Monthly Economic and Financial Developments (MEFD)

December 2023

Remarks by the Governor
29 January, 2024

The Bahamian economy recovered beyond its pre-pandemic levels in 2023, based on available indicators, closely linked to gains in tourism and sustained foreign investment inflows. With private sector demand more strengthened, and government borrowing operations shifted more towards local currency financing, the Central Bank's external reserves decreased moderately—in line with what was expected—and liquidity in the banking sector rose at a more tempered pace. Lending to the private sector also expanded further, halting a decade of steady contraction, while the debt servicing capacity of private borrowers was further improved. Meanwhile, the inflation rate eased, in line with reduced price pressures on imported international goods and services.

Although the economy has a positive outlook for 2024, enabling more employment creation and continued reduction in the fiscal deficit, downside risks continue to be posed from potential headwinds to tourism, if international central banks' efforts become more drawn out in their fight against inflation. In addition, both travel demand and import inflation remain vulnerable to the harmful effects of the wars in Europe and the Middle East.

In 2023, it is estimated that the economy grew in the 4.0 percent range, which is a levelling off from the significant post-pandemic recovery of around 14.0 percent in 2022. This captured a very robust boost in the cruise sector's contribution, a completion of the occupancy recovery in the stopover sector, and healthy appreciation in the average pricing for stopover accommodations, among both hotels and vacation rental properties. In 2024, the growth is expected to be within the low 2.0 percent range, still moderately above the estimate of the economy's medium-term potential. In this regard, along with sustained marketing efforts, the momentum in the hotel sector, where room availability is still temporarily reduced, remains contingent on how occupancy rates and pricing strengthen. The vacation rental segment meanwhile, has more growth headroom from both occupancy and pricing gains; and cruise market prospects remain robust.

An important boost to construction activity, foreign investment flows also supported positive economic momentum in 2023, targeting significant tourism projects and residential real estate development. However, stimulus to the domestic housing market and building activity through mortgage lending remain subdued. With the Central Bank's December 2023 relaxation of mortgage lending conditions, some added positive impacts are expected over the medium-term; although more significant expansion is more likely to be linked to downstream benefits of future employment and income growth that increase the pool of eligible homeowners.

Turning to foreign exchange markets, which provide the most current summary, the data showed that the economic recovery has reached a more matured state. Total foreign currency inflows through the banking sector, rose very mildly by only half a percentage point to an estimated $7.2 billion in 2023. The recovery pace of such inflows in 2022 was 34.0 percent. Although these measured flows can understate the actual volume of activities, due to leakages and potential diversion of some private revenues that never reach the local economy, the recorded transactions still significantly reveal the domestic impact though expenses, including wages taxes other costs that sustain the local presence of business enterprises. On the outflows side, foreign currency demand also strengthened, at a sharply moderated pace of about 1.5 percent, to an estimated level close to $7.1 billion in 2023.

Extending private sector transactions to their impact on reserves, the commercial banks' net purchase of foreign exchange from the public was significantly reduced in 2023; and consequently commercial banks' net sale of foreign exchange to the Central Bank was almost unchanged from 2022. The Central Bank's external reserves however decreased by almost $250 million in 2023, because of a strong reversal in net transactions with the public sector to net sale of $360 million, as opposed to a net purchase of $206 million in 2022. The reason for this difference was that the Government was able to reduce its net reliance on foreign currency borrowing, which had contributed to the net foreign exchange sales to the Central Bank in 2022.

Through the end of January 2024, the external balances, showed a modest rebound from the end-of year close to about $2.75 billion. This was mainly due to timing in the government's US dollar refinancing operations since December, which paid off some overdraft balances with domestic lenders, helped rollover significant US debt. Nevertheless, there is the seasonal pattern of build up in reserves that is projected to occur over the coming peak tourism season.

Turning to credit, commercial banks' lending to the private sector recovered further in 2023. This is a sign that conditions for lending have become more favourable, with more strengthening expected in 2024. That said, the increase in 2023 was for only consumers loans and business lending, with a reduction still seen for residential mortgages. The credit delinquency rates, also continued to fall. In particular, the proportion of total private sector loans that were 3 months or longer past due with payments (NPLs) decreased to 6.6 percent by December 2023, from 7.7 percent at the end of 2022. This pattern of reduction is expected to continue in 2024.

Given the very healthy outlook for foreign exchange flows, the Central Bank's posture is to continue to support faster growth in domestic credit over the medium-term, particularly in the private sector. The domestic environment, will also support more increased net financing of the government's deficit in local currency. As a result, it is projected that the increase spending stimulated by credit could lead to additional reduction in the external reserves, although not to any levels that would endanger the level of reserves needed to support the currency peg. In this context, the Central Bank is also taking a very, cautious and measured approach to further liberalization of exchange controls measures. After the forthcoming consultation with the government, we anticipate a further shift in delegated responsibility for investment currency market transactions to commercial banks; and some increased delegation for commercial banks to approve other foreign exchange transactions.

According to the Bahamas National Statistical Institute (BNSI), there was declining trend in inflation, in the latest available through October 2023. This included moderation in fuel costs felt in the transportation index, and reduced price pressures for imported food and some other goods. However, the delayed pass-through of the higher fuel surcharge for electricity still elevated the increases in the housing component of the retail price index through October. With this episode passed, the outlook is for inflation to moderate in 2024.

Returning to the outlook, the Central Bank expects that growth in 2024 and beyond will settle further to more closely resemble The Bahamas' longer term potential, although a future period of acceleration could occur after hotel capacity is replenished in New Providence. With credit expansion likely strengthened, the external reserves and bank liquidity levels could moderate, though both remaining very robust. In the meantime, the environment is also supportive of continued reduction in the fiscal deficit; and of more local currency sourcing of the residual net financing needs

While the Central Bank's monetary policy stance is to continue to accommodate firmer credit growth, there is still room for vigilance given the downside risks to the international economy—most notably in the form of the the wars in Eastern Europe and the Middle East, which could impede tourism, and lead to a protracted fight against inflation.