directors extends its sincere appreciation to all Bank staff for their continuous dedication and service during the past year.

The Central Bank of The Bahamas

Financial Statements

31 December 2008

PricewaterhouseCoopers

Providence House
East Hill Street
P. O. Box N-3910
Nassau, The Bahamas

PKF

Pannell House
44 Elizabeth Avenue
P. O. Box N-8335
Nassau, The Bahamas

INDEPENDENT AUDITORS' REPORT

To the Directors of the Central Bank of The Bahamas

Report on the Financial Statements

We have audited the accompanying financial statements of the Central Bank of The Bahamas, which comprise the balance sheet as of 31 December 2008, and the income statement, statement of changes in equity and reserves and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and the Central Bank of The Bahamas Act, 2000. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

Auditors' Responsibility (Continued)

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Central Bank of The Bahamas as of 31 December 2008, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards and the Central Bank of The Bahamas Act, 2000.

Chartered Accountants

Nassau, Bahamas
16 April, 2009

Chartered Accountants

Nassau, Bahamas
16 April, 2009

THE CENTRAL BANK OF THE BAHAMAS

BALANCE SHEET AS AT 31 December 2008

(Amounts expressed in Bahamian Dollars)

	Notes	2008	2007
		$	$
ASSETS			
PROPERTY, PLANT AND EQUIPMENT	4	13,209,026	14,565,722
EXTERNAL ASSETS	5		
Cash and deposits		205,828,879	59,540,754
Marketable securities issued or guaranteed by foreign governments	6	347,389,540	384,710,396
International Monetary Fund:	7		
Bahamas reserve tranche		9,643,124	9,893,418
Special drawing rights		66,569	90,099
		562,928,112	454,234,667
OTHER ASSETS			
Bahamas Development Bank bond	8	4,064,317	-
Advances to the Bahamas Government	9	72,431,539	73,412,547
Bahamas Government registered stocks	10	126,274,640	134,282,446
Loans to Bahamas Government agency	11	6,499,269	6,776,126
The Bridge Authority bonds	12	794,090	770,903
Clifton Heritage Authority bonds	13	638,865	637,973
Bahamas Government Treasury bills	14	6,352,896	144,098,022
Receivables and other accounts		10,862,830	10,158,879
		227,918,446	370,136,896
Total Assets		**804,055,584**	**838,937,285**

The notes on pages 50 to 76 form an integral part of these financial statements.

THE CENTRAL BANK OF THE BAHAMAS

BALANCE SHEET AS AT 31 December 2008

(Amounts expressed in Bahamian Dollars)

(Continued)

	Notes	2008 $	2007 $
LIABILITIES, EQUITY AND RESERVES			
DEMAND LIABILITIES			
Notes in circulation		305,961,648	317,146,751
Coins in circulation		17,600,463	16,798,735
Deposits by commercial banks	15	321,378,833	339,096,999
Deposits by the Bahamas Government and Bahamas Government agencies		14,517,803	26,041,541
Deposits by international agencies	16	358,537	426,966
Payables and other accounts		2,586,852	4,274,800
Provision for payment into the Consolidated Fund	18	6,118,113	-
		668,522,249	703,785,792
OTHER LIABILITIES			
International Monetary Fund allocation of special drawing rights	17	15,780,878	16,261,326
EQUITY AND RESERVES			
Authorized and fully paid capital		3,000,000	3,000,000
Exchange equalization account	18	(138,510)	(227,646)
Contingency reserve	18	750,000	750,000
Other reserves	18	9,799,944	9,799,944
Building fund	18	6,980,403	-
General reserves	18	99,360,620	105,567,869
		119,752,457	118,890,167
Total Liabilities, Equity and Reserves		**804,055,584**	**838,937,285**

The financial statements, as approved by the Board of Directors and authorized for issuance on 16 April, 2009, are signed on its behalf by:

Wendy Craig
Governor

Director

The notes on pages 50 to 76 form an integral part of these financial statements.

THE CENTRAL BANK OF THE BAHAMAS

INCOME STATEMENT

FOR THE YEAR ENDED 31 December 2008

(Amounts expressed in Bahamian Dollars)

	Notes	2008 $	2007 $
INCOME			
Interest on foreign investments	19	21,515,803	24,300,496
Interest on loans	19	772,965	727,166
Interest on domestic investments	19	7,701,608	6,152,268
Discount on held to maturity investments	19	2,307,805	2,476,033
Unrealized exchange gain/(loss)	19	89,136	(454,940)
Other income	19	1,161,310	1,686,978
TOTAL INCOME		33,548,627	34,888,001
EXPENSES			
General and administrative	20	(11,897,185)	(8,572,806)
Staff costs	20	(12,072,070)	(12,879,534)
Depreciation expenses	4	(2,185,362)	(1,607,630)
Interest expense		(413,607)	(647,375)
TOTAL EXPENSES		(26,568,224)	(23,707,345)
NET PROFIT FOR THE YEAR		**6,980,403**	**11,180,656**

The notes on pages 50 to 76 form an integral part of these financial statements.

THE CENTRAL BANK OF THE BAHAMAS

STATEMENT OF CHANGES IN EQUITY AND RESERVES

FOR THE YEAR ENDED 31 December 2008

(Amounts expressed in Bahamian Dollars)

	Authorized and fully paid capital	Exchange equalization account	Contingency reserve	Other reserves	Building fund	General reserves	Total
	$	$	$	$	$	$	$
Balance at 1 January 2007	3,000,000	227,294	750,000	13,758,811	-	89,973,406	107,709,511
Net profit for the year	-	-	-	-	-	11,180,656	11,180,656
Transfer from other reserves to General reserves	-	-	-	(3,958,867)	-	3,958,867	-
Transfer of unrealized exchange losses	-	(454,940)	-	-	-	454,940	-
Balance at 31 December 2007	3,000,000	(227,646)	750,000	9,799,944	-	105,567,869	118,890,167
Transfer to the Consolidated Fund	-	-	-	-	-	(6,118,113)	(6,118,113)
Net profit for the year	-	-	-	-	-	6,980,403	6,980,403
Transfer from other reserves to General reserves	-	-	-	-	-	-	-
Transfer from General reserves to Building fund	-	-	-	-	6,980,403	(6,980,403)	-
Transfer of unrealized exchange gains	-	89,136	-	-	-	(89,136)	-
Balance at 31 December 2008	**3,000,000**	**(138,510)**	**750,000**	**9,799,944**	**6,980,403**	**99,360,620**	**119,752,457**

The notes on pages 50 to 76 form an integral part of these financial statements.

CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 December 2008

(Amounts expressed in Bahamian Dollars)

	Notes	2008 $	2007 $
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net profit for the year		6,980,403	11,180,656
Adjustments for non-cash items:			
Amortization of premiums on marketable securities	6	1,607,595	2,377,842
Depreciation	4	2,185,362	1,607,630
Interest income		(29,990,376)	(31,179,929)
Discount amortization		(2,307,805)	(2,476,033)
Interest expense		413,607	647,375
Net cash used in operating activities before changes in operating assets and liabilities		(21,111,214)	(17,842,459)
(Increase)/decrease in operating assets:			
International Monetary Fund – Special Drawing Rights		(206,624)	224,120
Receivables and other accounts		(723,884)	395,441
(Decrease)/increase in operating liabilities:			
Notes in circulation		(11,185,103)	14,773,394
Coins in circulation		801,728	734,503
Deposits by commercial banks		(17,718,166)	88,136,376
Deposits by the Bahamas Government and Bahamas Government agencies		(11,523,738)	(400,000)
Deposits by international agencies		(68,429)	(119,970)
Payables and other accounts		(1,616,481)	936,917
Net cash (used in)/from operating activities		(63,351,911)	86,838,322

The notes on pages 50 to 76 form an integral part of these financial statements.

THE CENTRAL BANK OF THE BAHAMAS

CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 December 2008

(Amounts expressed in Bahamian Dollars)

(Continued)

	Notes	2008 $	2007 $
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of marketable securities	6	(35,883,088)	(27,000,000)
Proceeds from maturities of marketable securities	6	71,500,000	39,500,000
Purchases of property, plant and equipment	4	(828,666)	(1,568,419)
Advances (made to)/repaid by Bahamas Government	9	-	(10,000,000)
Purchase of Bridge Authority bonds	12	(22,300)	(9,400)
Purchases of Bahamas Government registered stocks	10	(3,307,400)	(56,210,900)
Proceeds from sales and maturities of Bahamas Government registered stocks	10	11,056,400	192,700
Repayments of loan by Bahamas Government agency	11	275,000	275,000
Purchase of Clifton Heritage Authority bonds	13	(900)	-
Purchase of Bahamas Government Treasury bills	14	(296,535,817)	(290,344,485)
Proceeds from the sale and maturities of Treasury bills	14	433,669,686	199,098,332
Proceeds from the maturity of Bahamas Mortgage Corporation bond		-	300,000
Purchase of Bahamas Development Bank bonds	8	(4,000,000)	-
Interest received		34,182,262	32,296,172
Net cash from/(used in) investing activities		210,105,177	(113,471,000)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Payment to the Consolidated Fund		-	(3,618,000)
Interest paid		(485,074)	(647,564)
Net cash used in financing activities		(485,074)	(4,265,564)
Net increase (decrease) in cash and cash equivalents		**146,268,192**	**(30,898,242)**
Cash and cash equivalents at beginning of the year		59,751,902	90,650,144
Cash and cash equivalents at end of the year		**206,020,094**	**59,751,902**
Cash and cash equivalents are comprised of the following:			
Cash and deposits		205,828,879	59,540,754
Cash on hand (included in receivables and other accounts)		191,215	211,148
		206,020,094	**59,751,902**

The notes on pages 50 to 76 form an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 December 2008

1. INCORPORATION AND ACTIVITIES

The Central Bank of The Bahamas (the Bank) was established under the Central Bank of The Bahamas Act Chapter 321, and was continued under the Central Bank of The Bahamas Act, 2000 (the Act). Its main place of business is located at Frederick Street, Nassau, Bahamas. The Bank's principal business is the provision of central banking facilities for the Commonwealth of The Bahamas. In accordance with the Act, it is the duty of the Bank to promote and maintain monetary stability and credit and balance of payments conditions conducive to the orderly development of the Bahamian economy.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

(a) Basis of preparation

The Bank's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). The financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets.

The preparation of the financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Bank's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 3.

Interpretations to existing standards that became effective for fiscal periods beginning on or after 1 January 2008 were not relevant to the Bank's operations and accordingly did not impact the Bank's accounting policies or financial statements.

With the exception of the amendments to IAS 1 Presentation of Financial Statements that become effective for fiscal periods beginning on or after 1 January 2009, the application of new standards and amendments and interpretations to existing standards that have been published but are not yet effective are not expected to have a material impact on the Bank's accounting policies or financial statements in the period of initial application. Upon adoption, the amendments to IAS 1 will require non-owner changes in equity to be presented separately from owner changes in equity, resulting in a statement of comprehensive income. Additionally, when the Bank restates corresponding information, the amendments to IAS 1 will require the presentation of a restated balance sheet as of the beginning of the corresponding period.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 December 2008

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Revenue and expense recognition

Revenues and expenses are recognized on the accrual basis.

(c) Foreign currency translation

(i) Functional currency and presentation currency

Items included in the financial statements are measured using the currency of the primary economic environment in which the Bank operates (the functional currency), namely, the Bahamian dollar. The financial statements are presented in Bahamian dollars, which is the Bank's functional and presentation currency.

(ii) Transactions and balances

Transactions in currencies other than Bahamian dollars are converted at the rates of exchange ruling at the time of the transactions. Balances in currencies other than Bahamian dollars at the balance sheet date are converted at the closing rate of exchange prevailing at the balance sheet date.

The net change in the Bank's assets and liabilities arising from movements in currency exchange rates is included in the income statement and, in accordance with Sections 32(2)(a) and 32(2)(b) of the Act, the unrealized portion is transferred to an exchange equalization account.

(d) Property, plant and equipment

Property, plant and equipment are recorded at historical cost less accumulated depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefit associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repairs and maintenance are charged to other operating expenses during the financial period in which they occur.

Depreciation is provided in equal annual instalments so as to write off the cost of assets, other than land, which is not depreciated, over their estimated useful lives. The following rates are used:

Buildings & renovations	2% - 20% p.a.
Office equipment	20% - 33% p.a.
Computer software	33% - 50% p.a.
Office furniture & fittings	20% p.a.
Other fixed assets	20% - 33% p.a.

Gains and losses on disposals are determined by comparing proceeds with the carrying amounts. These are included in other operating expenses in the income statement.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Financial instruments

Financial assets and financial liabilities are recognized on the Bank's balance sheet when the Bank has become a party to the contractual provisions of the instrument.

