

The Bahamas: 2005 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for The Bahamas

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 2005 Article IV consultation with The Bahamas, the following documents have been released and are included in this package:

- the staff report for the 2005 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 6, 2005, 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 June 9, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its June 24, 2005 discussion of the staff report that concluded the Article IV consultation.
- a statement by the Executive Director for The Bahamas.

The document listed below has been or will be separately released.

Selected Issues and Statistical Appendix

The policy of publication of 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 2005 Article IV Consultation

Prepared by the Staff Representatives for the 2005 Consultation with The Bahamas

Approved by Christopher Towe and Juha Kähkönen

June 9, 2005

- **Discussions.** A staff team held discussions in Nassau during April 26–May 6. The team met with Acting Prime Minister Pratt and her cabinet, other senior officials, and representatives from the political opposition, labor unions, and the business and financial sector.
- **Team.** W. Lewis (Head), M. Dehesa, A. Faria, and E. Verreydt (all WHD). M. Kruger (OED) attended key meetings.
- **Previous consultation.** At the conclusion of the last Article IV consultation on July 2, 2003, Directors stressed the need to consolidate the fiscal position, raise international reserves, and diversify the economic base. They recommended a gradual move toward a more flexible and market-oriented framework for liquidity and credit management.
- **Effectiveness of past surveillance.** The authorities have generally agreed with the Fund’s policy advice, particularly as regards the further strengthening of the supervisory and regulatory framework for the financial sector, maintaining an adequate level of international reserves, and the need for fiscal prudence. Directors have noted in past Article IV consultations the need to overhaul the tax structure and reverse the decline in the tax-to-GDP ratio by reducing tax exemptions, lowering import duty rates, and introducing a value-added tax. However, the authorities have not succeeded in building a domestic consensus for rapid progress in the areas of tax reform and trade policy. Also, Directors have urged private sector participation in key public utilities and infrastructure sectors, but progress in this area has been limited.
- **Fund relations.** The Bahamas has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund’s Articles of Agreement and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions (Appendix I). The Bahamas participates in the GDDS, and its metadata are posted on the Fund’s Data Standards Bulletin Board.

Contents	Page
Executive Summary	3
I. Background and Prospects for 2005	4
A. A Brief Perspective	4
B. Recent Developments	5
II. Policy Discussions	8
A. Fiscal Policy	8
B. Financial Sector Policies	10
C. Policies for Competitiveness and Growth and the Medium-Term Outlook and Risks	11
D. Other Issues	13
III. Staff Appraisal	13
Tables	
1. Selected Economic Indicators	23
2. Social Indicators	24
3. Operations of the Central Government	25
4. Operations of Nonfinancial Public Corporations	26
5. Public Debt	27
6. Selected Indicators of Tourism	28
8. Summary Accounts of the Central Bank and the Financial System	30
9. Commercial Bank Performance Indicators, 2000–04	31
10. Indicators of External and Financial Vulnerability	32
11. Summary Medium-Term Macro Flows: Baseline Scenario	33
12. Summary Medium-Term Macro Flows: Active Scenario	34
Figures	
1. Developments in the Real Sector	16
3. Fiscal Developments	18
4. Public and Central Government Debt, 1992–2005	19
5. Bank Credit, Liquidity and International Reserves, 1999–2005	20
6. Selected Interest Rates, and Bank Liquidity 1999–2004	21
7. Alternative Medium-Term Scenarios 2003–10	22
Appendices	
I. Fund Relations	35
II. Financial Relations with the Inter-American Development Bank	37
III. Statistical Issues	38
IV. Debt Sustainability Analysis	42

EXECUTIVE SUMMARY

Background

- **Growth.** Real GDP growth increased to 3 percent and unemployment declined in 2004 as the tourism sector began to turn around, despite two strong hurricanes in September 2004.
- **Fiscal performance.** The fiscal deficit remained above 3 percent of GDP during FY 2003/04, and declined to 2½ percent of GDP in FY 2004/05, mainly reflecting revenue effort. However, the debt-to-GDP ratio has continued to rise.
- **Monetary policy.** Net international reserves (NIR) increased steadily to reach 117 percent of base money at end-March 2005. In response, the central bank relaxed credit controls in August 2004. Reflecting the build-up of NIR, free bank reserves rose strongly in the last quarter of 2004 and the first quarter of 2005.
- **Financial sector.** Steps have been taken to implement the recommendations of the report of the Module 2 assessment of the offshore financial center, including the closure of “shell” banks and the establishment of a commission to determine how best to consolidate regulatory functions.
- **Medium-term outlook.** Large-scale investment in the tourism sector is expected to provide a stimulus to growth in 2005–06, but fiscal measures are needed to avoid larger fiscal deficits and a marked rise in the debt ratio by 2010.

Policy discussions

- **Fiscal targets and the budget for FY 2005/06.** Although the authorities are committed to lowering the government debt ratio to 30 percent over the next five years, the budget proposal for 2005/06 would allow the deficit to rise to almost 3 percent of GDP and postpone the needed adjustment. An additional fiscal effort is needed, focusing on improved tax administration and restraint on public sector wage increases. Public enterprises should be managed on commercial bases or privatized, as circumstances permit.
- **Financial sector policies.** The mission emphasized the potential for an increase in bank credit and loss in NIR, and recommended mopping up excess bank reserves. The authorities agreed that more market-oriented instruments of monetary policy should be introduced in the context of a gradual relaxation of capital controls.
- **Trade agreements.** The mission encouraged the authorities to continue with the process of integration into the regional economy through multilateral trade arrangements.

I. BACKGROUND AND PROSPECTS FOR 2005

A. A Brief Perspective

1. **The Bahamas is a small, open, and relatively wealthy economy, which is highly dependent on tourism from the United States and offshore financial activities.** Per capita GDP is US\$18,000, and other indicators of social development compare favorably with Caribbean averages (Tables 1 and 2). Offshore financial activities have developed rapidly since the early 1990s and now account for roughly 15 percent of GDP. This has reduced the economy's dependence on the tourism sector, which is focused on the higher end of the U.S. market but still accounts for a quarter of GDP. However, economic activity remains narrowly based, and options for further diversification appear limited.

2. **The economy's external dependence contributed to a marked weakening of the macroeconomic situation**

in 2001–02. Following average annual growth of 4½ percent during 1996–2000, real GDP growth slowed to an average of about 1 percent in the following two years, owing to the U.S. recession and the impact of the September 2001 terrorist attacks on tourism. However, with the exchange rate pegged to the U.S. dollar, annual inflation remained low at around 2 percent.

	Sources of Growth				
	(Contribution to GDP growth, in percentage points)				
	2002 GDP share	1991-1995	1996-2000	2001-2002	2003-2004
Tourism	22.8	-0.2	0.8	0.0	0.9
Financial sector	12.1	1.0	0.5	0.6	-0.4
Other	65.1	-0.9	3.1	0.5	2.0
GDP	100.0	0.0	4.4	1.1	2.5

Sources: The Bahamas Department of Statistics; and Fund staff calculations.

3. **The economic slowdown also contributed to a deterioration in the fiscal accounts (Table 3).** A boom in tax revenue and expenditure restraint lowered the central government deficit to ½ percent of GDP by FY 2000/01, but the deficit widened to ¾ percent of GDP in FY 2001/02 and 3½ percent of GDP in FY 2002/03, taking central government debt to 37 percent of GDP (Table 5).¹ Two thirds of the deterioration reflected the effects of lower imports and reduced stopover visitors on tax collections, and the remainder was the result of increased current outlays, especially following a wage contract that provided for a substantial increase in 1999 and escalators during 2001–04. Although deficits were almost fully financed by domestic banks, roughly half the bank financing involved U.S. dollar loans from the offshore books of foreign banks, which contributed to a large increase in the net foreign liabilities of the banking system.

4. **The authorities used credit controls to alleviate pressures on international reserves and the exchange rate.** The Bahamas maintains significant restrictions on capital flows and supplements these with direct instruments to control liquidity, including credit

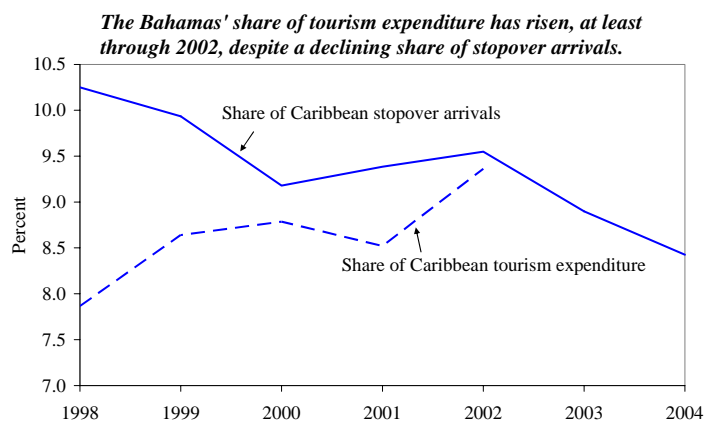
¹ Fiscal year ending June 30.

ceilings and moral suasion, with interest rates having a secondary role in policymaking. Accordingly, as net international reserves (NIR) declined in the third quarter of 2001 by US\$60 million to US\$300 million (77 percent of base money) and the peg appeared under threat, the central bank introduced in September a bank-by-bank freeze on domestic currency credit to the private sector. This action helped reverse the decline in NIR in 2002 by restraining household sector demand, which is import-intensive.

B. Recent Developments

5. **The Progressive Liberal Party enjoys a strong majority in Parliament.** The government's popularity has been strengthened by the launch of several large-scale tourism projects; general elections are due by August 2007.

6. **Economic activity recovered in 2003–04 (Figure 1).** Real GDP growth increased to 2 percent in 2003, owing to a rapid pick-up in financial and other services that offset continued weakness in tourism, and reached 3 percent in 2004 as the tourism sector began to turn around. Despite two hurricanes in September 2004, spending by tourists increased by over 6 percent in real terms in 2004, boosted by a continued rapid growth of cruise ship visitors.² The upturn in economic activity also contributed to a decline in the unemployment rate, to just over 10 percent in 2004.



7. **A depreciation of the real effective exchange rate vis-à-vis regional competitors in 2004 suggests an improvement in The Bahamas' competitiveness (Figure 2).**³ However, while the share of Caribbean tourism expenditure rose during 1998–2002, this trend may not have continued in 2003–04, judging by stopover arrivals.

8. **Fiscal performance fell short of budget objectives.** Although current outlays on nonwage goods and services and capital expenditure were contained, the fiscal deficit remained above 3 percent of GDP during FY 2003/04 (see Table 3 and Figure 3), compared with the authorities' target of 2¼ percent of GDP. Tax revenues were depressed, partly as a

² The hurricanes are estimated to have lowered GDP by close to 1 percent in 2004 through their impact on tourism, on the basis of monthly tourism data.

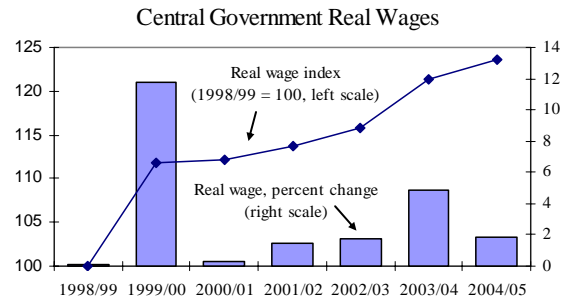
³ In particular vis-à-vis the Dominican Republic, which experienced double-digit inflation in 2004.

result of tariff exemptions aimed at stimulating the construction and tourism sectors, and public sector wages rose in line with the escalators established under the 1999 wage agreement.

9. **The government deficit is estimated to have narrowed to 2½ percent of GDP in 2004/05, slightly better than the budget projection.** About two thirds of the reduction in the primary deficit of 0.6 percentage point of GDP was attributable to one-time factors, namely, the settlement of tax arrears by a hotel being sold to a large developer and grants for post-hurricane repairs (0.3 percent and 0.1 percent of GDP, respectively). Revenues were boosted by a rapid growth in property tax and stamp tax collections in response to strengthened enforcement efforts. Budget reallocations made room for post-hurricane repairs while keeping outlays within budget limits, and total expenditure remained stable in relation to GDP. Although a new public sector wage agreement had not yet been reached, real wages continued to rise, owing to wage drift, resulting in a cumulative rise in real wages of 23 percent since 1998/99.

10. **The increase in public sector debt since 2000 has tended to reflect the rising central government debt (Figure 4 and Table 5).**

The debt of the rest of the public sector has remained stable at around 10 percent of GDP since the mid-1990s. However, total public sector debt in relation to GDP, at 46 percent at end-2004, was essentially unchanged from the year before, as a modest decline in public enterprise debt—whose balance shifted into surplus, in response to lower capital expenditure—offset an increase in central government debt.



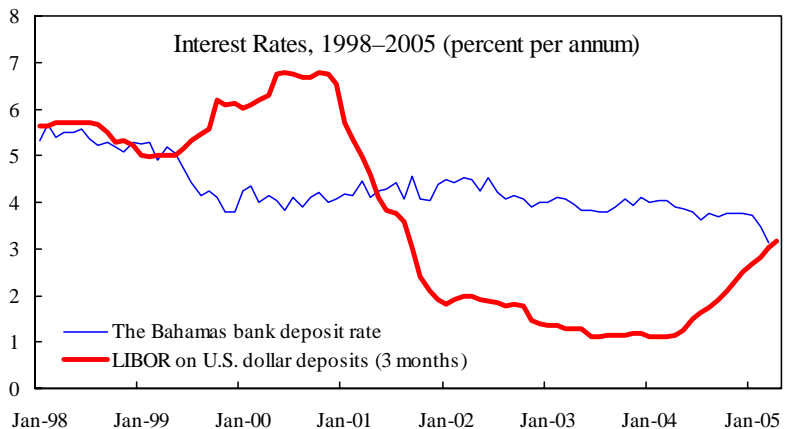
Source: Ministry of Finance.

11. **The balance of payments strengthened markedly in 2004, and net international reserves (NIR) rose substantially (Table 7).** The trade deficit widened, largely owing to the higher oil import bill, but this was offset by an expansion of tourism receipts and reinsurance-related inflows following the hurricanes that hit The Bahamas in September. As a result, the current account deficit narrowed to 5½ percent of GDP, from 8 percent in 2003. Coupled with an increase in direct investment, which boosted the financial account surplus, NIR—already buoyed by a government bond issue in 2003—rose further in 2004, reaching 105 percent of base money at end-2004.

12. **The central bank responded to the strengthening of net international reserves by relaxing credit controls in August 2004.** The bank-by-bank credit freeze—which had been introduced in 2001—was lifted, and was replaced by prudential guidelines for consumer loans and mortgages that were designed to contain the growth of household debt. Bank credit to the private sector grew by only 6 percent in 2004, after having stagnated during 2003, and credit growth remained subdued in first quarter of 2005, suggesting the lack of pent-up demand for credit by the private sector. Net international reserves have also continued to strengthen, reaching 117 percent of base money at end-March 2005.

13. **High and persistent excess bank liquidity has led interest rates to fall.** Domestic interest rates have tended to move independently from international interest rates, reflecting the autonomy gained from capital controls, and their recent decline contrasts with the firming of international rates.

However, bank liquidity rose sharply in late 2004 and early 2005, with excess bank reserves reaching the equivalent of 6 percent of M3 at end-March 2005; consequently, the interest rate on treasury bills fell to close to nil, and commercial bank deposit and lending rates and the intermediation margin fell



(Figures 5 and 6). A

reduction in the central bank discount rate of 50 basis points in February 2005 consolidated this trend by leading commercial banks to lower the prime lending rate by an equivalent amount, to 5.5 percent.

14. **The regulation and supervision of the domestic and offshore financial sectors have strengthened over the last two years.** The Module 2 assessment of the offshore financial center (OFC) report was generally favorable, including with regard to compliance with the Basel core principles for bank supervision.⁴ Steps were taken in 2003–04 to implement the report’s recommendations, including the closure by mid-2004 of all banks without a meaningful physical presence, and an ongoing study of how best to consolidate regulatory functions. Anti-money laundering legislation was reconciled with current best international practices; processes were streamlined; and legislation prohibiting the financing of terrorism was approved in December 2004. Bank soundness indicators improved somewhat in 2004, as nonperforming loans fell to just under 5 percent and provisioning increased (Tables 8 and 9).

15. **The economic expansion is expected to strengthen slightly in 2005, with real GDP growth rising by 3.5 percent.** A further recovery of tourism activity is expected (with the possible exception of Grand Bahama, the island most severely hit by the hurricanes), and buoyant construction activity will result from large-scale projects in the tourism sector and from post-hurricane reconstruction. Bank credit to the household sector is expected to pick up in response to rising employment and household incomes, leading to a decline in banks’

⁴ The assessment report, published in 2004, concluded that substantial progress had been made since 2000 toward the development of an effective regulatory regime (the same regulations apply to domestic banks), but identified some areas where further improvements are warranted.

excess reserves and some loss of international reserves. A higher oil import bill and construction-related imports are expected to widen the trade balance, despite the increase in tourism receipts.

