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THE BAHAMAS

2012 ARTICLE IV CONSULTATION

April 2013

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 2012 Article IV consultation with The Bahamas, the following documents have been released and are included in this package:

- **Staff Report** for the 2012 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on November 2, 2012, with the officials of The Bahamas on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 18, 2013. 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.
- **Staff Supplement (Informational Annex)** of January 18, 2013, updating information on recent developments.
- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its February 4, 2013, discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for The Bahamas.

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INTERNATIONAL MONETARY FUND

THE BAHAMAS

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

January 18, 2013

KEY ISSUES

Context: The economy continues to recover from the global financial crisis, with real GDP projected to grow at about 2.5 percent in 2012, supported by a modest rebound in tourism and ongoing investment projects. However, unemployment remains high. The fiscal balance is expected to remain weak in FY 2012/13 and the external current account deficit to continue high owing to substantial FDI-related imports.

Focus of the consultation: Discussions focused on fiscal consolidation, external stability, challenges to sustainable growth in the medium term, and the recommendations of the recent FSAP mission.

- **Implement fiscal consolidation.** Containing the rising debt will require comprehensive fiscal consolidation by addressing revenue underperformance, rationalizing tax incentives, strengthening public enterprises, and improving public sector efficiency.

- **Improve external sustainability.** While the large external current account deficit is predominantly financed through non-debt creating foreign direct investment (FDI), there is still a residual and persistent underlying current account deficit (estimated at up to 5 percent of GDP) that needs to be addressed.

- **Enhance medium-term growth.** Sustaining high growth and employment will require removing the key impediments to growth, particularly in the business environment and in the provision of public services, and fostering linkages across sectors by broadening tourism-related activities.

- **Further strengthen financial supervision and oversight.** The non-performing loan ratio remains high. Real estate prices have softened, reducing collateral values and increasing the need for provisioning, as well as strong monitoring.

Approved By
Charles Kramer (WHD) and Lorenzo Giorgianni (SPR)

The team that visited Nassau during October 22–November 2, 2012 comprised Messrs. Leon (head), El-Masry, Park, and Ms. Narita (all WHD). Mr. Canetti (WHD), who headed the MCM FSAP mission in July 2012, participated in the policy discussions. The team met with Prime Minister Christie, Minister of Tourism Wilchcombe, Attorney General Maynard Gibson, Minister of Financial Services Pinder, Minister of State for Finance Halkitis, Central Bank Governor Craigg, other government officials, and representatives of the Opposition, the private sector, and civil society.

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RECENT DEVELOPMENTS

1. **General elections were held on May 7, 2012,** and the Progressive Liberal Party (PLP), led by Mr. Perry Christie, defeated the incumbent Free National Movement government of Mr. Hubert Ingraham in a landslide victory, taking 29 of the 38 seats in the House of Assembly. The PLP contested the elections on a platform that emphasized the need to address rising levels of crime and unemployment against a backdrop of weak economic growth.

2. **The economy has continued to recover.** Real GDP picked up in 2011 on an improvement in tourism and ongoing investment projects, including the US$3.5 billion private Baha Mar project (Box 1). Public capital projects, such as airport modernization and road work, contributed as well. Nonetheless, unemployment remained high, as the recovery did not spread to other sectors of the economy. Inflation picked up in 2011, mainly due to higher world oil prices.

Key Economic Indicators

	2009	2010	Prel. 2011
Real GDP growth (in%)	-4.9	0.2	1.6
Inflation (average, in %)	1.9	1.3	3.2
Unemployment (in%)	14.2	...	15.9
International reserves			
Millions of US dollars	816	860	885
Months of non-FDI imports	4.9	4.5	4.5

Sources: The Bahamian authorities, and IMF staff estimates.

3. **The fiscal deficit in FY 2011/12 (July to June) is estimated to have increased to about 6 percent of GDP, significantly higher than the budget target.** Revenues underperformed, reflecting continuing weak economic activity and lower real estate tax collections. Current spending, particularly on goods and services and on transfers (including to financially weak public utilities) continued to rise. Capital expenditure significantly overshot target, largely on cost overruns on the New Providence Road Improvement Program.

Fiscal Indicators
(In percent of GDP)

	FY07/08	FY09/10	Prel. FY11/12
Revenue and grants	17.2	16.8	18.4
Current expenditure	16.2	18.0	19.2
Capital expenditure	2.8	3.2	5.0
Overall balance	-1.8	-4.4	-5.9
Central government debt	32.3	43.9	49.3

Sources: The Bahamian authorities, and IMF staff estimates.

4. **The marked deterioration in the fiscal position continues to place upward pressure on public debt.** The central government debt topped 49 percent of GDP at end FY 2011/12, an increase of 17 percentage points of GDP over the past five years. Noting the country's deteriorating fiscal profile, and a change in its methodology that placed greater emphasis on 'diversification' and 'growth prospects,' Standards and Poor's has lowered over the past year the sovereign credit rating from BBB+/A-2 to BBB/A-2.

Box 1. Baha Mar Resort Project

The Baha Mar resort is a major tourism project on the northern coast of New Providence. Construction started in February 2011 and is expected to be completed by late 2014. The project, funded (US$2.45 billion) by the China Export-Import Bank and built by a Chinese construction company, includes a range of hotel categories, residential units, a casino, a convention center, a water park, and a golf course. The resort will cost US$3.5 billion (over 40 percent of 2012 GDP).

The project is having an important impact on the Bahamian economy. The start of construction coincided with a period of otherwise weak economic activity, providing much needed stimulus and employment opportunities. An estimated 6,000 construction workers are expected to be employed during construction, with about a half of those jobs going to Bahamian workers. In addition, about US$190 million is expected to be sub-contracted to Bahamian companies, of which some US$140 million had already been committed by October 2012. As is typical of such projects, Baha Mar is attracting large imports of goods and services, contributing to a significant widening of the current account deficit (which is expected to average about 6–8 percent of GDP over 2011–14).

Air transportation capacity and the availability of trained personnel are challenges to be resolved before the grand opening in December 2014. The resort will create more than 2,200 new rooms, increasing total room capacity by about 15–20 percent. In order to accommodate the expected increase in tourism arrivals, the authorities and representatives from the tourism sector have been working together to enhance airlift from the United States, Latin America, and China. When fully operational, Baha Mar is expected to provide employment for about 5,500 staff on a permanent basis, most of whom would be Bahamians. The authorities are collaborating with tourism sector and vocational and tertiary institutions to provide adequate and timely training opportunities to Bahamians.

5. **The external current account deficit widened in 2011.** Although exports improved along with the global recovery, these were more than offset by higher imports, reflecting a surge in FDI-related imports and high world oil prices. With large FDI as well as other private capital inflows, gross international reserves remained at a modest level of 2.3 months of next year's imports at end-2011. However, measured in terms of non-FDI imports, reserves were much higher at about 4.6 months. The real effective exchange rate has remained broadly stable over the past four years, reflecting both a pegged nominal rate vis-à-vis the U.S. dollar (along with a high weight of the United States in trade), and similar inflation to partner countries.

6. **Monetary policy remained supportive, with the discount rate having been reduced by 75 bps in 2011 to 4.5 percent.** Credit to the private sector increased moderately by 1.1 percent in 2011 (a turnaround from a 0.4 percent contraction in 2010), with banks being more selective and applying more stringent credit standards, especially with less qualified borrowers. The non-performing loan (NPL) ratio remained high (12.7 percent of total loans as of end-2011, rising slightly to 13.4 percent at end-September 2012), mostly owing to delinquent mortgages and commercial

loans. In September 2012, the government started the Mortgage Relief Plan (MRP) to provide relief to home owners adversely affected by the global financial crisis. The government announced that its expenditure commitment to the MRP will be limited to a maximum of US$10 million (⅛ percent of GDP).

