The State of the Bahamian Economy

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Introduction

I thank the organizers of the Nassau Conference for inviting me to speak on the State of the Bahamian Economy. You have asked me to give some coverage to the economic outlook, policy considerations, the state of the foreign reserves and structural reforms. These are interrelated topics that should be covered in any constructive discussion on the economy. As regards the policy considerations, I will try to limit my scope to the subset of issues around which the Central Bank can contribute to support the medium and longer-term environment for growth.

The Nassau Conference puts the spotlight on how The Bahamas can, in a reputable and competitive way, sustain and grow the economic contributions of international financial services. This should be viewed as similar to how tourism and our other economic sectors are nurtured. How the domestic financial services interface with this business model is, therefore, important for the ease of doing international business. Similarly, separate from the products inspired through financial services laws and regulations, other domestic side policies have an impact on the agility and competitiveness of the sector, as they do the economy in general. It is because, in order to do business from here, firms must maintain a physical presence inside the jurisdiction.

At the same time, because these are still financial services, the Bahamian regulatory approach to the development of the international sector has a direct bearing on how standards replicate and are applied in the domestic financial sector. These, for example, include customer due diligence practices around the ease of establishing and maintaining local banking relationships and the ease at which all financial institutions are able to maintain international correspondent banking relationships.

Overview of Recent Economic Developments

Turning to the current state of the economy, at the height of the COVID-19 pandemic, the Bahamian economy contracted by between one-fifth to one-quarter of its size. The impacts were concentrated in tourism, which was completely shut down and then more delayed in the pace of its international recovery, compared to other economic sectors. The Bahamas experienced a sharp rise in unemployment, and the burden shifted to the Government to stabilize the economy— concentrated on unemployment and social assistance, reprioritized spending on the health care system; and subsidy support to revenue-deprived public corporations.

However, with the Government also deprived of tax receipts, the size of the fiscal deficit and borrowing needs escalated. Moreover, The Bahamas had to contend with its dependence on foreign exchange to sustainably uphold deficit-financed spending. Hence, the deficit, rightly, had to be majority financed in foreign currency.

The economy started to rebound from COVID-19 in 2021, with an outwardly impressive recovery, tied to tourism. While the data is not available, the reports suggest that foreign investments in high-end residential real estate are also robust. Other foreign investments, with a significant tourism and construction component, held steadier during the pandemic and have also firmed since the economy reopened.

Tourism

Again, with reference to tourism, and particularly to stopover activity, the relative extent of the rebound can be assessed, based on the monthly seasonal pattern of arrivals over the last three years. The tracking devised by the Central Bank compares post-pandemic outcomes with the best numbers recorded pre-pandemic, which were the months of January to August 2019 and September to December 2018. The last one-third of 2019 is not an appropriate baseline, because tourism was already experiencing a setback due to Hurricane Dorian.

The seasonal rebound in stopover tourism is expected to be concluded at some point, in 2023. Hence, the rebound effects, which have a strong undercurrent of pent-up demand for travel, will show up as above-average growth for The Bahamas in 2021, 2022 and to an important extent in 2023. Going into 2024, this momentum is expected to end. The Bahamas could again face potential GDP growth that is still below 2.0 percent per annum.

This brings attention back to improving the performance and outlook of activities like international financial services, which are embedded in these projections. It also keeps tourism in the spotlight—as attracting and maintaining the flow of investments into the stopover plant is critical for some of the medium-term visitor spending boost that The Bahamas is targeting; in addition to extracting more value-added from the existing base of both stopover and cruise visitors.

Beyond the rebound, tourism is likely to be more constrained by the headwinds from elevated oil prices, and the countermeasures at the major foreign central banks to fight off inflation. Any severe flare-up in COVID-19 could also pose frustration. Hence, at a minimum, The Bahamas needs to have firm control over the elements of the domestic health infrastructure that feed into tourism's vulnerabilities.

Public Finance

In the public sector, the economy's rebound is already having significant improving effects. With revenue recovery, the deficit is shrinking, and the Government is fine-tuning its fiscal consolidation strategy. The legacy of the pandemic, however, is that the public debt burden has increased substantially. Nevertheless, some of the recent analyses of the debt exaggerate the burden, by not taking into account that the GDP base was temporarily but significantly reduced in 2020. The more normalized debt to GDP ratio for the direct charge, central Government obligations, is in the high 80 percent range. The national debt, which is a larger stock, and the public sector total, which is the largest—all will show similar trends, and all have implications for public financial management reform.

