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THE BAHAMAS

March 2014

2013 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2013 Article IV consultation with The Bahamas, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse of time basis, following discussions that ended on November 16, 2013, with the officials of The Bahamas on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 3, 2013.
- An **Informational Annex** prepared by the IMF.
- A **Press Release** summarizing the views of the Executive Board.

The publication policy for staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

THE BAHAMAS

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

January 3, 2014

KEY ISSUES

Context. Economic activity remains tepid, unemployment is high, and inflation is subdued. The fiscal and external positions have weakened, with reserves declining toward worrisome levels. Non-performing loans (NPLs) are elevated, but the financial system is well capitalized and liquid.

Focus of the consultation. Discussions focused on policies to secure fiscal, external, and financial sector stability, and strengthen medium-term growth.

Policy recommendations and authorities' views:

- **Contain rising central government debt through timely fiscal consolidation.** The authorities need to implement comprehensive policies to curb the central government deficit and reduce debt to comfortable levels.
- **Enhance external stability and bolster growth potential.** To improve the external position and rebuild eroding reserves, the authorities should rigorously implement fiscal consolidation and intensify efforts to diversify tourism and exports. Identified structural impediments to growth should be removed expeditiously, with the authorities' comprehensive growth strategy finalized by the announced deadline of late 2014.
- **Further strengthen financial supervision**. Close monitoring of credit risks is required in view of persistently elevated non-performing loans (NPLs); and financial crisis prevention and resolution frameworks should be promptly strengthened.
- **The authorities broadly concurred with staff's assessment and recommendations**. They especially recognized the urgent need for budget consolidation and expressed commitment to timely implementation of underpinning reforms, as well as to the finalization of a comprehensive economic diversification and growth strategy.

Past surveillance. In concluding the 2012 Article IV consultation, Executive Directors emphasized that The Bahamas' key policy priority is to strengthen public finances, improve competitiveness, and begin rebuilding the policy buffers eroded in the aftermath of the 2008 crisis. Directors underscored the importance of measures to improve the business environment, develop infrastructure, enhance human capital, and promote economic diversification. They also welcomed the finding of the Financial Sector Stability Assessment that there are no immediate threats to financial stability.

Approved By
Charles Kramer (WHD) and Mark Flanagan (SPR)

The team that visited Nassau during November 3–November 16, 2013, comprised Messrs. Matungulu (head), Kanda, Lutz, and Park; it was assisted at headquarters by Mr. Stavis, Ms. Kapijimpanga, and Ms. Sirbu (all WHD). The team reviewed recent economic developments and the outlook, and discussed the main policy issues. It met with Prime Minister Christie; Minister of Tourism Wilchcombe; Minister of Financial Services Pinder; Minister of State for Finance Halkitis; Minister of State for Investments Rolle; Central Bank Governor Craigg; Financial Secretary Rolle; other senior government officials; and representatives of the opposition, the banking, tourism, and business communities. Mr. Hockin, Executive Director, and Mr. Parent, Senior Advisor in the Executive Director's Office, attended some of the policy discussions.

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RECENT DEVELOPMENTS

Economic activity continues to recover from the global financial crisis, but at a slow pace. The fiscal situation deteriorated in FY2012/13, mainly due to customs revenue underperformance. Reflecting weak tourism receipts, the external current account deficit increased further, adding to pressures on reserve adequacy. While private sector deleveraging continues, the financial sector appears sound.

1. **Growth remains tepid.** Real GDP grew by 1.8 percent in 2012, similar to 2011, and well below pre-global-crisis performance (Table 1 and Figure 1). Investment, led by construction of the US$3.5 billion Baha Mar tourist resort project, grew by 20.6 percent, but private consumption (70 percent of GDP) declined for the fifth consecutive year. Tourism receipts—the bulk of exports—have been weaker than expected, partly reflecting Hurricane Sandy in late 2012 and early 2013, but also owing to persistent softness in the high value-added stopover segment, a temporary loss in hotel room inventory[1], and increased competition from low-cost regional destinations. In 2013 growth in tourism visitors declined to 2.3 percent for the first nine months, from 8.3 percent in 2012, and preliminary data indicate that hotel receipts fell 7½ percent in January–September. However, increased construction at Baha Mar has helped support activity. Inflation has eased from 2 percent in 2012 to an average of 0.3 percent for January–October 2013, in keeping with anemic activity and softening fuel prices. Against a background of broadly subdued activity, unemployment rose to 16.2 percent in mid-2013.

Key Economic Indicators

	2009	2010	2011	Prel. 2012	Est. 2013
Real GDP growth (%)	-4.2	1.0	1.7	1.8	1.9
Inflation (average, %)	1.9	1.3	3.2	2.0	0.3
Unemployment (%)	14.2	…	15.9	14.0	16.2
International reserves					
Millions of US dollars	816	860	885	810	867
Months of next year's non-FDI imports	4.5	4.1	3.8	3.4	3.6

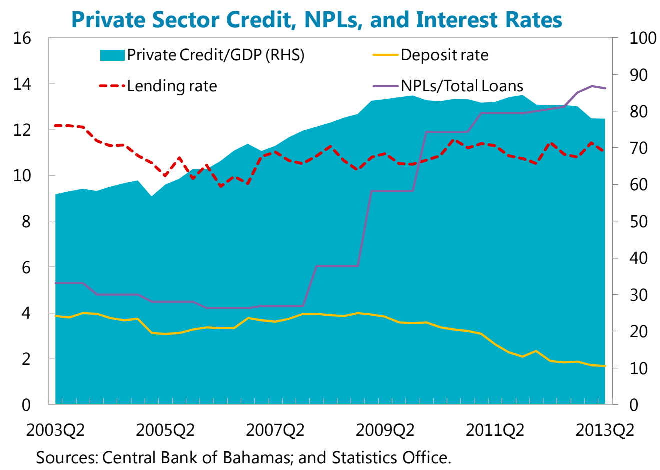
Note: Labor force data are not available for 2010 which was census year.

2. **The fiscal situation deteriorated further in FY2012/13 (Tables 2–4 and Figure 2)**. Revenue underperformed, mainly owing to slower-than-expected economic recovery and lower customs revenues, while current spending, especially on wages and goods and services, remained elevated at a time of general elections. Reflecting these developments, the fiscal deficit widened to 5½ percent of GDP. Further, the authorities contracted in late 2012 a US$180 million (2.2 percent of GDP) external loan to stem the decline of foreign reserves, and central government debt rose to 56 percent of GDP (49 percent in FY2011/12).

[1] About seven large hotels have undertaken some degree of renovation constraining inventory in 2013. Also, the refurbishment of the 694-room Melia Nassau Beach Resort is to commence shortly.

3. **The current account deficit increased further in 2012 and 2013, pressuring reserve adequacy.** The deficit reached 17½ percent of GDP in 2012, up from 13½ percent in 2011, largely driven by an increase of goods and services imports related to Baha Mar (Table 5). From a saving/investment perspective, an increase in the investment/GDP ratio by 5 percentage points to 33 percent of GDP in 2012 outpaced a small increase in the saving ratio (Figure 4). Data indicate that the current account imbalance has increased in 2013 owing to weakened tourism and on-going construction of Baha Mar, with foreign reserves declining to $685 million in October from $810 million at end-2012.

4. **Credit growth has slowed markedly in recent years (Table 6).** The economic downturn in the wake of the global financial crisis led to a near doubling of non-performing loans (NPLs). Private sector credit has stalled since 2009 as banks tightened lending standards and debtors deleveraged. In the face of declining profit margins, banks have increased their interest rate spreads, largely through cutting deposit rates. The financial sector is otherwise in good overall standing.



OUTLOOK AND RISKS

Economic activity is expected to pick up more strongly from 2014 onward as the US recovery accelerates and Baha Mar starts operations. As the fiscal deficit narrows over the medium term, supported by ongoing consolidation efforts, and tourism activity picks up, the external current account balance should strengthen as well, reducing pressures on foreign reserves. Despite upside potential in the medium term, risks to the near-term outlook appear tilted downwards.

5. **Growth is expected to pick up over the medium term, reaching 2¾ percent in 2015–16, while inflation is expected to remain subdued:**

- Demand should recover more strongly from 2014 onward as the US economic recovery accelerates, raising stopover tourist arrivals. Investment is projected to remain strong in the near term, but then to tail off as the Baha Mar project reaches a conclusion. Private consumption growth is expected to be close to zero through 2014, as the ongoing fiscal consolidation (Section A) and private deleveraging (below) take a toll (staff projections assume a current-year fiscal multiplier of ½ and a second-year multiplier near zero, in line with findings for Caribbean islands).[2] However, consumption should gain strength as the pickup in the tourism sector

[2] The multipliers estimates are based on a panel regression on 14 Caribbean countries including The Bahamas in Narita, *Fiscal Multipliers in the Caribbean*, in International Monetary Fund, and Amo-Yartey and Turner-Jones (Eds), Caribbean Renewal: *Tackling Fiscal and Debt Challenges*, forthcoming in 2014.

bolsters employment and incomes, and this should help offset the impact of declining investment, as the Baha Mar project reaches its conclusion.

- A key factor underlying medium-term projections is the expected expansion in supply. The full operation of Baha Mar could allow for an increase of almost 10 percent in total arrivals; and two smaller hotel projects planned on Grand Bahama and Bimini islands could add another 2¼ percent in arrivals. Growth performance will also depend on success in addressing a number of parallel supply challenges going forward, including expanding incoming airlift capacity; addressing infrastructure bottlenecks; strengthening the linkages between tourism and other sectors; and developing a more diversified tourism experience, including ongoing plans to boost sports and health care-based tourism.

- Inflation is expected to remain low, but planned VAT implementation in 2014 would add an annualized 3½ percentage-points to the CPI (as reflected in staff's baseline projections).

6. **In the financial sector, the medium-term outlook is for modest growth in bank lending as the private sector adjusts its balance sheet, and banks deal with continuing problem loans.** Mortgage lending growth is likely to be limited: residential investment fell by one third in nominal value during 2008–12 and ongoing deleveraging is expected to continue. Accordingly, private sector demand for bank credit would remain subdued. And with tighter bank lending standards, the recent fall in nominal private credit may be only slowly reversed. The stock of NPLs appears to have peaked and is expected to slowly decline as well, with banks more willing to write off some NPL categories (e.g., unsecured consumer debt), while continuing to find other flexible arrangements to deal with nonperforming mortgages (which comprised 58 percent of the NPL portfolio at end-June 2013) in light of continuing softness in the real estate market. Overall, however, banks' balance sheets remain robust and near term stability risks are limited (Table 6–7 and Figure 5).

7. **The external account balance should strengthen over the medium term, replenishing official reserves.** The Bahamas' exchange rate appears to be broadly in line with macroeconomic fundamentals, although the declining reserve position does raise some external stability concern (Section B below). Nonetheless, the completion of Baha Mar would reduce construction imports and boost tourism services exports. Overall, a decline in the investment/GDP ratio is projected against a recovery in the saving rate—mostly the result of higher fiscal saving. With the current account deficit thus projected to revert to lower, pre-global crisis and pre-Baha Mar levels, net external financing needs would be contained, strengthening foreign reserves and external stability.

8. **Supported by the authorities' budget consolidation efforts, the fiscal position is projected to steadily improve in the period ahead.** Last July, the authorities instituted new and/or increased various business license fee rates applicable to on- and off-shore financial institutions, and to state-owned enterprises; and introduced a new environmental levy and customs processing fees. These are expected to be complemented by a VAT in July 2014. With regard to spending, the authorities are implementing stronger controls, including on wages and goods and services outlays in view of the excesses in the run up to the last general elections.

9. **With the primary budget projected to be balanced by FY2014/15 (from a projected deficit of 1.9 percent of GDP for FY2013/14) and to move into surplus beyond, central government debt would be contained and set on a declining path over the medium term. There are however downside risks**. Central government debt is projected to peak at nearly 60 percent of GDP in fiscal year 2014/15, but to decline to 55 percent of GDP by fiscal year 2017/18. However, the forecast track record shows a tendency toward optimism in staff forecasts of real GDP growth and the primary balance, pointing to downside risks to the baseline scenario. This underscores the need for rigorous adherence to the ongoing fiscal consolidation program (DSA, Annex I).

10. **Despite upside potential in the medium term, risks to the outlook appear tilted downwards (Risk Assessment Matrix, page 20).** The Bahamas faces a number of internal and external risks, but the following risks could be especially disruptive, highlighting the need for timely implementation of plans for fiscal consolidation and economic diversification:

- **Disappointing Baha Mar performance.** Baha Mar's success critically hinges on effective implementation of the project's strategic positioning (e.g., more focus on high-end products, more diversification to Europe, South America and East Asia) in the region's fiercely competitive tourism market. While staff's baseline is conservative about Baha Mar's growth impact, and the project was based on a thorough feasibility study, significantly lower-than-assumed net tourist arrivals or expenditure relating to the project would limit the upside boost to domestic economic activity. In a tail risk scenario where the project completely fails to raise overall tourism exports, the uptick in growth currently projected for 2015 onward would not materialize, with adverse implications for fiscal revenues and the public debt outlook (the project entails no direct fiscal risks as it is entirely financed by foreign private sources). If the project did fail to deliver, there could also be significant pressure on reserves, and maintaining external and internal stability would then require a more aggressive approach to structural fiscal consolidation.

- **Delay in fiscal consolidation.** Delays in implementing fiscal consolidation, especially tax revenue reforms, could pose risks to long-term debt sustainability and the country's investment grade credit rating. In affirming its rating of The Bahamas (BBB/A-2, with a negative outlook) in November 2013, Standard and Poor's warned that the agency could lower the rating by one or two notches if the authorities do not take additional action to reduce the fiscal deficit and arrest the increase in debt to GDP over the next several years. If revenue reforms do not deliver, the authorities would need to implement deeper spending cuts to help hold debt down.

- **Lower than anticipated emerging market (EM) growth potential.** With the tourism strategy aimed at exploiting arrivals in part from EM countries, a further slowdown of EM growth would undercut the growth outlook. That said, the negative impact could be tempered by an accompanying decline in fuel prices. If tourism demand from new markets proves stagnant, the authorities may need to pursue ambitious structural reforms to help reduce the internal price level and draw in more demand from existing markets.

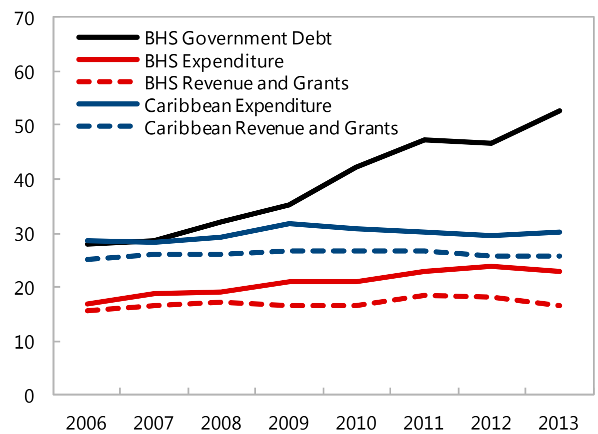
POLICY DISCUSSIONS

Discussions focused on key policies to secure fiscal and public debt sustainability, external stability, and robust economic growth. Achieving these objectives requires putting the budget on a sustainable path; containing the external current account deficit and building up foreign reserves; promoting growth through improved competitiveness and economic diversification; and continued reforms to advance financial stability.

A. Ensuring Long-Run Fiscal Sustainability

11. **The authorities recognized that comprehensive policies are urgently needed to place the government debt-to-GDP ratio on a declining path and support external stability**. Central government debt currently exceeds 50 percent of GDP, which makes The Bahamas a "High Scrutiny" country under the Market-Access Countries (MAC) DSA. The Prime Minister's 2013/14 Budget Communication to Parliament noted the importance of "fiscal consolidation and lower debt as a means to the attainment of far greater economic and social goals," as well as the necessity to aggressively seek to enhance revenue performance and to be more cost efficient in government operations.[3] While the Bahamas' revenue effort remains below regional standards, spending has increased towards the regional average and the fiscal deficit and central government debt have significantly risen in recent years.[4] The authorities agreed that fiscal performance needs immediate strengthening to reduce central government net financing requirements, reverse the increasing debt trajectory, and begin rebuilding depleted policy buffers; all of which would help contain borrowing costs in the economy in the medium term. They also concurred that fiscal consolidation would create space for a healthy expansion of physical and social infrastructure spending, and for higher outlays on human capital.

Central Government: Revenues, Grants and Expenditure
(percent of GDP)



12. **Staff discussed with the authorities a medium-term fiscal framework aimed at achieving a balanced budget and a fall in the debt ratio to some 55 percent of GDP by FY2017/18 from a projected peak of 59 ½ percent in FY2014/15** (Tables 2 and 3). Under the scenario, tax revenue would increase by an annual average of about 0.8 percentage-points of GDP over the next five years, the bulk of which from planned introduction of the VAT; and only moderate

[3] Commonwealth of The Bahamas, *2013/14 Budget Communication to Parliament*, May 2013.

[4] The Bahamas is the only country in the Caribbean that has no corporate income tax; a June 2013 FAD TA report notes that it utilizes only 40 percent of its tax capacity.

savings would be achieved on government expenditures in view of limited spending flexibility. In this regard, the authorities especially stressed the elevated budgetary cost of basic infrastructure and public utilities in an archipelago of sparsely populated and dispersed islands.

Medium-Term Fiscal Framework 1/
(In percent of GDP)

		Staff Projections				
	FY12/13	FY13/14	FY14/15	FY15/16	FY16/17	FY17/18
Revenue	16.4	17.1	18.6	19.6	20.3	20.8
Of which: Net gains from VAT			1.3	1.8	2.2	2.3
Expenditure	21.8	21.6	21.3	21.2	21.0	20.8
Of which: Net acquisition of nonfinancial assets	2.9	2.3	2.2	2.2	2.2	2.2
Memorandum items:						
Primary balance 2/	-3.0	-1.9	0.0	1.1	2.0	2.5
Overall fiscal balance	-5.4	-4.5	-2.8	-1.7	-0.7	-0.1
Debt-to-GDP ratio	56.1	59.1	59.3	58.6	57.1	55.1

Sources: Ministry of Finance; and Fund staff estimates and projections.
1/ Fiscal year ends June 30th.
2/ Defined as revenue and grants minus total expenditure (excluding interest payments).

13. **Revenue would rise to about 21 percent of GDP by FY2017/18 from 17 percent of GDP in 2013/14**. The revenue effort is underpinned by several critical measures and reforms, especially (i) the upward revision of various business license fees in July 2013; (ii) introduction of a value added tax (VAT) in July 2014; (iii) establishment of a Central Revenue Agency in the first quarter of 2014; (iv) adoption of Tax Identification Numbers; (v) overhaul of customs administration in the context of a $16.5 million IDB-funded reform project; and (vi) modernization of the real property tax (RPT) system. The Bahamian Customs and RPT departments rely heavily on manual procedures and outdated information systems; as a result, revenue collection is currently estimated at below 50 percent of the potential. Envisaged reforms aim to bring management of the two revenue agencies up to international standards, involving extensive computerization of revenue assessment and collection functions, and introduction of risk-based monitoring of operations. Staff concurred with the authorities that reform of the two revenue departments could yield significant revenue gains. However, given pervasive capacity limitations and the record of low tax compliance, staff urged caution in factoring the anticipated revenue improvements into the medium-term fiscal framework (Tables 3.1 and 3.2).