II. POLICY DISCUSSIONS

16. **The policy discussions centered on the need to provide a stable macroeconomic environment that would foster private sector growth.** The main policy challenges lie in the fiscal area, where policy adjustments are needed to lower the government debt-to-GDP ratio to a more prudent level and to strengthen the financial performance of the rest of the nonfinancial public sector.

A. Fiscal Policy

17. **The authorities agreed that the budget for 2005/06 should be geared toward a medium-term objective of lowering the government debt-to-GDP ratio.** In the budget communication for 2003/04, the government stated its intention to eliminate the budget deficit “as quickly as possible and return the ratio of government debt to GDP to well below 40 percent.” The mission supported this objective, and suggested that the government aim at a reduction in the debt ratio to the lower end of the range observed over the last 10–15 years (around 30 percent; see Figure 4). Therefore, the mission called on the authorities to establish a debt reduction objective in the context of a budget for 2005/06 that would demonstrate credible movement toward this goal. In this context, the team suggested aiming to lower the FY 2005/06 deficit to just under 2½ percent of GDP. Although only a modest decline relative to 2004/05, it would require significant adjustment relative to a baseline scenario (¾ percentage point of GDP), given that the 2004/05 position had been boosted by the nonrecurring payment of tax arrears.

18. **The authorities are concentrating revenue enhancement efforts on improved tax administration.** In particular, they have begun to implement a customs information management system, which encompasses better tracking of information needed for good governance within the customs administration, better internal controls, and more efficient, risk-based control and audit procedures.

19. **The mission supported these efforts, but also emphasized the need for additional revenue measures.** There is scope for reducing customs duty exemptions, which have become more extensive since 2001 and do not appear to have been accompanied by commensurate benefits in terms of increased investment and private sector growth.⁵ Moreover, many fees have long remained unchanged and could be adjusted (e.g., business licenses for offshore firms, road user fees, and business license fees for all but the smallest domestic firms); excise taxes on tobacco and liquor could be adjusted; and the updating of property tax rolls and collection of property taxes intensified.

⁵ Equivalent to 3–4 percent of GDP in the period from 2000/01 to 2003/04.

20. **The authorities have not yet committed themselves to tax reform.** They acknowledge that the tax base is heavily dependent on trade taxes, and that accession to the WTO would require lower tariffs that significantly reduce tax receipts. Although consideration was being given to the introduction of a VAT or sales tax, the authorities cautioned that implementation would be difficult, given the absence of an institutional framework for administration of income or sales taxes upon which to build. In their view, the more pressing priority was the program for the modernization of customs administration, which also would be an essential prerequisite for a VAT administration.

21. **The authorities agreed that expenditure restraint should be focused on public sector wages.** They acknowledged that wages had increased substantially in real terms since 1999, and hoped that demands from the wage negotiations now underway could be contained. This would reduce the need for other fiscal measures in support of the deficit target, and it would also help discipline private sector wage demands and reduce pressures on cost competitiveness. The mission noted that there was also a need to reduce and rationalize the transfers and net lending to public enterprises.

22. **A budget proposal for 2005/06 was presented to Parliament in late May, allowing for a modest increase in the deficit, to 2.9 percent of GDP.** The Budget Communication stated the government's intention to reduce government debt to 30 percent of GDP within a five-year period, and it provided indicative deficit targets for the following two fiscal years, which would stabilize the debt ratio at just under 38 percent. The staff welcomes the authorities' announcement of deficit targets for the next three years. However, the authorities' deficit path implies a postponement of adjustment efforts until close to the 2007 electoral period (Figure 7). In the staff's view, a somewhat lower deficit in 2005/06 would be needed to establish the credibility of the authorities' objective on lowering the government debt ratio. The team also stressed the importance of monitoring budgetary developments closely during the year and establishing contingency plans that could be activated if needed to lock in the fiscal targets.

23. **The authorities agreed with the mission on the need to broaden the scope of debt management to include government-guaranteed debt.** In this context, they are seeking to fund a major expansion of the main airport through a Build/Operate/Transfer (BOT) contract that would avoid government guarantees as well as direct budgetary support. The mission supported these objectives, and emphasized the importance also of monitoring the government-guaranteed debt of the public utilities and other state-owned enterprises that are incurring debt to finance capital projects.

24. **The authorities have taken steps to revive their privatization program.** The sale of a large government hotel has been agreed; consideration is being given to the privatization of the state airline; and there is a renewed interest in selling the telephone company. While welcoming these efforts, the mission noted that the government's clear support of the privatization efforts would be required to overcome the inertia that previously has kept such enterprises in the public sector. Staff also emphasized the need to ensure that other public enterprises were operated on sound, commercial bases and to address inefficiencies in the financial public sector.

25. **The mission welcomed the preparation of a major reform of the public pension system.** Although the system is not facing immediate funding problems, a proposal aimed at ensuring its long-term sustainability is expected to be presented to parliament by end-2005. It will be based on recent recommendations from a government-sponsored commission, which included phased adjustments to contribution rates, a higher retirement age, and changes in pension eligibility requirements.⁶ There also is considerable scope for reducing administrative costs of the public pension system, currently equivalent to 20 percent of contribution income. The authorities are separately considering the introduction of a health insurance scheme, to be financed through a payroll tax and administered by the National Insurance Board, under which benefits would be provided by both public and private health care providers. Specific proposals on the scope and cost of the new scheme are expected to be assessed by the government by end-2005.⁷

B. Financial Sector Policies

26. **The mission welcomed the recent build up of international reserves but cautioned that the high level of bank reserves posed risks.** The mission observed that, with credit growing moderately and NIR strengthening through the first quarter of 2005, the risks inherent in the high level of excess bank reserves had thus far been contained. However, with the expected pick-up in economic activity, the apparent liquidity overhang could stimulate a sharp increase in bank credit and a rapid loss in NIR, and it would seem prudent to begin mopping up excess bank reserves. The authorities agreed that it would be appropriate—now that NIR had reached comfortable levels—to maintain external reserves at least at the equivalent of base money. However, they took a more sanguine view of the banks' liquidity position, namely, that banks' excess reserves were likely to remain high for an extended period of time, hence did not pose a major near-term risk to NIR.

27. **The Central Bank is exploring alternative operational frameworks to support the exchange rate peg.** The authorities noted that one specific option being considered is the possibility of establishing a targeting framework for international reserves. The mission cautioned, however, that the operational aspects of reserves targeting—including trigger points and response mechanisms—had not yet been well defined, and there did not seem to be obvious merits to this approach. It would seem preferable to avoid a mechanistic rule and, instead, to leave the Central Bank with the discretion to determine whether reserve movements reflected temporary or permanent factors. Partly in response to these concerns, the authorities have postponed the adoption of a targeting framework.

⁶ The commission proposed increases in the minimum contribution period, a revision of the formula for the reference wage used to calculate pension benefits, an increase in the income ceiling for pension contributions.

⁷ An additional component of a possible social security reform that is being discussed is a personal disaster relief fund (see background paper on selected issues for details).

28. **The authorities are considering a partial and gradual relaxation of exchange controls on capital transactions.**⁸ The mission supported the objective of easing controls, which would foster a deepening of the domestic capital market and increase competition in the financial sector. However, the team cautioned that the pace and extent of easing controls should depend on the authorities' ability to maintain adequate international reserves and a strong fiscal position, and to develop effective indirect instruments of credit control.

29. **The authorities agreed that efforts should be made to promote more market-oriented instruments of liquidity and credit management.** They plan to develop a secondary market for government securities, which could facilitate other measures, including the possible use by the central bank of repos to adjust commercial bank liquidity.

30. **The authorities have taken several steps to implement the recommendations of the Module 2 assessment of the offshore financial center.** Most recently, legislation to combat the financing of terrorism was approved in December 2004; a commission was established in April 2005 to develop recommendations for the consolidation of regulatory functions; and the securities legislation is being revised with assistance from MFD.⁹

C. Policies for Competitiveness and Growth and the Medium-Term Outlook and Risks

31. **The exchange rate peg continues to serve the country well.** The small size of The Bahamas and its strong commercial ties with the United States argue for maintaining the peg to the U.S. dollar. Inflation has remained low, contributing to the stability of the currency in real effective terms (see Figure 2). The strategy of targeting the high end of the tourism market has allowed The Bahamas to keep a broadly stable share of Caribbean tourism expenditure, and plans for major investments in the tourism sector over the next several years should provide for further expansion over the medium term. However, the steady decline in The Bahamas' share of stayover tourist arrivals during the past decade highlights a source of vulnerability, which may partly reflect the high wage costs in The Bahamas relative to other Caribbean destinations.

32. **The mission supports the authorities' ongoing efforts to promote diversification of the economy.** The aim is to foster a more broadly based growth and to reduce the vulnerabilities arising from the high degree of dependence on the tourism sector. Plans to promote e-commerce and private sector initiatives to install a pharmaceutical plant and a ship

⁸ The central bank proposals would halve the premium—currently 25 percent—on approved purchases of foreign securities; expand the listing of foreign securities on the Bahamas stock exchange through depositary rights; allow cross-listings of Bahamian and foreign companies on principal CARICOM exchanges; and allow limited foreign investments by the National Insurance Board at the official exchange rate.

⁹ The status of key recommendations in the Module 2 assessment is described in the background paper on selected issues.

repair facility in Freeport are steps in this direction. In addition, the authorities are actively considering proposals for the installation of an LNG terminal to supply Florida.

33. **The mission encouraged the authorities to continue with the process of economic integration through multilateral trade arrangements.** Remaining outside the multilateral system would deprive The Bahamas of formal mechanisms to resolve differences with other countries and make it more vulnerable to unilateral pressures because of its reduced bargaining power. The mission understands that accession to the WTO is likely to be drawn out over an extended period of time, as it would need to be linked to a plan for reducing trade taxes.

34. **Staff has prepared a baseline ‘debt sustainability’ scenario through 2010 that illustrates the dangers of an unchanged fiscal stance (Table 11).** Large-scale investment in the hotel sector is expected to provide a stimulus to growth of output in 2005–06. However, over the medium term, an unchanged fiscal policy stance would raise the central government’s deficit considerably, owing to adverse debt dynamics, and its debt would increase from 37 percent of GDP in 2005 to 44 percent of GDP by 2010. The domestic borrowing requirement would increasingly crowd out investment by Bahamian enterprises and constrain economic activity, which the staff estimate would cause growth to decline gradually to 3 percent.¹⁰ The debt of the rest of the public sector is projected to stabilize at 11½ percent of GDP, following the increase in deficits of the public utilities to finance capital expenditures in 2005.

35. **This scenario is also subject to downside risks:**

- Hurricanes represent a perennial threat to the tourism sector. Although they have caused less damage to The Bahamas than to other Caribbean economies, their timing and severity are inherently uncertain.¹¹
- Large wage settlements in the hotel sector could erode competitiveness, especially in the lower and middle tiers of the Bahamian tourism industry.
- Further increases in oil prices would directly affect the economy and worsen the trade deficit, including by dampening growth in partner countries.

¹⁰ The largely foreign-owned hotel sector would be less affected than other sectors. Tourism is projected to grow in real terms by 3 percent a year on average from 2007 to 2010, compared with 2 percent annual growth during the past decade, on the assumption that foreign investment eases capacity constraints and that tourism grows roughly in line with projected growth of private consumption in the United States (3–3½ percent a year).

¹¹ According to one study, the cumulative damage over the period 1970–2002 was 13 percent of annual GDP in The Bahamas, compared with 37 percent in the Caribbean region (WP/04/224).

- The team's debt sustainability analysis illustrates that the public debt dynamics would worsen further in the event of shocks to growth, interest rates, or the demand for tourism (possibly induced by an unanticipated weakness in U.S. private consumption) (Appendix IV).

36. **Staff has prepared an active scenario through 2010 that assumes a fiscal adjustment path that would yield a gradual but sustained decrease in the debt-to-GDP ratio, broadly consistent with the authorities' medium-term fiscal objective (Table 12).** A fiscal adjustment of $\frac{3}{4}$ percentage point of GDP in 2005/06, relative to the baseline projection, would result in a small decline in the deficit compared with the year before. The primary balance would improve by a further $1\frac{1}{2}$ points of GDP over the following four years. For a discussion of specific measures that could be considered, see Section II.A. This scenario targets a downward path for the government budget deficit that would lower the debt-to-GDP ratio modestly, to 33 percent of GDP, by 2010. Growth in 2005 would be lower than in the baseline scenario, owing to the cut in public sector demand. It is assumed that growth would stabilize at 4 percent annually, slightly lower than in the second half of the 1990s, as significant increases in tourism capacity come on stream. This scenario, while still subject to many of the downside risks that apply to the baseline scenario, would leave the economy in a stronger position to absorb eventual exogenous shocks.

D. Other Issues

37. **The authorities have recently completed a revision of the national accounts, which were published shortly after the mission.** The mission welcomes the publication of these statistics, given that previously published data on GDP extended only to 1995.¹² The methodology for calculating the official GDP series may not be fully supported by the country's current statistical capacity, and the decision to use an average of production and expenditure estimates will require additional resources for the data compilation. The authorities also are planning to implement a data release schedule to further improve data dissemination practices. To help identify priorities for this work, the mission encouraged the authorities to undertake a data module ROSC to assess the quality of data, and recommend steps to address remaining weaknesses.

III. STAFF APPRAISAL

38. **The economy has recovered well from the 2001–02 slowdown and the damage from two hurricanes in 2004.** Inflation has been contained, reserves have rebounded, and growth is expected to strengthen in 2005, boosted by the expansion of construction in the tourism sector.

¹² Final national accounts statistics through 2002 and preliminary data for 2003–04 were released.

39. **The medium-term outlook appears broadly favorable, but challenges remain.**

Low inflation, a sound banking system, and generally prudent fiscal policies have set the stage for private-sector led growth. The key prerequisites going forward will be a strengthening of the fiscal position sufficient to place the debt/GDP ratio on a downward path, and structural policies and private infrastructure investment that will support further growth and diversification of the economy.

40. **Against this background, the authorities' intention to lower the government debt-to-GDP ratio to 30 percent over the medium term is welcome.** However, the 2005/06 fiscal stance still needs to be further strengthened, relative to the budget proposal for 2005/06, to support the authorities' debt objective. The rise in the government debt-to-GDP ratio in recent years underscores the importance of a more frontloaded path for lowering the deficit and the debt ratios, and of creating more room for policy responses to economic shocks. In any event, it will be important to monitor closely budgetary developments in the course of the year, and to develop contingency plans to ensure that the authorities' budget deficit target is not disrupted by exogenous shocks.

41. **Revenue and expenditure measures will be needed to support the 2005/06 budget and medium term debt reduction.** The steps being taken to modernize the customs administration are welcome, and there would also seem to be scope to enhance revenues by adjustments to a number of user fees. Over the medium term, since accession to the WTO will require significantly lower tariffs, a comprehensive tax reform involving a VAT or sales tax could help sustain revenues and reduce the vulnerability of the economy to external shocks. On the expenditure side, it will be important to contain public sector wage demands given the large increases over the last several years and the need to maintain international competitiveness. There also is a need to reduce and rationalize transfers to public corporations.

42. **Improvements in debt management would also help contain fiscal vulnerabilities.** In particular, the scope of debt management should be broadened to encompass all public sector debt, including government-guaranteed debt and contingent fiscal liabilities. In this context, the authorities' intention to meet the needs for expansion of the main airport through a commercial arrangement that would avoid government guarantees as well as direct budgetary support is welcome.

43. **The efforts to reinvigorate the government's privatization program are encouraging.** In order to maintain the new-found momentum, it will be important to actively pursue opportunities to divest the state airline and public utilities, and to ensure that the other public enterprises are managed on commercial bases and privatized as circumstances permit.

44. **The authorities are taking welcome steps to strengthen the monetary policy framework in support of the exchange rate peg.** The development of a secondary market for government securities could provide a useful basis for developing more market oriented instruments for the central bank to adjust commercial bank liquidity. The relaxation of exchange controls on capital transactions that is contemplated may bring benefits, including by improving the efficiency of the domestic financial sector. However, care will be needed to

ease controls in a gradual and prudent manner, ensuring that prudential systems and reserves are strong. In this latter regard, the monetary authorities are appropriately aiming at ensuring that reserves are kept at a level of at least the equivalent of reserve money. With the prospective strengthening of economic activity and credit demand, the central bank should be prepared to withdraw some of the banks' excess reserves, possibly through repos, to protect NIR.

45. **The authorities have taken commendable steps to implement the recommendations of the Fund's offshore financial center assessment report.** However, it will be important to finalize the guidelines concerning the confidentiality required from overseas regulators in order to permit the efficient exchange of information.

46. **The exchange rate peg at parity with the U.S. dollar continues to be appropriate for The Bahamas.** Low inflation has helped keep the currency stable in real effective terms; The Bahamas has maintained a generally stable share of Caribbean tourism expenditure; and plans for investment projects in the tourism sector should provide for further expansion over the medium term.