Financial assets

Financial assets represent a contractual right to receive cash or another financial asset or to exchange financial assets or financial liabilities with another entity under conditions favourable to the Bank.

The Bank classifies its financial assets in the following categories: loans and receivables; held-to-maturity investments and available-for-sale financial assets. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its investments at initial recognition and re-evaluates this designation at every reporting date.

(i) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than: (a) those that the Bank intends to sell immediately or in the short term; (b) those that the Bank, upon initial recognition, designates as available-for-sale; or (c) those for which the Bank may not recover substantially all of its initial investment, other than because of credit deterioration, which are classified as available-for-sale.

Advances to the Bahamas Government

The advances to the Bahamas Government are classified as loans and receivables originated by the Bank and not held-for-trading. These loans, which are payable on demand, are stated at amortized cost, less any provision for impairment.

Loans to Bahamas Government agency

The loans to Bahamas Government agency are classified as loans and receivables originated by the Bank and not held-for-trading. These loans, which have a fixed maturity period, are measured at amortized cost, using the effective interest rate method.

Bahamas Government registered stocks

Bahamas Government registered stocks are classified as loans and receivables by the Bank and not held-for-trading and are measured at amortized cost.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 December 2008

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES. (Continued)

(e) Financial instruments (continued)

The Bahamas Development Bank bonds

The Bahamas Development Bank bonds are classified as loans and receivables by the Bank and not held-for-trading and are measured at amortized cost.

The Bridge Authority bonds

The Bridge Authority bonds are classified as loans and receivables by the Bank and not held-for-trading and are measured at amortized cost.

Bahamas Government Treasury bills

The Bahamas Government Treasury bills are classified as loans and receivables by the Bank and not held-for-trading and are measured at amortized cost.

Section 29(1)(c) of the Act requires that the total amount of Government issued or guaranteed securities held at any time by the Bank, which mature beyond five years after their date of issue, shall not exceed 20% of the demand liabilities of the Bank. At the balance sheet date, such securities held by the Bank which mature beyond five years after their date of issue was approximately 19.88% (2007: 19.27%) of such liabilities.

The Act further requires that any holdings of Government issued or guaranteed securities should not have maturities extending beyond 20 years from the date of their acquisition. The Bank held no such securities maturing beyond 20 years, at either 31 December 2008 or 2007.

(ii) Held-to-maturity financial assets

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank's management has the positive intention and ability to hold to maturity. If the Bank were to sell other than an insignificant amount of held-to-maturity assets, the entire category would be reclassified as available-for-sale.

Marketable securities issued or guaranteed by foreign governments

Marketable securities issued or guaranteed by foreign governments are classified as held-to-maturity investments, and are stated at amortized cost, using the effective interest rate method. Such investments are subject to review for impairment.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 December 2008

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Financial instruments (continued)

Clifton Heritage Authority bonds

Clifton Heritage Authority bonds are held-to-maturity investments, and are stated at amortized cost, using the effective interest rate method. Such investments are subject to review for impairment.

(iii) Available-for-sale financial assets

Available-for-sale financial assets are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

Regular-way purchases and sales of financial assets categorized as held-to-maturity and available-for-sale are recognized on the trade-date (that is the date on which the Bank commits to purchase or sell the asset).

Financial assets are initially recognized at fair value plus transaction costs for all available-for-sale financial assets. Financial assets are derecognized when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all risks and rewards of ownership.

Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognized directly in equity, until the financial asset is derecognized or impaired. At this time, the cumulative gain or loss previously recognized in equity is recognized in the income statement. However, interest calculated using the effective interest rate method for investments classified as available-for-sale is recognized in the income statement.

The fair values of quoted investments in active markets are based on current bid prices.

Financial liabilities

Financial liabilities are any liabilities that are contractual obligations to deliver cash or another financial asset to another entity or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the Bank; or a contract that will or may be settled in the Bank's own equity instrument.

Financial liabilities are initially recognized at fair value and subsequently measured at amortized cost using the effective interest rate method, where applicable.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(f) Impairment of assets

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset is impaired. A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount. The amount of the impairment for assets carried at amortized cost is calculated as the difference between the assets carrying amount and the present value of expected future cash flows discounted at the financial instrument's original effective interest rate.

If, in a subsequent period, the amount of the impairment decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment is decreased and the decrease is recognized in the income statement.

(g) Numismatic coins

Numismatic coins, which are specially minted or packaged as collectors' items and are not issued for monetary purposes, are not included in coins in circulation. Any profit or loss arising from the sale of these coins is included in the income statement.

(h) Retirement benefit costs

The Bank's retirement plan is a contributory defined benefit plan with participants being permanent employees who join the Bank prior to age 55. The cost of providing such benefits is determined using the projected unit credit method, with actuarial valuations being carried out at each balance sheet date. Actuarial gains and losses which exceed 10% of the greater of the present value of the Bank's pension obligations and the fair value of the plan's assets are amortized over the expected average remaining working lives of the participating employees. Past service cost is recognized immediately to the extent that the benefits are already vested, and otherwise is amortized on a straight-line basis over the average period until the amended benefits become vested. Contributions are made by both the employer at 8.2% (2007: 9.3%) and the employee at 5%.

The amount recognized in the balance sheet represents the present value of the defined benefit obligation as adjusted for the unrecognized actuarial gains and losses and unrecognized past service costs, and reduced by the fair value of plan assets. Any asset arising as a result of this calculation is limited to the unrecognized actuarial losses and past service cost plus the present value of available refunds and reductions in future contributions to the plan.

(i) Fiduciary items

No account is taken in these financial statements of assets held or liabilities incurred by the Bank in a fiduciary capacity.

(j) Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from date of acquisition and demand deposits.

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Such accounting estimates and judgments are disclosed in Notes 2 (f) and 2 (h).