14. **The implementation of the VAT is the cornerstone of the authorities' fiscal consolidation agenda**. The reform will provide a more efficient means to broaden the tax base, increase revenues, and improve the effectiveness of tax administration more generally. The potential revenue yield from a 15-percent VAT is generally estimated at slightly over 7 percentage points of GDP.[5] In The Bahamas, the reform's net revenue gain is assessed at 2.2 percent of GDP in view of

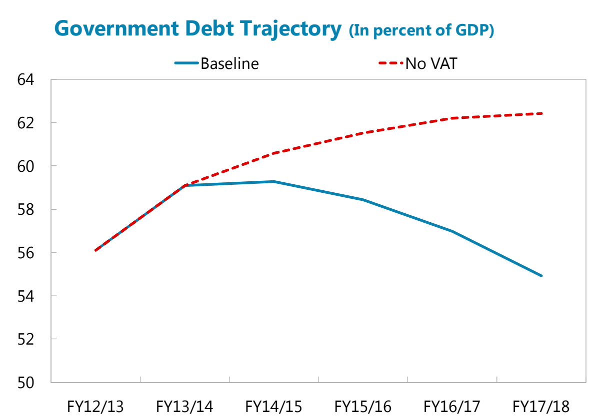
[5] Data on VAT productivity suggest that, on average, 1 percentage point of VAT collects revenue equivalent to about ½ percent of GDP.

VAT exemptions and other tax reductions expected to be adopted along with the new tax (the hotel VAT rate will be at the regional Caribbean average of 10 percent) and of capacity limitations in revenue management. Other limiting factors in the initial year of the reform include delays in rolling out the public campaign and securing passage of relevant legislation in Parliament, which could complicate the timely acquisition and testing of IT systems needed in both the public and private sectors. The absence of a consumption tax and the lack of local experience in its management would contain the initial revenue gains from the VAT as well. Because of these constraints, staff projects the net revenue gain from the VAT at 1.3 percent of GDP for the initial FY2014/15.

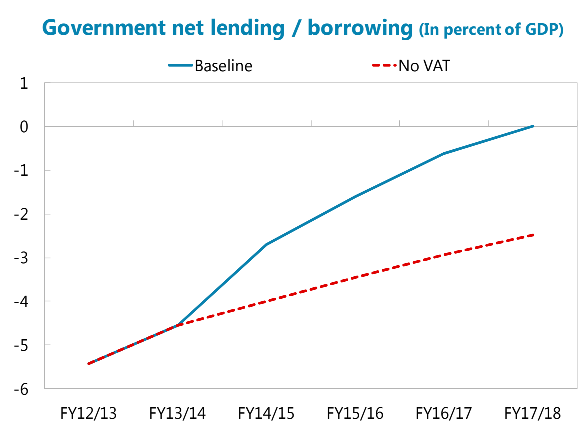
The Bahamas: VAT Rate in the Caribbean Region[6]

Country	Introduction Date	Standard Rate (%)	Hotel Rate (%)
Antigua and Barbuda	2007	15	12.5
Barbados	1997	17.5	8.75
Dominica	2006	15	10
Grenada	2010	15	10
St. Kitts and Nevis	2010	17	10
St. Lucia	2012	15	8
St. Vincent and Grenadines	2007	15	10

An illustrative "no VAT" scenario shows the fiscal consolidation program veering considerably off track, with the debt-to-GDP ratio already above 60 percent of GDP in FY2014/15 (figure below). Staff underscored setting the VAT base as broadly as possible; and encouraged the authorities to insure that adequate efforts and resources are deployed to secure the timely implementation of the reform.



Source: The Bahamian authorities; and Fund staff estimates and projection



Source: The Bahamian authorities; and Fund staff estimates and projection.

[6] International Monetary Fund, Schipke, A., A. Cebotari, and N. Thacker, The Eastern Caribbean Economic and Currency Union: Macroeconomics and Financial Systems, Washington, D.C., 2013.

15. **The authorities' fiscal consolidation program also calls for enhanced spending discipline, especially as regards wages, goods and services, and subsidy outlays** (Tables 2 and 3). Against a backdrop of more favorable employment prospects for the tourism sector, especially after the opening of Baha Mar, pressure on central government hiring should be manageable beyond 2014, permitting limitation of wage outlays to the last three years' average of 7.4 percent of GDP. Also, in view of unusually sharp increases in recent years, the growth of spending on goods and services will be strictly limited. In the same vein, the authorities' medium-term fiscal program assumes some downsizing of the public investment budget given the completion last year of several high-cost road and airport rehabilitation projects. Staff underscored keeping budget transfers and subsidies in check as well; and, to that effect, urged the expeditious implementation of planned reforms of public corporations, including adoption of cost-based pricing for public utilities to reduce these entities' net financing requirements (Box 1). Reflecting the ongoing and envisaged expenditure-streamlining efforts, total spending is expected to be reduced by 0.8 percent of GDP between FY2013/14 and FY2017/18, to 20.8 percent of GDP.

Box 1. Planned Reforms of Selected Public Corporations

The Bahamian public corporations (PCs) continue to face significant financial challenges, notably stemming from inefficiencies in operations (e.g., excessive staffing, aged facilities), but also reflecting these entities' tacit social duty to provide affordable services to all residents including in remote Family Islands. The PCs' aggregate debt reached 16 percent of GDP at end-June 2013 (10 ½ percent in December 2008). Envisaged reforms aim to begin alleviating the companies' financial distress.

Water and Sewage Corporation (WSC). In recent years, budget support to WSC has averaged B$30-40 million annually (0.4 percent of 2013 GDP). To improve the entity's operational efficiency and strengthen its financial independence, the company is implementing a number of reforms. These have included organizational restructuring to improve staffing efficiency; increased outsourcing of activity to the private sector to achieve higher operational efficiency; and stepped-up efforts to reduce water leakages, with external technical assistance.

Bahamas Electricity Corporation (BEC). Envisaged reforms seek to achieve more competition in the generation and higher efficiency in the distribution of power. Expected to be completed in 2014, they would break the BEC into two new entities.

- A new generation service company would operate, maintain, repair, and manage BEC's electricity generation facilities as well as develop new power plants. Planned private sector equity participation would permit involvement of energy sector partners of international repute, as well as adequate resources for capacity building and modernization.

- A new transmission and distribution company would operate, maintain, and expand BEC's current electricity transmission and distribution systems. The new entity would be 100 percent government owned, but operated by the private sector under a management contract.

16. **Staff commended the authorities for their commitment to fiscal consolidation and welcomed their intention to introduce a rule-based fiscal framework.** Although they have yet to settle on the specifics of such a framework, the authorities saw the adoption of a fiscal rule as essential to guarding against government fiscal shortsightedness (e.g., policy changes depending on political cycle) and making achievement of medium-term fiscal targets more predictable, taking account of The Bahamas' country-specific conditions (e.g., small island state, vulnerability to natural disasters). Resorting to a fiscal rule appears appropriate considering the rapid widening of the fiscal deficit and increase in central government debt in the last years. However, a rule-based fiscal framework has considerable transparency demands and requires a comprehensive coverage of fiscal operations; it also needs to strike a reasonable balance between sustainability and flexibility goals, and should make provisions for policy responses to unforeseen economic shocks (for instance, natural disasters). Staff signaled Fund readiness to provide technical assistance.

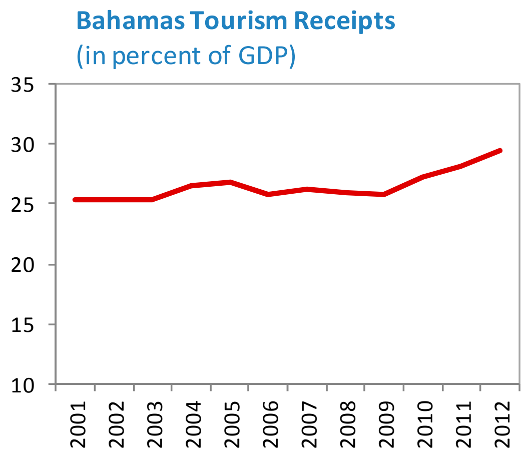
B. Enhancing External Stability

17. **The Bahamas' exchange rate appears to be broadly in line with macroeconomic fundamentals.** The peg to the U.S. dollar and low inflation have underpinned broad nominal (NEER) and real effective exchange rates (REER) stability in the last years (Figure 3); and a quantitative evaluation based on standard Consultative Group on Exchange Rate (CGER) methodologies reveals no significant misalignment.[7] This result is nevertheless contingent on execution of planned fiscal adjustment and the successful implementation of ongoing efforts to expand tourism capacity, further diversify the economy, and achieve stronger growth (see below and Figure 3).

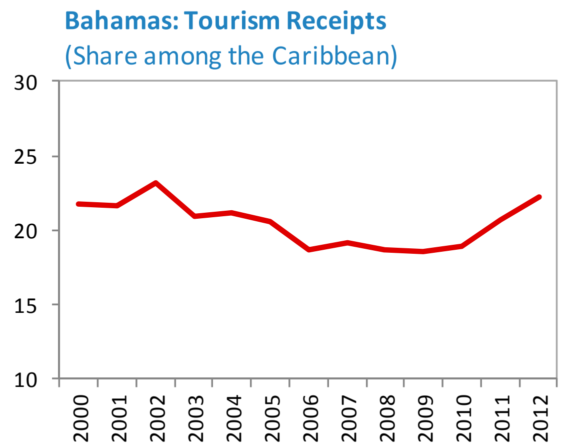
[7] The assessment based on the equilibrium real exchange rate approach (ERER) suggests that the real effective exchange rate is overvalued by about 4 percent, while the macroeconomic balance (MB) approach suggests that the rate is undervalued by 3 percent. An assessment based on the external sustainability (ES) approach was not undertaken owing to lack of official data on the country's international investment position (IIP). In addition, the lack of official IIP data precludes estimates of imputed, but re-invested earnings on inward and outward foreign direct investment positions, with offsetting imputed financial account flows. While this does not affect the overall balance and therefore reserves, it likely results in underestimates of the current account deficit, and suggests that the undervaluation from the MB approach is biased downward.

18. **The risks from the widened current account deficit and continuing pressures on foreign reserves are considerable (Box 2)**. The financing requirements for the sizable Baha Mar tourism project are broadly met through FDI and already-secured debt flows. However, a recent weakening of tourism receipts, a diminution of previously available "one-off" capital inflows (from privatization, bank capital increases, etc.), and an increase in commercial banks' profit remittances in light of extremely comfortable capital positions and a declining loan portfolio (about US$105 million during January-October 2013) have resulted in a steady decline in reserves. This has led the government, at Central Bank's request, to shift the bulk of its budget deficit financing to external loans, the proceeds of which (totaling $400 million for FY2013/14) have helped to bolster reserves. The authorities recognized that the higher foreign debt increases the economy's vulnerability to external shocks, but saw the undertaking as temporary—pending materialization of anticipated improvements in the external position in the medium term.

19. **Strong policy efforts are needed to stem a recent deterioration of the external position and replenish reserves.** A larger reserve cushion would help mitigate the impact of negative shocks, provide more room for needed counter-cyclical policy responses, and enhance the credibility of the peg. The Bahamas' growth and external sector performance is heavily dominated by developments in the US-dependent tourism sector. Although the country's tourism market share in the region has shown resilience in recent years,[8] the high dependence on one sector makes the economy highly vulnerable to external shocks. The authorities saw the recent and anticipated expansion of the tourism base as key to reducing their country's traditional reliance on North American stopover tourists. They emphasized that progress on that front, together with improvements in non-price competitiveness through removal of structural impediments to growth (Figure 6), would strengthen the external position and enhance external sustainability going forward.



Source: IMF staff estimates.



Source: IMF staff estimates.

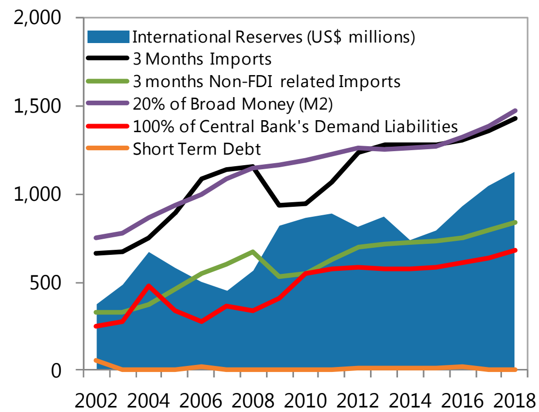
[8] The market share data covers Anguilla, Antigua and Barbuda, The Bahamas, Belize, Dominican Republic, Dominica, Grenada, Guyana, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, and Trinidad and Tobago. However, the authorities noted a wider diversity of actual competitors for Bahamian tourism services, including gambling venues (e.g., Las Vegas and Atlantic City, as well as, with the opening of Baha Mar, Asian alternatives), and family tourism (e.g., Disneyland and other Orlando sites), which complicates estimates of the relevant markets.

Box 2. Assessment of Reserve Adequacy

The Bahamas' international reserves declined by $75 million to $810 million in 2012. With external current account imbalances persisting in the first half of 2013 and higher foreign-owned banks' profit remittances, reserves fell further to $685 million (1.6 months of imports or 2.8 months of non-FDI imports) at end-October 2013 despite a foreign loan ($100 million) contracted by the government, which added 0.4 months of non-FDI import cover.

The country's reserve adequacy profile is mixed.

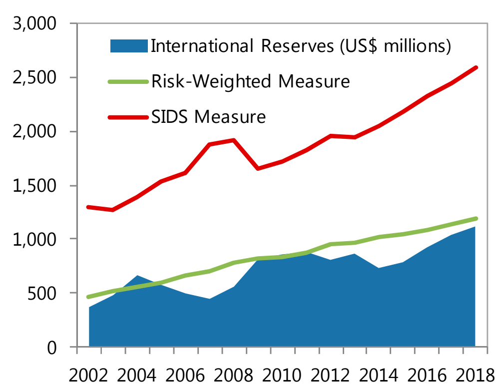
- Reserves are projected to comfortably cover all short-term external debt over the medium term, but would continuously fall short against thresholds pertaining to broad money and total imports. However, 70–80 percent of capital goods imports are financed by FDI. Evaluated against a non-FDI imports benchmark, the reserves have been and would remain adequate throughout the baseline projection period. The Bahamas' reserve adequacy outlook is also not clear-cut when analyzed under the broad money-based method that is used to capture the risks from currency mismatches and drains arising from possible bank runs. The country's reserve holdings are projected to remain substantially below the broad money norm of 20 percent, but related risks would be relatively limited given the central bank's strong restrictions on capital flows—all outward capital transfers require exchange control approval, and outflows of resident-owned capital are restricted. Finally, while reserves are expected to undershoot the broad money standard, they would be more than adequate to cover the central bank's demand liabilities (base money plus government deposits), which the authorities use as an additional benchmark.



Sources: The Bahamian authorities, and IMF staff estimates.

- The country's reserves holdings are broadly adequate relative to the risk-weighted benchmark[1] that is designed to reflect a broader range of sources of risk, such as external liabilities, external demand collapse, and potential capital flight.

- Reserves are however much below desirable levels when assessed against the more stringent adjusted measure for small island developing states (SIDS)[2] that places more weight on exports and short-term debt and better reflects the high vulnerability of small islands.



Sources: The Bahamian authorities, and IMF staff estimates.

[1] IMF, *Assessing Reserve Adequacy* (February 2011). The measure for fixed exchange rate regimes is 30 percent of short-term debt at remaining maturity + 15 percent of other portfolio liabilities + 10 percent of broad money + 10 percent of exports.

[2] Nkunde Mwase, *How much should I hold? Reserve Adequacy in Emerging Markets and Small Islands* (WP/12/205). The measure for fixed exchange rate regimes is defined as 95 percent of short-term debt at remaining maturity + 10 percent of broad money + 35 percent of exports.

C. Maintaining Monetary and Financial Sector Stability

20. **Staff agreed with the authorities' view that the Bahamas' monetary framework continues to serve the country well.** The exchange rate peg to the dollar has been in place since prior to independence 40 years ago. This stability has reflected the strong tourism and offshore financial linkages with the United States, supported by a tradition of prudent fiscal policies (notwithstanding recent developments, Bahamas still has relatively low levels of government debt). The peg has delivered inflation performance in line with that for the country's main trading partners. The monetary framework has also helped deliver financial stability. The authorities remarked that their capital controls were quite effective in shielding domestic monetary conditions from relevant developments abroad. In their view, the eventual tapering of U.S. quantitative easing, with resulting higher foreign interest rates, would likely not exert undue pressures on external reserves.

21. **The staff and authorities concurred that the current low policy rate remains appropriate in light of weak credit demand and subdued domestic activity.** The official discount rate was reduced by 75 basis points in late 2011, to 4½ percent. Given sizable excess liquidity already held by banks, the authorities were skeptical that a further cut would increase lending activity. In this regard, while banks and the authorities welcomed improved transparency as part of the soon-to-be introduced credit bureau (and argued for its wide usage—including by retailers), they worried that knowledge of the true scope of domestic indebtedness may weaken incentives to make credit more readily available and frustrate its growth. The reform was nonetheless seen as essential to ensuring that future lending decisions are adequately informed.

22. **In view of persistently high NPL rates, the staff encouraged the authorities to continue closely monitoring commercial banks' credit risks and collateral values**. NPLs remain elevated (14 percent of total bank lending), although they appear to have peaked and are provisioned at over 50 percent. While banks have aggressively written off nonperforming consumer borrowing, in light of weak real estate and labor markets, many saw little benefit from aggressively addressing non-performing mortgages—which now account for the bulk of NPLs. Most viewed their case-by-case approach to handling restructuring as sufficient, acknowledging that this would lengthen the process, but seeing benefit in not flooding the market with foreclosures. The authorities viewed the legal framework for a case-by-case approach (including the incentives) as adequate, and thus supported the case-by-case handling of the litigious mortgages. However, they agreed with staff that it would be desirable to develop more reliable house price indices to promote a more liquid and transparent real estate market and thus help refine collateral assessments and provisioning.

23. **The authorities continue to make progress in implementing recommendations of the 2012 FSAP.** The authorities have established a Systemic Risk Surveillance Committee to monitor the stability of domestic banks; and, with IMF technical assistance, they are finalizing a financial crisis management and resolution plan and legal framework as they endeavor to rationalize and further strengthen the supervisory and regulatory frameworks. The insurance and securities sectors have recently adopted new legal and institutional frameworks, and oversight is improving. Supervisors are implementing other key recommendations from the 2012 FSAP (Box 3). The staff confirmed the authorities' commitment to undergo an AML/CFT assessment of compliance, although the standard

18-month deadline following completion of the July 2012 FSAP was likely to slip, with the assessment expected in second half of 2014 under the aegis of the Caribbean Financial Action Task Force (CFATF).