Growing the economy faster is an option that has also been embraced as necessary to help ease the debt burden; while public-private partnerships or privatization frameworks—which can also have a direct, burden-sharing impact on taxpayers—can help ease the direct financial burden on the Government to supply certain vital public services or public infrastructure. However, there is also a sense of urgency to hands-on fiscal consolidation, which has to be understood in the mix of policies around which consensus is built---on taxation, tax administration, and expenditure controls.

In terms of the outlook for public finances, there are some important points to emphasize.

The first is that The Bahamas is not in a situation of sovereign debt distress. The sovereign has the capacity to undertake whatever financial measures are needed to continue to meet its debt obligation, and taxpayers have the capacity to shoulder such measures if the extremes become necessary.

Second, the sovereign has the capacity in the near to medium-term to raise more of its financing needs in the local currency. The economy can sustain the increased domestic borrowing without a drain on foreign reserves. Over the course of 2022, the Central Bank has seen increasing institutional demand for the Government's domestic debt. While there is a large short-term component in the profile, it reflects the commercial banks' stated preferences; a stable to incrementally firming outlook for these banks' holding of the debt; and, therefore, a good measure of certainty over the rollover prospects for this component of the debt. The Central Bank's strategy, though, working with the Ministry of Finance, is to use every opportunity to lengthen the maturity profile of the domestic debt. We are also in the very advanced stages of developing a savings bond instrument to make it easier for smaller, retail investors to buy Government debt, and earn superior returns than on deposits. Our goal is to present the framework to the Ministry of Finance and have the process activated before the end of the current fiscal year.

Third, whether perceived or actual, those factors that affect the sovereign credit profile of the Government have to be strengthened. This would help to expand the investor base and give the Government more leverage on interest rate costs.

Tax Reform

The recent discourse on tax reform has started to narrow on corporate income taxes, with the momentum driven by the evolving expectations on global minimum taxes. The sensitivities of the international financial services sector cannot be downplayed. However, this conversation ought to appreciate that taxation will matter most for the domestic side of the economy: how it adds any buoyancy to the tax base potentially improves total yield, and in a progressive way, potentially shift more of the tax burden to those of greater financial means.

Even if it were to be done in a fashion that does not boost the total revenue intake, tax reform could have other benefits—provided that it was administratively as efficient as existing systems within the Government. Ideally, though, reform should be driven by self-interested, positive motives, rather than out of panic, fear or coercion. We should also expect that any discussion on corporate income taxes would not be complete without also tackling the subject of personal income taxes.

Financial Sector

The financial sector provided a stable economic contribution during the pandemic. However, it is still on a medium-term trajectory that has seen overall employment decrease in both domestic and international activities and reduced aggregate balance sheet on international activities. For international finance, we should expect more right-sizing in the near term, as the repositioning away from European clientele is still outweighing growth opportunities identified in emerging markets and Asia.

The sector also has some upside potential, providing support to The Bahamas' domiciled digital assets services. In this regard, the Central Bank will consult with the industry over the fourth quarter of 2022 on new guidance for banks and trust companies involvement, particularly, as service providers, in line with internationally robust standards on transparency, financial integrity and prudential soundness.

On the domestic side, in contrast to increasing lending to Government, private sector credit contracted on average since 2012. While there has been total balance sheet growth, the resources have accumulated in highly liquid form, and funding composition has also tilted to very short-term in nature—likely also affecting the revealed preference for very short-term government debt. This is not an ideal configuration from a financial stability perspective.

The domestic banks are estimated to have absorbed credit losses of over $250 million during the pandemic, but still had more than sufficient capital to cover the shortfall. On the rebound from COVID-19, delinquency rates have started to decrease again. The Central Bank's medium-term objective is to bring the delinquency rates even below pre-pandemic levels, which, even then, were still higher than at the onset of the Great Recession of 2008.

