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QUARTERLY OVERVIEW OF DOMESTIC ECONOMIC DEVELOPMENTS

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This summary is an early release, excerpted from the upcoming issue of the Central Bank's Quarterly Economic Review for the Quarter ended June 2006. The full text of the Economic Review will be released on 26 September 2006.

The Bahamas

Review of Domestic Economic Developments for Second Quarter 2006

Preliminary data indicate that the Bahamian economy maintained its positive momentum during the second quarter of 2006, benefiting from strengthened tourism output, construction activity and domestic consumer demand. Although the pass-through effects of higher international oil prices resulted in broad-based increases in domestic costs, inflation remained at relatively modest levels. The fiscal situation for the first eleven months of FY2005/06 was appreciably improved as higher tax and income-related receipts surpassed growth in expenditure, to occasion a sharp contraction in Government's deficit. In the monetary sector, public sector foreign currency borrowings augmented money supply growth which outpaced the sustained expansion in domestic credit. In this context, lower levels of accretion were achieved for both liquidity and external reserves. However, buoyant consumer demand conditions supported a narrowing in the loan-to-deposit spread. In the external sector, the escalation in fuel costs combined with heightened import demand resulted in a near doubling of the current account deficit, while increased investment inflows for tourism related projects led to a modestly higher surplus on the capital and financial account.

Net free cash balances of the banking system declined by 2.1% to \$184.9 million, representing a smaller 3.9% share of Bahamian dollar deposit liabilities compared to 6.6% in 2005. However, increased holdings of Government paper elevated the broader surplus liquid assets by 13.9% to \$192.8 million, although representing a reduced 24.2% over the statutory minimum relative to 42.3% last year. Amid a more competitive credit framework, the weighted average interest rate for loans softened by 35 basis points to 9.90%, and the comparative deposit rate was relatively stable at 3.30%. Consequently, the average loan-to-deposit spread narrowed by 34 basis points to 6.60%. Less buoyant liquidity conditions were reflected in the average 90-day Treasury bill rate gain of 33 basis points to 0.69%, while benchmark rates—Central Bank's Discount rate and commercial banks' Prime—were unchanged at 5.25% and 5.50%, respectively.

Favorable economic conditions alongside proceeds from public foreign currency borrowings underpinned accelerated growth in the monetary aggregates of 4.5% relative to 3.4% last year, for a stock of \$5,155.2 million. Strengthened expansion in narrow money of 6.9% from 3.8% a year ago reflected faster pace growth in demand deposits (8.2%) and stable currency in circulation following last year's 3.3% fall. The expansion in broad money (M2) was extended to 3.3% from 2.7% in 2005, based on healthy gains in private individuals' fixed deposits as savings deposit growth slowed.

Domestic credit advanced by \$243.9 million (4.0%), broadly in line with last year's \$221.6 million (4.1%) expansion—and was supported by sustained strong upswings in both residential mortgages (3.9%) and consumer credit (3.3%), and a firming in personal overdrafts (12.0%). Meanwhile, net claims on the public sector strengthened by \$71.1 million (7.6%), reflecting increased liabilities of both Government (3.4%) and public corporations (15.9%).

On the fiscal front, preliminary estimates for the first eleven months of FY2005/06 showed the deficit on the Government's operations contracted by \$65.6 million (45.5%). Increased import demand, associated with the expanding economy, reinforced growth of 19.5% to \$1,087.6 million, and outpaced the 10.6% hike in expenditures to \$1,166.0 million. Following a \$75.0 million bond issue in January, budgetary financing consisted largely of Government bond issues (\$201.6 million) alongside foreign currency loan drawings (\$9.1 million). With debt repayment at an estimated \$62.0 million, the Direct Charge on Government rose by 1.2% to \$2,316.8 million and the National Debt, by 1.2% to \$2,823.5 million at end-June 2006.

Developments in the tourism sector featured a 1.1% recovery in total visitor arrivals to 1.31 million, from last year's 7.9% decline. The 4.2% expansion in air arrivals

offset the 0.5% contraction in cruise visitors, as traffic to both the Grand Bahama and New Providence markets strengthened by 10.9% and 0.4%, respectively. In contrast, visitors to the Family Islands fell by 2.2%. The

latest earnings indicators for the first two months of the review quarter, point to continuing expansion in room revenues, reinforced by firming in both room occupancy and average daily rates. Led by New Providence, average occupancy rates rose by 1.4 percentage points to 75.3%, and average daily room rates advanced by 8.5% to \$183.81, mainly on account of developments in Grand Bahama and the Family Islands. As a result, total earnings expanded by an estimated 13.6% to \$76.9 million.

Preliminary indications are that construction sector output continued its upward momentum during the second quarter, benefiting from sustained investments in tourism and residential developments. Mortgage data from banking institutions, insurance companies and the Bahamas Mortgage Corporation, which tend to be correlated with construction activity, indicated a 10.1% hike in total loan disbursements to \$123.7 million. Amounts earmarked for residential projects advanced by 7.1%, with a more significant 61.3% gain for commercial activities. In contrast, mortgage commitments fell by 11.1% to \$50.9 million, as the contraction in residential loan approvals countered the improvement in the number of commercial loan commitments.

During the review quarter, consumer price inflation, as measured by changes in the average Retail Price Index, moderated to 1.7% from 2.5% in the comparable 2005 period. The most significant cost increases were recorded for other goods and services (6.9%) – mostly owing to price hikes for professional services, and average food and beverage costs rose by 4.3%. The most dominant component, housing, recorded a modest 1.9% gain, whereas average costs for transport and communication declined by 2.9%, partly reflecting the continuing volatility in energy costs.

In the external sector, preliminary estimates for the June 2006 quarter, point to a further widening in the current account deficit to \$362.9 million from \$186.6 million over the comparable period of 2005. Rising international oil prices engendered a 55.6% upsurge in the value of oil imports which, combined with a modest 2.6% expansion in non-oil imports led to a deterioration in the merchandise account deficit by 8.1% to \$537.6 million. Moreover, the services account surplus contracted by 31.6% to \$223.5 million, as accretions to net travel receipts were offset by higher net outflows for offshore companies' local expenses and other "miscellaneous" outflows related to construction services. Net foreign income outflows were relatively stable at \$66.1 million, as the slowdown in domestic banks' outflows negated accretions to remittances by other local companies. Net current transfer receipts slackened by 9.3% to \$17.4 million, reflecting the decrease in Government inflows which countered the reduction in private sector remittances.

The capital and financial account surplus strengthened by \$9.7 million to \$206.4 million during the review quarter, partially offsetting the widening of the current account deficit. This development mainly reflected a \$110.5 million increase in private sector inflows associated with tourism sector construction projects. In contrast, direct investment net inflows softened by \$15.5 million to \$92.8 million, while domestic institutions invested an estimated \$12.5 million in non-resident debt securities during the quarter.