7. **Near-term risks to the banking sector were contained.** A Financial Sector Assessment Program (FSAP) mission in July 2012 found that onshore commercial banks were well capitalized (with capital adequacy ratios far above the 14 percent prudential threshold) and profitable (Box 2). And supervisory oversight was strengthened, with the central bank improving the monitoring of credit risk, including through enhanced monthly monitoring of credit quality indicators, monthly review of provisions and write-offs, and by increasing the minimum capital adequacy ratio from 8 percent to 14 percent (trigger) and 17 percent (target).[1] Further, spillover risks between the large offshore and onshore financial sectors remained limited, owing to effective capital and exchange controls.[2]

OUTLOOK AND RISKS

8. **In the near term, growth prospects are improving and capital inflows are likely to remain strong, but fiscal imbalances are likely to persist and weak balance sheets pose headwinds to growth.**

- **Real GDP growth in 2012 is projected to reach 2½ percent,** driven by strong tourism and construction activity, but below the level required to absorb the high level of unemployment. Inflation is projected to decrease to about 2.3 percent (y/y) at end-2012, mainly owing to softer world oil prices. The external current account deficit and FDI inflows would remain large and stable, with international reserves broadly adequate by end-2012 at about US$830 million (2 months of next year's imports or 4 months of non-FDI related imports).

- **The fiscal account will remain under pressure.** The central government deficit would remain around 6 percent of GDP in FY 2012/13, with some improvement in tax administration and a moderation in capital spending, but offset by increased pressure on current spending, including for crime prevention and community development. The central government debt would rise further to about 54 percent of GDP. Additional fiscal pressure could stem from contingent liabilities for public corporations, such as Bahamas Electricity Corporation.

[1] A breach of the 17 percent target ratio activates discussions with the CBoB about a plan to restore capital; below 14 percent, the CBoB could force the bank to restrict lending/asset growth until capital is restored.

[2] See Annex IV of the accompanying Financial Sector Stability Assessment report.

Box 2: Key Findings and Recommendations of the July 2012 FSAP Mission

The FSAP mission found no short-term threats to financial stability. It noted that the country's financial system had weathered the global crisis reasonably well. Tight capital and exchange controls helped insulate the financial system from global stability threats and provided the authorities considerable scope for policy independence. In addition, while the offshore financial sector is disproportionately large (with total assets about 65 times GDP), capital and exchange controls and limited exposure to the domestic real estate market provide a credible and effective firewall that separates the offshore from the onshore financial system, limiting spillover risks. Ongoing macroprudential measures affecting global SIFIs could impact the operations of the offshore sector in The Bahamas whose linkages with the real economy are, however, limited.

The onshore financial sector is resilient and could withstand considerable shocks. Onshore commercial banks are very well capitalized and rely on traditional funding from deposits and equity. While non-performing loan (NPL) ratios, which had risen during the recent economic downturn, appear to have since stabilized, they remain elevated and are a source of concern. Stress tests conducted by the FSAP team suggest, however, that the overall banking system could withstand substantial economic, solvency, and liquidity shocks. Other financial institutions have limited systemic impact. The credit union sector is relatively small, mostly well capitalized, and profitable. Credit unions, currently licensed and regulated by the Department of Cooperative Development of the Ministry of Agriculture and Marine Resources, are slated to come under the supervision of the central bank within the next 6–12 months. The insurance sector has stagnated, although it has achieved high penetration levels. The securities markets are small and illiquid.

The FSAP mission concluded that the oversight of the financial system is independent and strong, particularly with respect to banking supervision. The insurance and securities sectors have recently adopted new legal and institutional frameworks, and their oversight is improving rapidly. Notwithstanding these achievements, the FSAP team encouraged the authorities to persevere with efforts to rationalize and further strengthen the supervisory and regulatory frameworks. In particular, it advised the authorities to strengthen the current framework for financial crisis management and resolution. The authorities are in the process of developing a National Financial Crisis Management Plan, and recently completed a crisis management simulation exercise to inform their plan. In addition, a Systemic Risk Surveillance Committee has been constituted to monitor the stability of domestic banks. The FSAP team noted that the Deposit Insurance Corporation's (DIC's) equity capital is low by international standards and would likely be unable to absorb losses in the case of a significant bank failure. It recommended that the DIC's capital base be strengthened and arrangements clarified on how it could access backstop funding.

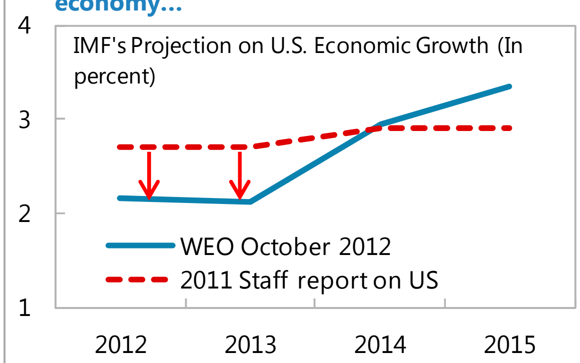
- **High NPL ratios remain a challenge, but near-term threats to financial stability are limited.** The elevated NPL ratios (13.4 percent of total loans as of end-September 2012)—reflecting high unemployment and banks' reluctance to foreclose on non-performing mortgages—are not expected to reverse soon, as the debt overhang of the private households and firms is only expected to fall gradually. Real estate prices have also softened, increasing uncertainty about collateral values of nonperforming loans and possible need to increase provisions. Further, business confidence and employment prospects could remain subdued, as concerns linger about the global environment. However, stress tests conducted by the FSAP team suggest that the overall banking system could withstand substantial economic, solvency, and liquidity shocks.

9. Over the medium term, the economy is projected to expand by 2–3 percent, broadly in line with that of the United States. Staff's projections assume that construction activity will ease somewhat as large projects are completed, and much smaller private projects are undertaken. However, slackening construction is expected to be more than offset by a sustained pickup in tourism activity as new hotels come on stream and partner country demand recovers. At the same time, the tourism sector faces a number of challenges going forward, including designing an exit strategy from air credit programs, expanding incoming airlift, and diversifying the country's tourism product as well as source markets.

10. The medium-term outlook is tilted to downside risks. Medium-term growth could get a boost if new tourism projects materialize and trade and industry initiatives under discussion advance. On the other hand, external downside risks include adverse prospects for the U.S. economy, the main source of tourists travelling to The Bahamas, volatile global food and fuel prices, a decline in FDI inflows, and the occurrence of natural disasters. There are several domestic risks as well.

- **With the U.S. accounting for about 80 percent of the total tourist arrivals, a slowdown in the U.S. economy would have a high impact on employment and export receipts,** and put pressure on international reserves.[3] Debt dynamics would worsen, reflecting lower growth and higher fiscal deficits.

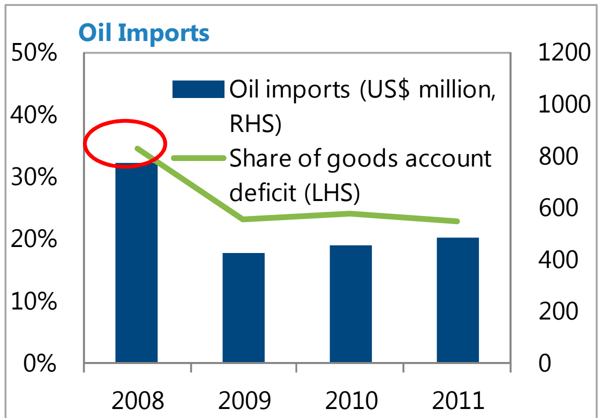
Downside risks are still high in the global economy…



Sources: IMF staff estimates and projections.

[3] Tourism receipts account for 35 percent of total receipts from the export of goods and services.

- **A spike in global oil and food prices would feed into higher inflation,** since fuel and food account for more than 40 percent of the CPI basket. It would also weaken the external current account balance directly through higher oil imports (about 6–7 percent of GDP) and indirectly through higher travel costs. A weak global economy could compound these impacts through negative-wealth and low-consumer-confidence effects in the U.S.



Sources: The Bahamian authorities, and IMF staff estimates.