This delinquency overhang and limited pool of new borrowers have continued to constrain overall private sector credit. The Central Bank expects that private lending conditions will stay very subdued in the near to medium-term, even with the more relaxed down payment and debt service ratio requirements that were just introduced in August 2022.

Over the medium-term, the Central Bank is focused on strengthening the operating environment for the provision of domestic financial services.

The credit bureau is expected to be a positive force because it will improve the information systems on which institutions rely to make lending decisions. The bureau is fully operational, except for some non-bank entities that are still being enrolled into the reporting framework.

In the meantime, a movable collateral assets registry is being scoped for The Bahamas that would strengthen the environment for secured lending to businesses. The initial consultation period for the collateral registry just ended in August. The Central Bank is now collating the public feedback that was received and expects now to work with the Government to finalize the drafting of the legislation for the registry.

For efficiency and access, the delivery channels for domestic financial services also have to become more digital. The Central Bank is working with the sector to ensure that this result is achieved with better financial inclusion outcomes, especially for the Family Islands, and greater attention to consumer financial protection. On the inclusion side, we have already begun to review customer due diligence standards, for more progressive changes that should streamline the account opening process for businesses; and, particularly, for payments and merchant services, make the on-boarding process less onerous for micro and small businesses. The Chamber of Commerce has agreed to work with the Central Bank on a survey that will be released to the local business community within the next week, which will help identify some of the pain points being experienced. The Central Bank also plans to develop a scorecard for each domestic entity on inclusion and ease of doing business, to motivate and benchmark more targeted improvements in these areas.

In payments, the Central Bank will now begin to ramp up the adoption process for the Sand Dollar. In our national campaign, at least one million Sand Dollars will be distributed to mobile wallet users, over the next two years to further initialize the payments by phone experience. We will also execute a broader public education campaign to encourage the public to use less cash.

Inflation and Oil Prices

Two pertinent and related issues for the economy are oil prices and inflation.

The inflation rate is unlikely to have peaked yet for The Bahamas, though it is expected to closely track the pattern experienced in the United States. Because it is being imported, what we are experiencing is beyond the direct influence of any wholesale monetary or fiscal policy response for The Bahamas. It does, however, justify the Government being able to provide targeted, direct social assistance to the most vulnerable families. Others have to be prepared to make adjustments in their personal finances, where possible. Aside from this, higher inflation represents a stepped-up usage of foreign exchange to pay for pricier imports. All else considered, our net accumulation of foreign reserves is less than it might otherwise have been.

It is in The Bahamas' interest for the United States and other international economies to swiftly bring inflation under control. The downside risk to protracted high inflation is that the interest rate policies being pursued will erode the American and other consumers' ability to afford to travel. Also, the directly elevated cost of international capital in rising interest rates has to be seen as a drag on The Bahamas' ability to attract foreign direct investments and as putting more pressure on The Bahamas to make the returns to foreign investments more attractive.

High oil prices also undermine the economy's prospects, and such uncertainties are especially tied to the war in Ukraine. As in several episodes since 2008, energy imports will consume a greater share of the Bahamian foreign exchange earnings, and also undermine the travel sector's competitiveness. Beyond the bounce-back period for tourism, the headwinds for the sector could be significant if energy costs remain an issue after 2023, or if it becomes a more serious issue in the near-term.

Foreign Reserves and Exchange Controls

In the present environment, the foreign reserves remain near their highest levels ever recorded, and should close out 2022 higher than at the end of 2021. At this point, the Central Bank also expects some growth in 2023. As such, we are comfortable with and in support of the Government drawing on more of its financing needs in domestic currency. Our tolerance for private sector credit growth is also higher than is likely to materialize, as there is still some scope for some reduction in the reserves, to support productive purposes, while keeping the balances above the $2 billion mark.

This continues to sum up a healthy support for the Bahamian dollar fixed exchange rate.

The foreign reserves outlook affects exchange control liberalization policies, with elements of both the ease of doing business and capital flow management in the mix. Administratively, the Central Bank will continue to consult with the Government on liberalization that improves the ease of doing business. This includes areas where there could be more delegated authority to commercial banks to directly process higher value thresholds for trade and non-investment payments. On capital flows impacting outward convertibility from Bahamian dollars, the approach to liberalization remains cautious and gradual; however, and is always framed with careful consideration to long-term sustainability and how well the economy would cope with short-term shocks in the foreign exchange sector.