Box 3. Key Findings and Progress in Implementing Recommendations of the July 2012 FSAP Mission

The FSAP mission found no short-term threats to financial stability. It noted that the country's financial system had weathered the global crisis reasonably well. Tight capital and exchange controls supported The Bahamas' U.S. dollar peg, helping to insulate the financial system from global stability threats, while providing some scope for policy independence. In addition, while the offshore financial sector is disproportionately large (with total assets about 75 times GDP), it contributes less than 3 percent to GDP as capital and exchange controls and limited exposure to the domestic real estate market provide a credible and effective firewall that separates the offshore and onshore financial systems. The mission also found that the onshore financial sector is resilient, and could withstand substantial economic, solvency, and liquidity shocks. Other financial institutions (credit unions, the insurance sector, and securities markets) have limited systemic impact.[1]

The mission concluded that the oversight of the financial system is independent and strong, particularly with respect to banking supervision, and the authorities are addressing many of its recommendations. Revisions to the Central Bank Act are in progress, while a committee for implementing Basel III is now constituted. Actions are underway on creating a credit bureau and enhancing the deposit insurance system; and a credit union act has been released for consultation with relevant stakeholders. The FSAP team encouraged the authorities to persevere with efforts to rationalize and further strengthen the supervisory and regulatory frameworks. In November 2013, a Fund technical assistance mission recommended detailed legislative reforms to strengthen the bank crisis resolution framework, including increasing deposit insurance funds, establishing recovery and resolution plans, and further strengthening the provisions on emergency liquidity assistance.

[1] While offshore centers in general may face pressures in future years from shifts in the global regulatory environment, concerns of heightened financial sector risks in some advanced economies could increase the attractiveness of The Bahamas as a global hub for international financial services.

D. Boosting Growth Potential

24. **The Bahamas faces many challenges in boosting its growth potential.** First and foremost, the country must attract sufficient tourist demand to fill the large impending increase in supply. Second, labor market rigidities constrain the potential supply of labor in the medium-term. Persistently high unemployment rates suggest the presence of wage rigidities, while business surveys cite a lack of skilled labor as an important constraint to growth. Third, significant impediments to the growth of small and medium enterprises (SMEs) include (i) limited access to bank loans, training and business development services; (ii) a complex system of land administration that raises business transaction costs; and (iii) weak trade-logistics mechanisms and customs procedures that constrain SME access to external markets. As a result, SMEs are concentrated in low-

productivity services in less technology and knowledge-intensive areas.[9] Fourth, there are more general constraints to investment. The Bahamas slipped 7 places to 84th place in the 2014 World Bank doing Business Indicators, mostly because other countries made improvements while the Bahamas stood still or worsened slightly. The Bahamas has particularly low rankings in starting a business, getting credit, protecting investors, enforcing contracts, and registering property.[10]

25. **There was general agreement between the authorities and staff that achieving stronger growth requires diversifying tourism and the economy more generally.**

- Plans to diversify tourist source markets beyond the eastern seaboard of the US and to promote non-traditional segments such as health care, sports, heritage and religious tourism are being developed. In this regard, the authorities have allocated B$10 million in FY2013/14 to conduct marketing for the Baha Mar resort.

- Initiatives to strengthen human capital have included the opening of the National Training Agency to provide vocational and technical job training to (school-drop out) young adults, which the authorities showcased as a strong step toward addressing private-sector indentified skills shortages in the workforce, particularly ahead of the opening of Baha Mar and other investment projects in the Family Islands. In addition, the authorities have allocated B$30 million for special education and the transition of the College of The Bahamas to University status. Also, an agriculture college in progress would provide a foundation for the development of the sector.

- A new policy framework under consideration would enhance the creation and expansion of small and medium sized enterprises and long-term employment opportunities.

- On the business environment, the authorities intend to make key government agencies more customer-friendly and their services easier to access (e.g., through expanding the e-Government platform). The initial focus would be on improving services in business licensing, real property tax administration, and customs.

- Stronger economic diversification is being sought through the further development of financial services, agriculture, and port services; and provision of appropriate physical (notably competitive and reliable power) and social infrastructure, including through public-private partnerships (PPPs)—while limiting the associated risks. Pending development of a formal PPPs regulatory framework, they pointed to successful PPP arrangements achieved in recent years, most notably in the case of a $400 million Nassau Airport refurbishing project.

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[9] Inter-American Development Bank, *Country Strategy with the Commonwealth of The Bahamas, 2012–2014*. The document also indicates that about 90 percent of all registered businesses employ fewer than 20 persons.

[10] As pointed out in an independent evaluation of the Doing Business survey, care should be exercised when interpreting these indicators given subjective interpretation, limited coverage of business constraints, and a small number of reporters, which tend to overstate the indicators' coverage and explanatory power (see www.worldbank.org/ieg/doingbusiness).

26. **Staff welcomed the authorities' plans to develop a comprehensive national development plan (NDP) with technical assistance from the Inter-American Development Bank**. The NDP, to be prepared during the first nine months of 2014, would assess the country's macroeconomic performance, institutions and governance, and propose strategies to accelerate economic, institutional, and social development over the medium term and long run. Within a comprehensive framework, it would craft specific development strategies for (i) sectors with a promising outlook, including tourism, agriculture, port services, and financial services, (ii) individual islands, (iii) human capital, (iv) infrastructure, and (v) effective government.

E. Others

27. **The staff discussed recent developments in The Bahamas' exchange system and the legal framework for monetary policy with the authorities.** The authorities confirmed that The Bahamas has not introduced any new exchange measures on the making of payments and transfers for current international transactions or measures that would give rise to multiple currency practices since the last Article IV consultation. Revisions to the central bank act, mainly to further enhance independence and policy flexibility in open market operations, are in progress and should be completed by mid-2014.

STAFF APPRAISAL

Both the fiscal and external imbalances have widened in recent years, while reserves coverage is slipping. In this light, close adherence to planned fiscal consolidation and accelerated implementation of policies to bolster growth and competitiveness will be essential.

28. **The Bahamian economy is recovering from the global financial crisis, but at a painfully slow pace.** Economic activity should recover more strongly from 2014 onward with stronger growth in the US and the opening of Baha Mar, helping to reduce high unemployment. However, growth performance over the medium term will also depend on success in addressing a number of challenges going forward, including diversifying tourist source markets and the tourism experience and expanding incoming airlift capacity; advancing efforts to close infrastructure bottlenecks and workforce skills shortages; and strengthening non-tourism sectors. Steadfast and timely execution of needed reforms will be crucial.

29. **Rigorous implementation of the authorities' fiscal consolidation plan is essential to recapturing medium-term budget and debt sustainability.** The VAT is the cornerstone of the fiscal adjustment program; staff encourages the authorities to insure its timely and successful launch. On the spending side, the efforts to reinforce expenditure controls and monitoring should be accelerated, especially as regards goods and services and transfers; and reforms to improve the weak financial position of key public corporations and rein in transfers and subsidies should be given high priority.

30. **The introduction of a fiscal rule would enhance the predictability and credibility of budget policies.** This would notably help ensure that the authorities' public finance reforms are implemented within a well articulated and durable medium-term fiscal framework; staff encourages the authorities to flesh out the reform's details and implementation timeframe. The Fund stands ready to provide technical assistance.

31. **The exchange rate peg has served The Bahamas well, and should be further supported by efforts to restore budget and external viability and rebuild depleting policy buffers.** Staff encourages the authorities to closely adhere to prudent fiscal policies and structural reforms aimed at preserving strong economic fundamentals.

32. **The steady implementation of key FSAP recommendations and enhanced monitoring of developments in the financial system are commendable.** The establishment of a Systemic Risk Surveillance Committee, creation of a credit bureau, and strengthening of the deposit insurance system should further strengthen the resilience of the financial system and improve its already generally favorable standing. A financial crisis management and resolution plan is also under preparation with Fund technical assistance. The high level of non-performing loans, however, calls for intensifying the monitoring of financial institutions.

33. **The authorities' efforts to craft a comprehensive national development plan (NDP) in 2014 to guide development efforts over the long run and insulate policies from the political cycle are welcome**. It would be important to ensure that the plan is completed in a timely fashion and backed by a broad cross section of society to maximize its probability of success. Sustained efforts will be needed to enhance structural competitiveness by strengthening the business environment, improving educational standards to foster human capital development, and identifying clear strategies for the development of islands and key sectors such as tourism, agriculture, financial services, and port activities. Government initiatives in these areas should be informed by the NDP's pertinent guidance and recommendations.

34. **Staff recommends that the next Article IV consultation with The Bahamas be conducted on the standard 12-month cycle.**

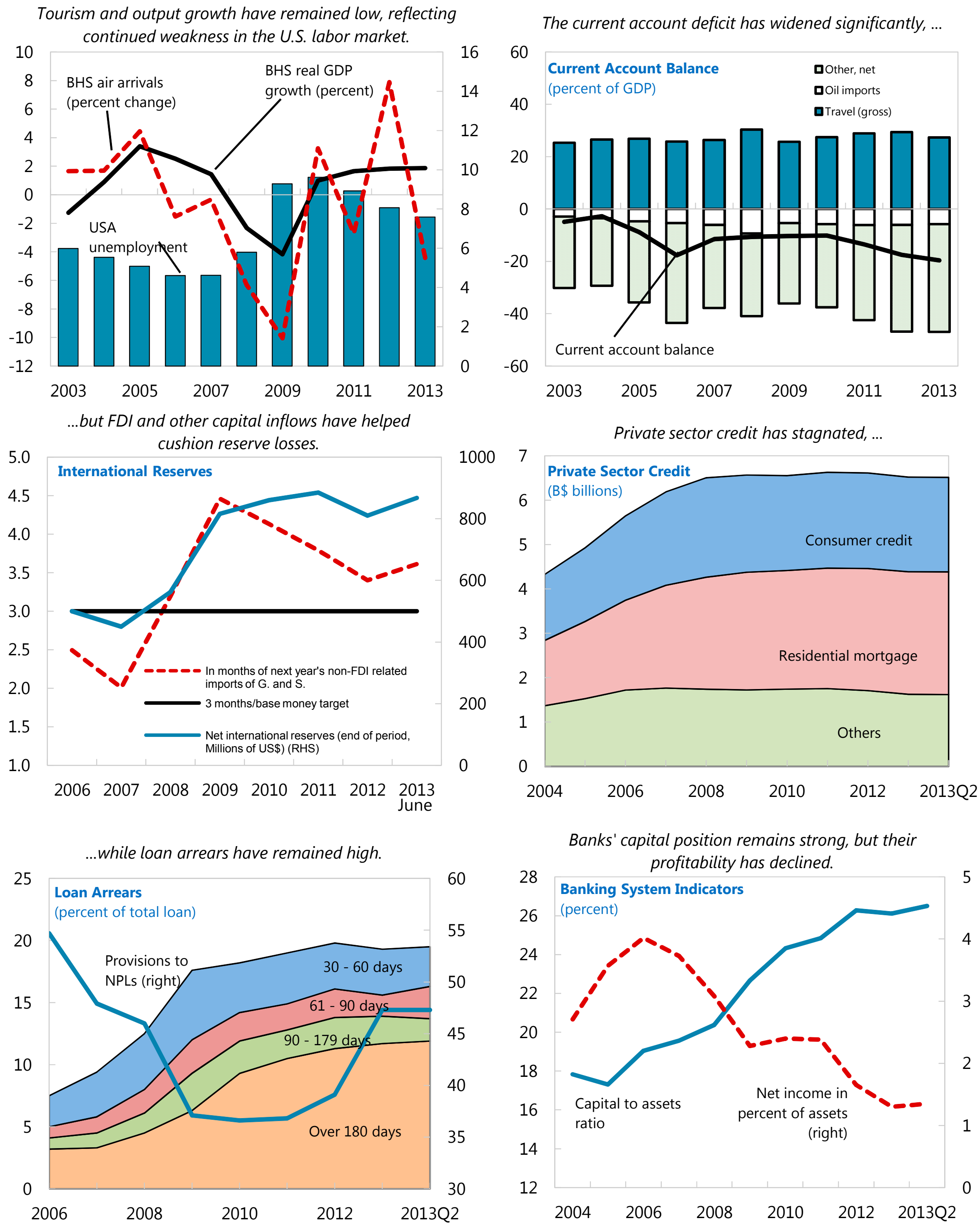
The Bahamas: Risk Assessment Matrix[11]

Main Threats	Likelihood of Realization of the Threat	Expected Impact if Threat is Realized
Fiscal policy shock in the United States (failure to raise the debt ceiling).	**Low** The US economy continues to recover, but setbacks, possibly arising from domestic fiscal policy errors (such as a failure to raise the debt ceiling in a future political impasse) cannot be ruled out.	**High** A future fiscal impasse that causes another government shutdown or a failure to raise the debt ceiling could have substantial adverse effects on the global economy, weakening tourism. This would pressure the balance of payments, causing reserve coverage to fall. Fiscal deficits would remain elevated as the revenue base narrows.
Global oil shock.	**Low** A global oil shock could be triggered by geopolitical events.	**Medium** Rising fuel prices would raise headline inflation and boost travel costs, reducing tourist arrivals.
Disappointing results from the Baha Mar project.	**Low** The foreign investor appears proficient in the tourism business and there was a feasibility study before project commencement. Also, staff's baseline is conservative about the impact of Baha Mar on the growth outlook. However there remains a risk of disappointing tourist arrivals or expenditures at the project, or cannibalization of the customers of other Bahamas resorts.	**High** In a tail risk scenario where the project fails to raise overall tourism exports, the uptick in growth currently projected for 2015 onward would not materialize, with adverse implications for fiscal revenues and the public debt outlook (the project entails no contingent fiscal risks as it is entirely financed by foreign private sources). Moreover, if the project fails to deliver and fiscal adjustment also falls short, there could be substantial pressure on the exchange rate.

[11] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities.

Lower than anticipated emerging market growth potential.	**Medium** Growth slowdown is already observable in key emerging economies, and could intensify, possibly signaling lower potential growth. Financial stresses or setbacks in fiscal and labor market reforms in emerging markets could also lower potential growth.	**Medium** With the tourism strategy aimed at exploiting arrivals from emerging markets (EM) countries, a further slowdown of EM would undercut the growth outlook. That said, the negative impact could be tempered by an accompanying decline in fuel prices.
Delays in implementing fiscal consolidation.	**Medium** Implementation of the authorities' fiscal adjustment plans has been delayed.	**High** Further delays in consolidation, especially as related to tax revenue-enhancing reforms, could pose risks to long-term debt sustainability and the country's investment-grade credit rating.
Credit risk.	**Low** The non-performing loan (NPL) ratio remains high. There is some degree of uncertainty on the value of underlying collateral for non-performing mortgages.	**Low** The banking system's capital buffers provide shock-absorbing capacity. However, NPLs that remain on the balance sheet for prolonged periods could gradually result in higher provisioning and charge-offs, dragging down banks' future profitability.
Other risks.	**Medium** Other potential downside risks economy include weather-related natural disasters and a possible increase in crime (as is occurring elsewhere in the Caribbean).	**Medium/high** Weather related disasters would undermine the growth and fiscal outlooks. A rise in crime would negatively affect tourism if not swiftly and appropriately addressed.

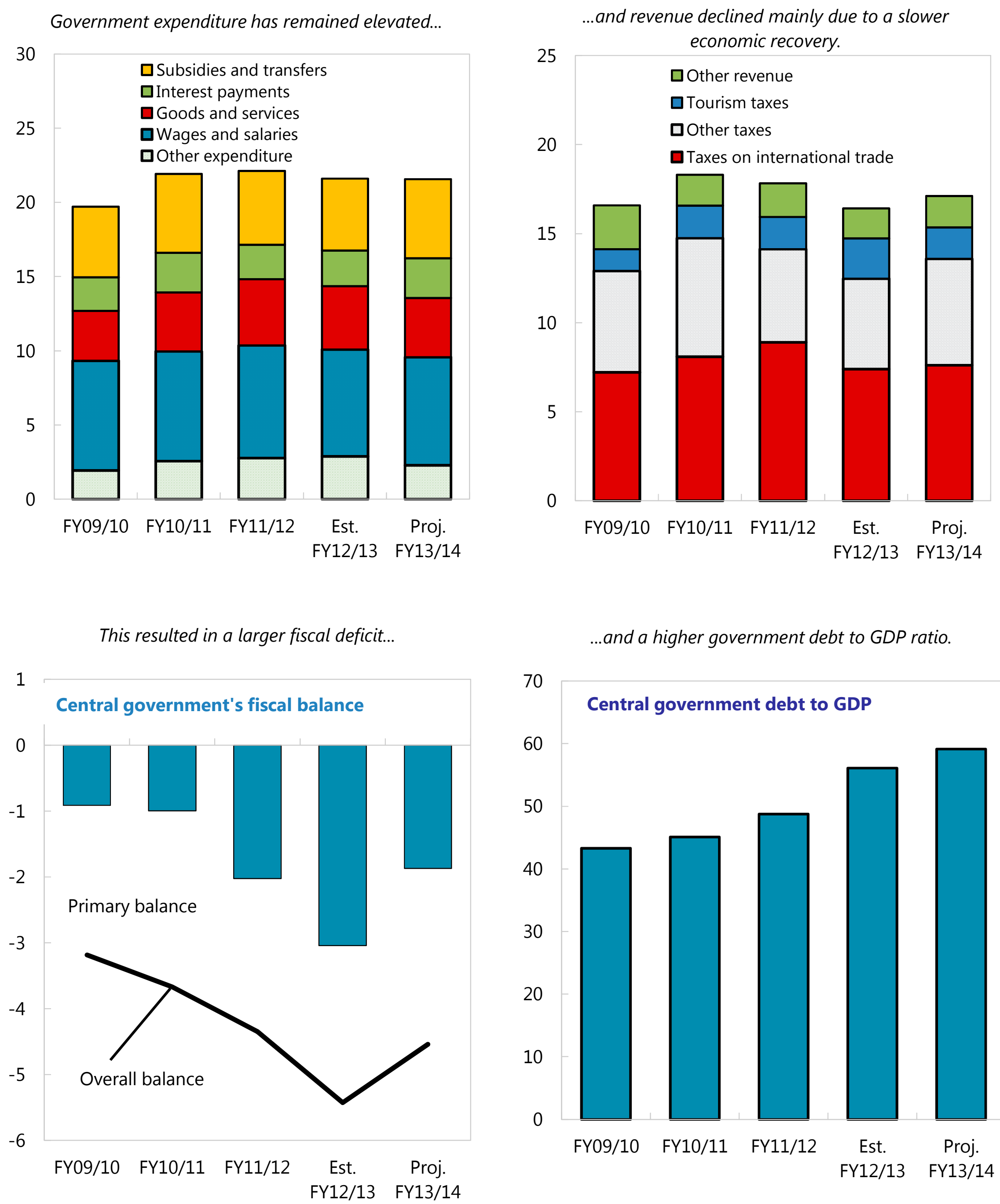
Figure 1. The Bahamas: Recent Developments



Sources: The Bahamian authorities; WEO; and Fund staff estimates and projections.