4. PROPERTY, PLANT AND EQUIPMENT

	Land $	Buildings & renovations $	Office equipment $	Computer software $	Office furniture & fittings $	Other fixed assets $	Total $
COST							
At 1 January 2008	2,452,938	12,442,248	10,116,131	6,734,705	3,317,490	498,658	35,562,170
Transfers In/(Out)*		150,657	(136,618)	15,698	85,414	(115,151)	-
Additions	-	57,657	663,195	104,672	3,142	-	828,666
Disposals	-	-	(301,770)	-	-	-	(301,770)
At 31 December 2008	2,452,938	12,650,562	10,340,938	6,855,075	3,406,046	383,507	36,089,066
ACCUMULATED DEPRECIATION							
At 1 January 2008	-	4,584,580	6,772,119	6,366,668	2,903,469	369,612	20,996,448
Transfers In/(Out)*	-	106,845	292,043	(371,068)	44,120	(71,940)	-
Charge for the year	-	416,812	1,039,975	550,055	135,37	43,144	2,185,362
Disposals	-	-	(301,770)	-	-	-	(301,770)
At 31 December 2008	-	5,108,237	7,802,367	6,545,655	3,082,965	340,816	22,880,040
NET BOOK VALUE							
At 31 December 2008	**2,452,938**	**7,542,325**	**2,538,571**	**309,420**	**323,081**	**42,691**	**13,209,026**
COST							
At 1 January, 2007	2,452,938	12,175,003	9,441,931	6,381,926	3,078,282	463,671	33,993,751
Additions	-	267,245	674,200	352,779	239,208	34,987	1,568,419
At 31 December 2007	2,452,938	12,442,248	10,116,131	6,734,705	3,317,490	498,658	35,562,170
ACCUMULATED DEPRECIATION							
At 1 January 2007	-	4,185,509	5,895,352	6,217,697	2,784,316	305,944	19,388,818
Charge for the year	-	399,071	876,767	148,971	119,153	63,668	1,607,630
At 31 December 2007	-	4,584,580	6,772,119	6,366,668	2,903,469	369,612	20,996,448
NET BOOK VALUE							
At 31 December 2007	**2,452,938**	**7,857,668**	**3,344,012**	**368,037**	**414,021**	**129,046**	**14,565,722**

*Transfer of assets includes both adjustments made in the general ledger and primarily reclassifications within the asset classes.

5. EXTERNAL ASSETS

External assets comprise those assets defined by Section 18(1) of the Act. The Act also requires that the value of external assets shall not at any time be less than 50% of the value of the aggregate of the notes and coins in circulation and other demand liabilities of the Bank. At year-end, external assets represented approximately 84.98% (2007: 64.54%) of such liabilities.

6. MARKETABLE SECURITIES ISSUED OR GUARANTEED BY FOREIGN GOVERNMENTS

Section 18(1) of the Act requires that marketable securities issued or guaranteed by foreign governments, which mature beyond 5 years, shall at no time constitute more than 30% in value of the Bank's external assets. At 31 December 2008, marketable securities held by the Bank, which mature after 5 years, constituted 13.62% (2007:14.68%) of the Bank's external assets.

The movement in marketable securities is as follows:

	2008	**2007**
	$	**$**
At beginning of year	380,531,908	395,409,750
Purchases	35,883,088	27,000,000
Redemptions	(71,500,000)	(39,500,000)
Amortization of premium	(1,607,595)	(2,377,842)
End of year	**343,307,401**	**380,531,908**
Add: Accrued interest	4,082,139	4,178,488
Total	**347,389,540**	**384,710,396**

The fair value of these securities at the balance sheet date was $359,421,252 (2007: $386,394,914). These securities bear interest at rates varying between 2.50% and 6.50% (2007: 2.62% and 6.50%).

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 December 2008

(Continued)

7. INTERNATIONAL MONETARY FUND

Bahamas Tranche

The International Monetary Fund (IMF) reserve tranche represents the amount by which The Bahamas' quota of Special Drawing Rights (SDR) with the IMF exceeds subscription payments as noted below:

	2008		**2007**	
	SDR (millions)	**$**	**SDR (millions)**	**$**
Quota	130.3	200,697,126	130.3	205,906,336
Subscription payments in promissory notes	(119.3)	(184,392,113)	(119.3)	(188,731,460)
Subscription payments in currency	(4.7)	(6,661,889)	(4.7)	(7,281,458)
Reserve tranche	**6.3**	**9,643,124**	**6.3**	**9,893,418**

The reserve tranche was purchased from the Government of The Bahamas in 1976.

Subsequent to that purchase, the Bank has funded 25% of each increase in the IMF subscriptions of The Bahamas by issuing interest-free promissory notes which are payable on demand. In the opinion of the Directors, it is not probable that an outflow of resources employing economic benefits will be required to settle these promissory notes, which total $55,513,853 (2007: $51,678,036). Consequently, this amount is regarded as a contingent liability and is not recognized in the Bank's balance sheet.

Special Drawing Rights

This amount represents SDR holdings with the IMF, is repayable on demand and bears interest at rates varying from 0.82% to 3.09% (2007: 3.50% to 4.32%).

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 December 2008

(Continued)

8. BAHAMAS DEVELOPMENT BANK BONDS

These bonds bear interest at the prime rate of 5.5% (2007: N/A).

The movement of the Bahamas Development Bank bonds, is as follows:

	2008	2007
	$	$
At beginning of year	-	-
Purchases	4,000,000	-
Redemptions	-	-
Amortization of premium	-	-
End of year	**4,000,000**	**-**
Add: Accrued interest	64,317	-
Total	**4,064,317**	**-**

9. ADVANCES TO THE BAHAMAS GOVERNMENT

Sections 28(3) and 28(4) of the Act require that advances to the Government, which may be outstanding at any one time, shall not exceed 10% of either the annual average ordinary revenue of the Government over the three preceding years for which the accounts have been laid before Parliament or the estimated ordinary revenue of the Government for the year, whichever is the less.

At the balance sheet date, advances to the Government approximated 7.4% (2007: 5.6%) of the lesser of such revenues. Of those advances, $19,000,000 (2007: $19,000,000) bear interest at a rate of 1.09% (2007: 1.09%), $5,969,000 (2007: $5,969,000) bear interest at a rate of 0.08% (2007: 0.08%) and $10,000,000 (2007: $10,000,000) bear interest at a rate of 2.25% (2007: 2.25%). The remaining advances were interest free during both 2008 and 2007. The advances are repayable on demand.