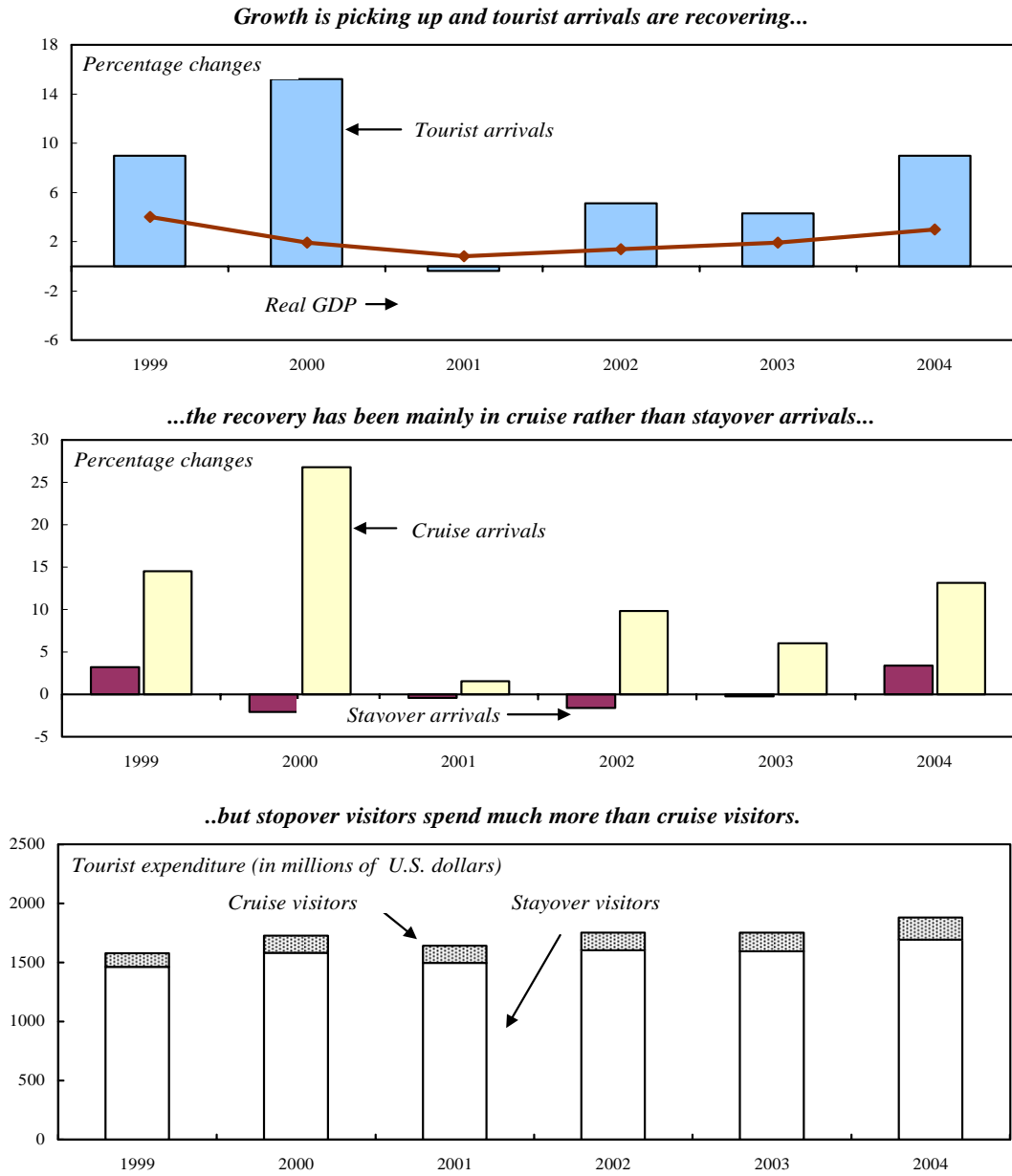
47. **The authorities' ongoing efforts to promote diversification of the economy are welcome.** These efforts will help foster a more broadly based growth and reduce the vulnerabilities arising from the high degree of dependence on the tourism sector. At the same time, however, it remains important to safeguard the tourism industry's competitiveness by maintaining low inflation.

48. **The authorities are encouraged to continue to move toward closer integration into the global economy through multilateral trade arrangements.** Remaining outside the multilateral system would deprive The Bahamas of formal mechanisms to resolve differences with other countries and make it more vulnerable to unilateral pressures.

49. **The recent revision—and publication—of national accounts statistics is a positive achievement.** The authorities are encouraged to participate in the data module of the ROSC, to help identify further steps to improve the quality of economic statistics.

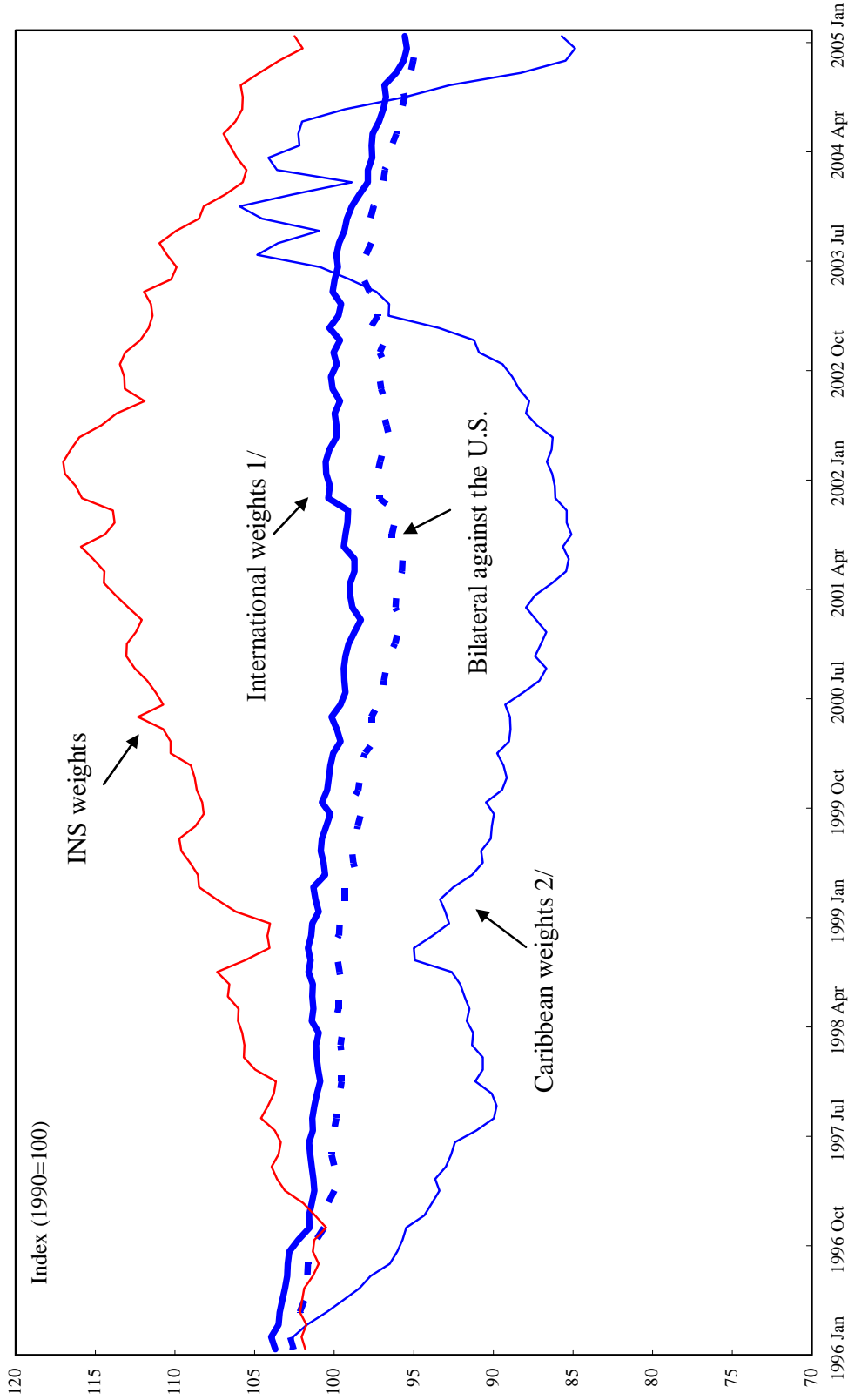
50. It is proposed that the next Article IV consultation with The Bahamas take place on the 24-month cycle.

Figure 1. The Bahamas: Developments in the Real Sector



Source: Caribbean Tourism Organization; Ministry of Tourism; and Fund staff estimates.

Figure 2. The Bahamas: Real Effective Exchange Rates



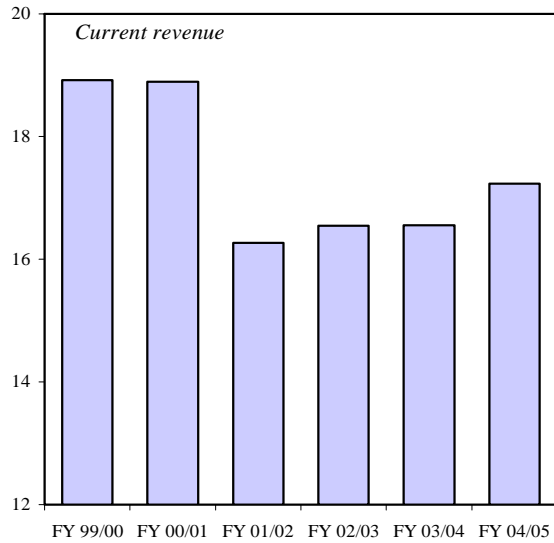
Source: Fund staff estimates.

1/ Weighted by country of origin of tourists (Argentina, Belgium, Brazil, Canada, France, Germany, Italy, Japan, The Netherlands, Spain, Sweden, Switzerland, United Kingdom, United States, and Venezuela).

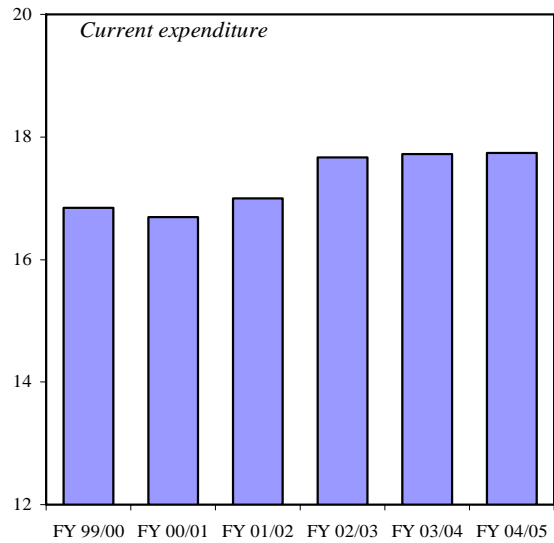
2/ Weighted by share of main competitors in the Caribbean tourism market (Antigua and Barbuda, Barbados, Belize, Dominican Republic, Grenada, Guyana, Jamaica, Mexico, Netherlands Antilles, St. Lucia, St. Vincent and The Grenadines, and Trinidad and Tobago).

Figure 3. The Bahamas: Fiscal Developments
(In percent of GDP) 1/

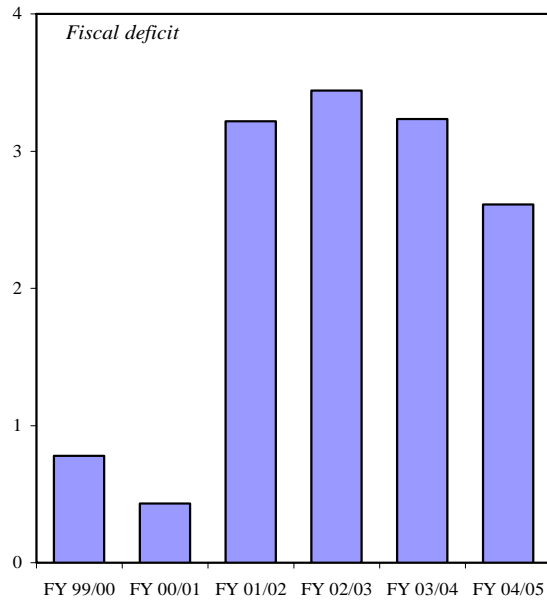
Fiscal revenues have fallen markedly as import taxes decreased...



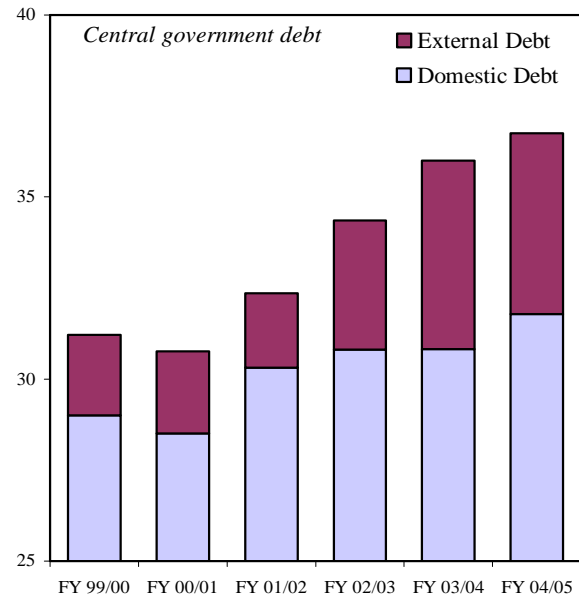
...while current expenditures remained high under the legacy of the wage agreement signed in 1999 and the wage drift ...



...leading to a sizable fiscal deficit...



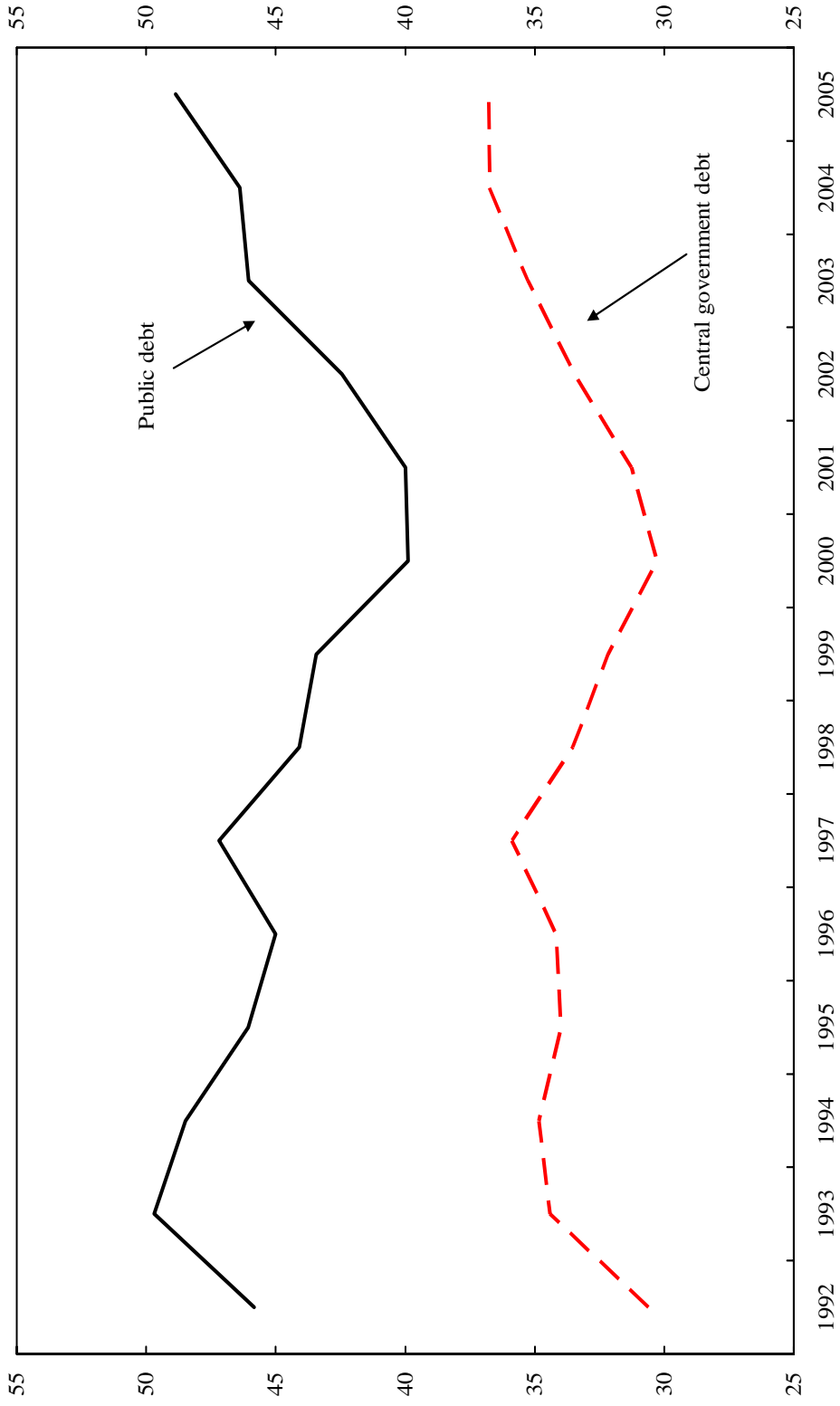
...and a marked increase in the debt-to-GDP ratio.