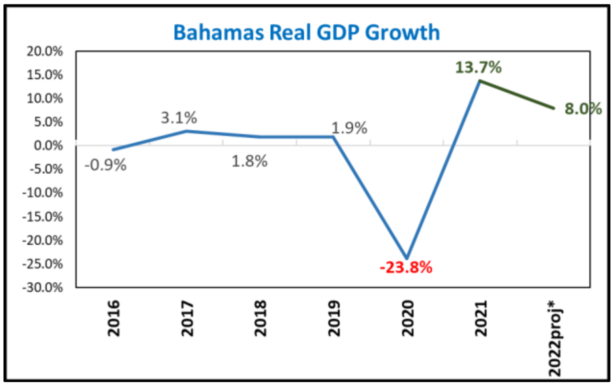
This would include the approach for the investment currency market, where given current downside risks to the economy, the capacity is greater for administrative reforms, which retain the current market premium. I anticipate that the Central Bank will be able to work on a shorter timeline, however, on increased access to foreign exchange to fund direct investments abroad. There is already some accommodation for such investors to purchase foreign exchange at the official rate. Such access also applies to investments that Bahamians might make to capitalize or acquire ownership in the international financial services sector—which is pertinent for increasing local participation in the sector.

Conclusions

In conclusion, the Bahamian economy is exhibiting a strong rebound from COVID19, largely to the benefit of tourism and real estate investments. Beyond the COVID19 rebound, there are still significant downside risks to the economy that must continue to be managed, including any residual health sector vulnerabilities. Once the COVID rebound is completed, the growth outlook is expected to reduce back into line with The Bahamas' medium and longer-term potential. Hence, the policy challenge is to improve the medium-term growth potential. The Central Bank's role in this process is to work with all stakeholders to increase the efficiency of the banking and payments systems; promote better outcomes for financial inclusion, and support increased prospects for growth in international financial services. In addition, we have a continued role to play in supporting the improvements in systems of public debt management; and stability of the domestic financial system, to which there is a strong connection to the adequacy of the foreign reserves and maintaining the Bahamian dollar fixed exchange rate.

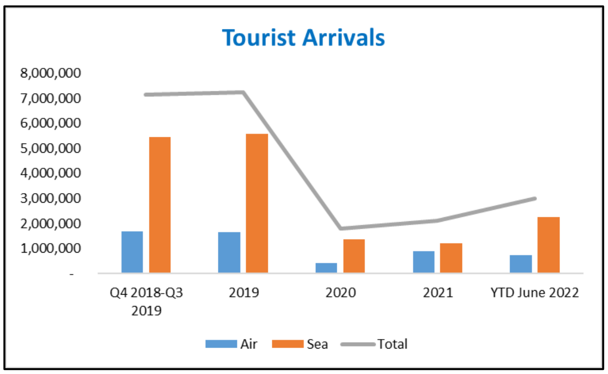
Appendix of Charts

Chart 1



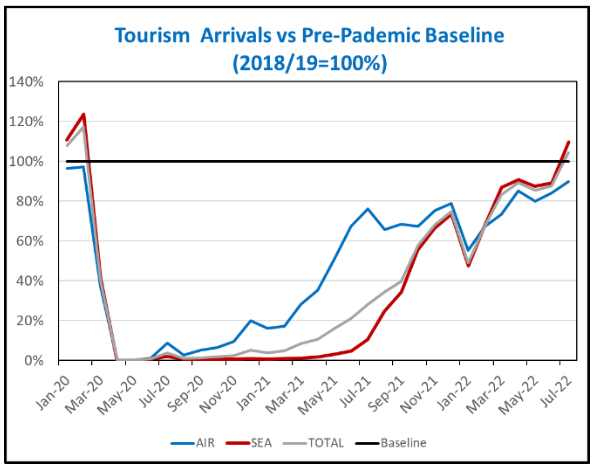
Source: Bahamas National Statistical Institute and
*IMF Projections

