Monthly Economic and Financial Developments (MEFD)

June 2023

Remarks by the Governor
31 July 2023

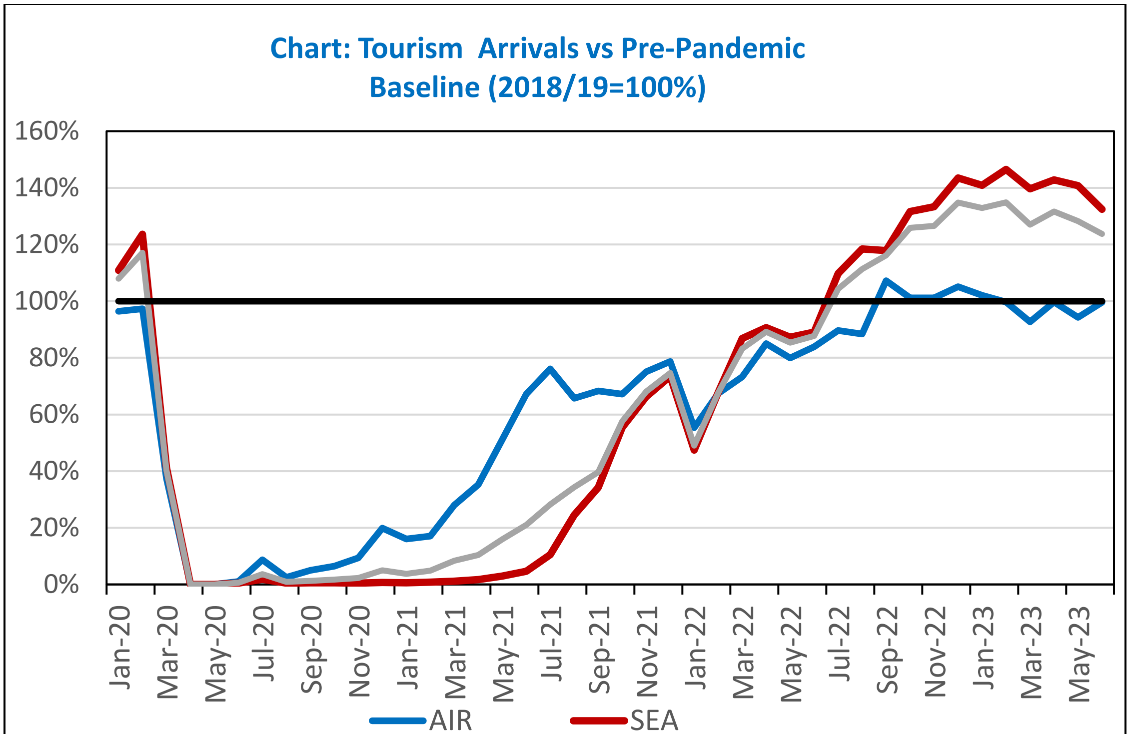
Indications are that the Bahamian economy expanded at a healthy rate during the first half of 2023. Momentum in tourism was still brisk, but slowed in comparison to 2022, since the industry had less shortfall to recapture relative to the pandemic losses. Foreign investment inflows also propelled growth. These developments supported revenue-driven improvements in the Government's finances, and increased private sector employment. Some evidence of tapering in inflation also emerged, in line with moderating trends in the United States and other trading partners. In the monetary sector, there was less seasonal accumulation in external reserves, due both to the significant absence of public sector foreign currency borrowing, and increased net outflows through the private sector. There was incremental upturn in private sector credit, while the economy continued to support decreasing rates of delinquency on private sector loans.

While the outlook for the economy remains positive, there are still downside risks associated with the negative effects of the war in Ukraine, rising interest rates abroad, in the push back against inflation, and uncertainties about oil prices.

Let me preface the discussion on tourism by underscoring that analysis of the recent performance in the industry are important to assessing the overall growth prospects for the economy, post-recovery trends in net foreign exchange flows, and the Central Bank's foreign reserves management policies. In this regard, the Central Bank still projects some recovery-laced, above average real GDP growth in the 3 percent range for 2023. However, potential annual growth beyond 2023 is resettling closer to the two percent range.

Gains in tourism during the first six months of 2023 were still driven by significant pent up demand, as travel was no longer constrained by COVID19 precautions. In addition, the industry benefited from appreciated stopover pricing, both within hotels and vacation rental properties. Based on comparisons against the pre-pandemic highs and the best seasonal performance before hurricane Dorian, sea arrivals, which largely represent cruise visitors, have exceeded the pre-pandemic highs by an average of 40 percent since December 2022. However, the comparative index has not trended further upwards since February 2023. In addition, since January, the seasonal recovery in air arrivals stabilised, on average, just two percent below the pre-pandemic comparisons. Over the first half of 2022, air arrivals were still an average of 25 percent below pre-pandemic volumes, while the sea segment still trailed by 22 percent.