- **There are also significant downside risks on the domestic front.** These include (i) delays in implementing fiscal consolidation (especially enhancing revenue collections) and reforming state-owned enterprises (including reducing contingent liabilities), which could pose risks to long-term debt sustainability and the investment grade rating;[4] (ii) inadequate product and market diversification in tourism, to reduce vulnerabilities to external shocks; (iii) high unemployment and crime, which could negatively affect tourism if not urgently addressed; and (iv) a continuation of high NPLs, which could compromise banking system stability. Further, continued low confidence in the private sector could act as a drag on domestic activity.

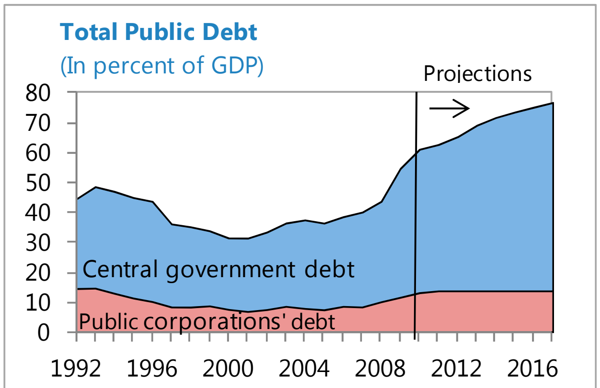
POLICY DISCUSSIONS

11. The authorities and staff agreed that the main challenge facing the country was how to rebuild macroeconomic buffers against shocks, while supporting growth and development. The Bahamas emerged from the global crisis with less policy space—higher public debt and a lower policy interest rate—and rising vulnerabilities. In that regard, staff encouraged the authorities to implement fiscal adjustment while advancing structural reforms to increase economic diversification, promote growth and efficiency, and reduce exposure to exogenous shocks. Against this backdrop, the discussions focused on:

- A credible strategy for medium-term fiscal consolidation;
- Policies to contain the non-FDI-related current account deficit and build reserve buffers;
- Measures to promote growth and improve the business environment; and
- Initiatives to further strengthen financial regulation and supervision.

[4] Citing the continued deterioration in the fiscal stance of The Bahamas, Standard and Poor's reaffirmed the country's rating of "BBB/A-2" on September 24, 2012, but revised the outlook from stable to negative. On December 13, 2012, Moody's downgraded the country's sovereign credit rating from A3 to Baa1, citing limited growth prospects, significant deterioration of the government's balance sheet, and a weakening of debt sustainability metrics.

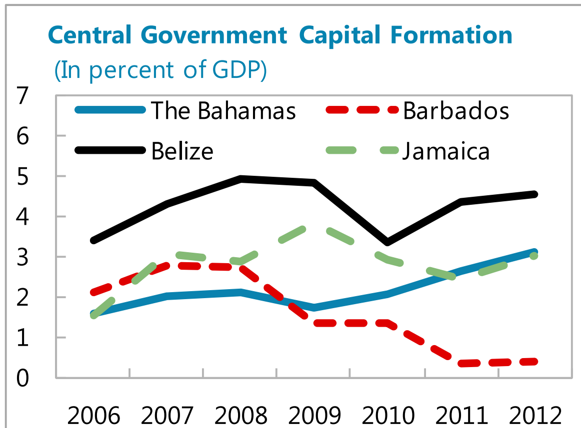
A. Fiscal policies



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

12. Staff urged the authorities to implement a medium-term framework for broad-based fiscal consolidation, reflecting a balanced approach of raising revenue, rationalizing expenditure, and reforming public enterprises. In particular, staff encouraged the authorities to consider: tax reform, strengthening customs and tax administrations, ensuring that public investment projects are carefully selected, prioritized, and monitored, improving public financial management, and reforming public corporations.

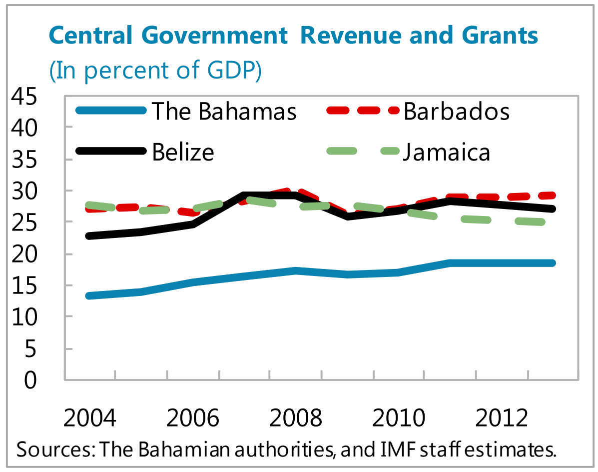
- **The public debt-to-GDP ratio is rising.** With a primary deficit averaging 2½ percent of GDP over the medium term, the central government debt is projected to continue to rise, reaching about 62 percent of GDP by FY 2016/17. Adding the debt owed by non-financial public corporations (about 14 percent of GDP) and assuming no new net debt is contracted by these institutions,[5] total public sector debt is projected to increase to about 76 percent of GDP by FY 2016/17. Reducing the debt ratio over the medium term is an imperative, not only to create buffers for future shocks, but also to provide financing for growth-oriented infrastructure and to maintain an adequate investment rating. In that regard, budget expenditure composition and prioritization are key. The authorities should also explore other means to mitigate budget constraints, including through well-designed public-private-partnerships (PPPs). Capital expenditure in The Bahamas is low compared to other countries in the Caribbean, and key transportation, energy, and communications infrastructure could benefit from upgrade and modernization.



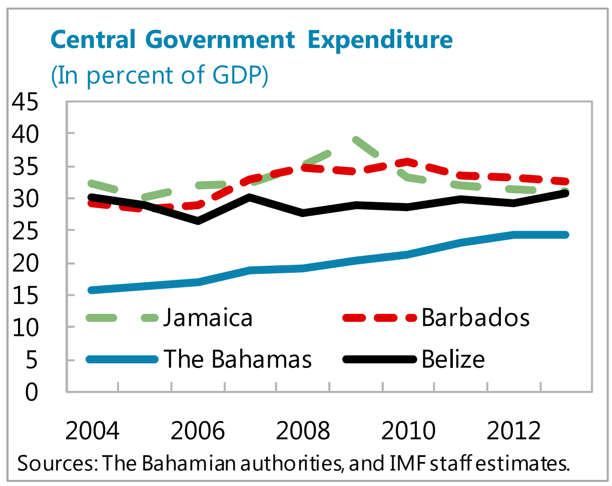
Sources: The Bahamian authorities, and IMF staff estimates.

[5] Deficits of public corporations are assumed to be covered by central government transfers.

- **Revenue underperformance should be addressed as a priority.** Revenue-to-GDP is low by regional comparison and persistently below expenditure-to-GDP. Further, the tax base is narrow, and tax administration and compliance are weak. More fundamentally, staff emphasized that the growth sectors of the economy—mainly the tourism and financial sectors—generate a small proportion of net revenue, delivering low yield from growth and resulting in weak tax buoyancy. Staff encouraged the authorities to implement tax reform, including broadening the tax base through the implementing a domestic consumption tax (with an estimated additional yield, based on regional experience, of about 2–3 percent of GDP), introducing a simple broad-based corporate income tax, and rationalizing the system of tax incentives.[6] Staff also welcomed the authorities' efforts—supported by the IADB—to strengthen customs and tax administrations, including by targeting large taxpayers and non-compliance.



- **Expenditure should be rationalized.** Spending is projected to remain close to 20 percent of GDP. Wages account for almost 50 percent of revenues, and, as a percent of GDP, they have risen from countercyclical policies implemented during the global economic crisis. Transfers to public enterprises remain high, and interest costs are rising in line with the public debt. The staff recommended strengthening debt management to contain fiscal costs, and replacing less efficient and more costly subsidy schemes by developing targeted social support mechanisms that can strengthen automatic stabilizers during crises.