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

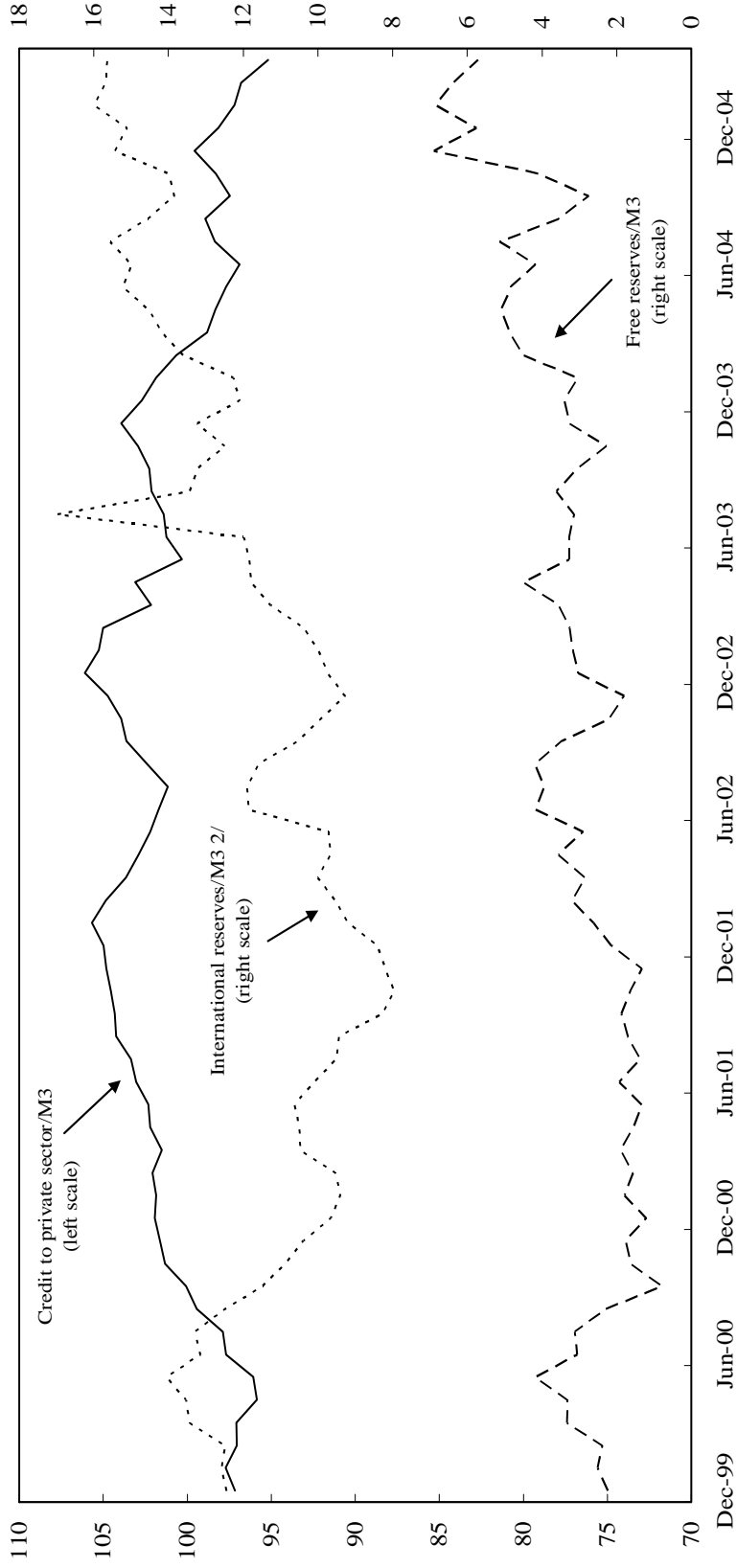
1/ Central government; fiscal year ending June 30.

Figure 4. The Bahamas: Public and Central Government Debt, 1992–2005
(In percent of GDP)



Sources: Minister of Finance; and Fund staff estimates and projections.

Figure 5. The Bahamas: Bank Credit, Liquidity and International Reserves, 1999-2005 1/



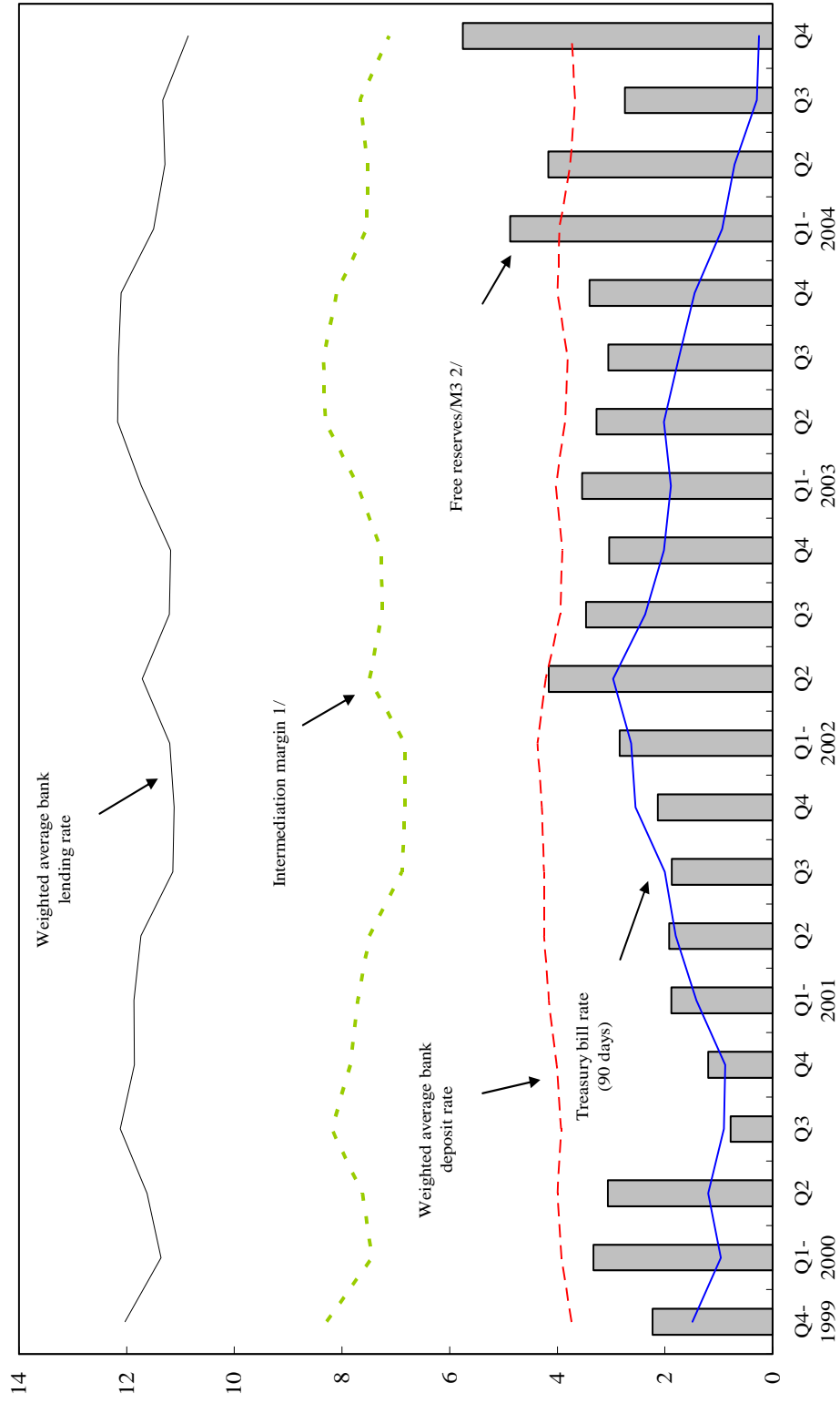
Source: Central Bank of The Bahamas.

1/ Broad money in this figure includes deposits of public agencies.

2/ Net international reserves of the central bank.

3/ Cash-in-vault and deposits at the central bank.

Figure 6. The Bahamas: Selected Interest Rates, and Bank Liquidity 1999–2004
(Quarterly average; in percent per annum)

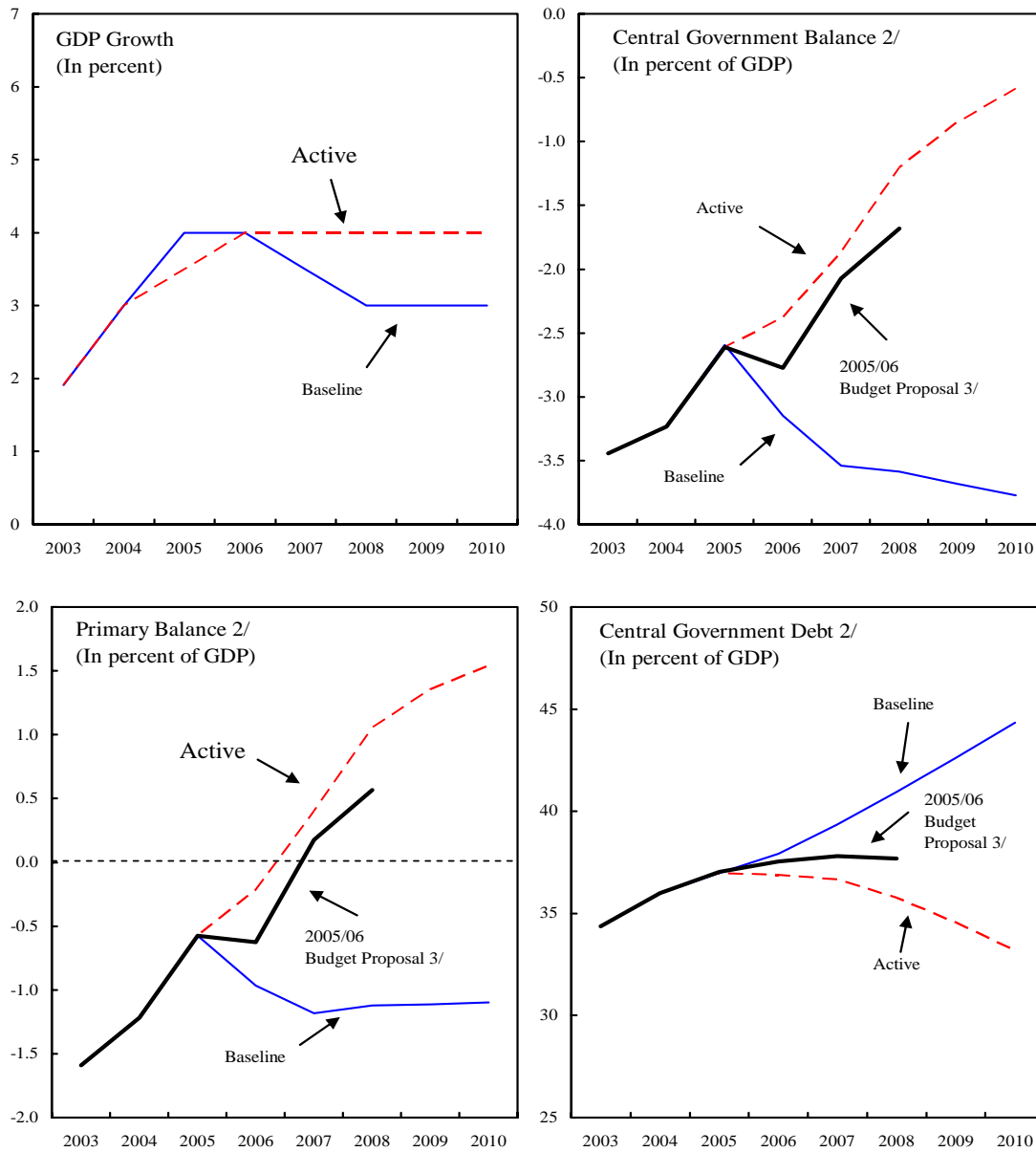


Sources: Central Bank of The Bahamas.

1/ Lending rate less deposit rate.

2/ In percent, end-of-period.

Figure 7. The Bahamas: Alternative Medium-Term Scenarios 2003–10 1/



Sources: 2005/06 Budget Communication; and Fund staff projections.

1/ Baseline scenario reflects staff projections on the basis of current fiscal policies and measures. See Tables 11 and 12 for projections under baseline and active scenarios.

2/ Data for the central government refer to the fiscal year ending June 30.

3/ Based on the 2005/06 Budget Communication. Projections assume a 5 percent nominal GDP growth over the medium-term.

Table 1. The Bahamas: Selected Economic Indicators

	2000	2001	2002	2003	Est. 2004	Proj. 1/ 2005
(Annual percentage changes, unless otherwise indicated)						
Real sector						
Real GDP	1.9	0.8	1.4	1.9	3.0	3.5
Nominal GDP	6.4	2.6	5.2	1.9	3.9	5.4
Consumer price index (annual average)	1.6	2.0	2.2	3.0	0.9	1.8
Unemployment rate (in percent)	...	6.9	9.1	10.8	10.2	...
Total visitor arrivals	15.2	-0.4	5.1	4.3	9.0	5.8
<i>Of which:</i>						
Stayover arrivals	-2.1	-0.4	-1.6	-0.2	3.4	4.1
Cruise arrivals	26.8	1.6	9.8	6.0	13.1	6.7
Central government finances 2/						
Current revenue	14.2	4.3	-10.5	5.2	3.0	8.9
Current expenditure	9.4	3.5	5.8	7.6	3.2	4.8
Capital expenditure and net lending	8.7	-4.0	-1.6	-3.5	-8.2	11.8
Financial sector						
Net domestic assets 3/	8.6	8.2	7.1	-0.4	4.8	7.9
Credit to the nonfinancial public sector 3/	-3.1	2.2	2.8	1.2	0.4	2.0
Credit to the private sector 3/	15.4	8.8	5.0	0.7	6.7	8.1
Liabilities to the private sector	7.5	3.6	3.5	5.7	11.6	6.4
Reserve money	-3.4	12.9	10.8	7.3	31.9	-20.9
Average bank deposit rate (in percent)	4.0	4.2	4.1	3.9	3.8	...
Average bank lending rate (in percent)	11.7	11.5	11.3	12.0	11.2	...
External sector						
Exports of goods and services	12.1	-11.1	9.5	-1.9	8.7	4.1
<i>Of which:</i>						
Travel receipts (net)	12.8	-5.5	8.9	-4.2	8.0	4.6
Imports of goods and services	15.3	-6.7	-4.9	4.2	10.8	9.1
Real effective exchange rate (end of period; depreciation -)						
Tourism-based 4/	-1.6	1.6	-0.6	-1.2	-3.0	...
Information Notice System	3.4	3.4	-3.5	-4.8	-4.5	...
(In percent of GDP, unless otherwise indicated)						
Central government 2/						
Primary balance	1.2	1.4	-1.3	-1.6	-1.2	-0.6
Overall balance	-0.8	-0.4	-3.2	-3.4	-3.2	-2.6
Central government debt	31.2	30.8	32.4	34.4	36.0	37.0
External sector						
Current account balance	-10.4	-11.4	-6.3	-8.0	-5.3	-11.2
Overall balance	-1.2	-0.6	1.1	2.0	3.2	-0.4
External public debt (end of period)	6.7	6.1	5.1	6.3	5.9	6.8
Memorandum items:						
Net international reserves						
(end of period; millions of U.S. dollars)	342.6	312.4	373.2	484.1	667.8	642.0
In percent of reserve money	94.9	76.7	82.7	99.9	104.5	127.0
In percent of M2 5/	9.9	8.6	10.0	12.4	15.4	14.0
In months of merchandise imports	2.2	2.1	2.8	3.6	4.4	3.3
External debt-service ratio 6/	3.1	3.9	3.1	8.0	3.3	2.5
GDP (in millions of Bahamian dollars)	5,004	5,131	5,400	5,502	5,718	6,025
Nominal GDP per capita (in U.S. dollars)	16,523	16,694	17,315	17,396	17,831	18,541

Sources: Central Bank of The Bahamas; Department of Statistics; Ministry of Finance; and Fund staff estimates and projections.

1/ Staff projections assuming active scenario.

2/ Corresponds to the fiscal year ending June 30.

3/ In relation to liabilities to the private sector at the beginning of the year.

4/ Weighted by country of origin of tourists.

5/ Liabilities in local currency, including deposits of public corporations.

6/ In percent of exports of goods and services.

