



Monthly Economic and Financial Developments (MEFD) December 2021

***Remarks by the Governor
31 January, 2022***

The available data through the fourth quarter of 2021 revealed that the Bahamian economy began a significant turnaround from the adverse impact of the COVID19 pandemic. However, it still reflected the lagging pace at which international tourism is recovering relative to other pandemic stricken activities, and risks that continue to be present from fluctuating COVID19 conditions. Alongside tourism, The Bahamas benefitted from sustained foreign investment inflows, including expansion in high-end real estate activity that have contributed to increased construction sector activity. These trends are helping to support resumed employment for displaced workers and improved financial outcomes for the government, though relative to a fiscal recovery that is still expected to span several years. The indicative information on employment is that it will keep closer pace with the recovery and in 2022 than it did in 2021.

Economic growth in 2022 is expected to exceed five percent—which would be significantly stronger than the recovery onset of just above two percent in 2021. For the first time in two years, the tourism product is positioned to experience uninterrupted business over the entire calendar period. In contrast, both industry segments only recorded partial year performances in 2021. Again, however, the industry will have to wait until 2023, at the earliest, to be fully recovered. In particular, neither the seasonal capacity for cruise lines nor hotels is being projected to reach pre-pandemic earnings levels during the first half of 2022. This is noteworthy because it is during the first half of each year that the industry records more than half of its revenues.

That said, conditions in the Bahamian foreign exchange markets have recovered to a significantly more sustainable state. On a net basis, the private sector's reliance on foreign currency supplies from the Central Bank, shrunk by two-thirds in 2021, even though by the third quarter of the year the Bank had relaxed all of the conservation measures that were put in place early in the pandemic to protect the external reserves. As evidence of the turnaround, in 2021 there was a 40 percent or \$1.5 billion recovery in foreign currency sales through the private sector to commercial banks, a dominant majority due to the resumption of tourism activity. Likewise with the economy reopened, domestic demand for foreign exchange that were purchased from commercial banks also recovered sharply by 27 percent, or \$1.1 billion.

In the absence of the IMF special drawing rights (SDRs) allocation, The Bahamas would have experienced a net reduction in the external reserves of \$167 million in 2021. With the SDRs boost, the reserves rose instead by approximately \$80 million. The reduction, in the portion of reserves that were not denominated in SDRs was in line with the Central Bank's accommodating stance for increased domestic spending. Under similar accommodation, the external reserves could also tolerate some reductions in 2022, without cause for concern.

In respect of domestic credit, in the near-term, the pandemic could result in additional losses for lending institutions—though very moderated from the upfront charges for which Banks made provisions in 2020.

A key measure of risk, and the potential for losses, the private sector delinquency or non-performing rate on commercial bank loans had increased to 9.6 percent at the end of 2021 from a pre-pandemic level of approximately 8.0 percent. Although this rate could rise further in the immediate months ahead, the Central Bank believes that it will stabilise and begin to decline before the end of 2022. As a sign of the improved clarity, at present, virtually all loans that were in deferred payment arrangements at the middle of 2020 have returned to some regular payment status.

In 2021, however, credit to the private sector contracted again, reflecting net repayments for mortgages, and consumer loans. Nevertheless, there was further increase in lending for business and other purposes.

Outstanding credit could remain flat to contracted in 2022. In particular, lending institutions are still held back by delinquency rates which have to improve to levels even below the average ratios experienced ahead of the pandemic. Such an outcome remains dependent upon expanding economic activity, and increasing the pool of qualified borrowers for credit as the economy improves. Structural reforms such as the credit bureau and the anticipated collateral registry will also have positive impacts on this environment over the medium-term.

In summary, the outlook is for stronger growth in 2022 as the calendar year impact of the economy's reopening takes hold. Elements of rebuilding are also expected to maintain growth above average in 2023, though less accelerated than in 2022.

In its monetary policy posture, the Central Bank will continue to accommodate strengthening domestic demand for foreign exchange, and therefore concede some reduction in the external reserves in the near term. This includes expanding capital market transactions, through the investment currency market.

The Central Bank also expects the environment to be less reliant on government financing in foreign currency, as private sector inflows continue to strengthen.

However, there are downside risks in the economic outlook, which require vigilance. One of these is increased inflation which, although not an outsized concern, could boost the import bill, and consume a greater share of foreign exchange earnings. While pent-up demand for vacations is a still a strong component in tourism recovery, the US central bank's response to raise interest rates to fight off inflation could erode some of this momentum. It could also frustrate the Bahamian fiscal consolidate efforts, by increasing costs on new or refinanced foreign currency debt. That said, the opportunity remains for other reforms to strengthen the Bahamian sovereign risk assessments and tackle existing interest spreads on foreign currency debt. Likewise, COVID19 is still an uncertainty, both in terms of uneven access to vaccines at the international level, and domestic factors that also weigh on the travel sector assessment of the safety of vacationing in The Bahamas. Where necessary, the Central Bank remains well positioned to respond to shore up the adequacy of foreign reserves and support for the Bahamian dollar fixed exchange rate.