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QUARTERLY OVERVIEW OF DOMESTIC ECONOMIC DEVELOPMENTS

DECEMBER 2006

This summary is an early release, excerpted from the upcoming issue of the Central Bank's Quarterly Economic Review for the Quarter ended December 2006.

The Bahamas
Review of Domestic Economic Developments for Fourth Quarter 2006

Preliminary evidence suggests that economic activity remained positive during the fourth quarter, buoyed by steady growth in construction output and domestic demand, which offset weakness in the tourism sector. Fiscal operations were characterized by a slight expansion in the overall deficit, as expenditure gains outstripped moderate accretions to revenues. Developments in the monetary sector featured continued tightening in liquidity conditions, with commercial banks rediscounting holdings of short-term Government debt to boost cash reserves. In this context, credit growth moderated and, alongside the receipt of public sector foreign currency borrowing proceeds, occasioned a more tempered decline in external reserves. Meanwhile, the current account deficit deteriorated as elevated outflows associated with tourism-related construction services offset the improvement in the visible trade deficit. However, this position was substantially funded by a surge in direct and other related investment inflows, which resulted in a four-fold increase in the surplus on the capital and financial account. Sustained credit expansion throughout the year lowered banks' net free cash balances in the fourth quarter by $54.1 million (31.6%) to $117.2 million, and to a reduced 2.4% share of total Bahamian dollar deposits from 4.2%. Likewise, the broader surplus liquid assets contracted by 61.5% to $63.1 million, shaving the excess over the statutory minimum to 7.9% from 19.1% in 2005.

Amid the moderation in credit growth and the public sector's foreign currency borrowing proceeds, external reserves contracted by a lesser $43.0 million (7.9%) to $499.7 million.

Movements in banks' average interest rates reflected increased competition in the deposit and loan markets as liquidity tightened. Consequently, the weighted average loan-to-deposit spread weakened by 34 basis points to 6.28 percentage points, as the average loan rate contracted by 14 basis points to 9.79%, and deposit rates firmed by 20 basis points to 3.51%. The average 90-day Treasury bill rate trended higher to 1.74% from 0.17% in the corresponding period last year, whereas benchmark interest rates—Central Bank's Discount Rate and the commercial banks' Prime Rate—were unchanged at 5.25% and 5.50%, respectively.

Money growth (M3) slackened to 1.3% from 3.4% in the corresponding quarter of 2005, placing the overall stock at $5.15 billion. Accretions were recorded for local currency fixed and savings balances, of 2.2% and 1.3%, respectively, whereas demand deposits fell by 1.5%. Currency in active circulation grew by 1.6% and residents' foreign currency deposits strengthened by 3.9%.

Domestic credit growth abated to $217.9 million (3.3%) from the previous year's $275.3 million (4.9%). Underlying this, the expansion in the dominant Bahamian dollar component was reduced to 3.1% from 5.2% in 2005, while foreign currency credit increased by 5.4%. Private sector credit strengthened further by $148.3 million (2.7%), following a $205.7 million (4.3%) rise in 2005, with gains registered for residential mortgages (3.8%), consumer credit (4.1%), and personal overdrafts (6.9%). Buoyed mainly by a foreign currency bond issuance, claims on the public corporations advanced more strongly by 7.8%, while the increase in net credit to Government slackened to 6.4% from 11.7% in 2005.

During the second quarter of FY2006/07, fiscal operations turned in a slight deterioration in the overall balance, as total overlays rose by 8.8% to $352.7 million, reflecting a 49.6% surge in capital expenditure and a 4.6% increase in current payments, while net lending to public corporations widened by 26.1% to $18.0 million. In contrast, total revenues strengthened by 9.4% to $299.1 million, reflecting a 3.1% advance in tax receipts and a near doubling in non-tax revenues to $40.4 million. Budgetary financing was predominantly sourced from commercial banks in the form of $83.0 million in short-term advances. Debt repayments totaled $17.5 million, the bulk of which was used to reduce outstanding Bahamian dollar obligations. Consequently, the Direct Charge on Government fell by 0.6% ($15.0 million) to $2,381.7 million over the previous quarter. The Government's contingent liabilities contracted by 0.8% to $499.1 million;

and the National Debt was 0.7% lower at $2,880.7 million.

In the tourism sector, visitor arrivals for the first ten months of the year weakened by 4.7% to 3.9 million, extending the 2.3% decline recorded during the corresponding period of 2005. In particular, sea visitors, the largest segment of the market, fell by 7.0% to 2.7 million, as increased competition from extra-regional destinations contributed to a comparable decline in cruise arrivals. In contrast, air traffic rose marginally by 0.5% to 1.3 million passengers. By port of entry, total arrivals to the New Providence market—which accounted for approximately 58.4% of the visitors—contracted by 6.7%. A similar pattern was observed in both Grand Bahama and the Family Islands, where total visitor arrivals fell by 1.2% and 1.8%, respectively. Data from the hotel sector for the fourth quarter, showed that hotel room revenues declined by 1.6% to $68.2 million, in contrast to a 17.4% boast in 2005. This was primarily explained by a 5.7% contraction in average occupancy rates, which overshadowed the 9.1% firming in average nightly room rates.

Construction sector activity continued to be buoyed by strong levels of commercial and residential investments. The total value of mortgage disbursements for the period grew by 7.5% to $146.9 million, with 90.7% attributed to residential developments. Consequently, the total value of outstanding mortgages increased by 16.0% to $2,503.9 million; with a 15.9% rise in the residential component to $2,288.6 million and a 16.8% increase for commercial to $215.3 million. Commitments for new construction and repairs—a more forward looking indicator of activity—fell by 51.7% to $29.7 million, with residential commitments accounting for roughly 91.4% of the total. In terms of mortgage financing, the latest combined data for all three major lenders, showed modest changes in average interest rates for residential and commercial mortgages, to 8.4%, and 9.0%, respectively.

Inflation for the quarter, as measured by changes in the Retail Price Index, firmed to 2.36% from 1.36% in the comparable period of 2005. Cost increases were noted for all categories, particularly other goods and services, food and beverages, medical care and health, recreation and entertainment services, furniture and household operations and clothing and footwear. Lesser accretions were recorded for housing, transportation and communication, and education.

In the external sector, the estimated current account deficit expanded by $157.9 million to $443.3 million, primarily on account of a marked reduction in the services account surplus, which dampened improvements in the merchandise trade deficit. Net service account inflows contracted by 70.3% to $65.9 million, owing to a three-fold hike in payments for construction services related to various foreign investment projects, which outstripped the moderate gain in travel receipts. Net current transfer inflows firmed by $2.5 million to $11.3 million. In contrast, a downturn in imports combined with firming in exports, resulted in the merchandise deficit narrowing by 3.8% to $462.9 million. Moreover, net income outflows expanded, owing to a doubling in net repatriation of investment income, and notable growth in profit remittances among banks and other private sector companies.

The estimated surplus on the capital and financial account surged to $415.4 million from $133.9 million in the corresponding quarter of 2005. This outturn reflected higher tourism-related direct investment inflows, which increased by $155.9 million to $273.2 million, as equity inflows expanded to $173.7 million. Added to this were expansions in net loan receipts for private investment ($112.5 million), and net inflows of domestic bank's short-term financing ($13.4 million) to $125.1 million and $30.3 million, respectively.