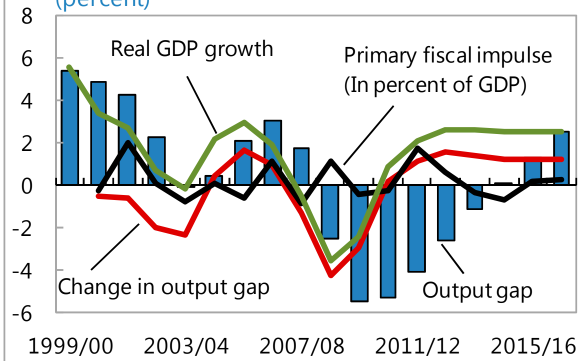
- **Public enterprises should aim to eventually eliminate deficits.** The financial position of several state-owned enterprises (including Bahamas Air, the electricity, and the water and sewerage companies) is weak. They require continuing transfers, face challenges regarding the maintenance of capital equipment, and are handicapped from investing in capacity-increasing or efficiency-generating technological improvements (Box 3). The staff recommended addressing their organizational and staffing weaknesses, improving their tariff structure, and investing in critical infrastructure and equipment. To this end, staff welcomed the reforms that the

[6] In FY 2011/12, fiscal incentives amounted to B$285 million or 3.6 percent of GDP.

authorities are undertaking with regard to the Water and Sewerage Company (WSC), under a US$81 million project funded by the IADB. This multi-year project aims at significantly reducing water leakage, strengthening the institutional structure of the WSC, developing a master plan for the sewerage sector, and reforming the regulatory framework for the sector.

13. The authorities have expressed a commitment to place public debt on a downward trajectory. Staff estimates that an additional fiscal effort of about 3 percent of GDP (built over the years) would bring the central government debt down to 2012 levels by 2016/17. The authorities agreed with staff that such a fiscal effort could be attained through a combination of a broad-based consumption tax, savings from enhanced tax administration, the rationalization of fiscal incentives, a reduction in transfers to public corporations, and the use of well-designed private-public-partnership arrangements.

Fiscal Impulses and Output Gap Changes
(percent)



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

14. The authorities concurred that delays in implementing fiscal consolidation, especially revenue reforms, and the realization of large contingent liabilities from public corporations could pose risks to long-term debt sustainability. They agreed that this would also weaken the external current account balance, impact the credibility of the peg, and put at risk the country's investment grade credit rating.[7] Staff's public debt sustainability tests show that a primary balance shock and a no policy change scenario will result in a steep increase in the trajectory of the debt-to-GDP ratio (see Figure 4 on the fiscal DSA).

15. Staff discussed with the authorities an illustrative scenario that would allow them to attain a credible fiscal adjustment over the medium term. This would be achieved by first curbing the growth in overall debt and then placing it on a sustainable downward trajectory (see Appendix I). The adjustment efforts rely on a balanced approach that raises additional revenues and reins in non-interest current spending, while preserving fiscal space for important investments in infrastructure and human capital. Of note, the fiscal consolidation is not expected to have much of a negative impact on growth, which in this period will be driven by FDI-related construction and a recovery in tourism.

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[7] On September 24 2012, citing the continued deterioration in the fiscal stance of The Bahamas, Standard and Poor's revised the outlook from stable to negative.

Box 3. State-Owned Enterprises

A number of state-owned enterprises continue to face financial problems. The most prominent among these are the Water and Sewerage Corporation (WSC), the Bahamas Electricity Corporation (BEC), and BahamasAir. A common feature contributing to their financial distress is the accepted social responsibility of providing services at affordable and unified prices to an archipelago of sparsely populated and dispersed islands.

Water and Sewerage Corporation

The WSC is tasked with providing potable water and sewerage services to New Providence and the Family Islands. Historically, a large percentage of the population received water from wells, and discharged waste into private septic tanks. Market penetration, however, has been low (the WSC provides service to only about 30 percent of Bahamian households and businesses), limiting revenue performance. The low penetration achieved reflects, in part, institutional weaknesses and inadequate infrastructure. Most of the population lives on islands, including the populous New Providence Island, that do not have sufficient natural sweet water. Accordingly, the WSC relies on expensive desalination plants to produce potable water for New Providence and the other Family Islands. However, the WSC's water delivery system is antiquated, with 55 percent of its piped water lost to wide-spread leakage. The company also suffers from overstaffing and an inadequate tariff structure that, for more than a decade, has not kept up with mounting energy costs. As a result, the WSC has run persistent deficits, requiring government assistance to stay afloat—estimated at US$25–40 million annually—including through transfer payments and loan guarantees.

Bahamas Electricity Corporation

The BEC supplies electricity to all the islands except Grand Bahama, using power plants that rely on imported fuel. In 2011, BEC's oil imports cost about US$360 million (about 4.5 percent of GDP), representing about 70 percent of its total operating costs. In addition, because of the large distances between New Providence and the Family Islands, the BEC has had to set up separate fuel-powered generation plants on each of the inhabited islands, effectively eliminating economies of scale. While the BEC benefitted from a rate adjustment in July 2010 (the first in seven years), its cash flow problems were aggravated by a three-year government program (2010–13) aimed at alleviating the impact of high electricity bills on residential customers, at a time of economic distress. Under this program, all residential customers (irrespective of income) may stretch out bill payments over three years at very favorable terms. As a result, BEC's accounts receivable mushroomed—even as its payment for fuel inputs soared—forcing it to defer vital maintenance, take on additional loans, and accumulate arrears.

BahamasAir

BahamasAir has been the main air carrier mandated by the government to maintain air service between Nassau and all the main Family Islands. Originally, BahamasAir enjoyed a monopoly on all domestic scheduled air routes. However, that monopoly ended in 2006 when the domestic air market was deregulated. Today, there are 31 licensed, scheduled airlines operating air planes of 30 seats or more, in addition to nine smaller air carriers. These private companies are free to cherry-pick profitable destinations to fly to, while leaving less profitable islands for BahamasAir to serve. BahamasAir's financial shortfall is significant, requiring annual government subsidies of about US$18–20 million. Its problems are exacerbated by an aged airplane fleet that is costly to maintain and relies on oversized propeller planes to cover the domestic market, resulting in steadily declining load factors. In addition, fuel costs have more than doubled over the past decade. Despite reducing its staffing level through natural attrition from a peak of 822 down to about 630, BahamasAir is still considered, by industry standards, to be overstaffed by about one third, and its pay and pension structure to be rather costly.

Baseline and Adjustment Scenarios (In percent of GDP)							
	Prel.	Baseline			Adjustment		
	FY11/12	FY12/13	FY14/15	FY16/17	FY12/13	FY14/15	FY16/17
Revenue and grants	**18.4**	**18.5**	**18.7**	**18.8**	**18.6**	**19.7**	**20.2**
Tax revenue	16.3	16.7	17.1	17.2	16.8	18.0	18.6
Nontax revenue and grants	2.1	1.7	1.6	1.6	1.7	1.6	1.5
Total expenditure	**24.2**	**24.3**	**23.1**	**23.0**	**24.0**	**22.2**	**21.4**
Current expenditure	19.2	20.1	19.2	19.3	19.7	18.3	17.9
Of which: interest payments	2.4	2.3	2.5	2.6	2.2	2.4	2.3
Capital expenditure and net lending	**5.0**	**4.3**	**4.0**	**3.7**	**4.3**	**3.8**	**3.5**
Overall balance	**-5.9**	**-5.9**	**-4.4**	**-4.3**	**-5.5**	**-2.5**	**-1.3**
Memorandum items:							
Primary fiscal balance	-3.4	-3.6	-1.9	-1.7	-3.2	-0.1	1.1
Central government debt	49.3	53.6	58.8	62.1	52.9	54.5	52.4
Debt of public enterprises	13.8	14.1	14.1	14.1	14.0	13.5	13.0
Real GDP growth (CY, in percent)	1.6	2.5	2.7	2.5	2.5	2.2	2.5
GDP deflator (CY, annual percentage change)	-1.4	0.7	1.8	2.1	0.7	3.1	2.1
External current account balance (CY)	-14.0	-14.1	-12.7	-9.5	-14.1	-11.8	-8.0

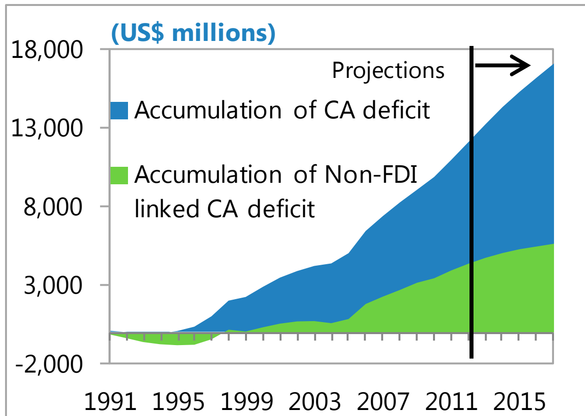
16. **The authorities generally agreed with the thrust of staff's illustrative scenario for fiscal consolidation, but noted that they were not ready to detail exact measures or a timetable for implementing their adjustment program**. They explained, however, that they supported a balanced approach, relying on both revenue and expenditure measures. Further, they indicated that they could favor even more ambitious revenue enhancements and an aggressive reduction in public capital expenditure over the medium term, provided economic recovery was more vigorous and offsetting private sector investment picked up. Staff emphasized the need for quality public investment, based on national priorities and consistent with the long-term development goals of the country.