Some of this levelling off in volumes may well reflect increasing limits on hotel room inventory, particularly in New Providence.



Note: The baseline uses arrivals for September-December 2018, and January to August 2019, which exclude the months impacted by Hurricane Dorian.

Given appreciated stopover pricing and the magnitude of cruise volume boost, the industry, however, experienced more than fully-recovered earnings in the first half of the year. The growth outlook beyond 2023 would, however, be more ameliorated if better pricing was reinforced, among other factors, by capacity-aided visitor volume gains.

Turning to the foreign exchange indicators and external reserve trends, over the first six months of 2023 total inflows through the banking system--which capture impacts from tourism, foreign investment spending, and other private sector activities--increased by 3.8 percent to $3.8 billion. This compared to a recovery-related rebound of 50 percent in 2022. Inflows though were expected to have been stronger, given the extent of strengthening in tourism indicators. This underscores the importance of boosting domestic retention from all subsectors in which there is growth.

As expected, the growth in spending on imports of goods and services and portfolio investments was stronger than trends on the inflow side, increasing by 11.1 percent in the first half of 2023. On a net basis, therefore, the private sector retained less foreign exchange, contributing to a smaller boost in the external reserves. In particular, the net amount of foreign exchange that commercial banks sold to the Central Bank was one-third less than in 2022. In addition, the volume of foreign currency denominated borrowing by the Government was sharply reduced in comparison to 2022, resulting in the public sector, on net, repaying some foreign currency debt and being a net purchaser of foreign exchange from the Central Bank.

As result, the external reserves grew by just $117 million in the first half of 2023, compared to a $788 million buildup in 2022. As at the end of July, the external balances were approximately $2.7 billion, not much changed from the end of June. These balances remain healthy, relative to the support that they provide for the Bahamian dollar fixed exchange rate. Over the remainder of 2023, the Central Bank will continue to plan for and to accommodate a net reduction in the external reserves, which would place the end of year balances below the closing levels of 2022. This remains consistent with an increased capacity, on net, for the Government to borrow in local currency, more room for growth in private sector credit, and other increased spending by residents from accumulated liquidity.

Nevertheless, the Central Bank is reviewing the administrative policies in place for the Investment Currency Market and the access permitted to overseas investment funding through the Bahamas Depository Receipt or BDR framework. On sum, the demand for investment currency, in particular, has accelerated, and the Bank is of the view that additional refinements are now needed to sustain more retail investor access, while moderating potential wholesale outflows, within a more defined multi-year framework. In addition, the Central Bank is continuing to explore how BDR activity, which already has a more concentrated retail appeal, could be increased. The Bank expects to consult with the Government on such reforms and other administrative adjustments to the Exchange Control policies before the end of the third quarter 2023.

There continued to be improvements in credit markets, although most concentrated in declining delinquency rates on outstanding loans. The fraction of private sector loans that were three or more months behind in payments fell to 7.4 percent in June 2023 from 9.0 percent in June 2022. This further repositioned the delinquency rate below where it was at the start of the pandemic. In the lending space though, commercial bank credit to the private sector was incrementally expanded during the first half of the year, with lending for commercial purposes boosted. However, there was still no uptrend in consumer loans and mortgages.

The Central Bank maintains a policy posture toward more growth in private sector credit, in a sustainable fashion that does not outpace our comfort level for the external reserves. The Bank is therefore exploring how lending institutions can have more flexibility in processing loan applications, by varying downpayment requirements, including for mortgages; while guided by limits on the debt service ratio and relative valuation of real estate compared to the amounts being financed. For The Bahamas, these are still the most effective policy levers in influencing the amount of credit flowing to the private sector.

Returning to the outlook, as stated earlier, it is expected that growth will moderate further in 2024 from the projected outcome for 2023, with subsiding inflation, chiefly as a result of the success in reducing inflation abroad. The economy’s expansion would also stimulate more employment, scope for increased labour force participation and improved conditions for bank lending.

In this context, downside risks are still those from increased headwinds, if rising interest rates outside The Bahamas slow demand for travel; or if oil price uncertainties, partly related to the war in Ukraine, lead to increased costs for transportation and accommodations. With foreign exchange flows recovered, the outlook remains favourable for the external reserves, though vigilance is always necessary in how credit and Exchange Control policies are set, considering the interplay of forces affecting the relative volume of foreign exchange inflows and outflows. In this regard commercial bank liquidity, which remains buoyant, is also a risk to be monitored, as it could be a pentup source for outflows over the medium-term. This places renewed emphasis on increasing the private sector's net take up of government debt that still sits on the Central Bank's balance sheet.