Monthly Economic and Financial Developments (MEFD)

December 2020

Remarks by the Governor
01 February, 2021

The virtual standstill of international travel in 2020 underscores the severe negative impact of the COVID-19 pandemic on the Bahamian economy. These effects will also weigh heavily on the economy in 2021 because the global vaccination drive is not expected to meaningfully boost travel confidence until the second half of the year. For The Bahamas, this limits the degree of economic strengthening that would be observed in 2021. The most significant upside potential for tourism recovery remains getting the virus under control in North America. The major fiscal stimulus being crafted for the American economy will also have positive spillovers for the speed of the Bahamian recovery.

It is estimated that the economy contracted by at least 16.0% in 2020. For tourism, cruise visitor activity was on pause since mid-March and stopover arrivals are projected to have achieved no more than one-quarter of the levels reached in 2019. In the stopover segment, revenue loses have been more severe for the hotel sector than for vacation rental properties, because Bahamian residents have made greater use of short-term rentals. Indications are that sales of vacation rentals achieved nearly 50% of the 2019 levels, compared to a much weaker result for hotels.

The data on the foreign exchange market flows also closely track the strength of private sector activities. In 2020, the estimated foreign exchange receipts sold to commercial banks decreased by slightly more than one-third to $3.8 billion. The lessened contribution from tourism explains this reduction, but with foreign investment activities maintaining stable to strengthened support. Similarly, with the spending power of domestic residents contracted, demand for foreign exchange, mainly to pay for foreign goods and services, fell by approximately 15.0%. Still, the reason demand for foreign exchange contracted by less than inflows was partly because of the impulse from public expenditure.

Elsewhere in the financial sector, credit risks increased for lenders in 2020, and banks, in particular, started to make larger provisions for loan losses. However, banks only recorded a slight increase in loan payment delinquencies, as borrowers facing hardships largely benefitted from deferred loan payment arrangements. As these arrangements have mostly expired, a truer extent of delinquencies will become evident in 2021. Up to the end of 2020, only 8.5% of loan balances remained in deferral state, compared about two-thirds of balances in June of 2020. Nevertheless, commercial banks have continued to show forbearance with borrowers who are facing difficulties.

Again, it is estimated that the financial system will emerge from the pandemic in a stable fashion. Banks have more than sufficient capital to absorb potential losses, whilst credit unions now have the protection of deposit insurance and a clearer timeline around which their borrowing members in the hotel sector will begin to see their earnings recover.

As to external reserves, the Central Bank's holdings were estimated at just over $2.3 billion at the end of 2020 and were still just over this threshold at the start of February 2021. Throughout 2021, the private sector's foreign exchange needs are expected to exceed inflows. This, therefore, maintains the outlook for a net reduction in reserves through the end of the pandemic, but not to levels that would stir up any concerns about the protection for the fixed exchange rate.

With the Government sector as the source of support running counter to the depressed state of tourism, the Central Bank's dialogue with Government continues to be around maintaining the right mix of local and foreign currency borrowing, because it is the borrowing in local currency that contributes to a reduction in the reserves when it stimulates spending on imports.

In the outlook, the economy is expected to remain most significantly challenged in the first half of 2021, and begin to show improvement in the second half of the year. The recovery should become much stronger over the course of 2022, at which time the private sector should revert to being a net contributor to growth in the foreign reserves.

In the near-term, the Central Bank will stay focused on conserving access to foreign exchange for essential international payments, including imports. Later in the year, the Bank will reevaluate the suspension of access to foreign exchange for international portfolio investments. While it is important that net flows strengthen, they need not be fully restored for any relaxation of measures to begin.

The Central Bank has already signalled that the moratorium on commercial bank' dividend repatriation will cease by the end of the first quarter of this year. Other categories of dividend payments on foreign investments in The Bahamas were never paused during the pandemic, hence banks are being restored to equal treatment. In addition, given the knowledge about the multi-year timeframe of bank dividend payments, the Central Bank remains in a position to manage the timing and magnitude of such outflows. In fact, the significant share of commercial banks' profit repatriation will materialize in 2022 and later years.

The Central Bank is also accommodative, on a targeted basis, for business and households that would need access to credit, timed with when the recovery starts to take hold. Banks are being allowed to relax loan qualification standards on a case-by-case basis so that qualified borrowers can take on debt service burdens above the levels normally stipulated by the Central Bank.

There are always risks to the immediate outlook, which are centred around how quickly the pandemic is brought under control, as well as the recurring threats from hurricanes. The prudent policy responses, for the time being, are to remain vigilant around the health of domestic financial institutions; be measured about the timing of easing of foreign exchange conservation measures; to continue to be sparing about the focus and magnitude of economic support that the Government provides, and to achieve accelerated execution on domestic and foreign investments that can provide some replacement support for the lull in tourism.