B. External stability and exchange rate policies

17. **Although the fixed exchange rate has fostered broad price stability, and the exchange rate appears to be broadly in line with fundamentals, fiscal consolidation would contribute to a needed improvement in the balance of payments.** The current account balance was below the estimated norm in recent years, largely owing to the financial crisis and weakened U.S. economy, but the deficit is projected to gradually narrow over the medium term as FDI-related imports abate and exports rise. Based on staff's current account projections, the exchange rate remains broadly in line with medium-term fundamentals (Appendix II). Estimates from the macro-balance (MB) approach suggest that the projected medium-term current account deficit is close to the estimated norm, while the equilibrium real exchange rate (ERER) approach suggests that the real effective exchange rate is broadly in line with fundamentals. Non-price measures (for example, rankings in the World Bank's *Doing Business Report*) suggest that there is some room for improvement. Staff argued that maintaining competitiveness (price and non-price) was necessary for external sustainability. In that regard, improvements in competitiveness in the service industry, including tourism, and implementation of reforms for fiscal consolidation will be important, going forward. Such improvements in the fundamentals will improve the current account and competitiveness. Staff also argued that, although The Bahamas has managed well in the past with relatively low reserve

coverage ratios, the vulnerability of export performance, as shown during the global crisis, suggests the need for a larger reserve cushion (Box 4).

18. The authorities expressed their commitment to supporting the peg and building reserves over the medium term. They recognize the need for policies to further promote exports, diversify sources of foreign currency receipts, and build more buffers to external shocks. Measures aimed at improving the external balance span: (i) supporting tourism by key investment projects; (ii) attracting FDI through improvements in the business environment and reducing crime; (iii) developing alternative energy sources; and (iv) implementing a credible fiscal consolidation. The authorities agreed with staff that the level of the exchange rate remains broadly in line with medium-term fundamentals, noting that increased exports, identified FDI, and low inflation are contributing to this stability.[8] Staff underscored the need to correct fiscal imbalances and maintain strong fundamentals to support the peg.



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

19. Staff stressed the need to improve external stability by reducing the non-FDI-related current account deficit. While the large external current account deficit is predominantly financed through non-debt creating FDI, there has been a residual current account deficit (estimated at about 5 percent of GDP) that needs to be addressed. The persistent deficits and modest reserves could pose challenges to external sustainability in the face of adverse shocks. Staff presented external sustainability and reserve adequacy analyses to highlight vulnerabilities. Of note, net indebtedness (largely non-debt creating liabilities) to the rest of the world has increased sharply. Yet, rates of economic growth have remained low, raising questions about whether the quality and mix of activities financed by these liabilities were appropriate. Although the authorities' growth agenda (see below) should assist in reducing the current account deficit, mainly through promoting exports, credible fiscal consolidation would also help to correct external imbalances.

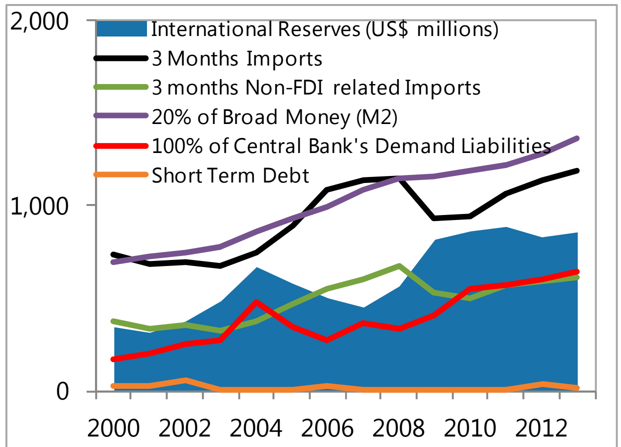
20. Staff and the authorities agreed that further monetary easing was not necessary at this time. The central bank reduced the discount rate significantly in 2011, and further easing may put pressures on reserves and the exchange rate. In addition, given that banks remain quite liquid, it is not clear whether further monetary loosening will necessarily stimulate growth, especially in the context of high NPLs, which may hamper banks' willingness to expand credit.

[8] The current account deficit is consistent with estimated norms, when imports associated with FDI-related projects are taken into account.

Box 4. Assessment of Reserve Adequacy [1/]

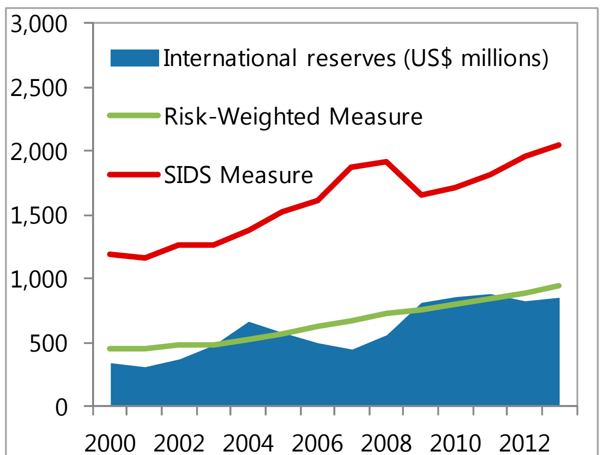
International reserves in The Bahamas have remained stable since 2009. In that year, external borrowing of US$300 million and the SDR allocations of US$179 million helped boost the country's external reserves to US$816 million, from US$563 million at end-2008.

The Bahamas' reserves are broadly adequate based on traditional metrics and under country-specific considerations. The traditional measures (three months of imports, full cover of short-term external debts, and 20 percent cover of broad money) are based on simple rules of thumb. International reserves are more than adequate when measured against short-term external debts. The authorities also ensure that the country's reserves cover 100 percent of the central bank's demand liabilities, well above the legal requirement of 50 percent. While reserves are below comfortable levels under two other methods, some country specific factors mitigate the perceived vulnerabilities. First, given that a large part (70–80 percent) of imports of capital goods is financed by FDI, it is reasonable to subtract this portion from total imports. Thus, measured in terms of next year's non-FDI imports, the country's reserves are projected to be at a comfortable level of four months at end-2012. Second, the broad-money-based method is used to capture the risks from currency mismatches and possible drains arising from bank runs. These risks are relatively limited in The Bahamas, given the central bank's effective controls on capital flows in order to ensure financial stability and manage pressures on the peg.



Sources: The Bahamian authorities, and IMF staff estimates.

The Bahamas' position as a small island country with high dependence on the tourism industry suggests that it needs to secure a larger reserve cushion. The Bahamas' reserves are broadly adequate against a risk-weighted measure, which is designed to reflect a broader range of sources of risk, such as external liabilities, external demand collapse, and potential capital flight. However, the adjusted measure for small island developing states (SIDS) suggests that the reserves are below comfortable levels.[2/] This measure is more stringent than the first metric because it places a higher weight on exports and short-term debts. It also reflects the high vulnerability of small islands to terms of trade shocks and the ability to borrow in times of need from their rather shallow domestic financial markets.



Sources: The Bahamian authorities, and IMF staff estimates.