Table 2. The Bahamas: Social Indicators

	The Bahamas	Caribbean Average 1/
Rank in 2004 UNDP human development index (out of 177 countries)	51	...
GDP per capita PPP, U.S. dollars (2002) 2/	16,852	8,761
Life expectancy at birth (years) (2003) 3/	69.8	72.4
Infant mortality (per 1,000 live births) (2003) 4/	11	24
Under-5 mortality (per 1,000) (2003) 4/	14	32
Population with access to an improved water source (in percent of population) (2002)	97	92
Total health expenditure, in percent of GDP (2002)	6.9	6.0
Physicians per 100,000 people (1998) 5/	106	126
Adult literacy (in percent of population ages 15 and above) (2003)	95.5	88.6
Primary school net enrollment (2001) 6/ (percent of relevant age of the population)	86	93
Secondary school net enrollment (2001) 7/ (percent of relevant age of the population)	76	74
Control of corruption index (2004) 8/	1.4	0.4

Sources: World Bank, World Development Indicators 2005; UNDP, Human Development Report 2004 (for the human development index, and adult literacy); and Kaufmann, Kraay, and Mastruzzi (2005) (for the control of corruption index).

1/ The set of countries covered depends on data availability for each indicator.

2/ Caribbean average refers to 2002, except for Puerto Rico for which 2001 data are used.

3/ Caribbean average refers to 2003, except for Bermuda for which 2002 data are used.

4/ Caribbean average refers to 2003, except for Cuba for which 2002 data are used.

5/ Caribbean average uses data that ranges from 1998 to 2003. This average does not include Cuba (590); with Cuba in the sample the average is 178. Without St. Lucia (518), the average drops to 70.

6/ Caribbean average refers to 2002, except for Aruba, Jamaica, and Suriname for which 2001 data are used, and for Guyana for which 1999 data are used.

7/ Caribbean average refers to 2002, except for Aruba, Guyana, Jamaica, and Suriname for which 2001 data are used.

8/ The control of corruption index measures perceptions of corruption, where corruption is the exercise of public power for private gain. The control of corruption index score reflects the statistical compilation of responses on the control of corruption given by a large number of enterprise, citizen, and expert survey respondents, as reported by survey institutes, think-tanks, non-governmental organizations, and international organizations. The index ranges, with 99 percent probability, between -2.5 (high perceived corruption) to 2.5 (low perceived corruption). For The Bahamas, the index uses two sources.

Table 3. The Bahamas: Operations of the Central Government 1/

	FY 01/02	FY 02/03	FY 03/04	FY 04/05		FY 05/06		
				Budget	Proj.	Budget 2/	Baseline	Active
(In percent of GDP)								
Total revenue	16.3	16.5	16.6	17.7	17.3	18.4	17.2	17.5
Current revenue 3/	16.3	16.5	16.6	17.7	17.2	18.4	17.2	17.5
Tax revenue	14.7	15.0	14.8	16.0	15.4	16.0	15.8	16.0
Taxes on international trade	9.4	9.7	9.3	9.8	9.3	9.7	9.6	9.7
Tourism taxes	1.6	1.5	1.7	1.5	1.7	1.7	1.7	1.7
Miscellaneous taxes	3.7	3.7	3.9	4.5	4.4	4.6	4.5	4.5
Other	0.0	0.0	0.0	0.2	0.0	0.0	0.0	0.0
Nontax revenue 4/	1.6	1.6	1.7	1.7	1.8	2.3	1.4	1.5
Grants and capital revenue	0	0	0	0.2	0.1	0	0	0
Total expenditure	19.5	20.0	19.8	20.6	19.9	21.2	20.4	19.9
Current expenditure	17.0	17.7	17.7	18.1	17.7	18.6	18.1	17.7
Wages and salaries 5/	9.2	9.3	9.8	9.9	9.8	...	10.0	9.5
Goods and services 5/	4.3	4.7	4.0	4.2	3.7	...	3.7	3.7
Interest payments	1.9	1.9	2.0	2.1	2.0	2.2	2.2	2.2
Subsidies and transfers 5/	1.5	1.8	2.0	1.9	2.1	...	2.2	2.3
Current balance	-0.7	-1.1	-1.2	-0.5	-0.5	-0.2	-0.9	-0.1
Capital expenditure	2.5	2.3	2.1	2.5	2.2	2.6	2.3	2.3
Capital formation	1.9	1.5	1.3	1.9	1.5	...	1.5	1.6
Capital transfers and net lending	0.6	0.9	0.7	0.6	0.7	...	0.7	0.6
Overall balance	-3.2	-3.4	-3.2	-2.8	-2.6	-2.9	-3.1	-2.4
Financing	3.2	3.4	3.2	2.8	2.6	2.9	3.1	2.4
Foreign financing	-0.3	0.0	3.5	0.3	0.0	...	0.1	0.2
Domestic financing	3.5	3.4	-0.3	2.4	2.4	...	3.0	2.2
Privatization proceeds	0	0	0	0	0.2	...	0	0
Memorandum items:								
Primary balance	-1.3	-1.6	-1.2	-0.7	-0.6	-0.7	-1.0	-0.2
Central government debt (end-June)	32.4	34.4	36.0	...	37.0	37.5	37.9	36.9

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

1/ Fiscal year begins July 1.

2/ As presented in the Budget Communication May 2005.

3/ Includes receipt of past due import taxes from The Bahamas Electricity company (0.8 percent of GDP) and payment of previous years' utility bills (current goods and services, 0.8 percent of GDP).

4/ Includes in FY 2004/05 tax arrears from the sale of the Hotel Corporation equivalent to 0.3 percent of GDP.

5/ Reclassifies central government transfers to the Public Hospitals Authority (PHA), College of The Bahamas, the Public Utilities Commission, and the Ministry of Tourism in wages and purchases of goods and services.

Table 4. The Bahamas: Operations of Nonfinancial Public Corporations 1/
(In percent of GDP)

	2000	2001	2002	2003	Est. 2004	Proj. 1/ 2005
I. Operations of the nonfinancial public corporations 2/						
Total revenue	12.8	12.6	12.3	12.3	12.4	11.7
Current revenue	12.0	11.9	11.6	11.7	11.8	11.1
Operating revenue	12.0	11.8	11.6	11.6	11.8	11.0
Other	0.1	0.0	0.0	0.0	0.0	0.0
Capital revenue	0.8	0.8	0.7	0.7	0.6	0.7
Total expenditure	12.5	12.7	12.8	12.7	12.3	14.7
Current expenditure	10.0	10.1	10.3	10.4	10.8	10.0
<i>Of which:</i>						
Operating expenditure	9.2	9.5	9.5	9.8	10.3	9.6
Interest payments	0.4	0.5	0.5	0.5	0.4	0.4
Capital expenditure	2.6	2.6	2.4	2.3	1.4	4.7
Operating balance	2.8	2.4	2.0	1.9	1.5	1.5
Current account balance	2.0	1.8	1.3	1.3	1.0	1.0
Revenue less expenditure	0.3	-0.1	-0.5	-0.4	0.2	-3.0
Statistical discrepancy 3/	0.6	0.8	-0.2	-0.6	0.5	0.0
Overall balance, adjusted 4/	0.9	0.8	-0.6	-1.0	0.6	-3.0
Total financing	-0.9	-0.8	0.6	1.0	-0.6	3.0
External	-0.2	-0.6	-0.3	-2.2	-0.1	1.3
Domestic	-0.7	-0.2	1.0	3.1	-0.5	1.7
II. Operations of the National Insurance Board (NIB)						
Revenue	3.6	3.7	3.5	3.5	3.4	3.5
Contributions	2.3	2.3	2.2	2.2	2.2	2.3
Investment income	1.2	1.3	1.2	1.2	1.1	1.1
Transfers from central government	0.1	0.1	0.1	0.1	0.1	0.1
Expenditure	2.5	2.7	2.6	2.5	2.7	2.6
Current	2.2	2.3	2.3	2.3	2.5	2.4
Wages and salaries	0.2	0.3	0.2	0.2	0.3	0.2
Benefit payments	1.8	1.8	1.9	1.9	2.0	2.0
Goods and services	0.1	0.2	0.2	0.2	0.2	0.2
Capital	0.4	0.4	0.3	0.2	0.2	0.2
Operating balance	0.1	0.0	-0.1	-0.1	-0.3	-0.1
Current account balance	1.4	1.3	1.2	1.2	0.9	1.1
Overall balance	1.0	0.9	0.9	1.0	0.7	0.9

Sources: Ministry of Finance; public corporations; National Insurance Board; and Fund staff estimates and projections.

1/ Staff projections, assuming active scenario.

2/ BTC, Bahamas Electricity, Water and Sewerage, Bahamasair, and Broadcasting Corporation.

3/ Difference between the balance measured from financing data and the balance measured from above the line.

4/ Balance measured from financing data.

Table 5. The Bahamas: Public Debt

(In percent of GDP)

	2000	2001	2002	2003	Prel. 2004	Proj. 1/ 2005
Central government debt	30.3	31.3	33.5	35.3	36.7	36.8
External	2.2	2.3	1.8	5.3	5.0	4.9
Domestic	28.1	29.0	31.7	29.9	31.7	31.9
<i>Of which</i> : in foreign currency	0.4	0.7	2.4	0.0	...	...
Public corporations' debt	9.6	8.7	9.0	10.8	9.7	12.1
External	4.4	3.8	3.3	1.0	0.8	1.9
Domestic	5.2	4.9	5.7	9.8	8.8	10.2
<i>Of which</i> : in foreign currency	1.3	0.9	2.0	4.6	3.9	5.0
Total public sector	39.9	40.0	42.5	46.1	46.4	48.9
External	6.7	6.1	5.1	6.3	5.9	6.8
Domestic	33.2	33.9	37.3	39.7	40.5	42.0
<i>Of which</i> : in foreign currency	1.7	1.6	4.4	4.6	3.9	5.0
Memorandum items:						
Bahamas Electricity Corporation	3.4	3.2	3.1	4.4	3.9	4.7
Bahamas Telecommunication Company	1.6	1.4	1.2	0.9	0.6	2.2
Financial public sector debt 2/	2.5	2.5	2.4	2.8	2.7	2.7

Source: Central Bank of The Bahamas.

1/ Staff projections, assuming active scenario.

2/ Debt of The Bahamas Mortgage Corporation and The Bahamas Development Bank, included in the total debt of the public sector.

Table 6. The Bahamas: Selected Indicators of Tourism

	1999	2000	2001	2002	2003	2004
Stayover arrivals 1/						
	(In thousands)					
The Bahamas	1,577	1,544	1,538	1,513	1,510	1,561
<i>Of which</i> : from the United States	1,293	1,294	1,308	1,310	1,305	1,361
Caribbean 2/	15,876	16,821	16,384	15,846	16,970	18,248
English-speaking Caribbean 3/	7,246	7,639	7,470	7,425	7,590	8,058
	(Percent change)					
The Bahamas	3.2	-2.1	-0.4	-1.6	-0.2	3.4
Caribbean	6.5	6.0	-2.6	-3.3	7.1	7.5
English-speaking Caribbean	2.9	5.4	-2.2	-0.6	2.2	6.2
The Bahamas' share in stayover arrivals						
Caribbean (percent)	9.9	9.2	9.4	9.5	8.9	8.6
Percent change in market share	-3.1	-7.6	2.3	1.7	-6.8	-3.8
English-speaking Caribbean (percent)	21.8	20.2	20.6	20.4	19.9	19.4
Percent change in market share	0.3	-7.1	1.8	-1.0	-2.4	-2.6
Cruise passenger arrivals						
	(In thousands)					
The Bahamas	1,981	2,513	2,552	2,802	2,970	3,360
Caribbean	12,154	14,538	14,892	15,825	17,152	17,565
	(Percent change)					
The Bahamas	14.5	26.8	1.6	9.8	6.0	13.1
Caribbean	-2.2	19.6	2.4	6.3	8.4	2.4
Percent change in market share	2.2	-16.4	-2.4	-5.9	-7.7	-2.4
Visitors expenditure						
	(In millions of U.S. dollars)					
The Bahamas	1,583	1,734	1,648	1,760	1,757	1,884
Caribbean	18,319	19,776	19,337	18,839	...	...
English-speaking Caribbean	9,207	10,152	10,266	10,072	...	...
	(In percent)					
The Bahamas' share of Caribbean	8.6	8.8	8.5	9.3	...	...
The Bahamas' share of English-speaking Caribbean	17.2	17.1	16.0	17.5	...	...
Memorandum items:						
	(Percent change)					
Tourist arrivals from the U.S. to the Caribbean	2.0	10.2	-2.1	-1.4	...	...
Real GDP, United States	4.1	3.8	0.3	1.9	3.0	4.4
Worldwide tourist arrivals 4/	3.5	6.8	-0.3	2.8	-1.7	10.0

Sources: Caribbean Tourism Statistical Report, 2002–03, Caribbean Tourism Organization (CTO); and Ministry of Tourism.

1/ For Cancun, Cozumel, and Puerto Rico, data for 2004 concern nonresident hotel registrations only.

2/ Includes Cancun and Cozumel (Mexico).

3/ Commonwealth Caribbean countries and U.S. territories.

4/ Stayover arrivals as estimated by World Tourism Organization.

Table 7. The Bahamas: Balance of Payments

	2000	2001	2002	2003	Est. 2004	Proj. 1/ 2005
(In millions of U.S. dollars)						
Current account	-521	-584	-342	-441	-305	-673
Trade balance	-1,334	-1,340	-1,151	-1,204	-1,349	-1,562
Exports	576	423	446	425	469	494
Imports	1,910	1,764	1,598	1,628	1,818	2,056
Services (net)	897	823	978	877	937	982
Travel	1,474	1,392	1,516	1,453	1,569	1,641
Construction services	-102	-33	-55	-38	-22	-65
Insurance	-73	-83	-91	-104	-80	-114
Other services	-402	-453	-391	-433	-531	-479
Income (net)	-162	-176	-211	-163	-144	-149
<i>Of which</i> : interest and dividends	-111	-128	-161	-107	-81	-82
Current transfers	78	110	42	49	251	56
Capital and financial account	420	243	381	232	312	647
Capital transfers	-16	-21	-25	-37	-48	-50
Long-term public sector	-3	-22	-35	58	-14	77
Disbursements	27	26	17	207	6	90
Amortization	-30	-48	-52	-149	-20	-20
Financial system	-30	120	184	-102	-64	36
Direct investment	250	102	153	165	273	325
Other private capital	219	64	104	148	165	259
Net errors and omissions	39	311	22	320	177	0
Change in net international reserves (increase -)	61	30	-61	-111	-184	26
(In percent of GDP)						
Current account	-10.4	-11.4	-6.3	-8.0	-5.3	-11.2
Trade balance	-26.7	-26.1	-21.3	-21.9	-23.6	-25.9
Exports	11.5	8.2	8.3	7.7	8.2	8.2
Imports	38.2	34.4	29.6	29.6	31.8	34.1
Services (net)	17.9	16.0	18.1	15.9	16.4	16.3
<i>Of which</i> : travel receipts	29.5	27.1	28.1	26.4	27.4	27.2
Income (net)	-3.2	-3.4	-3.9	-3.0	-2.5	-2.5
Current transfers	1.6	2.1	0.8	0.9	4.4	0.9
Capital and financial account	8.4	4.7	7.0	4.2	5.5	10.7
Capital transfers	-0.3	-0.4	-0.5	-0.7	-0.8	-0.8
Long-term public sector	-0.1	-0.4	-0.6	1.1	-0.2	1.3
Financial system	-0.6	2.3	3.4	-1.9	-1.1	0.6
Direct investment	5.0	2.0	2.8	3.0	4.8	5.4
Other private capital	4.4	1.2	1.9	2.7	2.9	4.3
Net errors and omissions	0.8	6.1	0.4	5.8	3.1	0.0
Change in net international reserves (increase -)	1.2	0.6	-1.1	-2.0	-3.2	0.4
Net international reserves, end of period						
In millions of U.S. dollars	342.6	312.4	373.2	484.1	667.8	642.0
In percent of reserve money	94.9	76.7	82.7	99.9	104.5	127.0
In months of merchandise imports	2.2	2.1	2.8	3.6	4.4	3.7

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

1/ Staff projections, assuming active scenario.