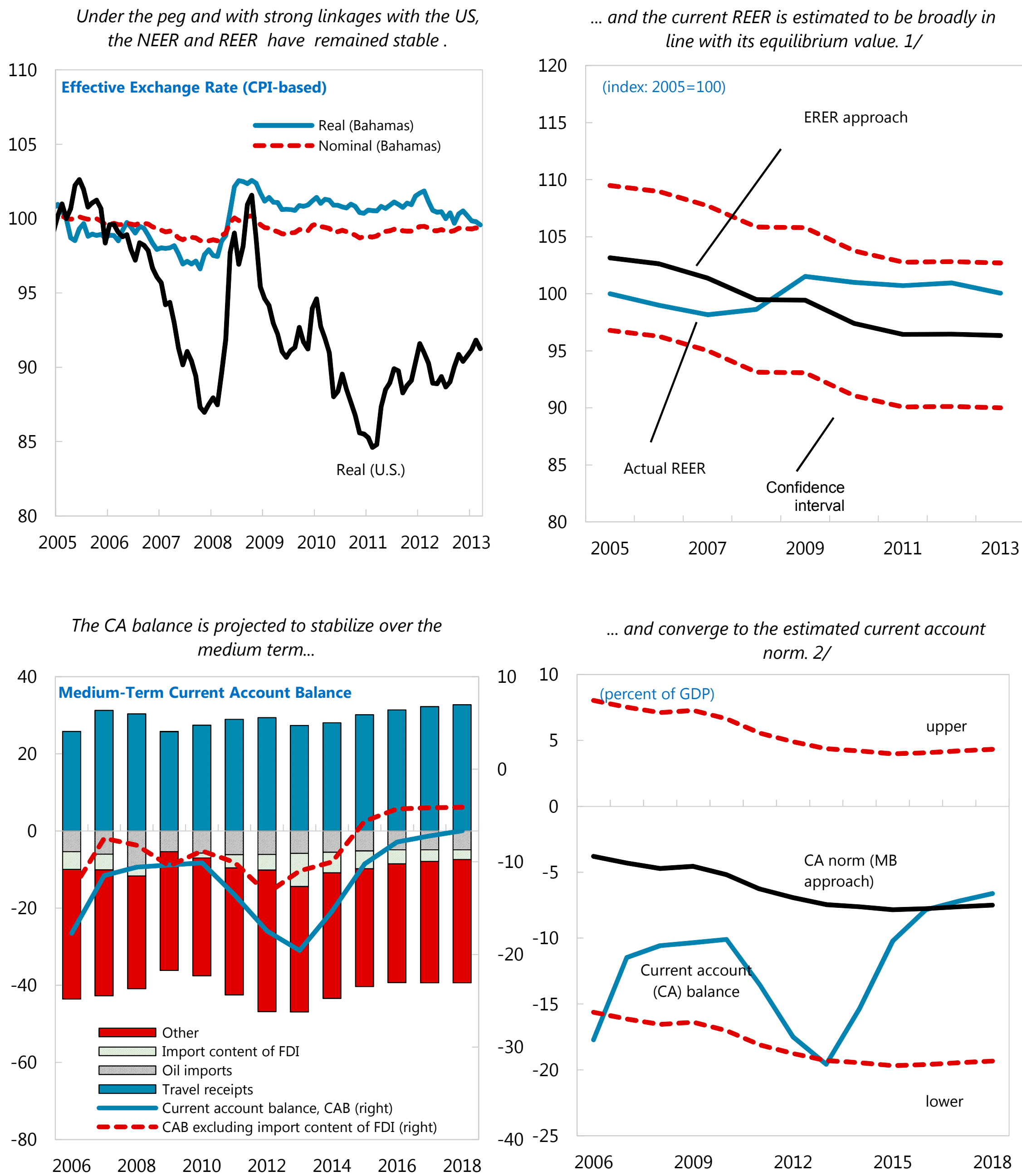
Figure 2. The Bahamas: Fiscal Developments and Outlook 1/

(In percent of GDP)



Sources: The Bahamian authorities; and Fund staff estimates and projections.
1/ Central government fiscal year ending June 30.

Figure 3. The Bahamas: Exchange Rate Assessment



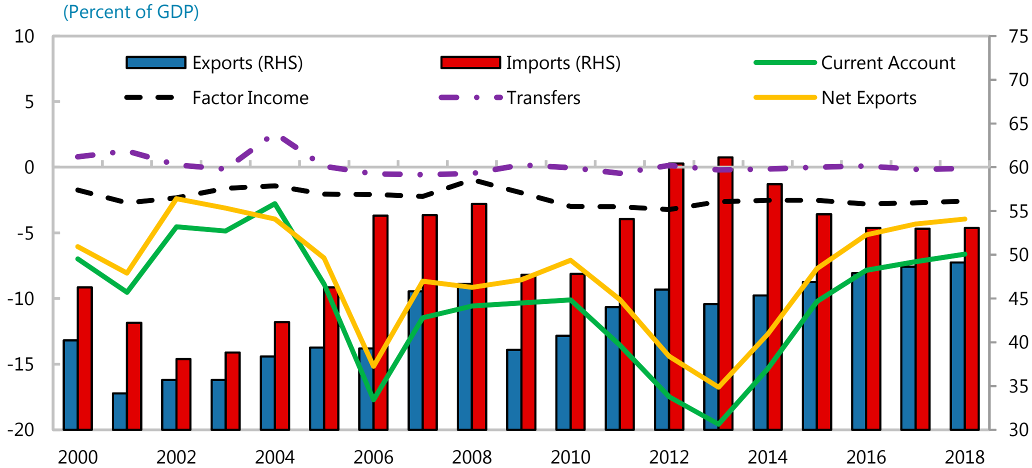
Sources: IMF, Information Notice System; and Fund staff calculations.

1/ The equilibrium value is computed using the equilibrium real exchange rate approach as in Vitek (2010).

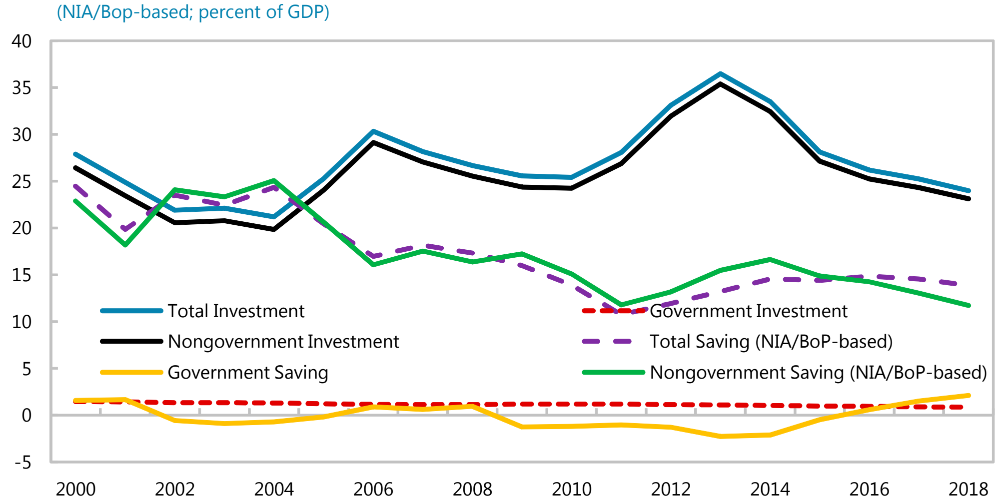
2/ The current account (CA) norm is computed using the estimated parameters from the panel regression in Vitek (2010), and staff medium-term projections for the conditioning variables. In particular, the CA norm depends positively on the country's oil trade balance, the level of net foreign assets, relative fiscal balance, and negatively with respect to relative income growth.

Figure 4. The Bahamas: External, Saving, and Investment Developments

External Sector Developments
(Percent of GDP)



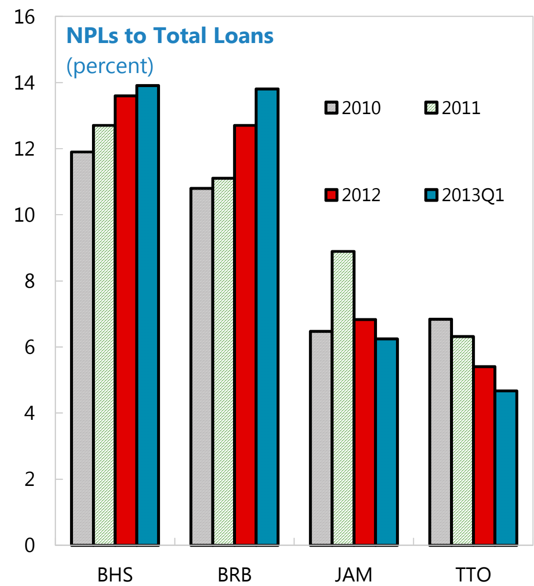
National, Government, and Nongovernment Saving and Investment
(NIA/Bop-based; percent of GDP)



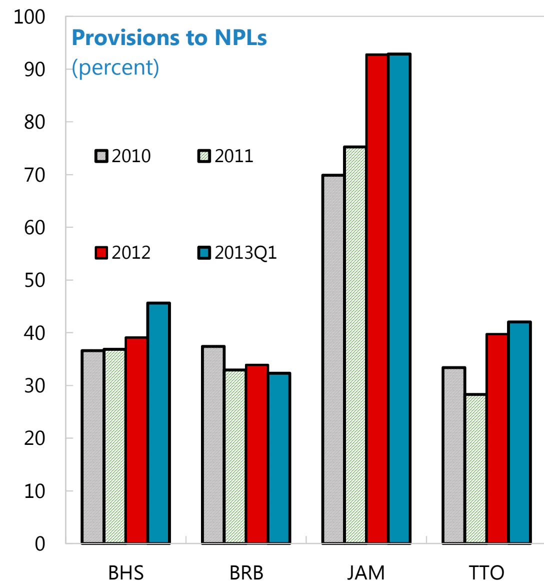
Source: The Bahamian authorities, and IMF staff estimates and projections.

Figure 5. The Bahamas: Financial Developments 1/ (Regional Comparison)

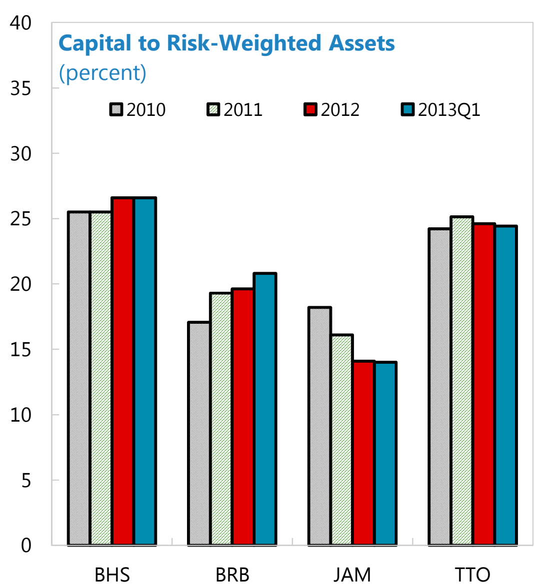
As in other countries, NPLs rose sharply following the recession...



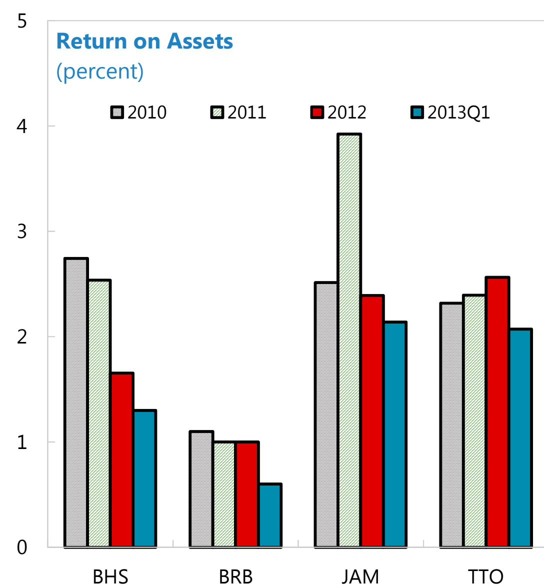
Provisions to NPLs remain around the 40 percent level...



The banking system's ample capital buffers provide shock-absorbing capacity...



...but profitability is declining.

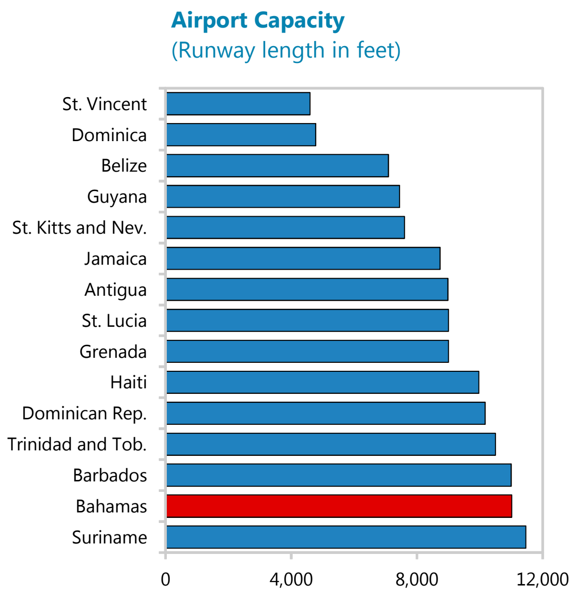


Sources: International Financial Statistics; National authorities; and Fund staff estimates.

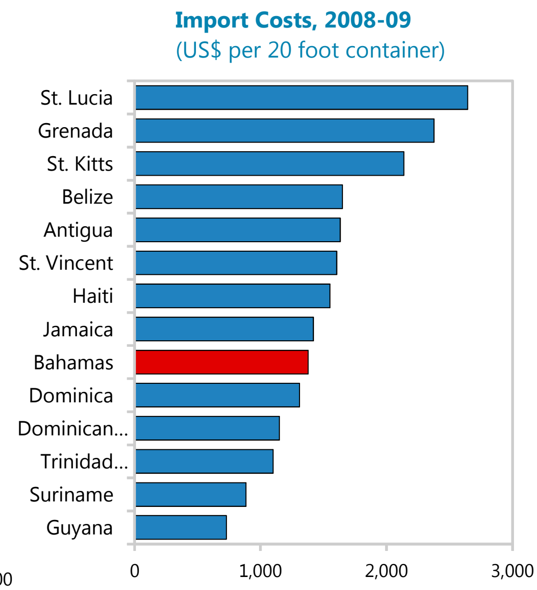
1/ Regional comparators include Barbados, Jamaica, and Trinidad and Tobago.

Figure 6. Structural Competiveness Indicators

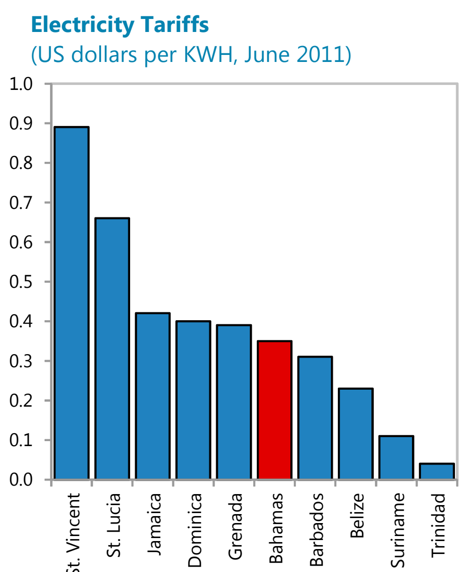
The Bahamas scores well on airport capacity...



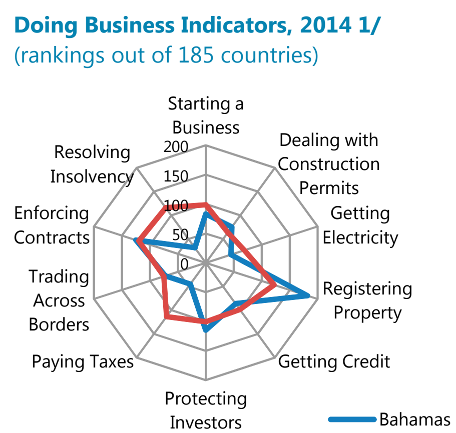
...and is near the regional average on import costs...



...as well as electricity tariffs...



...but the regulatory environment needs improvement, in some areas.



1/ The closer the line to the center of the chart, the more conducive the regulatory environment is to starting and operating a local firm.

Sources: World Bank, Doing Business Indicators, Utility Companies, International Energy Agency, and azworldairport.com.

Table 1. The Bahamas: Selected Social and Economic Indicators

	2010	2011	Est. 2012	Proj. 2013	2014	2015
(Annual percentage changes, unless otherwise indicated)						
Real sector						
Real GDP	1.0	1.7	1.8	1.9	2.3	2.8
Nominal GDP	0.9	-0.2	3.5	2.7	5.4	5.9
Consumer price index (annual average)	1.3	3.2	2.0	0.3	1.9	2.6
Consumer price index (end of period)	1.5	3.2	0.7	0.3	5.4	2.6
Unemployment rate (in percent)	n.a	15.9	14.0	16.2	15.5	14.5
Saving rate (percent of GDP)	15.3	14.5	15.7	16.9	18.2	17.9
Investment rate (percent of GDP)	25.4	28.1	33.1	36.5	33.5	28.2
Financial sector						
Credit to the nonfinancial public sector	37.5	4.0	14.9	6.5	4.1	5.7
Credit to the private sector	-0.4	1.1	-0.3	0.0	1.4	0.4
Liabilities to the private sector	2.6	1.9	-0.1	-0.4	0.1	0.6
External sector						
Exports of goods and services	4.9	7.9	8.3	-1.0	7.7	9.5
Of which: Travel receipts (gross)	7.4	5.4	5.0	-4.4	8.1	13.8
Imports of goods and services	1.1	12.9	15.6	3.9	0.1	-0.4
(In percent of GDP, unless otherwise indicated)						
Central government 1/						
Revenue and grants	16.6	18.3	17.8	16.4	17.1	18.6
Expenditure	19.8	22.0	22.2	21.8	21.6	21.3
Overall balance	-3.2	-3.7	-4.3	-5.4	-4.5	-2.8
Primary balance	-0.9	-1.0	-2.0	-3.0	-1.9	0.0
Central government debt	43.3	45.1	48.8	56.1	59.1	59.3
External sector 2/						
Current account balance	-10.1	-13.5	-17.5	-19.6	-15.4	-10.2
Change in net international reserves						
(Increase -)	-0.6	-0.3	0.9	-0.7	1.5	-0.6
External public debt (end of period)	11.6	13.2	17.8	19.7	21.3	20.7
Memorandum items: 2/						
Gross international reserves						
(End of period; millions of U.S. dollars)	860	885	810	867	735	789
In months of next year's G&S imports	2.4	2.2	1.9	2.0	1.7	1.8
In months of next year's non-FDI related G&S imports	4.1	3.8	3.4	3.6	3.0	3.1
In percent of reserve money	104	100	90	97	82	87
External debt-service ratio (in percent of exports of G&S)	11.1	8.0	7.4	11.3	4.9	4.4
GDP (in millions of Bahamian dollars)	7,888	7,873	8,149	8,367	8,819	9,338

Sources: Central Bank of The Bahamas; Department of Statistics; Ministry of Finance; UNDP Human Development Report; CIA World Factbook and Fund staff projections.