The movement in the advances to The Bahamas Government is as follows:

	2008	2007
	$	$
At beginning of year	71,987,608	61,987,608
Additions	-	10,000,000
End of year	**71,987,608**	**71,987,608**
Add: Accrued interest	443,931	1,424,939
Total	**72,431,539**	**73,412,547**

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 December 2008

(Continued)

10. BAHAMAS GOVERNMENT REGISTERED STOCKS

The movement in Bahamas Government Registered Stock is as follows:

	2008 $	2007 $
At beginning of year	132,385,000	76,366,800
Purchases	3,307,400	56,210,900
Redemptions/maturities	(11,056,400)	(192,700)
End of year	**124,636,000**	**132,385,000**
Add: Accrued interest	1,638,640	1,897,446
Total	**126,274,640**	**134,282,446**

Bahamas Government Registered Stocks bear interest at rates ranging between 5.53% and 8.75% (2007: 5.53% and 8.75%).

11. LOANS TO BAHAMAS GOVERNMENT AGENCY

This balance is comprised of three loan facilities made available to a Government agency in accordance with Section 29(l) (f) of the Act.

The movement in loans to Bahamas Government Agency is as follows:

	2008 $	2007 $
At beginning of year	6,750,000	7,025,000
Repayments	(275,000)	(275,000)
End of year	**6,475,000**	**6,750,000**
Add: Accrued interest	24,269	26,126
Total	**6,499,269**	**6,776,126**

The loans bear interest at 2.00% (2007: 2.00%).

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 December 2008

(Continued)

12. THE BRIDGE AUTHORITY BONDS

These bonds bear interest at rates ranging from 1.00% to 1.50% (2007: 1.00% to 1.50%) per annum over the prime rate.

The movement for the Bridge Authority Bonds, is as follows:

	2008 $	2007 $
At beginning of year	757,800	748,400
Purchases	22,300	9,400
End of year	**780,100**	**757,800**
Add: Accrued interest	13,990	13,103
Total	**794,090**	**770,903**

13. CLIFTON HERITAGE AUTHORITY BONDS

The Bank is the registrar for the Clifton Heritage Authority Bonds guaranteed by The Bahamas Government.

These bonds bear interest at a rate of ½% (2007: ½%) per annum over the prime rate.

The movement in the Clifton Heritage Authority Bonds is as follows:

	2008 $	2007 $
At beginning of year	633,700	633,700
Purchases	900	-
End of year	**634,600**	**633,700**
Add: Accrued interest	4,265	4,273
Total	**638,865**	**637,973**

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 December 2008

(Continued)

14. BAHAMAS GOVERNMENT TREASURY BILLS

The movement in the Bahamas Government Treasury bills is as follows

	2008 $	2007 $
At beginning of year	143,460,999	52,214,846
Purchases	296,535,817	290,344,485
Redemptions/maturities	(433,669,686)	(199,098,332)
End of year	**6,327,130**	**143,460,999**
Add: Accrued interest	25,766	637,023
Total	**6,352,896**	**144,098,022**

Bahamas Government Treasury bills which matured on 5 February 2009 were discounted at 3.13%. Due to the short-term nature of these securities, amortized cost approximates fair value.

15. DEPOSITS BY COMMERCIAL BANKS

Deposits by commercial banks consist of current account balances deposited as statutory reserves in accordance with Section 19 of the Act. The remaining funds deposited in the current account are used to, inter alia, facilitate settlement and effect foreign currency transactions.

The present level of the statutory reserves applicable to commercial banks is 5.00% of the total Bahamian dollar deposit liabilities, of which at least 4.00% must be placed on deposit with the Bank. These deposits are interest free and are repayable on demand, subject to maintenance of minimum balances required by the Act.

16. DEPOSITS BY INTERNATIONAL AGENCIES

The Bank is designated as the fiscal agency for the Commonwealth of The Bahamas. Deposits by international agencies include deposits in Bahamian currency by the World Bank, the International Monetary Fund, the Inter-American Development Bank, the Caribbean Development Bank and the Commission of the European Development Fund. These deposits are interest free and are repayable on demand.

17. INTERNATIONAL MONETARY FUND ALLOCATION OF SPECIAL DRAWING RIGHTS

In accordance with a resolution of the Board of Governors of the IMF, effective 11 December 1978, The Bahamas became a participant in the Special Drawing Rights Department of the IMF, receiving a total allocation of SDR10,230,000 between 1979 and 1981. The Special Drawing Rights allocation bore interest during the year at rates varying between 0.82% and 3.09% (2007: 3.50% and 4.32%), includes accrued interest of $23,920 (2007: $95,387) and is repayable on demand.

18. EQUITY AND RESERVES

a. **Capital management** - The Bank's objectives when managing capital, which is a broader concept than 'equity' on the face of the balance sheet, are:

- to comply with the capital requirements outlined in Sections 6 and 7 of the Act;
- to safeguard the Bank's ability to continue as a going concern so that it can continue to provide central banking facilities for the Commonwealth of The Bahamas; and
- to maintain a strong capital base to support the development of the Bahamian economy.

Capital adequacy and the use of regulatory capital are monitored by the Bank's management, and in accordance with the guidelines established by the Act. Provision is made in Section 6(1) and (2) of the Act for the paid-up portion of the authorized capital of the Bank to be increased each year by an amount from the Consolidated Fund at such times and in such amounts as the Board, with the approval of the Minister, may determine. At 31 December 2008, the Bank's paid-up capital was equal to the authorized capital of $3,000,000.

b. **Exchange equalization account** – Under the terms of Sections 32(2)(a) and 32(2)(b) of the Act, this account represents the net unrealized profits or losses arising from the revaluation of foreign currency assets and liabilities of the Bank at the balance sheet date.

c. **Contingency reserve** – This reserve is maintained in accordance with the provisions of Section 7(1) of the Act.

d. **Other reserves** – In accordance with the provisions of Section 7(1) of the Act, the Bank has determined to transfer $Nil (2007: $3,958,867) from other reserves to general reserves.

e. **Building fund** – In accordance with the provisions of Section 7(1) of the Act, the Bank has established a building fund, to assist in defraying the cost of new premises, and into which the current year's profit of $6,980,403 was transferred.

f. **General reserves** – Section 7(2) of the Act requires that, at the end of any year, where the amount in the general reserves exceeds twice the authorized capital of the Bank or 15% of its demand liabilities, whichever is greater, the excess shall be paid to the Consolidated Fund unless the Minister of Finance determines otherwise.