Table 8. The Bahamas: Summary Accounts of the Central Bank and the Financial System

	2000	2001	2002	2003	2004	Proj. 1/ 2005
(In millions of Bahamian dollars, end of period)						
Central Bank						
Net international reserves	343	312	373	484	668	642
Net domestic assets	18	95	78	0	-29	-136
Credit to nonfinancial public sector (net)	114	185	165	93	62	62
<i>Of which</i> : central government	121	188	173	109	142	142
Other	-96	-90	-86	-93	-91	-198
Reserve money	361	407	451	484	639	506
Currency held by the private sector	151	153	155	160	177	193
Liabilities with financial institutions	209	254	297	324	462	312
Financial system						
Net foreign assets	-84	-235	-357	-144	104	43
<i>Of which</i> : held by commercial banks and OFIs	-427	-547	-730	-628	-564	-599
Net domestic assets	3,322	3,588	3,828	3,812	3,989	4,312
Credit to nonfinancial public sector, net	340	412	505	545	560	640
<i>Of which</i> : central government	509	626	651	507	547	593
Credit to private sector	3,619	3,902	4,070	4,095	4,339	4,673
Other	-636	-726	-747	-827	-910	-1,001
Liabilities to the private sector (broad money)	3,238	3,353	3,470	3,669	4,093	4,355
Money	761	748	777	846	1,011	1,108
Currency	151	153	155	160	177	193
Demand deposits	609	594	622	686	835	914
Quasi-money	2,477	2,606	2,693	2,824	3,082	3,248
(Change in percent of liabilities to the private sector at the beginning of the period)						
Net foreign assets	-1.1	-4.6	-3.7	6.1	6.8	-1.5
Net domestic assets	8.6	8.2	7.1	-0.4	4.8	7.9
Credit to nonfinancial public sector	-3.1	2.2	2.8	1.2	0.4	2.0
Credit to private sector	15.4	8.8	5.0	0.7	6.7	8.1
Liabilities to private sector	7.5	3.6	3.5	5.7	11.6	6.4
Money	1.5	-0.4	0.9	2.0	4.5	2.4
Quasi-money	5.9	4.0	2.6	3.8	7.0	4.0
(12-month percent change)						
Net domestic assets	8.4	8.0	6.7	-0.4	4.6	8.1
Credit to nonfinancial public sector	-21.8	21.1	22.7	7.9	2.6	14.4
Credit to private sector	14.7	7.8	4.3	0.6	6.0	7.7
Broad money	7.5	3.6	3.5	5.7	11.6	6.4
Money	6.4	-1.7	3.9	8.8	19.6	9.5
Quasi-money	7.8	5.2	3.4	4.8	9.2	5.4
(In percent of GDP)						
Credit to the private sector	72.3	76.0	75.4	74.4	75.9	77.6
Money	15.2	14.6	14.4	15.4	17.7	18.4
Liabilities to the private sector	64.7	65.4	64.3	66.7	71.6	72.3
Memorandum item:						
Central bank credit to the public sector in percent of reserve money	31.7	45.4	36.4	19.2	9.7	12.3

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

1/ Staff projections, assuming active scenario.

Table 9. The Bahamas: Commercial Bank Performance Indicators, 2000–04

(In percent at end-period, unless otherwise noted)

	2000	2001	2002	2003	2004
Size, dollarization and maturity structure					
Total assets, percent of GDP	97.3	105.2	112.4	115.2	...
Assets in foreign currency, percent of total assets	10.8	11.0	13.0	11.6	10.5
Foreign currency deposits, percent of total deposits	2.5	2.6	2.5	2.7	2.4
Deposits maturing within 3 months, percent of total deposits	32.9	33.9	28.9	26.9	24.2
Asset quality					
Nonperforming loans, percent of total loans	4.3	3.5	4.1	5.1	4.9
Provisions, percent of total loans	1.2	1.5	1.7	1.9	2.0
Provisions, percent of nonperforming loans	40.2	40.4	31.0	40.1	44.9
Profitability					
Pretax return, percent of average assets	3.4	3.3	2.6	1.7	2.0
Pre-tax net revenue, percent of net worth	30.4	26.2	21.0	11.8	12.1
Liquidity					
Liquid assets, percent of total deposits	17.2	18.1	18.8	20.3	21.9
Loans, percent of total deposits	99.1	102.1	101.5	100.7	98.6
Capital adequacy ratio					
Ratio of capital to risk-weighted assets	19.9	29.0	29.1	23.2	...
Interest rates					
Lending rate, percent	11.7	11.5	11.3	12.0	11.2
Deposit rate, percent	4.0	4.2	4.1	3.9	3.8
Average interest rate spread, percentage points	7.8	7.2	7.2	8.1	7.4

Source: Central Bank of The Bahamas.

Table 10. The Bahamas: Indicators of External and Financial Vulnerability

	2000	2001	2002	2003	Prel. 2004	Proj. 1/ 2005
Financial indicators						
Broad money (12-month percentage change)	7.5	3.6	3.5	5.7	11.6	6.4
Private sector credit (12-month percentage change)	14.7	7.8	4.3	0.6	6.0	7.7
Three-month treasury-bill rate (end of period)	0.9	3.0	2.3	...	0.3	...
Domestic public debt (in percent of GDP, end of period)	33.2	33.9	37.3	39.7	40.5	42.0
External indicators						
Exports of goods and services (12-month percentage change)	12.1	-11.1	9.5	-1.9	8.7	4.1
Imports of goods and services (12-month percentage change)	15.3	-6.7	-4.9	4.2	10.8	9.1
Current account balance (in percent of GDP)	-10.4	-11.4	-6.3	-8.0	-5.3	-11.2
Capital account balance (in percent of GDP) 2/	8.4	4.7	7.0	4.2	5.5	10.7
Net international reserves (end of period, millions of US\$)	343	312	373	484	668	642
In months of merchandise imports	2.2	2.1	2.8	3.6	4.4	3.7
In percent of reserve money	94.9	76.7	82.7	99.9	104.5	127.0
In percent of broad money	10.6	9.3	10.8	13.2	16.3	14.7
Commercial banks, net foreign assets (end of period, millions of US\$)	-427	-547	-730	-628	-564	-599
External public debt (in percent of GDP)	6.7	6.1	5.1	6.3	5.9	6.8
External debt service (in percent of exports of goods and services)	3.1	3.9	3.1	8.0	3.3	2.5
Central Government External debt service (in percent of government revenue)	1.7	1.7	4.5	2.3	2.9	2.0
REER appreciation (+) (end of period) 3/	3.4	3.4	-3.5	-4.8	-4.5	...
Banking sector risk indicators						
Foreign currency deposits, percent of total deposits	2.5	2.6	2.5	2.7	2.4	...
Deposits maturing within 3 months, percent of total deposits	32.9	33.9	28.9	26.9	24.2	...
Capital to risk-weighted assets ratio, percent	19.9	29.0	29.1	23.2	...	...
Nonperforming loans to total loans ratio, percent	4.3	3.5	4.1	5.1	4.9	...
Provisions to total loans ratio, percent	1.2	1.5	1.7	1.9	2.0	...
Pre-tax net revenue, percent of net worth	30.4	26.2	21.0	11.8	12.1	...
Administrative expenses, percent of total assets	3.6	3.5	3.2	3.4	2.3	...
Liquid assets to deposits ratio, percent	17.2	18.1	18.8	20.3	21.9	...
Average interest rate spread, percent	7.8	7.2	7.2	8.1	7.4	...

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

1/ Staff projections, assuming active scenario.

2/ Includes errors and omissions.

3/ Information Notice System.

Table 11. The Bahamas: Summary Medium-Term Macro Flows: Baseline Scenario

	2003	Prel. 2004	Projections					
			2005	2006	2007	2008	2009	2010
(Annual percentage change)								
National income								
GDP at constant prices	1.9	3.0	4.0	4.0	3.5	3.0	3.0	3.0
Tourism								
Total arrivals	4.3	9.0	5.8	5.3	4.6	3.6	3.5	3.5
<i>Of which:</i>								
Stayover arrivals	-0.2	3.4	4.1	4.0	3.4	2.4	1.9	1.9
Balance of payments								
Exports of goods and services	-1.9	8.7	4.2	6.1	5.6	4.7	4.4	4.4
<i>Of which:</i>								
Travel receipts (net)	-4.2	8.0	4.5	6.3	5.7	4.5	4.0	4.0
Imports of goods and services	4.2	10.8	9.6	6.4	4.1	4.0	4.4	4.2
(In percent of GDP, unless otherwise indicated)								
Balance of payments								
Current account	-8.0	-5.3	-11.3	-11.7	-10.9	-10.5	-10.5	-9.9
Capital and financial account	4.2	5.5	10.7	12.1	11.5	10.3	10.2	9.5
Public sector (net) 1/	0.4	-1.1	0.8	-0.7	-0.6	-0.6	-0.6	-0.7
Private sector (net) 2/	9.7	9.6	9.9	12.8	12.1	11.0	10.8	10.1
Direct investment	3.0	4.8	5.4	7.9	7.3	7.0	7.1	6.6
Other private sector 3/	6.7	4.9	4.6	4.9	4.9	4.0	3.7	3.5
Change in net international reserves (increase -)	-2.0	-3.2	0.6	-0.4	-0.5	0.2	0.3	0.5
Central government 4/								
Revenue	16.5	16.6	17.3	17.2	17.2	17.2	17.2	17.2
Expenditure	20.0	19.8	19.9	20.4	20.7	20.8	20.9	21.0
Current	17.7	17.7	17.7	18.1	18.5	18.6	18.7	18.8
Capital	2.3	2.1	2.2	2.3	2.2	2.2	2.2	2.2
Overall balance	-3.4	-3.2	-2.6	-3.1	-3.5	-3.6	-3.7	-3.8
Memorandum items:								
Primary balance 4/	-1.6	-1.2	-0.6	-1.0	-1.2	-1.1	-1.1	-1.1
Central government debt (end-June)	34.4	36.0	37.0	37.9	39.4	40.9	42.6	44.3
External debt service 5/	8.0	3.3	2.5	3.1	3.0	2.8	5.0	2.3
Net international reserves								
In millions of U.S. dollars	484	668	629	642	679	661	639	602
In percent of reserve money	99.9	104.5	123.9	122.8	121.6	111.5	101.5	90.0
In percent of M2 6/	12.4	15.4	13.7	13.1	13.1	12.1	11.1	9.9
In months of merchandise imports	3.6	4.4	3.7	3.5	3.6	3.4	3.1	2.8
GDP (in millions of Bahamian dollars)	5,502	5,718	6,054	6,422	6,780	7,123	7,483	7,862

Source: Fund staff projections.

1/ Includes capital transfers.

2/ Includes errors and omissions.

3/ Includes financial sector.

4/ Refers to fiscal year ending June 30.

5/ In percent of exports of goods and services.

6/ Liabilities in local currency, including deposits of public corporations.

Table 12. The Bahamas: Summary Medium-Term Macro Flows: Active Scenario

	2003	Prel. 2004	Projections					
			2005	2006	2007	2008	2009	2010
(Annual percentage change)								
National income								
GDP at constant prices	1.9	3.0	3.5	4.0	4.0	4.0	4.0	4.0
Tourism								
Total arrivals	4.3	9.0	5.8	5.3	4.8	4.8	4.8	4.8
<i>Of which:</i>								
Stayover arrivals	-0.2	3.4	4.1	4.0	4.0	4.0	4.0	4.0
Balance of payments								
Exports of goods and services	-1.9	8.7	4.1	6.1	6.1	6.1	6.1	6.1
<i>Of which:</i>								
Travel receipts (net)	-4.2	8.0	4.6	6.3	6.2	6.2	6.2	6.2
Imports of goods and services	4.2	10.8	9.1	6.4	4.6	5.3	5.4	5.4
(In percent of GDP, unless otherwise indicated)								
Balance of payments								
Current account	-8.0	-5.3	-11.2	-11.5	-10.8	-10.3	-9.9	-9.2
Capital and financial account	4.2	5.5	10.7	12.2	11.4	11.0	10.6	9.8
Public sector (net) 1/	0.4	-1.1	0.4	-0.7	-0.7	-0.8	-0.6	-0.7
Private sector (net) 2/	9.7	9.6	10.3	12.9	12.1	11.7	11.2	10.5
Direct investment	3.0	4.8	5.4	7.9	7.3	7.6	7.6	7.4
Other private sector 3/	6.7	4.9	4.9	5.0	4.9	4.2	3.6	3.1
Change in net international reserves (increase -)	-2.0	-3.2	0.4	-0.6	-0.6	-0.6	-0.6	-0.6
Central government 4/								
Revenue	16.5	16.6	17.3	17.5	17.8	18.2	18.4	18.5
Expenditure	20.0	19.8	19.9	19.9	19.6	19.4	19.2	19.1
Current	17.7	17.7	17.7	17.7	17.4	17.2	17.0	16.9
Capital	2.3	2.1	2.2	2.3	2.2	2.2	2.2	2.2
Overall balance	-3.4	-3.2	-2.6	-2.4	-1.9	-1.2	-0.8	-0.6
Memorandum items:								
Primary balance 4/	-1.6	-1.2	-0.6	-0.2	0.4	1.1	1.4	1.5
Central government debt (end-June)	34.4	36.0	36.8	36.9	36.7	35.8	34.6	33.2
External debt service 5/	8.0	3.3	2.5	3.1	3.0	2.8	4.8	2.1
Net international reserves								
In millions of U.S. dollars	484	668	642	683	726	772	822	874
In percent of reserve money	99.9	104.5	127.0	131.3	130.1	129.0	127.9	126.9
In percent of M2 6/	12.4	15.4	14.0	14.0	14.0	14.0	14.0	14.0
In months of merchandise imports	3.6	4.4	3.7	3.8	3.9	3.9	4.0	4.0
GDP (in millions of Bahamian dollars)	5,502	5,718	6,025	6,391	6,780	7,192	7,629	8,093

Source: Fund staff projections.

1/ Includes capital transfers.

2/ Includes errors and omissions.

3/ Includes financial sector.

4/ Refers to fiscal year ending June 30.

5/ In percent of exports of goods and services.

6/ Liabilities in local currency, including deposits of public corporations.

The Bahamas—Fund Relations
(As of March 31, 2005)

I. Membership Status: Joined August 21, 1973; Article VIII.

A. Financial Relations

II. General Resources Account:	SDR Million	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

III. SDR Department:	SDR Million	Percent Allocation
Net cumulative allocation	10.23	100.0
Holdings	0.02	0.19

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements: None

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

	Forthcoming				
	2005	2006	2007	2008	2009
Principal					
Charges/interest	0.19	0.25	0.25	0.25	0.25
Total	0.19	0.25	0.25	0.25	0.25

B. Nonfinancial Relations

VII. Exchange Rate Arrangement:

The Bahamian dollar is pegged to the U.S. dollar at B\$1 per US\$1. The official buying and selling rate B\$1.0025 (buying) and B\$1.0040 (selling) per U.S. dollar. In addition, the central bank buys and sells investment currency at premium bid and

offer rates of 20 percent and 25 percent, respectively.

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.

VIII. Last Article IV Consultation:

The Bahamas is on a 24-month consultation cycle. The last Article IV consultation was concluded on July 2, 2003.

IX. Technical Assistance:

Department	Dates	Purpose
STA	December 2003	National accounts
STA/ CARTAC	June/October 2004	National accounts
MFD	November 2004	Securities legislation

X. Resident Representative:

None.

The Bahamas: Financial Relations With The Inter-American Development Bank

A. Active Loans as of March 24, 2005

Purpose	Approval		Amount disburse d
	date	Amount	
Solid waste management	2/17/1999	23.5	12.3
Infrastructure rehabilitation	9/13/2000	21.0	15.3
New Providence transport program	5/30/2001	43.4	10.9
Land use policy and administration project	11/17/2004	3.5	0.0
Immediate response facility	3/8/2005	16.7	0.0
		108.1	38.5

Source: The Inter-American Development Bank.

B. Net Flow of Convertible Currencies

	2002	2003	2004	Proj. 2005
Loan approvals	0.0	0.0	3.5	51.7
Loan disbursements	13.8	6.7	4.2	28.7
Repayments (principal)	11.6	135.6	4.4	4.5
Net loan flow	2.2	-128.9	-0.2	24.2
Interest and charges	12.4	14.4	3.5	4.6
	-			
Net cash flow	10.2	-143.3	-3.7	19.6

Source: The Inter-American Development Bank.

C. Recent Country Strategy

The IDB's strategy has been to focus on: (i) supporting private sector development; (ii) mitigating vulnerability to external shocks; (iii) promoting social development and equity enhancement; (iv) integrating the Family Islands; and (v) improving environmental management and natural resource conservation.

The Bahamas—Statistical Issues

The Bahamas has made significant recent progress in the timeliness and quality of economic data, although weaknesses remain. The Bahamas Department of Statistics (DOS) has just published official GDP series for the period from 1989 through 2002, and preliminary data for 2003 and 2004. The central bank produces annual and quarterly reports covering macro economic developments, but several series have long lags and are frequently revised. The DOS is responsible for generating output statistics, but many series have been discontinued or are not available.

The Bahamas began participation 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.

National Accounts

The DOS calculates the GDP from the production and the expenditure sides. The main source of the production-based estimates of GDP is the annual business establishment survey, which is complemented with information from the Department of Agriculture, the Department of Fisheries, the Central Bank, the Registrar of Insurance, the Government Treasury Accounts, public corporations, and some other sources.