[1/] This box assesses reserve adequacy of The Bahamas, using traditional methods and newly proposed risk-weighted measures (see "Assessing Reserve Adequacy," IMF, February 2011).
[2/] "How Much Should I Save? Reserve Adequacy in Emerging Markets and Small Islands," Nkunde Mwase, IMF WP (2012).

C. Growth strategy

21. Staff discussed with the authorities measures to enhance medium-term growth and employment. Economic growth can be further strengthened by a broad strategy that identifies and removes key impediments to private sector activity. The growth strategy would also need to be complemented by measures to strengthen the business environment, improve physical infrastructure (including public utilities) enhance human capital, and address social tensions and reduce crime.

22. The authorities are formulating a strategy to improve growth performance. While near-term growth is expected to be driven by the recovery of tourism and ongoing large construction projects, the authorities' plan embraces economic diversification, including of the tourism industry; and identifying and removing growth-constraining factors in the business environment.

- **Diversification.** The authorities recognize the need for policies to diversify the overall economy (including within the tourism industry). Measures aimed at enhancing diversification include: (i) supporting tourism by increasing airlift,[9] including to the Family Islands, and expanding programs to boost cruise arrivals; (ii) encouraging human capital investment, including through language and culture training; (iii) promoting linkages between tourism and the rest of the economy, including agriculture and creative industries; (iv) leveraging existing trade protocols to develop industries in logistics and intellectual property; (iv) further developing financial and other professional services, including in arbitration; and (v) incentivizing investment into the Family Islands.

- **Improving the business environment.** The authorities intend to achieve requirements for World Trade Organization (WTO) accession,[10] adopt measures to address the country's lowest-ranking indicators in the World Bank's *Doing Business Report*, and launch an e-government project. Initiatives are being implemented, with the appropriate legislation and inter-agency collaboration, to improve efficiency in the Office of the Attorney General, including enhanced administration of justice and dispute resolution, incorporation and dissolution of corporations, the issuance of official public registrar documents, and management of intellectual property.

- **Reducing unemployment.** Ongoing infrastructure and private sector investment projects have created employment opportunities, promising to reduce social tensions and boost domestic demand.

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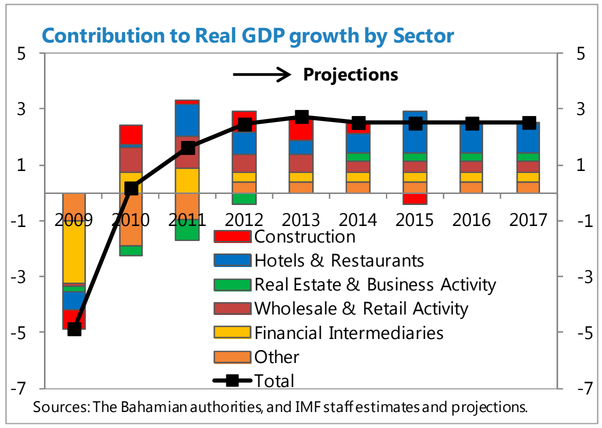
[9] Authorities and representatives from the tourism sector have been working together to increase airlift from the United States., Latin America, and China, to tap new markets and cater to the opening of the Baha Mar resort.

[10] The recent efforts include an ongoing initiative to modernize the Bahamas Customs Department, which is funded by IADB and one of the key elements toward WTO accession.

- **Combating crime.** The authorities aim to reduce crime by providing greater resources to law enforcement, expanding the courts system, strengthening the prosecutorial process, and promoting urban renewal.[11]

23. Staff welcomed the authorities' broad-based strategy to enhance growth. Staff highlighted the need for diversification to foster medium-term growth, emphasizing that the ongoing large construction activities are expected to end by 2015, and the tourism sector's growth will eventually moderate as new capacity is gradually filled. Staff also underscored the benefits of promoting innovative high value-added downstream tourism products to foster linkages across sectors, improving economic diversification and employment.



D. Financial sector oversight

24. The financial system faces no serious near-term stability threats. However, the authorities should continue to strengthen the regulatory, supervisory, crisis management, and financial safety net frameworks to ensure the financial system remains robust. Stress tests conducted by the FSAP team show that the domestic banking system can withstand a range of adverse scenarios, including the effects of sizeable hurricanes. While, resilience varies across individual banks, no systemically large banks appear to show serious vulnerabilities. Further, spillover risks between banks and other domestic financial institutions and between the offshore and onshore financial systems appear minimal.

25. The main challenge is a still high level of non-performing loans. Although banks are well capitalized, liquid, and profitable, the non-performing loan (NPL) ratio remains high (13.4 percent of total loans as of September 2012), mostly owing to delinquent mortgages and commercial loans.[12] The banking system's ample capital buffers provide shock-absorbing capacity. However, downgrades of adversely classified and restructured loans to lower categories could exert pressure to raise the amount of provisions that banks need to set aside against loan losses. Further, there is some degree of uncertainty on the value of underlying collateral for non-performing mortgages, which constitute over half of NPLs. The authorities remain vigilant about the potential impact of NPLs on bank capital and have substantially improved credit risk monitoring of onshore commercial banks.

[11] These efforts are being supported by institutional strengthening ("Swift Justice Initiative") and the better use of information technology ("Integrated Justice system").

[12] The Mortgage Relief Plan, started in September 2012, has received fewer eligible applicants than expected, and it is expected to have a marginal impact on non-performing mortgage loans.

26. The central bank has pursued macro-prudential policies to contain financial risks. A CAR trigger of 14 percent was introduced early in the global financial crisis, to better monitor banks, and a debt service-to-income limit of 45 percent was imposed on household loans. Since November 2009, banks have been restricted from distributing dividends without central bank approval. In addition, the central bank maintained at 85 percent the maximum loan-to-value ratio for personal loans, and kept the foreign exchange net open position limit at 5 percent of total Tier 1 capital, up to a maximum of US$5 million.

27. Oversight of the financial system has improved significantly. The supervisory authorities have implemented or are in the process of implementing a risk-based approach for both onshore and offshore sectors, supported by a regime of information sharing and regulatory colleges. Staff encouraged the use of guidelines on the scope and methods of consolidated supervision, as well as for managing operational, interest rate, and market risk, consistent with Basle III principles. The authorities have committed to undertaking an assessment of Anti-Money Laundering and Combating the Financing of Terrorism, within 18 months after the FSAP mission and under the Caribbean Financial Action Task Force's next round of evaluations.

28. Staff welcomed the authorities' initiative to develop a National Financial Crisis Management Plan (NFCMP). The central bank has designated all onshore commercial banks as systemic for the purpose of supervision, but agrees that there needs to be a more narrowly tailored definition to determine those banks eligible for solvency support or other extraordinary intervention. Other areas for improvement include the legal power to provide financial assistance under law, the legal provisions for receivership and resolution of financial institutions, and access to backstop funding by the Deposit Insurance Corporation, to allow absorption of losses in the case of a significant bank failure. The resilience of the financial sector will also benefit from the establishment of the proposed credit bureau, as well as reforms to strengthen the regulatory and supervisory frameworks for non-banks, including by bringing credit unions under central bank supervision.

29. The authorities generally agreed with the recommendations of the FSAP mission. They highlighted their ongoing work to improve supervision and regulation of credit unions and to establish credit bureaus as examples of their commitment to improve the financial soundness. Further, they had also engaged external advisors to conduct a simulation exercise in crisis management in early November 2012. The objective was to acquaint the various high-level officers and government officials of their roles and responsibilities in the event of a crisis, identify lines and sequence of communications, with the view to preparing a reference manual.

STAFF APPRAISAL

30. The Bahamas economy is recovering from the global financial crisis. However, unemployment remains high, and public debt has risen substantially since the crisis broke. Real GDP growth is projected to pick up in 2012 and over the medium term, supported by strong activity in the construction sector and a bounce in tourism. The Bahamas is also poised to experience a marked increase in tourism activity, as capacity expands and partner countries recover. Inflation remains contained at around partner-country levels.