The balance of the general reserves at year end amounted to $99,360,620 (2007: $105,567,869) equivalent to 15.00% (2007: 15.00%) of demand liabilities prior to a provision of $6,118,113 (2007: $Nil) to be paid into the Consolidated Fund.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 December 2008

(Continued)

19. INCOME

Interest Income

	2008	2007
	$	$
Interest on Foreign Investments		
Interest on demand deposits	517,073	1,085,401
Interest on fixed deposits	5,478,867	6,915,512
Interest on marketable securities	15,517,780	16,299,583
Interest on bond (Caribbean Development Bank)	2,083	-
	21,515,803	24,300,496
Interest on Loans		
Interest on loans to public corporations	131,843	138,247
Interest on Government advances	438,802	369,663
Interest earned on staff loans	202,320	219,256
	772,965	727,166
Interest on Domestic Investments		
Interest on Bahamas Development Bank Bond	195,055	-
Interest on Bahamas Government stocks	7,417,143	6,056,200
Interest on Bahamas Mortgage Corp. Bonds	-	9,421
Interest on Bridge Bonds	51,350	49,873
Interest on Clifton Heritage Bonds	38,060	36,774
	7,701,608	6,152,268
Unrealized Exchange Gain/(Loss)	89,136	(454,940)
Discounts on Investments		
Discount on marketable securities	1,006,659	890,367
Discount on local Treasury bills	1,270,776	1,556,173
Discount on Government of Dominica Treasury bill	30,370	29,493
	2,307,805	2,476,033
Other Income		
Other	281,042	218,506
Bank statutory fines	68,641	743,314
Commission on foreign currency sales	624,695	719,232
Premium on investment currency market	186,932	5,926
	1,161,310	1,686,978
Total Income	**33,548,627**	**34,888,001**

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 December 2008

(Continued)

20. EXPENSES

General and Administrative

	2008	2007
	$	$
Premium on marketable securities	2,469,201	2,522,288
Currency (printing and shipping)	4,595,587	1,347,939
Professional fees	1,373,493	1,295,552
Utilities	1,044,027	830,760
Repair and maintenance	477,538	534,529
Rent	448,773	462,368
Insurance	218,235	237,645
Subscription and membership fees	147,559	167,261
Stationary and office supplies	134,801	144,488
Director's remuneration	33,750	26,250
Other	954,221	1,003,726
	11,897,185	**8,572,806**

Staff Costs

	2008	2007
Salaries and wages	9,860,894	9,568,981
Group Insurance Plan	960,503	927,037
Staff training	327,946	342,421
National Insurance	261,728	267,543
Staff pension fund	211,429	850,847
Responsibility allowance	101,094	90,416
Other	348,476	832,289
	12,072,070	**12,879,534**

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 December 2008

(Continued)

21. THE DEPOSIT INSURANCE CORPORATION

In accordance with Section 5(1) of the Protection of Depositors Act, 1999, the Bank has made an initial capital contribution of $500,000, representing 100% of the paid-up portion of the capital of the Deposit Insurance Corporation. This Corporation was established to manage the Deposit Insurance Fund, which was established to protect funds deposited with member institutions in the domestic financial system. While the share capital was put up by the Bank, the Deposit Insurance Corporation was always conceived to be a separate and independent institution with its own mandate and operates as such.

In the opinion of the Directors, the Bank does not have the power to govern the financial and operating policies of the Deposit Insurance Corporation so as to attain benefits from its activities. Consequently, the Deposit Insurance Corporation is not treated as a subsidiary in these financial statements.

Additionally, the Directors do not consider that the investment in the Deposit Insurance Corporation will be recoverable, and consequently, the Bank has made a full provision against this investment.

22. COMMITMENTS

The Bank is committed to rent office space under an operating lease. The Bank is committed to the following future payments under the lease agreement:

Year	**$**
2009	427,186
2010	148,736
2011	42,237

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 December 2008

(Continued)

23. CONCENTRATIONS OF ASSETS AND LIABILITIES

The Bank has the following concentrations of assets and liabilities:

EXTERNAL ASSETS	**2008**	**2007**
	%	**%**
Geographic Region		
North America	88.72	99.77
Europe	11.02	0.20
Other	0.26	0.03
Industry		
Financial Sector	100.00	100.00

OTHER ASSETS	**2008**	**2007**
	%	**%**
Geographic Region		
Bahamas	100.00	100.00
Industry		
Government Sector	100.00	100.00

DEMAND LIABILITIES	**2008**	**2007**
	%	**%**
Geographic Region		
Bahamas	99.95	99.94
Other	0.05	0.06
Industry		
Financial Sector	100.00	100.00

OTHER LIABILITIES	**2008**	**2007**
	%	**%**
Geographic Region		
North America	100.00	100.00
Industry		
Financial Sector	100.00	100.00

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 December 2008

(Continued)

24. RELATED-PARTY TRANSACTIONS

The Bank could be regarded as related to state corporations such as Bahamas Electricity Corporation (BEC) and National Insurance Board (NIB). However, the only transactions that the Bank has with such related entities are purely on commercial terms.

The Bank provides certain services to the Government of The Bahamas in accordance with its mandate under Sections 26 to 29 of the Act.

The Bank's senior management personnel are regarded to be its only key management personnel.

The following transactions were carried out with related parties:

a. **Compensation:**	**2008**	**2007**
	$	**$**
Salaries and short-term employee benefits	1,473,656	1,365,517
Termination benefits	-	-
	1,473,656	**1,365,517**

b. **Loans:**	**2008**	**2007**
	$	**$**
Beginning of the year	725,058	837,012
Loans advanced during the year	286,933	27,352
Loan repayments received	(228,367)	(139,306)
End of year	**783,624**	**725,058**

25. CONTINGENT LIABILITIES

The Bank is party to asserted and unasserted claims in the normal course of business, which are at various stages of the judicial process. The Bank is defending all such claims and is of the opinion that the outcome, which cannot presently be determined, will not adversely affect its operations and financial statements.

In connection with the IMF subscription, the Bank has issued promissory notes which are regarded as contingent liabilities. (See Note 7).

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 December 2008

(Continued)

26. OFF-BALANCE SHEET ITEMS

The Bank has off-balance sheet items totalling $47,060,395 (2007: $40,907,368). These items, which are held in a fiduciary capacity, comprise offsetting assets consisting of bank accounts, and liabilities consisting of dormant retail customer accounts of $47,060,395 (2007: $40,907,368).

Certain dormant retail customer accounts, which are received in foreign currencies, are invested in the same currency. These currencies are converted to Bahamian Dollars at the rate of exchange prevailing at the date of accepting their funds, and listed as a memorandum account in the trial balance. Foreign currency deposits are repaid by liquidating investments in the same currency, which does not involve currency conversion.