There are few independent sources for the estimation of the expenditure on GDP. Whereas government expenditure is based on data from the government,¹³ and exports and imports of goods and services data come from the balance of payments,¹⁴ roughly 55 percent of the private final consumption expenditure is estimated based on the retail trade sales data from the business establishment survey. The remaining 45 percent is estimated based on the census, Central Bank data, the 1994 household expenditure survey, and the 2001 Bahamas Living Conditions Survey. A substantial portion of gross capital formation is also based on estimates from the business establishment survey.

Despite the fact that a substantial portion of the expenditure-based estimates of GDP come from the production data, the DOS regards the quality of expenditure-based estimates as superior to the production-based estimates. The weakness of production data results from the fact that several of the surveys have very low response rates and reduced coverage, many times limited to the islands of New Providence and Grand Bahama. The retail trade survey,

¹³ The main sources are the Government Treasury Accounts, the Central Bank, the Ministry of Tourism, the Airport Authority, The College of The Bahamas, and the Public Hospital Authority.

¹⁴ The main sources are the DOS External Trade Report, the Ministry of Tourism, the Central Bank, and the U.S. Statistical Abstract.

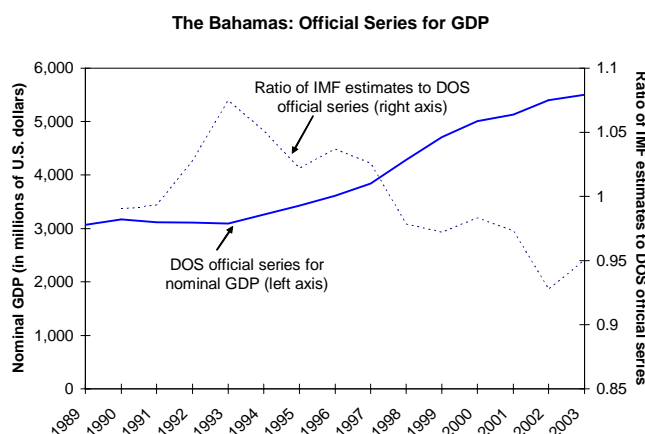
the part of the business establishment survey used to estimate private final consumption expenditure, is, by contrast, one of the surveys with the highest response rates (especially in New Providence). Also, the production-side estimates do not cover credit unions, timeshare, and the National Insurance Board.

In view of these limitations, the DOS decided to calculate the official series on GDP as an average of production and expenditure-based estimates of GDP.

From 1996 on, The Bahamas did not publish official numbers for the series of GDP. During this period, IMF estimates published in the Article IV staff reports were widely used by the government and the private sector. The table and chart below present a comparison of the two series, both in nominal and in 1991 constant prices.

The Bahamas: Estimates of Real GDP at 1991 prices
(Average annual percentage change)

	1990-2003	1990-95	1996-2000	2001-03
IMF estimates	1.6	0.6	4.3	-0.5
DOS official series	1.7	-0.3	4.4	1.4



Government Finance

Monthly and quarterly data are regularly reported by the central bank for publication in IFS. Data on budgetary operations of the central government (excluding social security) are updated on a quarterly basis. Annual data covering the budgetary central government accounts have been submitted for publication in the GFS Yearbook through 2003. The National Insurance Board (a social security fund) is not included in the coverage of central government data. Data are compiled in accordance with the *GFSM 1986*, but the authorities indicated that plans for improvements over the medium term include the compilation and dissemination of quarterly data using guidelines from the *IMF Government Finance Statistics Manual 2001*. Data on public enterprises are available only with long lags (in some cases exceeding one year) and do not follow the IMF's Government Finance Statistics methodology.

Money and Banking

The availability and quality of monetary and banking data are adequate. The central bank could improve the coverage of banking data in its quarterly economic bulletin by including a table on quarterly prudential indicators (weighted capital-to-assets ratios, share of nonperforming loans in total loans, provisions for past due loans, earnings to net worth

ratios) and indicators of the banking structure (number of banks and nonbank institutions, market shares in deposits and assets).

External Sector

Quarterly balance of payment statistics are reported to the Fund on a timely basis. However, the disaggregated series on imports and exports published by the DOS end in 2001. No information is available on private external debt.

The Bahamas: Table of Common Indicators Required for Surveillance
(As of May 23, 2005)

	Date of latest observation	Date received	Frequency of Data ⁶	Frequency of Reporting ⁶	Frequency of publication ⁶
Exchange Rates	Fixed	NA	NA	NA	NA
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	4/2005	5/2005	M	M	Q
Reserve/Base Money	3/2005	5/2/2005	M	M	Q
Broad Money	3/2005	5/2/2005	M	M	Q
Central Bank Balance Sheet	3/2005	5/2/2005	M	M	Q
Consolidated Balance Sheet of the Banking System	3/2005	5/13/2005	M	M	Q
Interest Rates ²	4/2005	5/13/2005 ³	M	M	Q
Consumer Price Index	2/2005	4/2005	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	3/2005	4/2005	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	12/2004	3/2005	Q	Q	Q
External Current Account Balance	12/2004	3/2005	Q	Q	Q
Exports and Imports of Goods and Services	12/2004	3/2005	Q	Q	Q
GDP/GNP	1995	1997	A	A	A
Gross External Debt	12/2004	3/2005	Q	Q	Q

¹Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

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

³Foreign, domestic bank, and domestic nonbank financing.

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

⁵Including currency and maturity composition.

⁶Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

The Bahamas—Debt Sustainability Analysis

Under the baseline scenario, public sector debt would be on an unsustainable path, rising steadily relative to GDP starting in 2005.¹⁵ The baseline scenario assumes that the government does not implement revenue and expenditure measures. Debt would increase to 56½ percent of GDP by 2010 from 49 percent in 2005, entailing rising gross financing needs, growing interest payments and a sustained rise in public debt relative to fiscal revenue. The authorities finance the fiscal deficit mainly in the domestic market to minimize external vulnerabilities but at the risk of crowding out domestic investment.

This scenario is vulnerable to shocks in the real GDP growth rate, interest rates and fiscal slippages. All these shocks would accelerate the rise in the public sector debt ratio that could reach as high as 68½ percent of GDP. Of particular interest is the tourism expenditure shock in 2006 and 2007 under which the public sector debt would rise to 60 percent of GDP in 2010, above the ratios under historical and baseline assumptions, but still 8½ percentage points below the ratio in the case of a shock to real GDP growth.

External debt vulnerabilities are less pronounced, owing to the relatively low level of external debt (6 percent of GDP at end-2004). With the large past and projected inflows of foreign direct investment, stabilization of the external debt ratio can be achieved with a relative large current account deficits (6½ percent of GDP), though smaller than the 10-year historical average (around 10½ percent of GDP). The shock in tourism expenditure increases slightly the ratio of external debt to GDP, but lowers the debt-stabilizing current account deficit.

¹⁵ Public debt on a gross basis includes the central government and the rest of the public sector debt but excludes assets from the National Insurance Board.

Table 1. The Bahamas: Public Sector Debt Sustainability Framework, 2000–10
(In percent of GDP, unless otherwise indicated)

	Actual				Projections					Debt-stabilizing primary balance 8/			
	2000	2001	2002	2003	2004	2005	2006	2007	2008		2009	2010	
Public sector debt 1/													
o/w foreign-currency denominated	39.9	40.0	42.5	46.1	46.4								
Change in public sector debt	8.4	7.7	9.5	11.0	9.8								
Identified debt-creating flows (4+7+12)	-3.5	0.1	2.5	3.6	0.3								
Primary deficit (includes public enterprises)	-2.8	0.8	1.2	3.3	1.7								
Revenue and grants	-2.4	-0.7	0.9	1.7	1.0								
Primary (noninterest) expenditure	21.5	20.3	18.4	17.5	18.0								
Automatic debt dynamics 2/	19.0	19.7	19.3	19.2	19.0								
Contribution from interest rate/growth differential 3/	-0.3	1.4	0.3	1.7	0.7								
Of which: contribution from real interest rate	0.4	1.8	0.8	2.5	2.0								
Of which: contribution from real GDP growth	-0.8	-0.3	-0.5	-0.8	-1.3								
Residual, including asset changes (2-3)	-0.8	-0.7	1.3	0.3	-1.4								
Public sector debt-to-revenue ratio 1/	186	197	231	263	258								
Gross financing need 4/	2.6	5.1	6.9	11.8	5.8								
In millions of U.S. dollars	131	259	374	650	333								
				Average 1995–2004								Projected Average	
Key Macroeconomic and Fiscal Assumptions													
Real GDP growth (in percent)	1.9	0.8	1.4	1.9	3.0	3.3	3.3	3.3	3.0	3.0	3.0	3.0	
Average nominal interest rate on public debt (in percent) 5/	5.5	6.3	6.0	5.9	5.4	6.6	6.6	6.2	6.2	6.2	6.2	6.3	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	1.1	4.5	2.2	5.9	4.5	4.2	4.2	4.2	4.2	4.2	4.2	4.1	
Inflation rate (GDP deflator, in percent)	4.4	1.7	3.8	0.0	0.9	2.4	1.8	2.0	2.0	2.0	2.0	2.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	-9.4	4.1	-0.4	1.2	2.3	3.9	6.9	6.9	3.4	3.0	3.0	2.9	
Primary deficit	-2.4	-0.7	0.9	1.7	1.0	0.1	1.3	3.0	1.1	1.0	1.0	0.9	
A. Alternative Scenarios													
A1. Key variables are at their historical averages in 2006-10 6/								49.2	49.7	50.1	50.6	51.0	51.5
A2. No policy change (constant primary balance) in 2006-10								49.2	52.2	55.5	59.1	62.7	66.4
B. Bound Tests													
B1. Real interest rate is at historical average plus two standard deviations in 2006 and 2007								49.2	52.4	55.9	57.5	59.1	60.8
B2. Real GDP growth is at historical average minus two standard deviations in 2006 and 2007								49.2	53.4	58.5	61.8	65.1	68.5
B3. Growth of real tourism expenditure is at historical level minus 10 percentage points in 2006 and 2007								49.2	51.7	54.4	56.2	58.1	60.0
B4. Primary balance is at historical average minus two standard deviations in 2006 and 2007								49.2	52.0	55.0	56.6	58.2	59.8
B5. Combination of B1-B3 using one standard deviation shocks								49.2	52.9	56.8	58.4	60.1	61.7
B6. One time 30 percent real depreciation in 2006 7/								49.2	55.9	57.3	58.9	60.5	62.2
B7. 10 percent of GDP increase in other debt-creating flows in 2006								49.2	60.4	61.7	63.4	65.1	66.8

1/ Public sector debt on a gross basis.
 2/ Derived as $[(r - \pi(1+g)) - g + \alpha\varepsilon(1+r)] / (1+g+\pi+g\pi)$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
 3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as $-g$.
 4/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period as share of GDP.
 5/ Derived as nominal interest expenditure divided by previous period debt stock.
 6/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
 7/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).
 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.

Table 2. The Bahamas: External Debt Sustainability Framework, 2000-10
(In percent of GDP, unless otherwise indicated)

	Actual					Projections					Debt-stabilizing non-interest current account 6/	
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009		2010
External debt 1/	6.7	6.1	5.1	6.3	5.9	6.8	6.6	6.4	6.2	6.1	6.0	-6.5
Change in external debt	-0.5	-0.6	-1.0	1.2	-0.5	1.0	-0.3	-0.2	-0.1	-0.1	-0.2	
Identified external debt-creating flows (4+8+9)	5.0	9.2	3.2	4.9	0.3	5.6	3.4	3.3	3.3	3.1	3.0	
Current account deficit, excluding interest payments	9.9	10.9	6.0	7.6	5.0	11.1	11.3	10.5	10.1	10.1	9.5	
Deficit in balance of goods and services	8.7	10.1	3.2	5.9	7.2	9.8	9.9	9.1	8.8	8.7	8.6	
Exports	49.8	43.2	44.9	43.3	45.2	44.5	44.5	44.5	44.4	44.1	43.8	
Imports	58.5	53.3	48.1	49.2	52.5	54.3	54.4	53.7	53.2	52.8	52.4	
Net non-debt creating capital inflows (negative)	-5.0	-2.0	-2.8	-3.0	-4.8	-5.4	-7.9	-7.3	-7.0	-7.1	-6.6	
Automatic debt dynamics 2/	0.0	0.3	0.0	0.3	0.1	-0.1	0.0	0.1	0.1	0.1	0.1	
Contribution from nominal interest rate	0.5	0.5	0.3	0.4	0.4	0.3	0.4	0.4	0.4	0.4	0.4	
Contribution from real GDP growth	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.3	-0.2	-0.2	-0.2	-0.2	
Contribution from price and exchange rate changes 3/	-0.3	-0.1	-0.2	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	
Residual, incl. change in gross foreign assets (2-3)	-5.5	-9.8	-4.2	-3.7	-0.8	-4.7	-3.7	-3.5	-3.4	-3.2	-3.2	
External debt-to-exports ratio (in percent)	13.4	14.1	11.4	14.7	12.9	15.3	14.7	14.3	14.0	13.9	13.6	
Gross external financing need (in millions of US dollars) 4/	549.3	630.6	395.2	587.8	325.0	698.0	769.0	758.2	768.6	800.7	803.2	
In percent of GDP	11.0	12.3	7.3	10.7	5.7	11.5	12.0	11.2	10.8	10.7	10.2	
Key Macroeconomic Assumptions												
				Average 1995-2004	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	1.9	0.8	1.4	1.9	3.0	4.0	4.0	3.5	3.0	3.0	3.0	3.4
GDP deflator in US dollars (change in percent)	4.4	1.7	3.8	0.0	0.9	1.8	2.0	2.0	2.0	2.0	2.0	2.0
Nominal external interest rate (in percent)	7.0	7.2	6.0	7.4	6.0	1.1	4.8	6.5	6.8	6.8	6.8	6.4
Growth of exports (US dollar terms, in percent)	12.1	-11.1	9.5	-1.9	8.7	4.4	4.2	6.1	5.6	4.7	4.4	4.9
Growth of imports (US dollar terms, in percent)	15.3	-6.7	-4.9	4.2	10.8	6.6	9.6	6.4	4.1	4.0	4.4	5.5
Current account balance, excluding interest payments	-9.9	-10.9	-6.0	-7.6	-5.0	-9.4	-11.1	-11.3	-10.5	-10.1	-9.5	-10.4
Net non-debt creating capital inflows	5.0	2.0	2.8	3.0	4.8	5.4	7.9	7.3	7.0	7.1	6.6	6.9
A. Alternative Scenarios												
A.1. Key variables are at their historical averages in 2006-10 5/	6.8	9.1	11.6	14.2	17.1	20.1						-3.2
B. Bound Tests												
B.1. Nominal interest rate is at historical average plus two standard deviations in 2006 and 2007	6.8	6.8	6.7	6.6	6.5	6.4						-6.5
B.2. Non-interest current account is at historical average minus two standard deviations in 2006 and 2007	6.8	16.8	27.7	27.9	28.1	28.4						-6.1
B.3. Growth of real tourism expenditure is at historical level minus 10 percentage points in 2006 and 2007	6.8	6.7	6.7	6.6	6.5	6.3						-5.7

1/ Includes public external debt only.
 2/ Derived as $[r - g - \rho(1+g) + \alpha\epsilon(1+r)] / (1+g+\rho+g\epsilon)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in U.S. dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.
 3/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \alpha\epsilon(1+r)] / (1+g+\rho+g\epsilon)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).
 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

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July 7, 2005

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

IMF Executive Board Concludes 2005 Article IV Consultation with The Bahamas

On June 24, 2005, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Bahamas.¹

Background

Economic activity recovered in 2003–04, following two years of low growth that reflected the effects on tourism of the U.S. recession and the September 2001 terrorist attacks. Real GDP growth increased to 2 percent in 2003, owing to a rapid pick-up in financial and other services, and reached 3 percent in 2004 as the tourism sector began to turn around despite two strong hurricanes in September 2004. The recovery also led to a decline in the unemployment rate in 2004, to just over 10 percent. The economic expansion is expected to strengthen slightly in 2005, with real GDP rising by 3.5 percent.

The medium-term outlook appears broadly favorable, but challenges remain. Low inflation, a sound banking system, and generally prudent fiscal policies have set the stage for private-sector led growth.

The government deficit rose sharply during the economic slowdown of 2001–02, albeit from a low level, and remained above 3 percent of GDP over the three years to FY 2003/04 and above the authorities' 2¼ percent of GDP target for 2003/04. Although current outlays on nonwage goods and services and capital expenditure were compressed, tax revenues remained depressed, and public sector wages continued to rise.

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. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

The government deficit in 2004/05 is estimated to have declined to 2½ percent of GDP, but the debt-to-GDP ratio continued to rise, to about 37 percent of GDP. The revenue effort improved in 2004/05, albeit less than projected, aided by a boost from the settlement of tax arrears by a hotel being sold to a large developer. Total expenditure remained stable in relation to GDP as post-hurricane repairs were accommodated through budget reallocations that kept outlays within budget limits.