31. Immediate and credible fiscal consolidation remains the key policy priority. The objective should be to curb the rise of, and then significantly reduce, the public debt-to-GDP ratio over the medium term, to restore policy buffers. Such an approach would need to include raising revenue collections, by strengthening tax administration and introducing new consumption or corporate income taxes, reining in current spending, in particular on wages, goods and services, and transfers and subsidies, and reforming public enterprises to make them commercially viable, thereby reducing the need for subsidies.

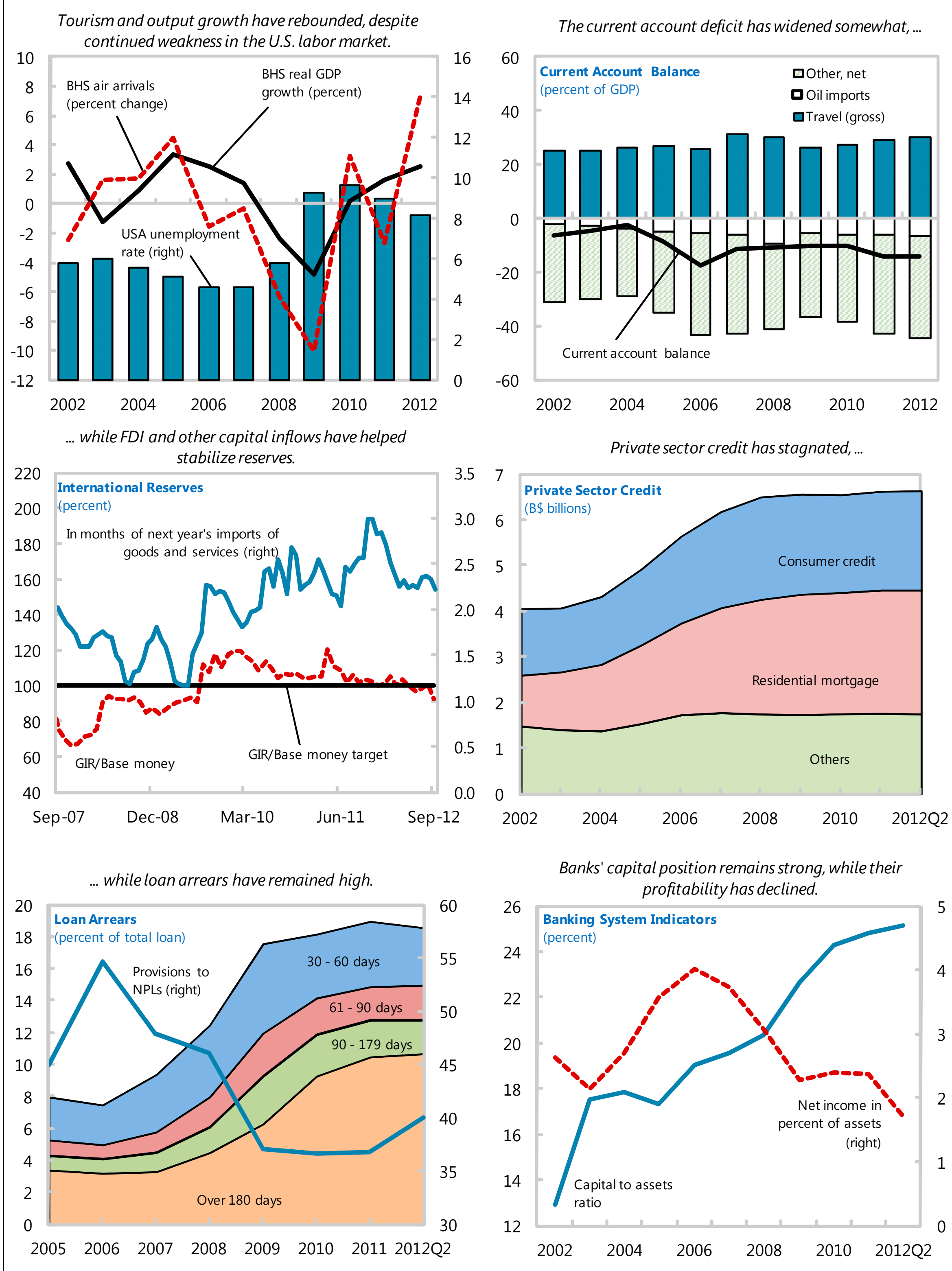
32. Staff welcomes the authorities' commitment to the U.S. dollar peg by encouraging foreign direct investment and boosting reserves. Staff calculations suggest that the exchange rate is broadly in line with fundamentals, and the U.S. dollar peg has served the country well over the years, enjoying widespread support and contributing to broad price stability. The recent global crisis has, however, increased the country's external vulnerability. Against this backdrop, staff encourages the authorities to continue their efforts to promote exports, especially tourism, and generally contain domestic demand, including through credible fiscal consolidation. Such measures to strengthen the fundamentals will bring about desirable shifts in the current account and real effective exchange rate. In this context, staff does not consider monetary easing to be appropriate, at this stage.

33. Staff supports the authorities' strategy of fostering growth over the medium to long term. While private and publicly financed construction in resorts and physical infrastructure are expected to sustain growth over the coming few years, the authorities are appropriately engaged in removing hurdles to longer-term economic development. Staff welcomes their efforts to diversify the economy, including by promoting closer linkages between the large tourism sector and other local industries; improving the business climate and streamlining government operations and certification procedures; and tackling crime and promote community development and urban renewal.

34. The Bahamian financial system faces no obvious serious threats to its near-term stability. Stress tests confirmed that onshore banks can generally withstand severe shocks to solvency and liquidity, and that the risks of spillovers between onshore and offshore banks are limited. However, the authorities will need to monitor credit risk closely given the relatively high levels of NPLs, predominantly in mortgages. Financial system oversight has improved greatly over the last decade but further strengthening is needed, particularly in insurance and securities. Staff welcomes the authorities' commitment to strengthen their crisis prevention and resolution frameworks, as well as their efforts to improve the regulatory and supervisory framework for credit unions and establish a credit bureau to better monitor consumer credit inside and outside the banking system.

35. Staff proposes that The Bahamas remain on the standard 12-month Article IV consultation cycle.

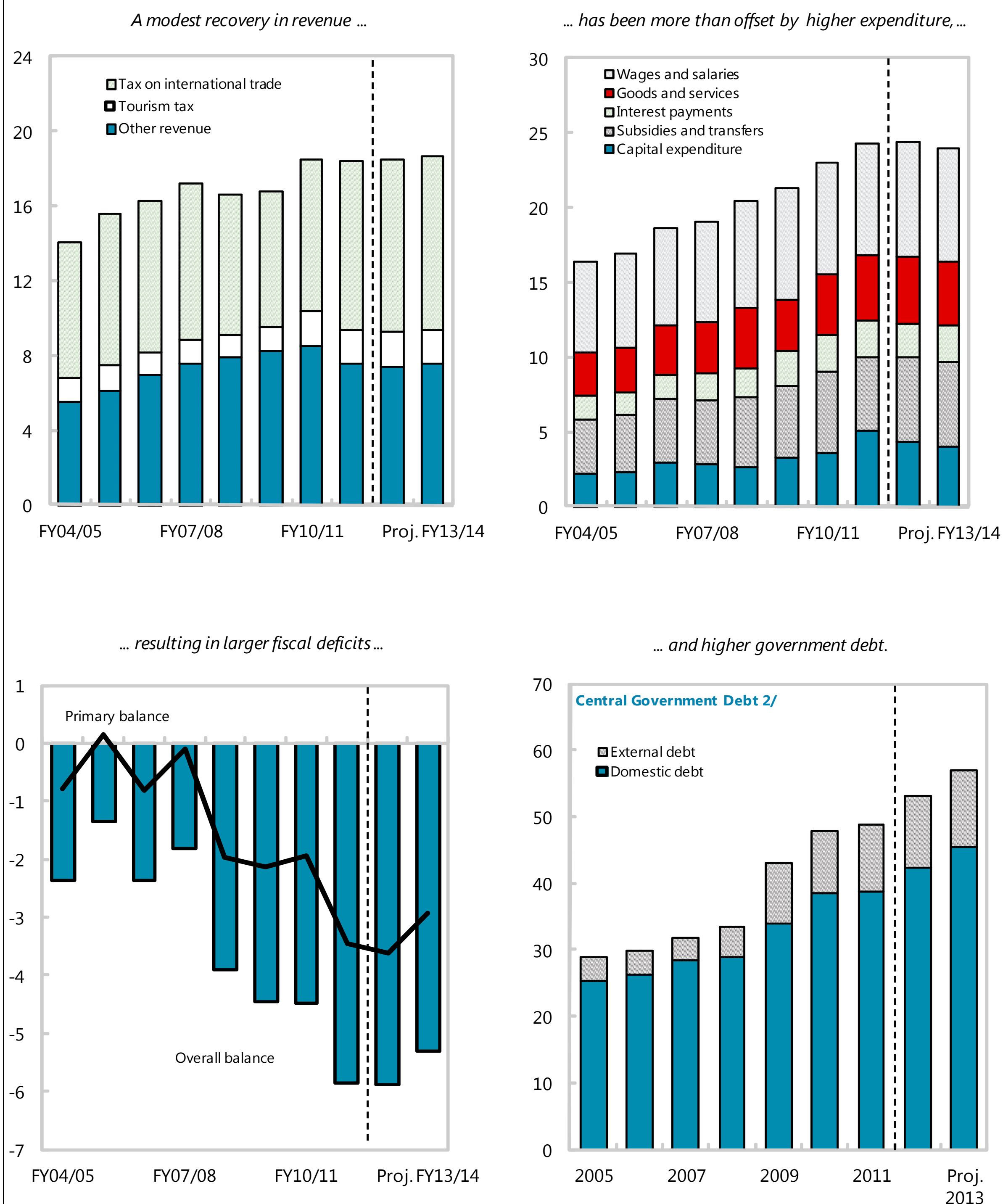
Figure 1. The Bahamas: Recent Developments