27. FAIR VALUE OF FINANCIAL INSTRUMENTS

With the exception of marketable securities, whose fair value is as stated in Note 6, and those financial assets classified as loans and receivables with an aggregate carrying value of $216,416,751 (2007: $359,340,044) and aggregate fair value of $216,971,481 (2007: $358,156,634), the Directors consider that all of the Bank's financial assets and liabilities are carried at amounts approximating their fair value.

28. FINANCIAL RISK MANAGEMENT

The Bank's activities expose it to a variety of financial risks and those activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is core to the financial business, and the operational risks are an inevitable consequence of being in business. The Bank's aim is therefore to achieve an appropriate balance between risk and return and minimize potential adverse effects on the Bank's financial performance.

The Bank's risk management policies are designed to identify and analyse these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The Bank regularly reviews its risk management policies and systems to reflect changes in markets, products and emerging best practices.

Risk management is carried out by the investment and monetary policy committees under policies approved by the Board of Directors. The committees identify, evaluate and hedge financial risks in close co-operation with the Bank's operating units. The Board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk and financial instruments.

The most important types of risks are credit risk, liquidity risk, market risk and other operational risk. Market risk includes currency risk and interest rate risk.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 December 2008

(Continued)

28. FINANCIAL RISK MANAGEMENT (Continued)

Credit risk

The Bank takes on exposure to credit risk, which is the risk that a counterparty will cause a financial loss for the Bank by failing to discharge an obligation. Significant changes in the economy, or in the health of a particular segment that represents a concentration in the Bank's portfolio, could result in losses that are different from those provided for at the balance sheet date. Credit exposures are primarily concentrated in cash and deposits, marketable securities and loans and advances. The credit risk management and control are monitored by the Investment Committee and reported to the Board of Directors regularly.

The Directors do not consider that the Bank is exposed to any significant credit risk because its financial assets consist primarily of cash and securities issued or guaranteed by either foreign Governments or The Bahamas Government.

Market risk

The Bank takes on exposure to market risk, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads, foreign exchange rates and equity prices. The Bank's exposure to market risk is from its financial investment portfolios.

The market risks arising from the Bank's activities are monitored by the investment and monetary policy committees. Regular reports are submitted to the Board of Directors and operating units.

Foreign exchange risk

The Bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.

The Bank's exposure to foreign exchange risk is largely limited by the fact that fluctuations in the prevailing foreign currency exchange rates are for the account of the Government under the terms of Sections 32(2)(a) and 32(2)(b) of the Act.

28. FINANCIAL RISK MANAGEMENT (Continued)

Interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Bank takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may decrease or create losses in the event that unexpected movements arise. The level of mismatch of interest rate repricing that may be undertaken by the Bank is monitored frequently by the investment and monetary policy committees.

Certain of the Bank's financial assets and liabilities are exposed to interest rate risk. Marketable securities carry an average yield of 4.62% (2007: 4.20%); however, if these securities had a reduced average yield of 3.17% (2007: 3.17%), derived from their varying yields at the lower end of the spectrum, income for the year and equity at year-end would have been reduced by $5,256,681 (2007: $4,000,908). Had the yield been tilted towards the higher end of the spectrum, to 4.80% (2007: 4.60%), income for the year and equity at year-end would have been increased by $644,040 (2007: $1,547,075).

At 31 December 2008, should interest rates have risen by 50 basis points with all other variables remaining constant, the increase in equity and net income for the year would amount to approximately $1,159,837, arising from funds placed on cash and deposits (2007: $408,764).

If interest rates had decreased by 50 basis points, the decrease in equity and net income for the year would amount to approximately $1,159,837 (2007: $408,764).

Liquidity risk

Liquidity risk is the risk that the Bank is unable to meet its payment obligations associated with its financial liabilities when they fall due, and to replace funds when they are withdrawn. The consequence may be the failure to meet obligations to repay depositors and fulfil commitments to lend.

Liquidity risk does not arise in the domestic currency as the Bank is the ultimate source of Bahamian dollar liquidity.

The Bank manages its foreign liquidity risks through appropriate structuring of its foreign investment portfolios to ensure that the maturity profiles of foreign assets sufficiently match those of foreign commitments. This is monitored and managed on a regular basis. In addition, the Bank's foreign investment portfolio comprises mainly short-term, highly liquid investment instruments.

28. FINANCIAL RISK MANAGEMENT (Continued)

Liquidity risk management process

The Bank's liquidity management process, as carried out within the Bank includes:

- day-to-day funding, managed by monitoring future cash flows to ensure that requirements can be met, inclusive of replenishment of funds as they mature. The Bank maintains an active presence in global money markets to enable this to happen;
- maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow;
- monitoring balance sheet liquidity ratios against internal and regulatory requirements; and
- managing the concentration and profile of debt and financial instrument maturities.

The table below analyses financial assets and liabilities of the Bank into relevant maturity groupings, based on the remaining period at the balance sheet date to the contractual maturity date. The amounts in the table are the undiscounted cash flows. Balances due within 12 months equal their carrying balances as the impact of discounting is not significant.

28. FINANCIAL RISK MANAGEMENT (Continued)

Liquidity risk (Continued)

	Up to 1 month $	1 to 3 months $	3 months to 1 year $	1 to 5 years $	Over 5 year $	Total $
As of 31 December 2008						
Period of maturity						
Financial Assets						
Cash and deposits	105,665,944	100,162,934	-	-	-	205,828,878
Marketable securities issued or guaranteed by foreign gov'ts	5,075,521	25,232,174	148,275,306	92,109,068	76,697,471	347,389,540
International Monetary Fund:						
Bahamas reserve tranche	9,643,124	-	-	-	-	9,643,124
Special drawing rights	66,569	-	-	-	-	66,569
Bahamas Development Bank bond	-	-	-	-	4,064,317	4,064,317
Advances to the Bahamas Gov't	72,431,539	-	-	-	-	72,431,539
Bahamas Gov't registered stocks	-	-	101	63,584	126,210,955	126,274,640
Loans to Bahamas Gov't agency	-	-	-	125,469	6,373,800	6,499,269
The Bridge Authority bonds	-	-	-	-	794,090	794,090
Clifton Heritage Authority bonds	-	-	-	-	638,865	638,865
Bahamas Gov't Treasury bills	-	6,352,896	-	-	-	6,352,896
Receivables and other accounts	6,657,937	-	-	-	4,204,893	10,862,830
Total financial assets	**199,540,634**	**131,748,004**	**148,275,407**	**92,298,121**	**218,984,391**	**790,846,557**
As of 31 December 2008						
Period of maturity						
Liabilities						
Notes in circulation	305,961,648	-	-	-	-	305,961,648
Coins in circulation	17,600,463	-	-	-	-	7,600,463
Deposits by commercial banks	321,378,833	-	-	-	-	321,378,833
Deposits by the Bahamas Gov't and Bahamas Gov't agencies	14,517,803	-	-	-	-	14,517,803
Deposits by international agencies	358,537	-	-	-	-	358,537
Payables and other accounts	2,586,852	-	-	-	-	2,586,852
International Monetary Fund allocation	15,780,878	-	-	-	-	15,780,878
Total liabilities	**678,185,014**					**678,185,014**
Net liquidity gap, 31 December 2008	**(478,644,380)**	**131,748,004**	**148,275,407**	**92,298,121**	**218,984,391**	**112,661,543**