Chart 2



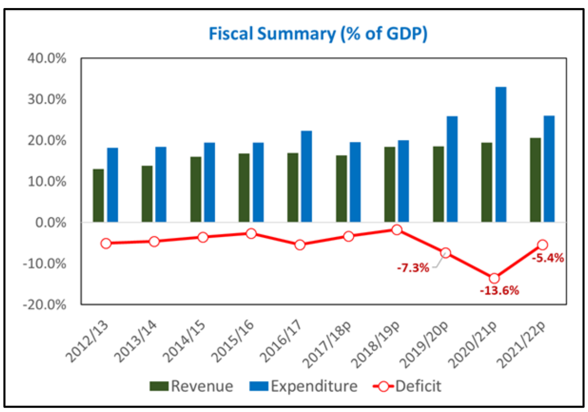
Source: Ministry of Tourism

Chart 3



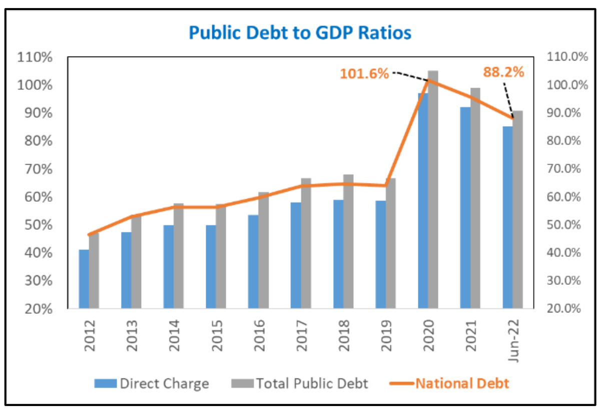
Source: Central Bank of The Bahamas

Chart 4



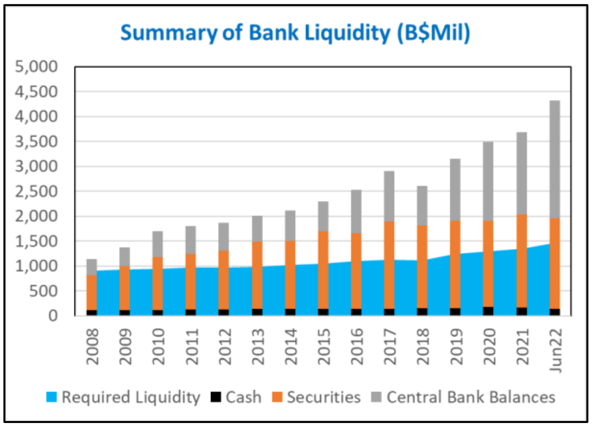
Source: Ministry of Finance Central Bank of The Bahamas

Chart 5



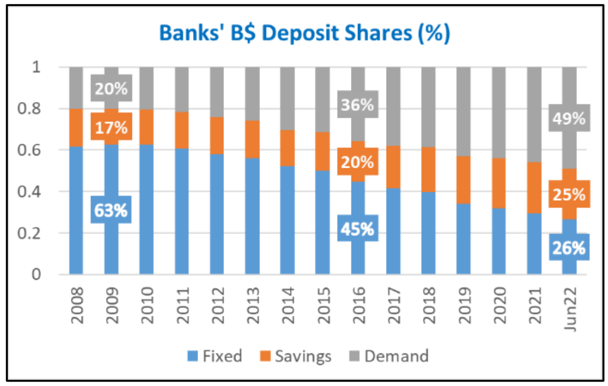
Source: Ministry of Finance & Central Bank of the Bahamas estimates