1/ The data refer to fiscal years ending on June 30.
2/ The data refer to calendar years.

Table 2. The Bahamas: Operations of the Central Government 1/
(In millions of Bahamian dollars)

				Prel.	Staff Projections				
	FY09/10	FY10/11	FY11/12	FY12/13	FY13/14	FY14/15	FY15/16	FY16/17	FY17/18
Revenue	**1,302**	**1,442**	**1,427**	**1,355**	**1,470**	**1,685**	**1,873**	**2,039**	**2,185**
Tax revenue	1,109	1,306	1,277	1,216	1,318	1,534	1,712	1,871	2,007
Taxes on international trade	566	637	712	610	653	699	756	813	863
Tourism taxes	96	144	145	186	152	161	170	178	186
Other taxes	447	525	419	419	513	555	613	659	717
Net gains from value added tax (VAT)						118	172	221	242
Other revenue	193	136	151	139	151	152	161	168	177
Expenditure	**1,553**	**1,731**	**1,776**	**1,803**	**1,860**	**1,935**	**2,033**	**2,109**	**2,192**
Expense	1,400	1,527	1,553	1,563	1,662	1,736	1,820	1,891	1,964
Current expenditure	1,396	1,525	1,550	1,545	1,655	1,729	1,813	1,883	1,956
Wages and salaries	580	582	608	594	625	672	708	743	778
Goods and services	265	313	357	354	344	336	354	371	389
Interest payments	178	211	186	197	229	250	263	268	272
Subsidies and transfers	373	419	399	400	457	472	488	502	517
Capital transfers	4	3	3	19	7	7	7	8	8
Net acquisition of nonfinancial assets	153	203	223	239	198	199	213	218	228
Net lending (+) / borrowing (–)	**-250**	**-289**	**-348**	**-448**	**-390**	**-250**	**-160**	**-70**	**-7**
Net acquisition of financial assets	**89**	**73**	**102**	**276**	**58**	**58**	**58**	**58**	**58**
Domestic	89	73	102	96	58	58	58	58	58
Foreign	0	0	0	180	0	0	0	0	0
Net incurrence of liabilities	**340**	**362**	**451**	**725**	**448**	**308**	**218**	**127**	**65**
Domestic	54	314	370	503	48	246	174	102	52
Foreign	286	48	80	221	400	62	44	25	13

Sources: Ministry of Finance; and Fund staff estimates and projections.
1/ Fiscal year ends June 30.

Table 3.1 The Bahamas: Operations of the Central Government 1/
(In percent of GDP)

				Prel.	Staff Projections				
	FY09/10	FY10/11	FY11/12	FY12/13	FY13/14	FY14/15	FY15/16	FY16/17	FY17/18
Revenue	**16.6**	**18.3**	**17.8**	**16.4**	**17.1**	**18.6**	**19.6**	**20.3**	**20.8**
Tax revenue	14.1	16.6	15.9	14.7	15.3	16.9	17.9	18.6	19.1
Taxes on international trade	7.2	8.1	8.9	7.4	7.6	7.7	7.9	8.1	8.2
Tourism taxes	1.2	1.8	1.8	2.3	1.8	1.8	1.8	1.8	1.8
Other taxes	5.7	6.7	5.2	5.1	6.0	6.1	6.4	6.6	6.8
Net gains from value added tax (VAT)						1.3	1.8	2.2	2.3
Other revenue	2.5	1.7	1.9	1.7	1.8	1.7	1.7	1.7	1.7
Expenditure	**19.8**	**22.0**	**22.2**	**21.8**	**21.6**	**21.3**	**21.2**	**21.0**	**20.8**
Expense	17.8	19.4	19.4	18.9	19.3	19.1	19.0	18.8	18.7
Current expenditure	17.8	19.3	19.3	18.7	19.3	19.0	18.9	18.8	18.6
Wages and salaries	7.4	7.4	7.6	7.2	7.3	7.4	7.4	7.4	7.4
Goods and services	3.4	4.0	4.5	4.3	4.0	3.7	3.7	3.7	3.7
Interest payments	2.3	2.7	2.3	2.4	2.7	2.7	2.7	2.7	2.6
Subsidies and transfers	4.7	5.3	5.0	4.8	5.3	5.2	5.1	5.0	4.9
Capital transfers	0.1	0.0	0.0	0.2	0.1	0.1	0.1	0.1	0.1
Net acquisition of nonfinancial assets	1.9	2.6	2.8	2.9	2.3	2.2	2.2	2.2	2.2
Net lending (+)/borrowing (–)	-3.2	-3.7	-4.3	-5.4	-4.5	-2.8	-1.7	-0.7	-0.1
Net acquisition of financial assets	**1.1**	**0.9**	**1.3**	**3.3**	**0.7**	**0.6**	**0.6**	**0.6**	**0.5**
Domestic	1.1	0.9	1.3	1.2	0.7	0.6	0.6	0.6	0.5
Foreign	0.0	0.0	0.0	2.2	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	**4.3**	**4.6**	**5.6**	**8.8**	**5.2**	**3.4**	**2.3**	**1.3**	**0.6**
Domestic	0.7	4.0	4.6	6.1	0.6	2.7	1.8	1.0	0.5
Foreign	3.6	0.6	1.0	2.7	4.7	0.7	0.5	0.3	0.1
Memorandum items:									
Primary balance (In millions of B$)	-72	-78	-162	-251	-161	0	102	198	264
In percent of GDP	-0.9	-1.0	-2.0	-3.0	-1.9	0.0	1.1	2.0	2.5
Central government debt (In millions of B$)	3,401	3,555	3,906	4,632	5,080	5,387	5,605	5,733	5,797
In percent of GDP	43.3	45.1	48.8	56.1	59.1	59.3	58.6	57.1	55.1
Nominal GDP (In millions of B$)	7,854	7,880	8,011	8,258	8,593	9,078	9,570	10,034	10,513

Sources: Ministry of Finance; and Fund staff estimates and projections.
1/ Fiscal year ends June 30.

Table 3.2 The Bahamas: Key Fiscal Measures for FY2013/14		
Content	Estimated yield (in millions of Bahamas dollars)	Effective date
Establish new business license fees on banks: 3 percent of gross revenue.	28	July 2013
Reform the business license fees schedule: establish new fees rates (0.75 – 1.75 percent) based on size of company turnover; and eliminate special categories, except for financial institutions and stand-alone gas stations.	20	July 2013
Increase business license fee rates for offshore banks and trust companies.	5.5	July 2013
Subject public corporations to business license fees (remove the exemption)—fees rates (0.75 – 1.75 percent) based on size of company turnover.	5	July 2013
Introduce an environmental levy on certain imported items (various fee rates depending on items).	7	July 2013
Introduce a customs processing fee of between B$10 and B$500; eliminate the old B$10 stamp tax levied on customs entries.	3	July 2013
Introduction of Financial Administration and Audit Act to enhance the efficiency of public sector administration, bolster transparency, and strengthen various cost control mechanisms in matters of public financial management.	N.A	July 2013
Total in millions of Bahamian dollars	68.5	July 2013
Total in percent of GDP	0.8	July 2013

Source: Ministry of Finance; and Fund staff estimates and projections.

Table 3.3 The Bahamas: Revenue Measures for FY2014/15–FY2016/17

Description of each measure	Staff estimates of net gains by FY2016/17
Introduction of a 15-perecnt VAT; along with concurrent reductions in various import duty, excise tax rates, and other fees.	2.2 percent of GDP
Customs operation reform: Main components: modernization of the organizational structure, corporate affairs, and human resource management; establishment of a customs electronic single window; deployment of automated systems to streamline administrative and overhead functions; strengthening of internal audit and revenue reporting (ongoing project from 2012).	0.3 percent of GDP (Authorities estimates: 0.5 percent of GDP)
Property tax reform: Comprehensive multi-year undertaking, comprised of : overhaul of IT systems; increasing the coverage of the property tax base information; providing more informative taxpayer education programs; adoption of operations manuals on tax administration and compliance procedures (e.g., fiscal cadastre maintenance valuation, billing, and collection); and enhanced enforcement initiatives (ongoing project from 2012).	0.6 percent of GDP (Authorities estimate: 1 percent of GDP)
Excise tax on tobacco: Introduction of stamps on tobacco products upon the payment of excise tax (effective from January 2014).	0.2 percent of GDP

Source: Ministry of Finance; and Fund staff estimates and projections.

Table 4. The Bahamas: Outstanding Stock of Public Debt

(In percent of GDP) 1/

	2008	2009	2010	2011	2012	June 2013
Central government debt	**33.5**	**42.5**	**47.2**	**48.3**	**53.9**	**56.1**
External	4.7	9.0	9.2	10.1	12.7	12.7
Domestic	28.9	33.5	37.9	38.2	41.2	43.4
Of which: in foreign currency	0.0	0.0	0.9	0.0	0.0	0.0
Public corporations' debt	**10.5**	**11.8**	**13.3**	**14.2**	**16.1**	**15.8**
External	0.7	0.8	2.4	3.1	5.1	5.1
Domestic	9.8	11.0	11.0	11.1	11.0	10.7
Of which: in foreign currency	5.0	5.4	5.4	5.2	5.1	4.9
Total public sector	**44.1**	**54.3**	**60.5**	**62.6**	**70.0**	**71.8**
External	5.4	9.8	11.6	13.2	17.8	17.8
Domestic	38.7	44.5	48.9	49.3	52.2	54.0
Of which: in foreign currency	5.1	5.4	6.2	5.2	5.1	4.9
Consolidated public sector 2/	**35.3**	**45.0**	**51.6**	**53.9**	**61.0**	**63.4**
External	5.4	9.8	11.6	13.2	17.8	17.8
Domestic 2/	30.0	35.2	40.0	40.6	43.2	45.6
Of which: in foreign currency	5.0	5.4	5.4	5.2	5.1	4.9

Source: Central Bank of The Bahamas.

1/ Calendar year basis.
2/ Excludes central government debt holdings by public corporations.

Table 5. The Bahamas: Balance of Payments

	2010	2011	Est. 2012	Staff Projections 2013	2014	2015	2016	2017	2018
	(In millions of U.S. dollars)								
Current account balance	**-797**	**-1,066**	**-1,424**	**-1,638**	**-1,354**	**-955**	**-770**	**-738**	**-713**
Goods (trade balance)	**-1,888**	**-2,132**	**-2,401**	**-2,402**	**-2,376**	**-2,366**	**-2,349**	**-2,422**	**-2,523**
Domestic exports	459	511	508	575	646	670	700	731	763
Domestic imports	-2,332	-2,624	-2,886	-2,952	-2,996	-3,010	-3,021	-3,124	-3,254
Oil	-453	-483	-496	-487	-485	-481	-481	-503	-525
Capital goods	-494	-583	-688	-688	-688	-698	-618	-568	-538
Other domestic imports	-1,386	-1,558	-1,702	-1,777	-1,823	-1,831	-1,922	-2,053	-2,191
Other net exports	-15	-19	-24	-24	-26	-27	-28	-30	-31
Services	**1,329**	**1,339**	**1,229**	**999**	**1,254**	**1,646**	**1,844**	**1,979**	**2,099**
Travel (net)	1,936	2,033	2,107	1,991	2,164	2,491	2,741	2,950	3,149
Travel (credit)	2,163	2,279	2,393	2,287	2,473	2,815	3,081	3,306	3,522
Travel (debit)	-228	-246	-286	-296	-309	-324	-340	-357	-374
Other services	-607	-694	-878	-992	-910	-846	-897	-971	-1,050
Of which:									
Construction services (net)	-16	-163	-266	-418	-315	-27	-29	-31	-34
Offshore companies local expenditure (net)	158	139	170	176	185	195	205	217	228
Income and transfers	**-237**	**-272**	**-252**	**-236**	**-233**	**-235**	**-265**	**-295**	**-289**
Capital and financial account	**1,144**	**986**	**1,140**	**1,696**	**1,222**	**1,009**	**907**	**853**	**792**
Capital transfers	-4	-6	-7	-4	-5	-5	-5	-5	-6
Long-term public sector 1/	148	128	411	409	234	57	39	20	-6
Commercial banks' NFA	24	-101	-2	-2	-2	-2	-2	-2	-2
Foreign direct investment	872	667	360	418	430	445	460	476	491
Other private capital	104	298	379	875	565	515	415	365	315
Overall balance	348	-79	-284	57	-133	54	137	115	79
Change in net international reserves (increase -)	**-45**	**-24**	**75**	**-57**	**133**	**-54**	**-137**	**-115**	**-79**
	(In percent of GDP)								
Current account balance	**-10.1**	**-13.5**	**-17.5**	**-19.6**	**-15.4**	**-10.2**	**-7.9**	**-7.2**	**-6.6**
Goods (trade balance)	**-23.9**	**-27.1**	**-29.5**	**-28.7**	**-26.9**	**-25.3**	**-24.0**	**-23.6**	**-23.4**
Domestic exports	5.8	6.5	6.2	6.9	7.3	7.2	7.1	7.1	7.1
Domestic imports	-29.6	-33.3	-35.4	-35.3	-34.0	-32.2	-30.8	-30.4	-30.2
Oil	-5.7	-6.1	-6.1	-5.8	-5.5	-5.2	-4.9	-4.9	-4.9
Capital goods	-6.3	-7.4	-8.4	-8.2	-7.8	-7.5	-6.3	-5.5	-5.0
Other domestic imports	-17.6	-19.8	-20.9	-21.2	-20.7	-19.6	-19.6	-20.0	-20.4
Other net exports	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Services	**16.8**	**17.0**	**15.1**	**11.9**	**14.2**	**17.6**	**18.8**	**19.3**	**19.5**
Travel (net)	24.5	25.8	25.9	23.8	24.5	26.7	28.0	28.7	29.3
Travel (credit)	27.4	28.9	29.4	27.3	28.0	30.1	31.4	32.2	32.7
Travel (debit)	-2.9	-3.1	-3.5	-3.5	-3.5	-3.5	-3.5	-3.5	-3.5
Other services	-7.7	-8.8	-10.8	-11.9	-10.3	-9.1	-9.1	-9.5	-9.8
Income and transfers	**-3.0**	**-3.5**	**-3.1**	**-2.8**	**-2.6**	**-2.5**	**-2.7**	**-2.9**	**-2.7**
Capital and financial account	**14.5**	**12.5**	**14.0**	**20.3**	**13.9**	**10.8**	**9.3**	**8.3**	**7.4**
Capital transfers	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Long-term public sector 1/	1.9	1.6	5.0	4.9	2.6	0.6	0.4	0.2	-0.1
Commercial banks' NFA	0.3	-1.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment	11.1	8.5	4.4	5.0	4.9	4.8	4.7	4.6	4.6
Other private capital 2/	1.3	3.8	4.6	10.5	6.4	5.5	4.2	3.6	2.9
Overall balance	**4.4**	**-1.0**	**-3.5**	**0.7**	**-1.5**	**0.6**	**1.4**	**1.1**	**0.7**
Change in net international reserves (increase -)	**-0.6**	**-0.3**	**0.9**	**-0.7**	**1.5**	**-0.6**	**-1.4**	**-1.1**	**-0.7**
Memorandum items:									
Gross international reserves (in millions of US dollars)	860	885	810	867	735	789	925	1,040	1,120
Nominal GDP (millions of U.S. dollars)	7,888	7,873	8,149	8,367	8,819	9,338	9,802	10,266	10,760

Sources: Central Bank, Department of Statistics; and Fund staff estimates.

1/ Includes SDR allocation in September 2009.
2/ Includes errors and omissions.

Table 6. The Bahamas: Summary Accounts of the Central Bank and the Financial System

			Est.	Staff Projections		
	2010	2011	2012	2013	2014	2015
(In millions of Bahamian dollars, end of period)						
Central Bank						
Gross international reserves	860	885	810	867	733	786
Net domestic assets	-35	-4	89	28	164	116
Credit to nonfinancial public sector (net)	255	292	390	329	464	417
Of which: Central Government	260	289	395	412	423	438
Other	-290	-296	-301	-301	-301	-301
Reserve money	826	881	899	896	897	902
Currency held by the private sector	308	324	344	343	343	345
Liabilities with financial institutions	518	557	555	553	554	557
Financial system						
Net foreign assets	152	281	208	263	127	177
Of which :						
Held by commercial banks and OFIs	-708	-604	-602	-604	-606	-609
Net domestic assets	6,039	6,030	6,095	6,015	6,160	6,147
Credit to nonfinancial public sector, net	1,437	1,493	1,715	1,827	1,901	2,010
Of which: Central Government	1,414	1,439	1,592	1,703	1,778	1,886
Credit to private sector	6,573	6,648	6,629	6,528	6,563	6,638
Other	-1,970	-2,111	-2,249	-2,339	-2,304	-2,500
Liabilities to the private sector (broad money)	6,191	6,310	6,304	6,278	6,287	6,325
Money	1,335	1,435	1,575	1,569	1,571	1,580
Currency	195	197	217	216	216	217
Demand deposits	1,141	1,238	1,358	1,353	1,355	1,363
Quasi-money	4,856	4,876	4,729	4,710	4,716	4,745
(Change in percent of liabilities to the private sector at the beginning of the period)						
Net foreign assets	0.3	2.1	-1.1	0.9	-2.2	0.8
Net domestic assets	2.3	-0.2	1.0	-1.3	2.3	-0.2
Credit to nonfinancial public sector	6.5	0.9	3.5	1.8	1.2	1.7
Credit to private sector	-0.4	1.2	-0.3	-1.6	0.6	1.2
Liabilities to private sector	2.6	1.9	-0.1	-0.4	0.1	0.6
Money	0.9	1.6	2.2	-0.1	0.0	0.1
Quasi-money	1.8	0.3	-2.3	-0.3	0.1	0.4
(Annual percentage change)						
Net domestic assets	2.4	-0.2	1.1	-1.3	2.4	-0.2
Credit to nonfinancial public sector	37.5	4.0	14.9	6.5	4.1	5.7
Credit to private sector	-0.4	1.1	-0.3	-1.5	0.5	1.1
Liabilities to private sector	2.6	1.9	-0.1	-0.4	0.1	0.6
Money	4.0	7.5	9.8	-0.4	0.1	0.6
Quasi-money	2.3	0.4	-3.0	-0.4	0.1	0.6

Sources: Central Bank of The Bahamas; and Fund staff estimates and projections.