28. FINANCIAL RISK MANAGEMENT (Continued)

Liquidity risk (Continued)

	Up to 1 month $	1 to 3 months $	3 months to 1 year $	1 to 5 years $	Over 5 year $	Total $
As of 31 December 2007						
Period of maturity						
Financial Assets						
Cash and deposits	59,540,754	-	-	-	-	59,540,754
Marketable securities issued or guaranteed by foreign gov'ts	-	5,033,572	67,796,133	245,183,000	66,697,691	384,710,396
International Monetary Fund:						
Bahamas reserve tranche	9,893,418	-	-	-	-	9,893,418
Special drawing rights	90,099	-	-	-	-	90,099
Advances to the Bahamas Gov't	73,412,547	-	-	-	-	73,412,547
Bahamas Gov't registered stocks	-	-	-	89,500	134,192,946	134,282,446
Loans to Bahamas Gov't agency	-	-	-	250,836	6,525,290	6,776,126
The Bridge Authority bonds	-	-	-	-	770,903	770,903
Clifton Heritage Authority bonds	-	-	-	-	637,973	637,973
Bahamas Gov't Treasury bills	-	144,098,022	-	-	-	144,098,022
Receivables and other accounts	6,587,986	-	-	-	3,570,893	10,158,879
Total financial assets	**149,524,804**	**149,131,594**	**67,796,133**	**245,523,336**	**212,395,696**	**824,371,563**
As of 31 December 2007						
Period of maturity						
Liabilities						
Notes in circulation	317,146,751	-	-	-	-	317,146,751
Coins in circulation	16,798,735	-	-	-	-	16,798,735
Deposits by commercial banks	339,096,999	-	-	-	-	339,096,999
Deposits by the Bahamas Gov't and Bahamas Gov't agencies	26,041,541	-	-	-	-	26,041,541
Deposits by international agencies	426,966	-	-	-	-	426,966
Payables and other accounts	4,274,800	-	-	-	-	4,274,800
International Monetary Fund allocation	16,261,326	-	-	-	-	16,261,326
Total liabilities	**720,047,118**	**-**	**-**	**-**	**-**	**720,047,118**
Net liquidity gap, 31 December 2007	**(570,522,314)**	**149,131,594**	**67,796,133**	**245,523,336**	**212,395,696**	**104,324,445**

29. CONTRIBUTORY DEFINED BENEFIT PLAN

The movement in the contributory defined benefit obligation over the year is as follows:

	2008 $	2007 $
Current service cost	1,317,277	1,365,716
Interest cost	1,812,940	1,703,810
Contribution by plan participants	375,971	361,668
Actuarial gain	560,251	535,090
Benefit paid	(785,910)	(596,830)
End of year	**3,280,529**	**3,369,454**

The actuarial gain at 31 December 2008 represented 1.77% (2007: 1.79%) of plan liabilities; and the actuarial loss (2007: gain) was 0.07% (2007: 0.15%) of plan assets.

The amount recognized as an asset in the balance sheet in respect of the Bank's contributory defined benefit plan is as follows:

	2008 $	2007 $
Present value of funded obligations	(31,734,047)	(29,949,990)
Fair value of plan assets	39,592,536	36,976,991
	7,858,489	7,027,001
Unrecognized actuarial gains	(4,443,677)	(3,926,543)
Net assets calculated in accordance with paragraph 54 of International Accounting Standard 19	**3,414,812**	**3,100,458**

Summary of plan investments, in accordance with IAS19:

	2008 $	2007 $
Bahamas Government registered stock	38,299,300	35,691,600
Other bonds	312,200	437,700
Shares	450,000	300,000
Total Investments	**39,061,500**	**36,429,300**

29. CONTRIBUTORY DEFINED BENEFIT PLAN (Continued)

The expense recognized in the income statement in respect of the Bank's contributory defined benefit plan is as follows:

	2008 $	2007 $
Current service cost	941,306	1,004,048
Interest cost	1,812,940	1,703,810
Expected return on plan assets	(2,411,059)	(2,239,286)
Net actuarial (gain) loss recognised in year	(15,155)	-
	328,032	**468,572**

Movements in the net assets recorded in the balance sheet are as follows:

	2008 $	2007 $
Net assets at beginning of year	3,100,458	2,869,018
Net expense recognized in the income statement	(328,032)	(468,572)
Employer contributions	642,386	700,012
Net assets at end of year	**3,414,812**	**3,100,458**

The Bank intends to contribute approximately 10.0% of gross payroll to the plan during 2009 (2008: actual 8.5%).

Principal actuarial assumptions used at the balance sheet date are as follows:

	2008	2007
Discount rate	6.00%	6.00%
Expected return on plan assets	6.25%	6.50%
Expected rate of salary increase at age 18	6.75%	9.00%
Expected rate of salary increase at age 59	3.00%	2.00%
Average expected remaining working lives of employees (years)	19.00	19.00

The actual return on plan assets during the year was $2,383,097 (2007: $2,294,016). The expected return on plan assets has been arrived at using a weighted average return approach.

30. CORRESPONDING FIGURES

The corresponding figures disclosed in Note 28 for liquidity risk has been restated to replace the presentation of maturity schedules for Notes 6, 8, 10, 11, 12 and 13. This change does not have any financial impact on the financial statements.

Frederick Street
P.O. Box N4868
Nassau | NP | The Bahamas

Telephone 1.242.302.2600
Fax 1.242.322.4321

Website | www.centralbankbahamas.com
Email | cbob@centralbankbahamas.com