Chart 6



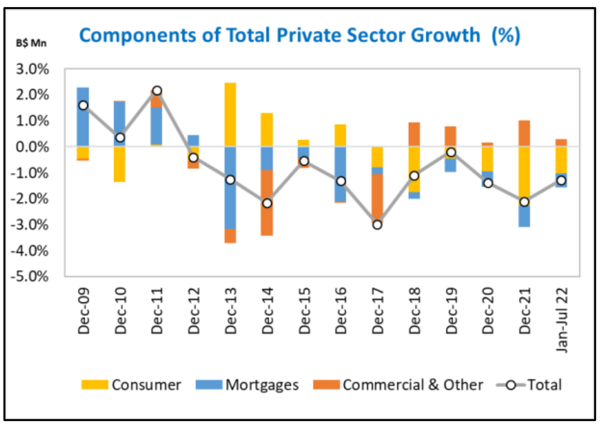
Source: Central Bank of The Bahamas

Chart 7



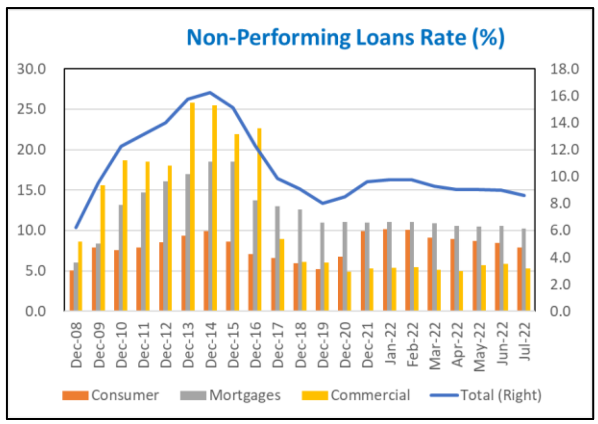
Source: Central Bank of The Bahamas

Chart 8



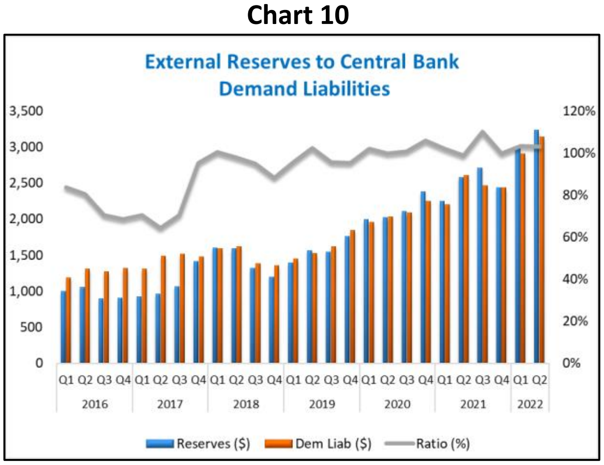
Source: Central Bank of The Bahamas

Chart 9



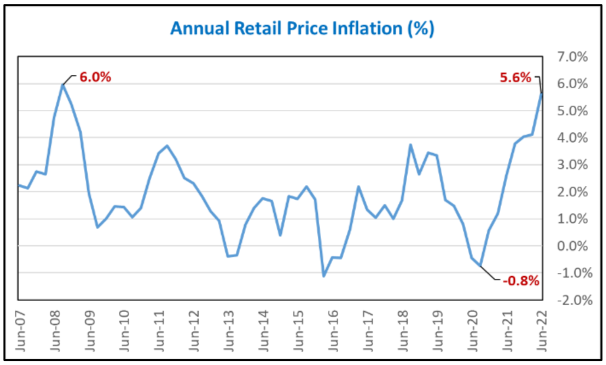
Source: Central Bank of The Bahamas

Chart 10



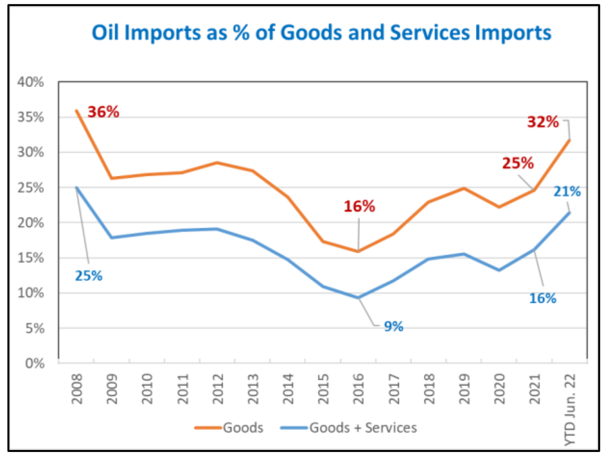
Source: Central Bank of The Bahamas

Chart 11



Source: Bahamas National Statistical Institute

Chart 12



Source: Central Bank of The Bahamas and Bahamas National Statistical Institute