Table 7. The Bahamas: Indicators of External and Financial Vulnerability

	2008	2009	2010	2011	2012	Latest Observation 2013	
Financial indicators							
Broad money (12-month percentage change)	5.1	1.8	2.6	1.9	-0.1	-1.0	June
Private sector credit (12-month percentage change)	5.1	0.9	-0.4	1.1	-0.3	-1.9	June
Three-month treasury-bill rate (end of period)	2.7	2.6	2.3	1.3	0.2	0.5	June
Domestic public debt (in percent of GDP, end of period)	38.7	44.5	48.9	49.3	52.2	53.3	June 1/
External indicators							
Exports of goods and services (12-month percentage change)	0.9	-20.4	4.9	7.9	8.3	-11.9	H1
Imports of goods and services (12-month percentage change)	1.5	-18.9	1.1	12.9	15.6	-1.0	H1
Current account balance (in percent of GDP)	-10.6	-10.3	-10.1	-13.5	-17.5	-8.2	H1 1/
Capital and financial account balances (in percent of GDP) 2/	14.7	14.3	14.5	12.5	14.0	3.2	H1 1/
Gross international reserves (end of period, millions of US$)	563	816	860	885	810	797	June
In months of merchandise imports	2.1	3.9	4.0	3.6	2.9	3.2	June 1/
In months of next year's imports of goods and services	1.8	2.6	2.4	2.2	1.9	2.7	June 1/
In months of next year's non-FDI related G&S imports	3.2	4.5	4.1	3.8	3.4	3.3	June 1/
In percent of reserve money	87.3	117.5	104.2	100.4	90.1	82.4	June
In percent of broad money	9.5	13.5	13.9	14.0	12.9	12.3	June 1/
Commercial banks, net foreign assets (end of period, millions of US$)	-704	-682	-708	-604	-602	-524	June
External public debt (in percent of GDP)	5.4	9.8	11.6	13.2	17.8	17.6	June 1/
External debt service (in percent of exports of goods and services)	6.0	24.7	11.1	8.0	7.4	…	
Central government external debt service (in percent of government revenue)	3.4	20.4	4.5	8.1	4.0	…	
REER appreciation (+) (end of period)	13.0	-5.6	0.2	0.3	-1.1	…	
Banking sector risk indicators 2/							
Foreign currency deposits, percent of total deposits	3.5	4.0	3.7	3.3	3.5	4.1	June
Deposits maturing within 3 months, percent of total deposits	19.7	21.5	20.9	25.2	22.4	20.2	June
Capital to risk-weighted assets ratio, percent	23.5	26.1	25.5	25.5	26.6	26.6	Q1
Nonperforming loans to total loans ratio, percent	6.1	9.3	11.9	12.7	13.6	13.9	Q1
Provisions to nonperforming loans ratio, percent	46.0	37.1	36.6	36.8	39.1	45.6	Q1
Pre-tax net revenue, percent of net worth	14.8	10.2	9.7	9.5	5.8	…	
Administrative expenses, percent of total assets	3.3	3.2	3.4	3.5	3.5	…	
Liquid assets to deposits ratio, percent	25.1	30.0	36.1	38.3	41.0	44.7	June
Average interest rate spread, percent	7.0	6.8	7.6	8.3	8.9	9.2	June

Sources: Central Bank of The Bahamas; and Fund staff estimates and projections.

1/ Share of the staff's projected 2013 base (e.g., GDP, imports,…).
2/ Includes errors and omissions.

Annex I: Debt Sustainability Analysis

The Bahamas' public debt[1] is expected to be sustainable in the medium term given the authorities' ongoing fiscal consolidation efforts and projected recovery of the economy. Under the baseline, public debt is projected to peak at almost 60 percent of GDP in fiscal year 2014/15, but to fall to about 55 percent of GDP by fiscal year 2017/18 and remain on a declining trajectory thereafter, with the government's gross financing needs also declining gradually from 7.8 percent to about 2.2 percent of GDP over the period. However, with the forecast track record showing a tendency toward optimism in forecasts of real GDP growth and the primary balance, the baseline scenario faces downside risks. While the recent increase in external borrowings to boost foreign reserves is an additional source of vulnerability, the authorities' explicit commitment to contain such borrowing is likely to be an important mitigating factor.

The Bahamas' public debt has steadily risen in recent years. From 33.5 percent of GDP in 2008, it is expected to increase to almost 60 percent of GDP in fiscal year 2014/15. However, driven by ongoing budget consolidation, the rising public debt trajectory is projected to be reversed gradually (Figure 4 below). The DSA shows that public debt dynamics are mainly driven by the near-term primary deficit, which is expected to be eliminated over the medium term as fiscal consolidation already in train accelerates notably following the introduction of the value-added tax in fiscal year 2014/15. The anticipated strengthening of real GDP growth over the medium term, initially underpinned by the nearly completed $3.5 billion Baha Mar tourist project, would also help curb the rise in the public debt ratio.

Risks arising from the maturity or currency composition of public debt are moderate, as short term debt and foreign currency denominated debt constitute relatively small fractions of total debt. Importantly, fiscal consolidation will be key to mitigating the risks to the baseline scenario—medium term projections using historical averages for the macroeconomic and fiscal paths or a constant primary balance indicate a sharp further rise of public debt, exceeding 70 percent of GDP over the medium term, with elevated gross financing needs as well.

The forecast track record shows a waning of optimism tendencies in forecasts of real GDP growth in recent years; and the unfavorable debt dynamics under assumption of historical performance for the primary balance underscores the need for stronger efforts in addressing the implementation risks and ensuring rigorous adherence to the ongoing fiscal consolidation program. While the projected fiscal adjustment is relatively large compared to relevant cross-country experiences, staff expects the undertaking to be generally manageable, given the authorities' commitment to and preparation of envisaged reforms and a moderate fiscal multiplier. Boom-bust risk is limited in light of relatively slow pace of economic recovery and very weak credit growth in recent years.

[1] The analysis is limited to central government debt as the operations of public corporations are not compiled into a consolidated set of public sector accounts.

The DSA's macro-fiscal stress tests indicate a moderate sensitivity of public debt to a variety of shocks, with the greatest sensitivity being to real GDP growth shocks and sensitivity to exchange rate shocks the lowest of the various shocks considered, including those to the real interest rate and the primary balance. The combined macro-fiscal shock scenario yields a public debt ratio exceeding 70 percent of GDP and gross financing needs of 7 percent of GDP in fiscal year 2017/18.

The heat map of public debt risks confirms the moderate sensitivity of the debt level to macro shocks, and reveals a low sensitivity of gross financing needs to the same set of shocks. While the recent uptick in short-term public debt may raise concerns about the debt profile, short-term liabilities remain a relatively small portion of total public debt (some 12 percent in 2012), have on average been stable during 2001–12, and are mostly held domestically. Recent increases in external borrowing warrant greater scrutiny. To bolster foreign reserves, the government contracted a US$180 million external loan in fiscal year 2012/13; the authorities also shifted the bulk of their deficit financing in fiscal year 2013/14 to external borrowings (contracting a US$100 million foreign loan in October 2013 and contemplating an additional US$300 million for the remainder of fiscal year 2013/14). The authorities concur that external borrowing to accumulate foreign reserves should be used only as a temporary measure as the policy increases the country's external debt service burden and makes the government's balance sheet more vulnerable to external shocks. They are committed to insuring that such borrowing is rigorously contained.

Absent comprehensive data on private external debt, the external DSA was limited to that for external public debt. The Bahamas' external public debt is relatively low, but moderately sensitive to shocks to the non-interest current account and the exchange rate.

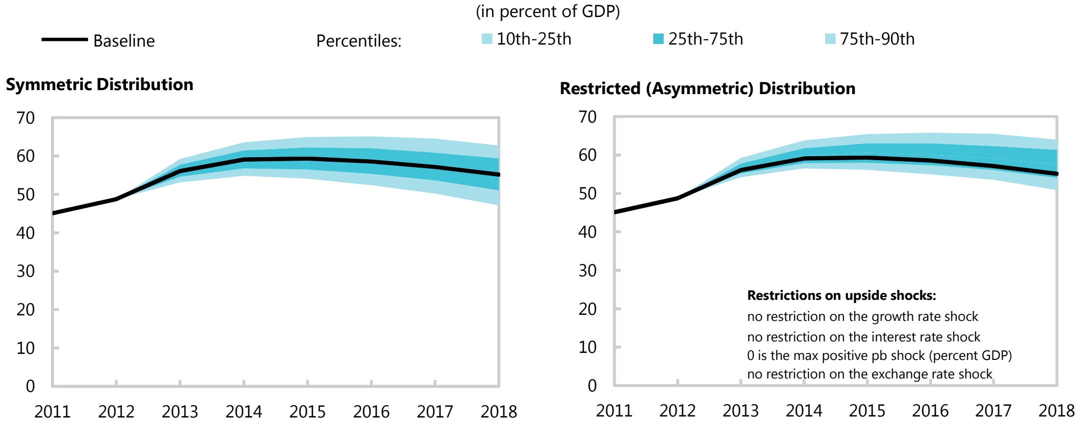
Annex 1. Figure 1. The Bahamas: Public DSA Risk Assessment

Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

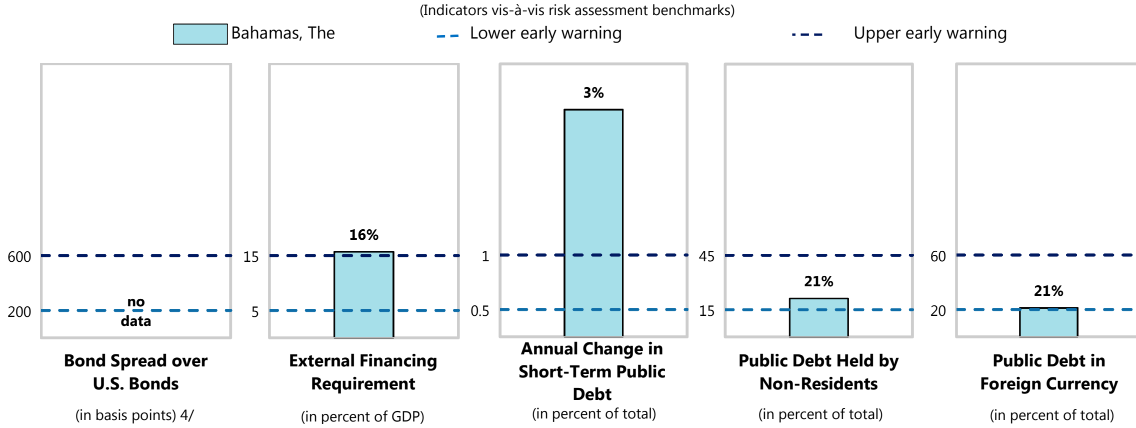
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

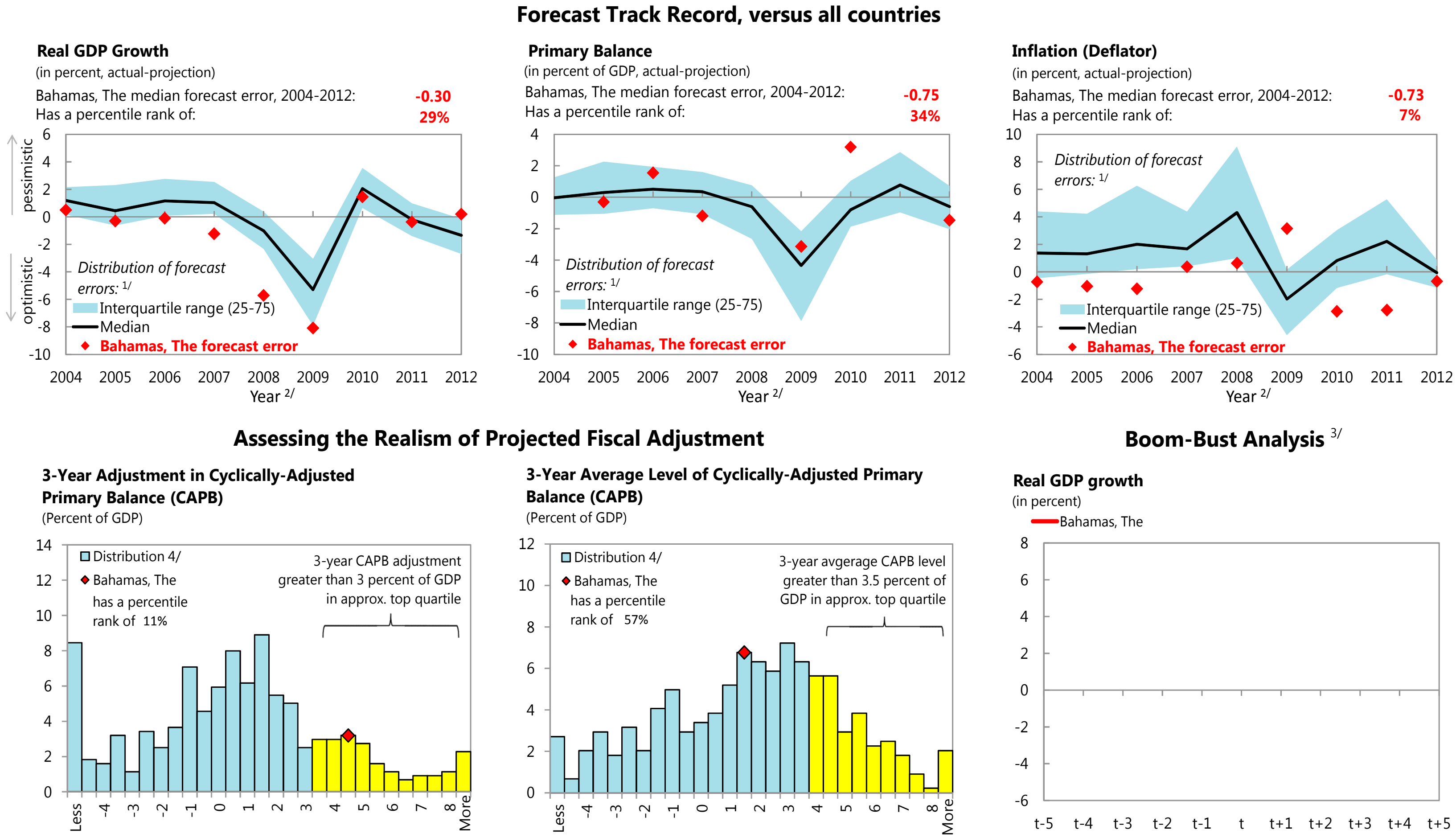
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ An average over the last 3 months, 25-Sep-12 through 24-Dec-12.

Annex 1. Figure 2. The Bahamas: Public DSA - Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Bahamas, The.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Annex 1. Figure 3. The Bahamas: Public DSA - Baseline Scenario

(in percent of GDP unless otherwise indicated)

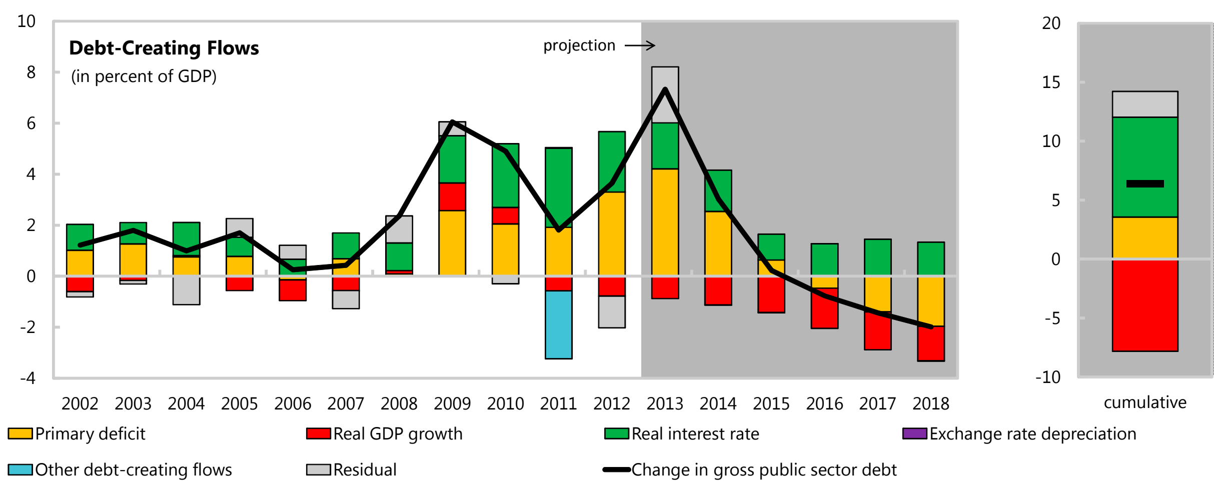
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2002-2010	2011	2012	2013	2014	2015	2016	2017	2018
Nominal gross public debt	31.3	45.1	48.8	56.1	59.1	59.3	58.6	57.1	55.1
Public gross financing needs	4.5	6.4	7.6	7.8	6.0	4.4	3.8	2.7	2.2
Real GDP growth (in percent)	0.5	1.3	1.7	1.9	2.1	2.5	2.8	2.7	2.5
Inflation (GDP deflator, in percent)	1.7	-1.0	-0.1	1.2	1.9	3.0	2.5	2.1	2.2
Nominal GDP growth (in percent)	2.3	0.3	1.7	3.1	4.1	5.7	5.4	4.9	4.8
Effective interest rate (in percent) [3/]	5.9	6.2	5.2	5.0	5.0	4.9	4.9	4.8	4.7

As of December 24, 2012		
Sovereign Spreads		
Spread (bp) 2/		n.a.
CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	Baa1	Baa1
S&Ps	BBB	BBB
Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2002-2010	2011	2012	2013	2014	2015	2016	2017	2018	cumulative	debt-stabilizing
Change in gross public sector debt	2.2	1.8	3.6	7.3	3.0	0.2	-0.8	-1.4	-2.0	6.4	primary
Identified debt-creating flows	2.1	1.8	4.9	5.1	3.0	0.2	-0.8	-1.4	-2.0	4.2	balance [8/]
Primary deficit	1.0	1.9	3.3	4.2	2.5	0.6	-0.5	-1.4	-2.0	3.6	0.0
Primary (noninterst) revenue and grants	15.0	18.3	18.1	16.4	17.1	18.6	19.6	20.3	20.8	112.7	
Primary (noninterest) expenditure	16.1	20.2	21.4	20.6	19.6	19.2	19.1	18.9	18.8	116.3	
Automatic debt dynamics [4/]	1.1	2.5	1.6	0.9	0.5	-0.4	-0.3	0.0	0.0	0.6	
Interest rate/growth differential [5/]	1.1	2.5	1.6	0.9	0.5	-0.4	-0.3	0.0	0.0	0.6	
Of which: real interest rate	1.2	3.1	2.4	1.8	1.6	1.0	1.3	1.4	1.3	8.5	
Of which: real GDP growth	-0.1	-0.6	-0.8	-0.9	-1.1	-1.4	-1.6	-1.5	-1.4	-7.8	
Exchange rate depreciation [6/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	-2.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	-2.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other debt-creating flows (specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [7/]	0.0	0.0	-1.2	2.2	0.0	0.0	0.0	0.0	0.0	2.2	



Source: IMF staff.

1/ Public sector is defined as central government.

2/ Bond Spread over U.S. Bonds.

3/ Defined as interest payments divided by debt stock at the end of previous year.

4/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

5/ The real interest rate contribution is derived from the denominator in footnote 4 as r - π (1+g) and the real growth contribution as -g.