The balance of payments strengthened markedly in 2004, and net international reserves (NIR) rose substantially. A widening of the trade deficit, owing mainly to the higher oil import bill, was offset by an expansion of tourism receipts and reinsurance-related inflows following the hurricanes. As a result, the current account deficit narrowed to 5½ percent of GDP.

In response to the increase in NIR, the central bank relaxed credit controls in August 2004. The bank-by-bank credit freeze—which had been introduced in 2001—was lifted, and it was replaced by prudential guidelines for consumer loans and mortgages that were aimed at containing the growth of household debt. In early 2005, NIR continued to rise, reaching 117 percent of base money at end-March, and excess bank reserves rose strongly, as credit growth remained subdued. A reduction in the central bank discount rate of 50 basis points in February 2005 led commercial banks to lower the prime lending rate by the same amount, to 5.5 percent.

The regulation and supervision of the domestic and offshore financial sectors have strengthened over the last two years. The IMF's Module 2 assessment report on the offshore financial center (OFC) was generally favorable, including with regard to compliance with the Basel core principles for bank supervision. Steps were taken in 2003–04 to implement the report's recommendations, including the closure by mid-2004 of all banks without a meaningful physical presence. Bank soundness indicators improved somewhat in 2004, as the share of nonperforming loans fell to just under 5 percent and provisioning increased.

Executive Board Assessment

The Directors observed that the Bahamas economy has recovered well from the 2001–02 slowdown, with some acceleration of activity in 2004 having been achieved even in the face of two hurricanes, and that economic growth is expected to strengthen further in 2005. Inflation has been contained, international reserves have rebounded, and the banking sector has remained sound.

Directors noted, however, that the fiscal position has been relatively weak in recent years, and that public debt has risen significantly. Although prospects for the tourism sector appear generally favorable, realizing the economy's growth potential would require a strengthening of the fiscal stance over the medium term to place the debt-to-GDP ratio on a downward path. This fiscal strengthening should be supported by structural policies and private infrastructure investment that would help promote the diversification of the economy. Several Directors also suggested that, in light of the significantly adverse impact of hurricanes on the Bahamas economy, consideration could be given to establishing a system to improve disaster management.

Against this background, Directors welcomed the authorities' intention to lower the government debt-to-GDP ratio to 30 percent over the medium term, as well as their

preparation of multi-year budget forecasts. Nonetheless, in part to provide greater room for policy responses to adverse shocks, Directors recommended a further strengthening of the 2005/06 fiscal stance relative to the budget proposal and closer monitoring of budgetary developments to help ensure that the more stringent objective is achieved.

Directors suggested that both revenue and expenditure measures could be used to support fiscal tightening. While welcoming the ongoing modernization of the customs administration, they noted that other revenue measures, such as adjustments to user fees, also would likely be needed. Directors noted that a comprehensive tax reform, entailing the introduction of a VAT or sales tax and a lowering of import tariffs, would help sustain revenues and reduce the vulnerability of the economy to external shocks, while also facilitating the possible accession to the World Trade Organization (WTO) that the authorities are presently considering. Noting the importance of adequate preparatory work for the introduction of a value added tax, Directors welcomed the studies commissioned by the government on operational and other aspects of the proposed system. On the expenditure side, Directors emphasized the importance of containing public sector wages—which have risen significantly in recent years—for maintaining international competitiveness, especially in the tourism industry. They also recommended reducing and rationalizing transfers to public corporations.

Directors observed that the fixed exchange rate peg to the U.S. dollar has served the Bahamas well, and welcomed the authorities' plans to strengthen the monetary policy framework in support of the exchange rate peg. They considered that the development of a secondary market for government securities could provide a useful basis for developing more market-oriented instruments for effective central bank control over commercial bank liquidity. Directors supported the authorities' intention to relax exchange controls on capital transactions to improve the efficiency of the domestic financial sector. However, they cautioned that controls would need to be eased in a gradual and prudent manner, while keeping prudential systems strong and international reserves at an adequate level, and therefore welcomed the authorities' intention to proceed cautiously in this area. Directors supported the monetary authorities' strategy of keeping international reserves at a level of at least the equivalent of base money, and stressed that the central bank should be prepared to withdraw some of the banks' excess liquidity if such a step were needed to protect international reserves.

Directors commended the authorities on their implementation of recommendations in the Fund's offshore financial center assessment report. They encouraged the finalization of guidelines for overseas regulators that will permit the efficient exchange of information while meeting the need for confidentiality. They welcomed the actions to strengthen the Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) framework.

Directors encouraged the authorities to reinvigorate the privatization program with an appropriate regulatory framework. In particular, they recommended that opportunities to divest the state airline and public utilities be actively pursued, and that other public enterprises be managed on a commercial basis or be privatized.

Directors welcomed the authorities' efforts to promote diversification of the economy, including the development of a National Information and Communications Framework to help promote e-commerce in the Bahamas. They considered that these efforts will help foster a more broadly based growth and reduce the vulnerabilities arising from the high degree of

dependence on the tourism sector. Directors encouraged closer integration into the global economy through accession to the WTO, and emphasized that the multilateral trading system would provide the Bahamas with formal mechanisms to resolve trade differences.

Directors welcomed the recent publication of revised national accounts statistics. They encouraged participation in the data module of the Report on Observance of Standards and Codes (ROSC) to help identify further steps to improve the quality of economic statistics.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

The Bahamas: Selected Economic Indicators

	2000	2001	2002	2003	Prel. 2004	Proj. 2005
(Annual percentage change, unless otherwise indicated)						
Real sector						
Real GDP	1.9	0.8	1.4	1.9	3.0	3.5
Total visitor arrivals	15.2	-0.4	5.1	4.3	9.0	5.8
<i>Of which:</i>						
Stayover arrivals	-2.1	-0.4	-1.6	-0.2	3.4	4.1
Cruise arrivals	26.8	1.6	9.8	6.0	13.1	6.7
Consumer price index (annual average)	1.6	2.0	2.2	3.0	0.9	1.8
Financial sector 1/						
Broad money	7.5	3.6	3.5	5.7	11.6	6.4
Credit to the private sector	15.4	8.8	5.0	0.7	6.7	8.1
(In percent of GDP at market prices, unless otherwise indicated)						
Central government finances						
Overall balance 2/	-0.8	-0.4	-3.2	-3.4	-3.2	-2.6
Savings 2/	2.1	2.2	-0.7	-1.1	-1.2	-0.5
Debt (end-June)	31.2	30.8	32.4	34.4	36.0	37.0
External sector						
Current account balance	-10.4	-11.4	-6.3	-8.0	-5.3	-11.2
Net international reserves, in millions of U.S. dollars	343	312	373	484	668	642
(In percent of base money)	94.9	76.7	82.7	99.9	104.5	127.0
External debt of central government 1/	2.2	2.3	1.8	5.3	5.0	4.9
Real effective exchange rate (percent change; depreciation -) 1/ 3/	-1.6	1.6	-0.6	-1.2	-3.0	...

Sources: The Central Bank of The Bahamas; The Bahamas Department of Statistics; Ministry of Tourism; Ministry of Finance; and IMF staff estimates and projections.

1/ End of period.

2/ Corresponds to the fiscal year ending June 30.

3/ Weighted by country of origin of tourists.

**Statement by Kevin G. Lynch, Executive Director for The Bahamas
Mark Kruger, Senior Advisor to Executive Director
June 24, 2005**

Our Bahamian authorities welcome the staff report as an objective and expert assessment of the performance of, and prospects for, the Bahamian economy. The staff's view is quite close to the authorities' own assessment. By and large, our authorities agree with the thrust of the IMF recommendations, both in the staff report and the selected issues papers, bearing in mind that, for many years, the Bahamian economy has been managed along lines which accord well with IMF advice and analysis.

Nevertheless, the authorities are well aware that challenges remain. The government is committed to ensuring that the debt-to-GDP ratio is put squarely on a downward trend. The authorities are assessing the benefits and issues arising from possible medium-term accession to the WTO. The government is also considering how best to deepen Bahamian capital markets, liberalize the capital account, and move to indirect instruments of monetary control.

Recent Economic Developments

Notwithstanding the dislocation caused by hurricanes Frances and Jeanne, the Bahamian economy grew by 3.0 percent in real terms in 2004, double the rate recorded in 2000-2003. The strengthening growth arose primarily from modest annual increases in real private sector consumption, steady rise in government expenditures and a healthy pickup in business and residential investment.

Growth is expected to increase to 3.5 percent in 2005, driven by stronger private investment. Moreover, there is every likelihood that these strong rates of growth will be sustained in subsequent years, given the flow of investment projects coming on stream.

The current account deficit narrowed to 5.3 percent of GDP in 2004, compared to an average of 9 percent of GDP in the four previous years. However, much of this improvement was due to the inflow of insurance claims following the hurricanes. The current account is expected to widen over the next few years as direct investment increases.

The Bahamas experienced very modest consumer price inflation during 2004. With a marginal decrease in average housing costs, the most heavily weighted component of the Retail Price Index, average consumer price inflation in The Bahamas declined to 0.9 percent in 2004, from 3.0 percent in 2003.

The Bahamas at a Glance

Population (2000 census)	303,611
Rank in UNDP HDI (2004)	51 of 177
Per capita income (PPP US\$ in 2002)	16,852
Central government debt as a % of GDP (2004)	36.7
Total public sector debt as a % of GDP (2004)	46.4
Budget balance as a percent of GDP (FY 04/05)	-2.6
Real GDP growth (2004)	3.0

Fiscal Policy

The deficit for the 2004/05 fiscal year came in at 2.6 percent of GDP, compared to the 2.8 percent of GDP forecast in the budget.¹ This represents an improvement from the deficits of 3.2 and 3.4 percent of GDP recorded in the 2003/04 and 2002/03 fiscal years, respectively. The 2005/06 Budget foresees a slight increase in the deficit to 2.9 percent of GDP, in part, because of increases in civil servants' pay.

The 2005/06 Budget is the first to provide multi-year budget forecasts, projecting public finances for 2006/07 and 2007/08, on the basis of present trends and policies. The authorities feel that this presentation is important in increasing the transparency of fiscal policy, since it illustrates how commitments can only be made when their full implications on the medium-term fiscal position are accounted for.

The authorities are well aware that high levels of debt could constrain their capacity to borrow on advantageous terms. The 2005/06 Budget aims to contain the ratio of government debt-to-GDP to just under 38 percent of GDP. Over the next five years, the authorities intend to bring the debt-to-GDP ratio down to the low 30 percent range, a policy which is broadly supported by the public.

Our Bahamian authorities have some reservations about some of the fiscal recommendations regarding the proposed approach and time-path for strengthening the fiscal position. The staff recommends a "front-loaded" fiscal effort in 2005/06 of $\frac{3}{4}$ percentage points of GDP. The authorities prefer to assess the impact of the scheduled capital inflows, which they believe will be pronounced during the course of 2005/06 and will positively impact the government's fiscal position. In this context, they cite the experience with the Atlantis hotel and resort, and related projects, in 1997-1999 as examples of the significant impact that this type of major capital inflow can have on improving the fiscal position in The Bahamas. The authorities expect that, given the projected private investments, public finances will benefit from revenue buoyancy, making it possible to reduce the fiscal deficit and bring down the ratio of government debt-to-GDP to the low 30 percent range. Furthermore, the Government envisages the early and successful sale of the telecommunications company, and there is

¹ The deficit figures noted here are according to IMF classification.

national consensus that a substantial portion of the net proceeds should be used to reduce government debt.

The Government is committed to a programme of improvement and modernization of the existing revenue regime. The authorities have implemented a number of revenue measures in 2005/06, which tighten loopholes for evading and avoiding stamp duty on property transactions, increase taxes on alcohol and bring taxable properties onto the real property tax register. A new Trade Information Management System is being implemented in the Customs Department and the needs of each of the other revenue agencies are being addressed. Furthermore, the Government intends to establish a compliance unit, which will strengthen the monitoring and administration of all major revenue units.

The authorities understand that while accession to the World Trade Organization would bring benefits to the economy, it would also entail the loss of significant customs duties. This would mean finding a satisfactory replacement to yield the same level of revenues. The Government has commissioned studies on operational and other aspects of a value-added tax, the successful implementation of which requires a soundly functioning revenue administration. The strategy is to ensure that when it is judged essential and desirable to do so, the administrative apparatus for a VAT can be readily put in place.

The fiscal situation is monitored on a monthly basis and, at a minimum, quarterly budget progress reports are submitted to Cabinet (including updating on macroeconomic issues). Furthermore, Parliament must approve any Government guaranteed debt or financial liability related to the Public Corporations. This procedure enables the Government to be aware of its contingent liabilities and to determine the Corporation appropriate borrowing methods.

The staff points to the need to restrain the growth in public sector wages. The authorities agree but note that, in view of the economy's dependence on services (tourism and financial services), it is vital to maintain a harmonious industrial relations climate while endeavoring to ensure moderation in wage expectations to maintain competitiveness. The Government endeavors to achieve these ends by engaging in close and open consultations with the representatives of organized labour.

Monetary Policy

In 2004, strong foreign currency inflows led to accelerated growth in bank deposits, which were more than adequate to fund domestic credit growth. These inflows also permitted a substantial buildup in external reserves. The Central Bank timed the relaxation of its credit restraint policy, which had been in place since 2001, with indications that asset quality in the local banking system was improving, as evidenced by the falling ratio of non-performing loans.

While banks have been permitted to resume growth in their private sector loans, they are required to do so within prudential parameters established by the Central Bank in August 2004. A minimum equity contribution of 15 percent from borrowers towards most new personal loans is required and the total debt service ratio from loans taken on is limited to 40-

45 percent of ordinary monthly income. The authorities feel that these measures will prevent the loss of reserves, which could occur if credit was to expand too rapidly. They continue to monitor the behaviour of bank credit very closely.

Financial Sector

In view of its importance to the national economy, the authorities intend to ensure that the offshore financial center meet international standards. The banking sector continued to adjust to the Central Bank's physical presence requirements, which are designed to eliminate "shell banks" that did not perform true banking services. The number of licensed banks and trust companies fell to 266 in 2004, from 284 in 2003 and 2002. As of the end March 2005, the number of licenses had decreased further to 262. However, total bank employment, which corresponds more closely to physical presence, increased during 2004 to more than 4,300 and banks' total expenditures in the economy rose above \$400 million (7 percent of GDP).

A number of important initiatives are being considered to accelerate the development of the local capital markets. A secondary market for government securities is being contemplated, as this would establish a benchmark for the pricing and issuance of private debt securities. Consideration is also being given to the further gradual liberalization of Exchange Controls, including those on certain portfolio investments.

The authorities intend to proceed cautiously, as advised, in further capital liberalization and in the development of a more active monetary policy. They appreciate that sound macroeconomic management, including appropriate fiscal policy, are essential for this purpose. They intend to proceed with care so as to maintain a stable environment, avoiding sharp or sudden and disruptive fluctuations in either interest rates or capital availability (particularly as these would affect private sector working capital requirements, household mortgages, and Government debt).

Economic Diversification

The authorities are mindful of taking advantage of every opportunity for diversification, and of the importance of safeguarding the competitiveness of the tourism sector. The Ministry of Finance, with technical assistance from Canada, is developing a National Information and Communications (NIC) Framework. The NIC Framework will provide on-line access to healthcare, education, and government services such as land registration and land use policy, and will be a driving force in developing e-commerce in The Bahamas.² Increased levels of e-commerce will enable Bahamian companies to compete in the global marketplace. The development of a vibrant and entrepreneurial information technology sector will create employment, encourage diversification, and boost investor confidence.

The Framework also envisages the transformation of the Bahamas Telecommunications Company (BTC), into a state-of-the-art communications firm. This process is already the

² The land use and administration programme is assisted by the Inter-American Development Bank.

subject of intense work, with the assistance of international consultants. BTC is proceeding urgently with the project to develop a fiber-optic cable linkage to provide all of the inhabited islands of The Bahamas with reliable and efficient connection. This project is of paramount importance to enable hotels and other facilities to develop in the inhabited Family Islands and to provide each Island with diversified economic opportunities.

The Government has been equally concerned with promoting investment by Bahamian entrepreneurs and has established a Venture Capital Fund. In the 2004/05 Budget, \$1million was made available for this fund, which was augmented by a further \$1 million in the 2005/06 Budget.

Data Issues

As noted in the staff report, the Department of Statistics has recently revised the National Accounts data and has published final data through 2002 and preliminary data for 2003-04. This is a major advance over previous years when only provisional data and partial indicators were available. The Bahamian authorities intend to maintain the momentum in this area and would welcome a ROSC to assess data quality.

Conclusion

While recent economic performance has been favourable, the authorities are not complacent and are actively addressing the challenges the economy faces. They are undertaking extensive improvements in tax administration to manage the debt ratio. They are actively examining the implications of moving to a VAT, in the context of possible WTO accession. They are exploring ways of deepening financial markets.

My Bahamian authorities would like to express their sincere appreciation to the staff for a constructive consultation. The mission provided useful input into the deliberations of the Cabinet during the formulation of the budget. The authorities plan to publish the staff report.