6/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

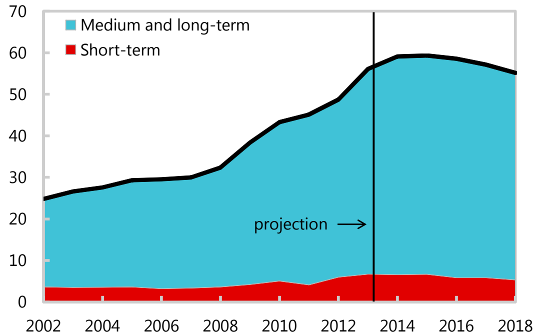
7/ For projections, this line includes exchange rate changes during the projection period.

8/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

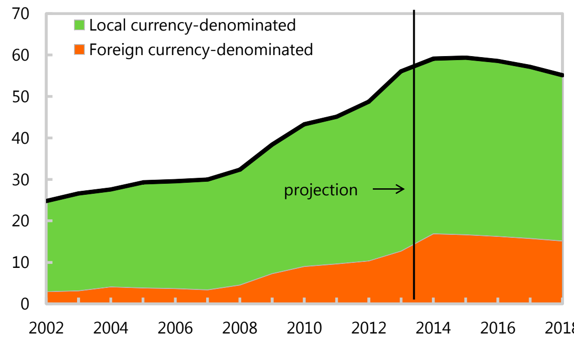
Annex 1. Figure 4. The Bahamas: Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



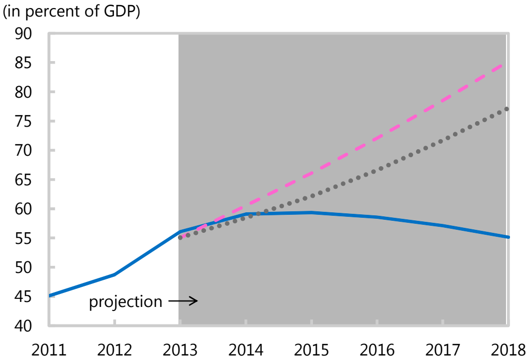
By Currency
(in percent of GDP)



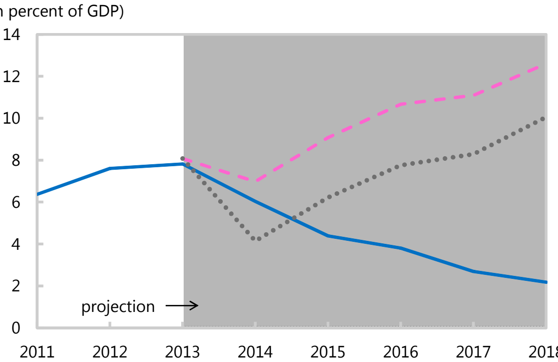
Alternative Scenarios

Baseline — Historical — Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

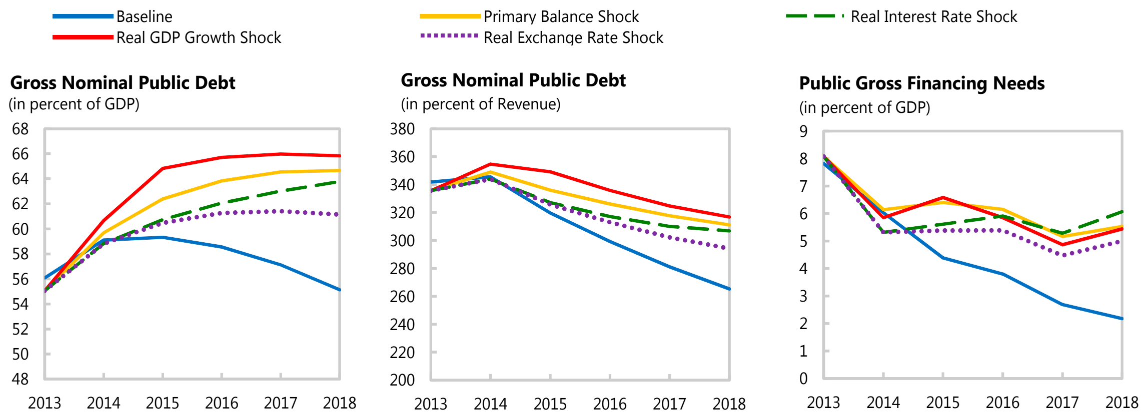
Baseline Scenario	2013	2014	2015	2016	2017	2018
Real GDP growth	1.9	2.1	2.5	2.8	2.7	2.5
Inflation	1.2	1.9	3.0	2.5	2.1	2.2
Primary Balance	-4.2	-2.5	-0.6	0.5	1.4	2.0
Effective interest rate	5.0	5.0	4.9	4.9	4.8	4.7
Constant Primary Balance Scenario						
Real GDP growth	1.9	2.1	2.5	2.8	2.7	2.5
Inflation	1.2	1.9	3.0	2.5	2.1	2.2
Primary Balance	-4.2	-4.2	-4.2	-4.2	-4.2	-4.2
Effective interest rate	5.0	6.1	6.5	6.5	6.5	6.4

Histocial Scenario	2013	2014	2015	2016	2017	2018
Real GDP growth	1.9	0.5	0.5	0.5	0.5	0.5
Inflation	1.2	1.9	3.0	2.5	2.1	2.2
Primary Balance	-4.2	-1.3	-1.3	-1.3	-1.3	-1.3
Effective interest rate	5.0	6.1	6.7	7.0	7.2	7.3

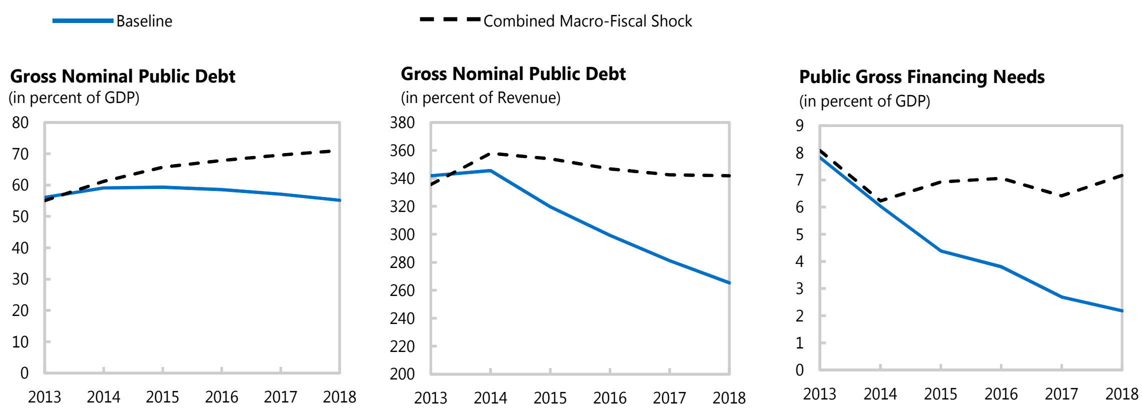
Source: IMF staff.

Annex 1. Figure 5. The Bahamas: Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

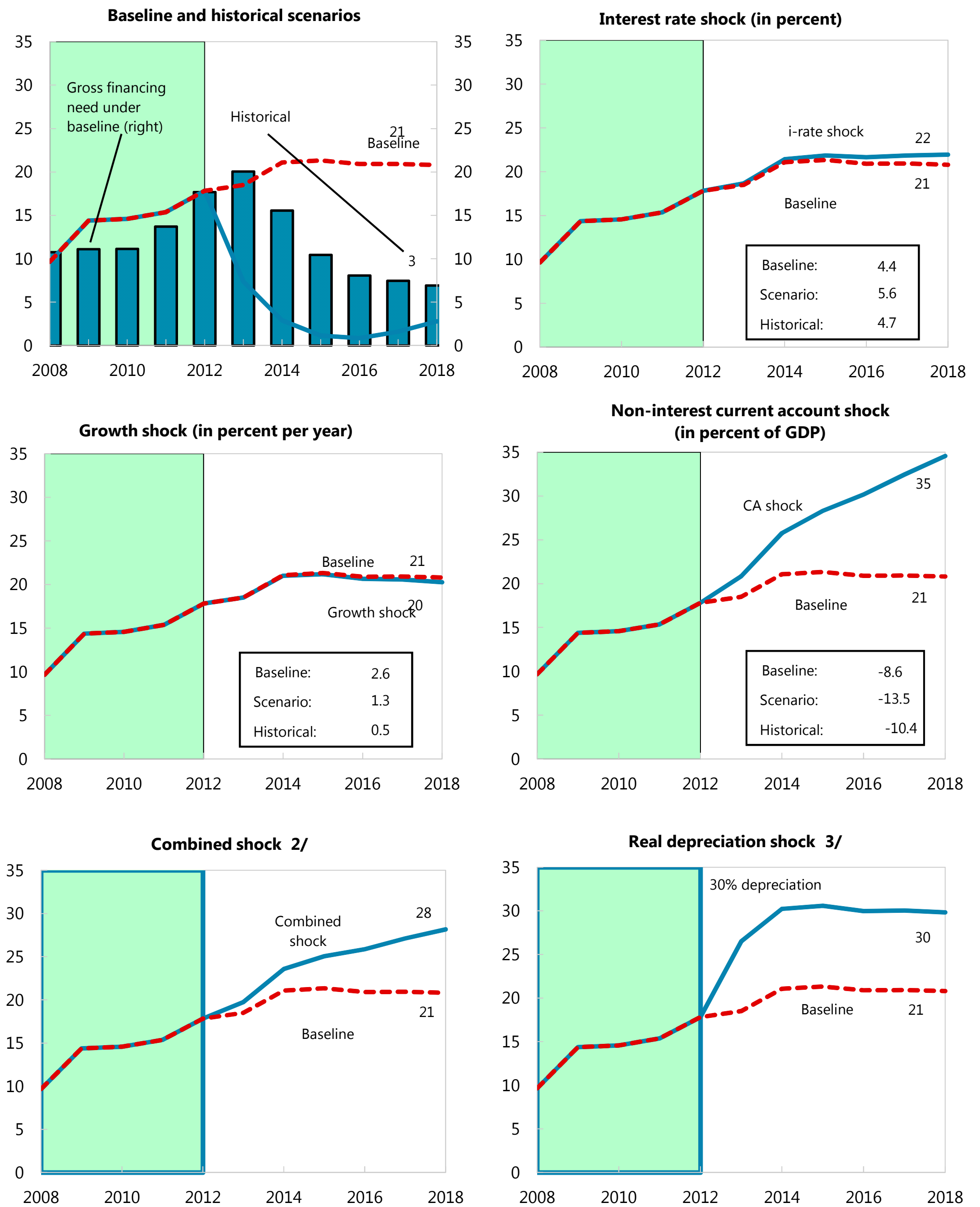
Primary Balance Shock	2013	2014	2015	2016	2017	2018
Real GDP growth	1.9	2.1	2.5	2.8	2.7	2.5
Inflation	1.2	1.9	3.0	2.5	2.1	2.2
Primary balance	-4.2	-3.4	-1.6	-0.1	0.9	1.7
Effective interest rate	5.0	6.1	6.5	6.7	6.7	6.8
Real Interest Rate Shock						
Real GDP growth	1.9	2.1	2.5	2.8	2.7	2.5
Inflation	1.2	1.9	3.0	2.5	2.1	2.2
Primary balance	-4.2	-2.5	-0.6	0.5	1.4	2.0
Effective interest rate	5.0	6.1	6.9	7.5	7.9	8.3
Combined Shock						
Real GDP growth	1.9	0.2	0.6	2.8	2.7	2.5
Inflation	1.2	1.4	2.6	2.5	2.1	2.2
Primary balance	-4.2	-3.4	-1.6	-0.1	0.9	1.7
Effective interest rate	5.0	6.1	7.0	7.6	8.0	8.3

Real GDP Growth Shock	2013	2014	2015	2016	2017	2018
Real GDP growth	1.9	0.2	0.6	2.8	2.7	2.5
Inflation	1.2	1.4	2.6	2.5	2.1	2.2
Primary balance	-4.2	-3.0	-1.6	0.5	1.4	2.0
Effective interest rate	5.0	6.1	6.5	6.7	6.7	6.8
Real Exchange Rate Shock						
Real GDP growth	1.9	2.1	2.5	2.8	2.7	2.5
Inflation	1.2	2.2	3.0	2.5	2.1	2.2
Primary balance	-4.2	-2.5	-0.6	0.5	1.4	2.0
Effective interest rate	5.0	6.1	6.5	6.7	6.7	6.8

Source: IMF staff.

Annex 1. Figure 6. The Bahamas: External Debt Sustainability: Bound Tests 1/

(External debt, in percent of GDP)



Sources: International Monetary Fund, Country desk data, and Fund staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

3/ One-time real depreciation of 30 percent occurs in 2010.

Annex 1. Table 1. The Bahamas: External Debt Sustainability Framework, 2008-2018

(In percent of GDP, unless otherwise indicated)

	Actual								Projections						
	2007	2008	2009	2010	2011	2012			2013	2014	2015	2016	2017	2018	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	**6.8**	**9.7**	**14.4**	**14.6**	**15.4**	**17.8**			**18.5**	**21.1**	**21.3**	**20.9**	**20.9**	**20.8**	**-4.8**
2 Change in external debt	-0.5	2.8	4.7	0.2	0.8	2.4			0.7	2.6	0.2	-0.4	0.0	-0.1	
3 Identified external debt-creating flows (4+8+9)	2.2	0.2	2.4	-1.1	5.1	12.8			14.3	10.1	4.9	2.6	2.1	1.6	
4 Current account deficit, excluding interest payments	11.2	10.3	10.0	9.5	12.9	16.6			18.7	14.4	9.3	7.0	6.4	5.9	
5 Deficit in balance of goods and services	8.7	9.2	8.6	7.1	10.1	14.4			16.8	12.7	7.7	5.2	4.3	3.9	
6 Exports	45.8	46.6	39.1	40.7	44.0	46.0			44.4	45.3	46.9	47.9	48.6	49.1	
7 Imports	54.5	55.8	47.7	47.8	54.1	60.4			61.1	58.1	54.6	53.1	53.0	53.1	
8 Net non-debt creating capital inflows (negative)	-9.0	-10.4	-8.5	-11.1	-8.5	-4.4			-5.0	-4.9	-4.8	-4.7	-4.6	-4.6	
9 Automatic debt dynamics 1/	-0.1	0.3	0.9	0.5	0.6	0.6			0.5	0.6	0.3	0.3	0.3	0.3	
10 Contribution from nominal interest rate	0.2	0.3	0.3	0.6	0.6	0.8			0.9	1.0	0.9	0.9	0.8	0.8	
11 Contribution from real GDP growth	-0.1	0.2	0.4	-0.1	-0.2	-0.3			-0.3	-0.4	-0.6	-0.6	-0.5	-0.5	
12 Contribution from price and exchange rate changes 2/	-0.2	-0.1	0.1	0.0	0.3	...			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	-2.7	2.6	2.3	1.3	-4.3	-10.3			-13.6	-7.5	-4.7	-3.0	-2.0	-1.7	
External debt-to-exports ratio (in percent)	14.9	20.7	36.7	35.8	34.9	38.7			41.7	46.5	45.5	43.6	43.0	42.4	
Gross external financing need (in billions of US dollars) 4/	**1.0**	**0.9**	**0.9**	**0.9**	**1.1**	**1.4**			**1.7**	**1.4**	**1.0**	**0.8**	**0.8**	**0.7**	
in percent of GDP	11.9	10.8	11.1	11.1	13.7	17.7			20.0	15.5	10.4	8.1	7.5	6.9	
Scenario with key variables at their historical averages 5/									**7.4**	**2.9**	**1.1**	**0.8**	**1.6**	**2.8**	**-7.7**
Key Macroeconomic Assumptions Underlying Baseline							10-Year Historical Average	10-Year Standard Deviation							
Real GDP growth (in percent)	1.4	-2.3	-4.2	1.0	1.7	1.8	0.5	2.4	1.9	2.3	2.8	2.8	2.5	2.5	
GDP deflator in US dollars (change in percent)	2.9	1.5	-1.0	-0.1	-1.8	1.6	1.1	1.9	0.8	3.0	3.0	2.1	2.2	2.3	
Nominal external interest rate (in percent)	3.4	4.1	3.4	4.4	4.1	5.6	4.7	2.0	4.9	5.5	4.5	4.2	4.0	3.8	
Growth of exports (US dollar terms, in percent)	21.8	0.9	-20.4	4.9	7.9	8.3	4.8	10.8	-1.0	7.7	9.5	7.2	6.3	5.8	
Growth of imports (US dollar terms, in percent)	4.6	1.5	-18.9	1.1	12.9	15.6	7.0	11.8	3.9	0.1	-0.4	2.0	4.5	5.0	
Current account balance, excluding interest payments	-11.2	-10.3	-10.0	-9.5	-12.9	-16.6	-10.4	4.7	-18.7	-14.4	-9.3	-7.0	-6.4	-5.9	
Net non-debt creating capital inflows	9.0	10.4	8.5	11.1	8.5	4.4	7.8	2.4	5.0	4.9	4.8	4.7	4.6	4.6	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate.
e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Appendix I. Draft Press Release

Press Release No. 14/xx
FOR IMMEDIATE RELEASE
[January 17, 2014]

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2013 Article IV Consultation with The Bahamas

On January 17, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with The Bahamas on a lapse-of-time basis, and considered and endorsed the staff appraisal without a meeting.[1,2]

Real Gross Domestic Product (GDP) grew by 1.8 percent in 2012, similar to 2011, but well below pre-global crisis performance; it is projected at nearly 2 percent for 2013. Unemployment rose to 16.2 percent in mid-2013. While tourist arrivals and expenditures have been subdued, brisk investment and construction for the Baha Mar resort project have helped support economic activity. In keeping with weak domestic demand and softening fuel prices, inflation is generally under control. The fiscal deficit widened to 5½ percent of GDP in FY 2012/13, mainly due to customs revenue underperformance; and the current account deficit reached 17½ percent of GDP in 2012, up from 13½ percent in 2011, largely driven by sustained goods and services imports related to Baha Mar. Foreign reserves were the equivalent of 1.6 months of imports (2.8 months of non-FDI imports) at end-October 2013.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] The lapse of time procedure is proposed for article IV consultations where the following conditions apply: (i) there are no acute or significant risks, or general policy issues requiring Board discussion; (ii) policies or circumstances are unlikely to have significant regional or global impact; (iii) in the event a parallel program review is being completed, it is also being completed on a lapse-of-time basis; and (iv) the use of Fund resources is not under discussion or anticipated.

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Economic expansion should strengthen from 2014 onward with higher growth in the U.S. and the opening of Baha Mar, helping to reduce the high unemployment rate. Supported by the authorities' budget consolidation efforts, the fiscal position should steadily improve in the period ahead. Central government debt is projected to peak at nearly 60 percent of GDP in fiscal year 2014/15, but to begin declining by fiscal year 2017/18. The risks from the widened current account deficit and continuing pressures on foreign reserves are still considerable. However, the completion of Baha Mar could reduce construction imports and boost tourism services exports, strengthening foreign reserves and external stability. Private sector demand for bank credit will likely remain subdued over the near term. While elevated NPL levels have stabilized, they will likely recede slowly as growth and employment pick up, and the debt overhang is reduced. Nevertheless, the banking system has ample capital and liquidity buffers. Despite upside potential in the medium term, risks to the outlook appear tilted downwards. Especially disruptive would be a disappointing Baha Mar performance, delay in fiscal consolidation, and lower than anticipated emerging market growth potential. The risks highlight the need for timely implementation of plans for fiscal consolidation and economic diversification.

Executive Board Assessment

<   >

The Bahamas: Selected Economic Indicators

				Est.	Proj.	
	2010	2011	2012	2013	2014	2015
(Annual percentage changes, unless otherwise indicated)						
Real sector						
Real GDP	1.0	1.7	1.8	1.9	2.3	2.8
Nominal GDP	0.9	-0.2	3.5	2.7	5.4	5.9
Consumer price index (annual average)	1.3	3.2	2.0	0.3	1.9	2.6
Consumer price index (end of period)	1.5	3.2	0.7	0.3	5.4	2.6
Unemployment rate (in percent)	n.a	15.9	14.0	16.2	15.5	14.5
Saving rate (percent of GDP)	15.3	14.5	15.7	16.9	18.1	18.0
Investment rate (percent of GDP)	25.4	28.1	33.1	36.5	33.5	28.3
Financial sector						
Credit to the nonfinancial public sector	37.5	4.0	14.9	6.5	4.1	5.7
Credit to the private sector	-0.4	1.1	-0.3	-1.5	0.5	1.1
Liabilities to the private sector	2.6	1.9	-0.1	-0.4	0.1	0.6
External sector						
Exports of goods and services	4.9	7.9	8.3	-1.0	7.7	9.5
Of which: Travel receipts (gross)	7.4	5.4	5.0	-4.4	8.1	13.9
Imports of goods and services	1.1	12.9	15.6	3.9	0.1	-0.4
(In percent of GDP, unless otherwise indicated)						
Central government 1/						
Revenue and grants	16.6	18.3	17.8	16.4	17.1	18.6
Expenditure	19.8	22.0	22.2	21.8	21.6	21.3
Overall balance	-3.2	-3.7	-4.3	-5.4	-4.5	-2.8
Primary balance	-0.9	-1.0	-2.0	-3.0	-1.9	0.0
Central government debt	43.3	45.1	48.8	56.1	59.1	59.3
External sector 2/						
Current account balance	-10.1	-13.5	-17.5	-19.6	-15.4	-10.2
Change in net international reserves						
(Increase -)	-0.6	-0.3	0.9	-0.7	1.5	-0.6
External public debt (end of period)	11.6	13.2	17.8	19.7	21.3	20.7
Memorandum items: 2/						
Gross international reserves						
(End of period; millions of U.S. dollars)	860	885	810	867	733	786
In months of next year's G&S imports	2.4	2.2	1.9	2.0	1.7	1.8
In months of next year's non-FDI related G&S imports	4.1	3.8	3.4	3.6	3.0	3.1
In percent of reserve money	104	100	90	97	82	87
External debt-service ratio (in percent of exports of G&S)	11.1	8.0	7.4	11.3	4.9	4.4
GDP (in millions of Bahamian dollars)	7,888	7,873	8,149	8,367	8,819	9,338

Sources: Central Bank of The Bahamas; Department of Statistics; Ministry of Finance; UNDP Human Development Report; CIA World Factbook and Fund staff projections.

1/ The data refer to fiscal years ending on June 30.
2/ The data refer to calendar years.

INTERNATIONAL MONETARY FUND

THE BAHAMAS

January 3, 2014

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By	Western Hemisphere Department (In consultation with other departments)

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FUND RELATIONS

(As of October 31, 2013)

Membership Status:
Joined August 21, 1973; Article VIII

General Resources Account:

	SDR Millions	Percent of Quota
Quota	130.30	100.00
Fund holdings of currency	124.04	95.20
Reserve position in the Fund	6.26	4.80

SDR Department:

	SDR Millions	Percent of Quota
Net cumulative allocation	124.41	100.00
Holdings	38.05	30.58

Outstanding Purchases and Loans: None

Latest Financial Arrangements: None

Projected Payments to the Fund:
(SDR Million; based on existing use of resources and present holdings of SDRs):

			Forthcoming		
	2013	**2014**	**2015**	**2016**	**2017**
Principal					
Charges/ Interest	0.02	0.08	0.08	0.08	0.08
Total	**0.02**	**0.08**	**0.08**	**0.08**	**0.08**

Exchange Rate Arrangement:
The Bahamas has a conventional fixed peg arrangement, with the Bahamian dollar pegged to the U.S. dollar at B$1 per US$1. The Bahamas has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions. There have been no changes in exchange restrictions since the last Article IV consultation.

Assessment of Data Adequacy for Surveillance:
Data provision is broadly adequate for surveillance. In particular, all critical macroeconomic data, including comprehensive central government finance statistics, are regularly published in the Central Bank of the Bahamas' "*Monthly Economic and Financial Developments*" and *"Quarterly Statistical Digest"*. However, the authorities have yet to develop the institutional capacity for the compilation of international investment position (IIP) statistics and general government accounts data. Also, The Bahamas has still not started compiling balance of payments statistics consistent with the *Balance of Payments Manual 6*. The authorities have expressed interest in technical assistance in the latter two areas, and Fund is ready to provide assistance upon their formal request.

Last Article IV Consultation:
The Bahamas is on a 12-month consultation cycle. The last Article IV consultation was concluded by the Executive Board on February 4, 2013 (IMF Country Report No. 13/100).

Technical Assistance

Department	**Dates**	**Purpose**
STA	January 2010	Consumer Price Index
STA	January 2010	Export/Import Price Index
CARTAC	March 2010	Macroeconomic Forecasting
STA	May 2010	Consumer Price Index
CARTAC	January 2011	CPI Revision
CARTAC	April 2011	Revenue Mod./Forecasting
CARTAC	May 2011	PFM Reform Action Plan
STA	October 2011	Government Finance Statistics
LEG	February 2012	Central Bank of The Bahamas Act
MCM	February-March 2012	Public Debt Management
STA	June 2012	Quarterly National Accounts
LEG	July 2012	Payment System Laws
STA	Jan 2013	Government Finance Statistics
MCM	February 2013	Financial Stability Reporting
FAD	April 2013	Tax Reforms for Increased Buoyancy
CARTAC	April 2013	Draft VAT Bill
MCM	May 2013	Basel II Implementation
CARTAC	May/September 2013	Central Revenue Agency
CARTAC	July 2013	Support for Customs and Excise Department's Preparation of VAT
MCM, LEG	November 2013	Banking Law: Contingency Planning

Resident Representative: None

FINANCIAL RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

Recent Country Strategy

The current Country Strategy (CS) for 2010–2014 supports the efforts of the government of The Bahamas (GoBH) to increase productivity and growth by improving infrastructure and enhancing competitiveness of Small and Medium Enterprises (SMEs). The CS priority areas are: energy, water and sanitation, transport, and SME development. As of October 2013, the Inter-American Development Bank's (IADB) sovereign-guaranteed portfolio had an average age of 1.9 years and had grown from two loans totaling US$113 million in 2010 to eight loans totaling US$333 million. The envelope of US$195 million was exceeded primarily due to the need to provide countercyclical support to the government's efforts to counteract the economic downturn that was triggered by the global financial crisis. Private sector support has been provided primarily via four multilateral investment fund operations, totaling US$852,764.

The technical cooperation portfolio is extensive, with total approvals of US$6.8 million. Most of the portfolio is in infrastructure (89 percent) that is critical to the tourism industry. Trade accounts for 5 percent of the portfolio, while education and social protection amount to 4 percent and 2 percent, respectively. Performance indicators have improved over the past three years, mainly due to better project execution in the road transport subsector.

The proposed Country Strategy 2013–2017, which was presented to IDB's Board of Directors in November 2013, would support transformative initiatives of GoBH to ensure macroeconomic sustainability; ensure social stability and employment; and increase resilience to the negative impacts of climate change. CS priority areas include: (1) Public Finances and Management; (2) Citizen Security and Justice; (3) Energy; (4) Private Sector Development; and (5) Coastal Risk Management and Climate Change Adaptation.

Active Loans as of October 31, 2013

(In millions of U.S. dollars)

Project	Name	Approval Date	Approved	Disbursed	Available
BH-L1003	Investing in Students and Programs for the Innovative Reform of Education (INSPIRE)	Nov30, 2005	12.9	10.8	2.0
BH-L1024	Supplementary Financing for New Providence Transport Program	May 22,2008	100.0	100	0
BH-L1027	Air Transport Reform Program (PBL)	Dec 14, 2011	47.5	15	32.5
BH-L1027	Air Transport Reform Program (TC Loan)	Dec 14, 2011	2.5	0.25	2.25
BH-L1028	WSC Support Program—New Providence Water Supply and Sanitation Systems Upgrade	Nov 16, 2011	81.0	24.8	53.9
BH-L1016	Trade Sector Support Program	Jul 18, 2012	16.5	0.19	16.3
BH-L1029	New Providence Transport Program Supplementary Financing II	Sep 04, 2012	65.0	38	26.8
BH-L1030	Social Safety Net Reform Program	Jul 18, 2012	7.5	0.70	6.8
Total Loans 8			**333.4**	**189.8**	**140.7**

Net Flow of IADB Convertible Currencies

(In millions of U.S. dollars)

Net Flow of IADB Convertible Currencies (US$ million)				
	2009	**2010**	**2011**	**2012(P)**
a. Loan Disbursements	24.6	32.8	57	83.8
…PBL disbursements	0	0	15	0
b. Repayments principal	7.9	8.6	9.4	12.2
c. Net Loan Flow (a–b)	**16.7**	**24.2**	**47.6**	**71.6**
d. Subscriptions & Contributions	0.7	0.3	0.3	1.2
e. Interests & Charges	5.1	5.6	5.7	6.0
f. Net Cash Flow (c–d–e)	**10.9**	**18.3**	**41.6**	**64.4**
(p) Projected.				

STATISTICAL ISSUES

Statistical data are broadly adequate for surveillance purposes, but some weaknesses remain. The central bank produces annual, quarterly, and monthly reports on macroeconomic developments, and monetary and fiscal data, and is the main source of economic information. The operations of public corporations are not compiled into a consolidated set of public sector accounts, although their debt is included in the public debt data. Thus, a presentation of the general government accounts, including revenue, expenditure, and overall balance is not available.

During 2009 and 2010, the main focus of the Department of Statistics (DoS) was the preparation and execution of the 2010 census (carried out every 10 years). The DoS also embarked on a series of initiatives to improve the national accounts, including rebasing the GDP.

The DoS updated the CPI methodology with technical assistance from CARTAC. The base year was moved to 2010 from 1995, and additional categories were introduced, with higher weights for some items, including for transport and communications. At the same time, the coverage was expanded to include the island of Abaco, in addition to the two islands already covered by the CPI (New Providence and Grand Bahama).

New export-import price indices (XMPI) for goods and major services were developed with technical assistance from CARTAC. Procedures for systematic re-sampling and re-weighting were modified in order to keep the market basket representative of what is being measured.

The Bahamas does not prepare data covering the economy-wide external debt position, nor an international investment position (IIP), although they have stated their intention to do so, and to adopt Balance of Payments Manual 6 (BMP6).

The Inter-American Development Bank (IDB), with the technical support of the United States Census Bureau (USCB), has promoted the development of a methodology called "Tool for Assessing Statistical Capacity" (TASC). This is a self-assessment instrument the general purpose of which is measuring and evaluating the statistical capacity of a country's National Statistical System (NSS), and more specifically, the operational capacity of its National Statistical Office (NSO), to produce and disseminate basic statistics drawn from censuses, surveys and administrative records. There was a mission in The Bahamas to meet with the Department of Statistics in late November, 2013.

Looking ahead, the main activities of the DoS in the coming years will include producing and disseminating comprehensive census data and implementing bi-annual labor force surveys.

The Bahamas began participating in the General Data Dissemination System (GDDS) in 2003. Its metadata were posted on the Fund's Dissemination Standards Bulletin Board on February 14, 2003.

The Bahamas: Table of Common Indicators Required for Surveillance

(As of November 30, 2013)

	Date of Latest Observation (mm/yy)	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	Fixed				
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	10/13	12/13	M	M	M
Reserve/Base Money	10/13	12/13	M	M	M
Broad Money	6/13	10/13	M	M	M
Central Bank Balance Sheet	10/13	12/13	M	M	M
Consolidated Balance Sheet of the Banking System	06/13	10/13	M	M	Q
Interest Rates[2]	10/13	12/13	M	M	M
Consumer Price Index	10/13	11/13	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	NA	NA	NA	NA	NA
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	06/13	11/13	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	06/13	11/13	Q	Q	Q
External Current Account Balance	06/13	10/13	Q	Q	Q
Exports and Imports of Goods and Services	06/13	10/13	Q	Q	Q
GDP/GNP	2012	07/13	A	A	A
Gross External Debt	06/13	11/13	Q	Q	Q
International Investment Position[6]	NA	NA	NA	NA	NA

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

Press Release No. 14/23
FOR IMMEDIATE RELEASE
January 23, 2014

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2013 Article IV Consultation with The Bahamas

On January 17, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with The Bahamas on a lapse-of-time basis, and endorsed the staff appraisal without a meeting.[1,2]

Real Gross Domestic Product (GDP) is projected to grow at nearly 2 percent for 2013, similar to 2012, but well below pre-global crisis performance. Unemployment rose to 16.2 percent in mid-2013. While tourist arrivals and expenditures have been subdued, brisk investment and construction for the Baha Mar resort project have helped support economic activity. As domestic demand remains weak and fuel prices are softening, inflation is generally under control. The fiscal deficit widened to 5½ percent of GDP in the Fiscal Year 2012/13 (July 1-June 30), mainly due to customs revenue underperformance; and the current account deficit reached 17½ percent of GDP in 2012, up from 13½ percent in 2011, largely driven by sustained goods and services imports related to Baha Mar. Foreign reserves were the equivalent of 1.6 months of imports (2.8 months of non-FDI imports) at end-October 2013.

Economic expansion should strengthen from 2014 onward, with higher growth in the U.S. and the opening of Baha Mar helping to reduce the high unemployment rate. The authorities' budget consolidation efforts should help improve the fiscal position. Central government debt is projected to peak at nearly 60 percent of GDP in fiscal year 2014/15, and to decline to 55 percent of GDP in fiscal year 2017/18. The completion of Baha Mar should reduce construction imports and boost tourism services exports, strengthening external stability. The banking system has ample capital and liquidity buffers. Elevated non-

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] The lapse of time procedure is proposed for article IV consultations where the following conditions apply: (i) there are no acute or significant risks, or general policy issues requiring Board discussion; (ii) policies or circumstances are unlikely to have significant regional or global impact; (iii) in the event a parallel program review is being completed, it is also being completed on a lapse-of-time basis; and (iv) the use of Fund resources is not under discussion or anticipated.

performing loans levels have stabilized, and will likely recede slowly as growth and employment pick up, and the debt overhang is reduced. Nevertheless, private sector demand for bank credit will likely remain subdued over the near term. There remain risks to the outlook, including shortfalls in Baha Mar performance, a delay in fiscal consolidation, and lower than anticipated tourist arrivals in the event that global growth weakens. The risks highlight the need for timely implementation of plans for fiscal consolidation and economic diversification.

Executive Board Assessment

In concluding the 2013 Article IV consultation with The Bahamas, Executive Directors endorsed the staff appraisal, as follows:

The Bahamian economy is recovering from the global financial crisis, but at a painfully slow pace. Economic activity should recover more strongly from 2014 onward with firmer growth in the U.S. and the opening of Baha Mar, helping to reduce high unemployment. However, growth performance over the medium term will also depend on success in addressing a number of challenges going forward, including diversifying tourist source markets and the tourism experience and expanding incoming airlift capacity; advancing efforts to close infrastructure bottlenecks and workforce skills shortages; and strengthening non-tourism sectors. Steadfast and timely execution of needed reforms will be crucial.

Rigorous implementation of the authorities' fiscal consolidation plan is essential to recapturing medium-term budget and debt sustainability. The VAT is the cornerstone of the fiscal adjustment program; the authorities should ensure its timely and successful launch. On the spending side, the efforts to reinforce expenditure controls and monitoring should be accelerated, especially as regards goods and services spending and transfers; and reforms to improve the weak financial position of key public corporations and rein in transfers and subsidies should be given high priority.

The introduction of a fiscal rule would enhance the predictability and credibility of budget policies. This would notably help ensure that the authorities' public finance reforms are implemented within a well articulated and durable medium-term fiscal framework. The reform's details and implementation timeframe authorities should be fleshed out; and the Fund stands ready to provide technical assistance.

The exchange rate peg has served The Bahamas well, and should be further supported by efforts to restore budget and external viability and rebuild depleting policy buffers. The authorities are encouraged to closely adhere to prudent fiscal policies and structural reforms aimed at preserving strong economic fundamentals.

The steady implementation of key Financial Sector Assessment Program recommendations and enhanced monitoring of developments in the financial system are commendable. The establishment of a Systemic Risk Surveillance Committee, creation of a credit bureau, and strengthening of the deposit insurance system should further strengthen the resilience of the financial system and improve its already generally favorable standing. A financial crisis management and resolution plan is also under preparation with Fund technical assistance. The high level of non-performing loans, however, calls for intensifying the monitoring of financial institutions.

The authorities' efforts to craft a comprehensive national development plan (NDP) in 2014 to guide development efforts over the long run and insulate policies from the political cycle are welcome. It would be important to ensure that the plan is completed in a timely fashion and backed by a broad cross section of society to maximize its probability of success. Sustained efforts will be needed to enhance structural competitiveness by strengthening the business environment, improving educational standards to foster human capital development, and identifying clear strategies for the development of islands and key sectors such as tourism, agriculture, financial services, and port activities. Government initiatives in these areas should be informed by the NDP's pertinent guidance and recommendations.

Table 1. The Bahamas: Selected Social and Economic Indicators

				Est.	Proj.	
	2010	2011	2012	2013	2014	2015
(Annual percentage changes, unless otherwise indicated)						
Real sector						
Real GDP	1.0	1.7	1.8	1.9	2.3	2.8
Nominal GDP	0.9	-0.2	3.5	2.7	5.4	5.9
Consumer price index (annual average)	1.3	3.2	2.0	0.3	1.9	2.6
Consumer price index (end of period)	1.5	3.2	0.7	0.3	5.4	2.6
Unemployment rate (in percent)	n.a	15.9	14.0	16.2	15.5	14.5
Saving rate (percent of GDP)	15.3	14.5	15.7	16.9	18.1	18.0
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Overall balance	-3.2	-3.7	-4.3	-5.4	-4.5	-2.8
Primary balance	-0.9	-1.0	-2.0	-3.0	-1.9	0.0
Central government debt	43.3	45.1	48.8	56.1	59.1	59.3
External sector 2/						
Current account balance	-10.1	-13.5	-17.5	-19.6	-15.4	-10.2
Change in net international reserves						
(Increase -)	-0.6	-0.3	0.9	-0.7	1.5	-0.6
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Sources: Central Bank of The Bahamas; Department of Statistics; Ministry of Finance; UNDP Human Development Report; CIA World Factbook and Fund staff projections.

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