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

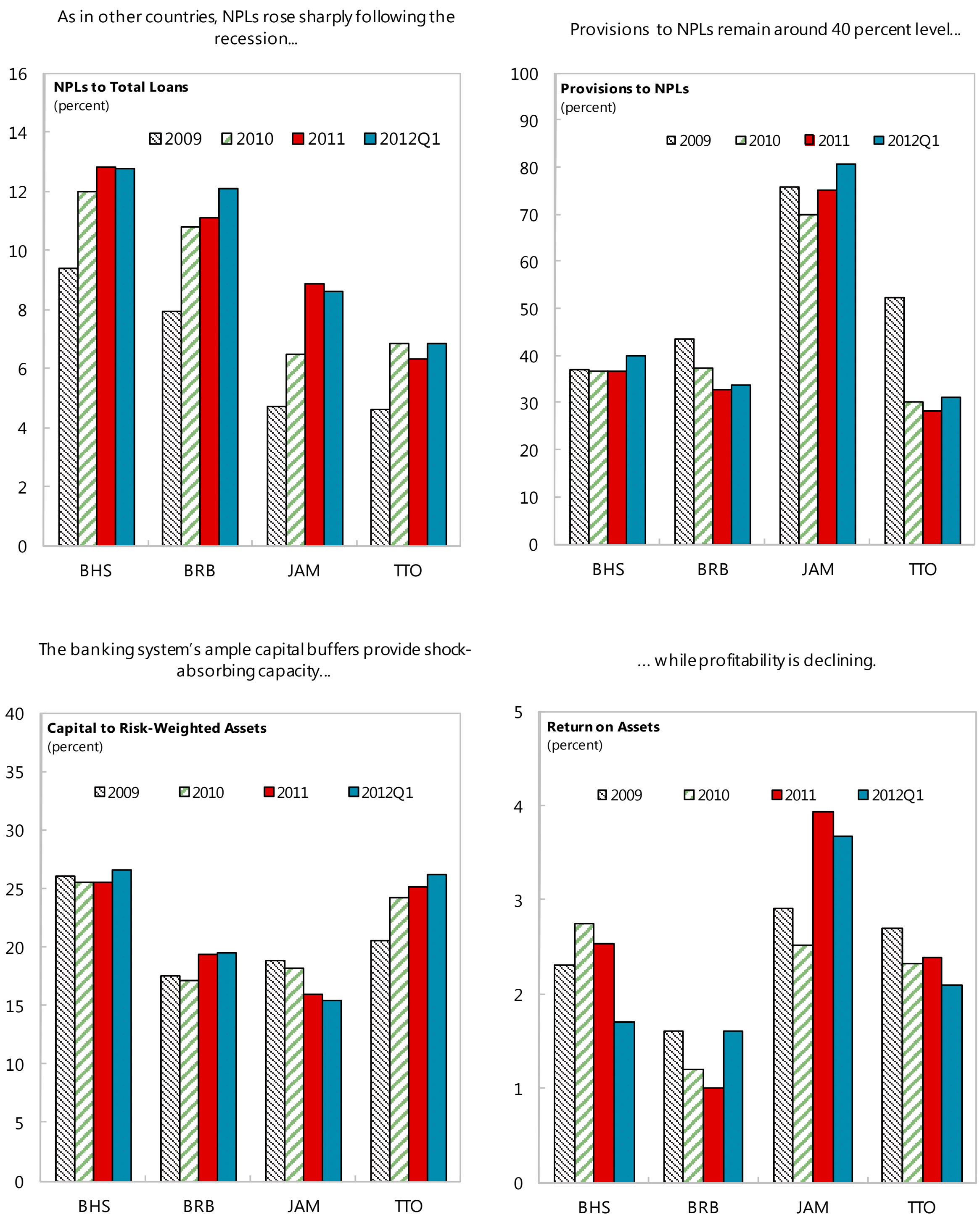
Figure 2. The Bahamas: Fiscal Developments and Outlook 1/

(In percent of GDP)



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

Figure 3. The Bahamas: Financial Developments 1/ (Regional Comparison)



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

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

Table 1. The Bahamas: Selected Social and Economic Indicators

I. Social Indicators

GDP (US$ millions), 2011	7,788	Poverty rate (percent), 2004	9.3
GDP per capita (US$), 2011	22,020	Unemployment rate (percent), 2012	14.7
Population (thousands), 2010	353.7	Population not using an improved water source (percent), 2006	3.0
Life expectancy at birth (years), 2010	74.4		
Adult literacy rate, 15 & up (percent), 2007	95.6	Human development index (rank), 2010	43

II. Economic Indicators

			Est.	Proj.	
	2010	2011	2012	2013	2014
(Annual percentage changes, unless otherwise indicated)					
Real sector 1/					
Real GDP	0.2	1.6	2.5	2.7	2.5
Nominal GDP	0.7	0.2	3.2	3.5	4.4
Consumer price index (annual average)	1.3	3.2	2.3	2.0	2.0
Consumer price index (end of period)	1.5	3.2	2.3	2.0	2.0
Unemployment rate (in percent) 2/	...	15.9	14.7	...	...
Financial sector					
Credit to the nonfinancial public sector	37.5	4.0	9.5	9.1	8.3
Credit to the private sector	-0.4	1.1	0.9	2.1	3.5
Liabilities to the private sector	2.6	1.9	5.0	6.3	7.2
External sector					
Exports of goods and services	4.4	7.6	6.6	5.8	4.0
Of which: Travel receipts (gross)	6.6	5.0	8.1	7.2	5.0
Imports of goods and services	1.1	12.9	7.3	4.6	2.5
(In percent of GDP, unless otherwise indicated)					
Central government 3/					
Revenue and grants	16.8	18.5	18.4	18.5	18.7
Current expenditure	18.0	19.4	19.2	20.1	20.0
Capital expenditure and net lending	3.2	3.6	5.0	4.3	4.0
Primary balance	-2.1	-1.9	-3.4	-3.6	-2.9
Overall balance	-4.4	-4.5	-5.9	-5.9	-5.3
Central government debt	43.9	45.7	49.3	53.6	56.9
External sector 4/					
Current account balance	-10.5	-14.0	-14.1	-13.6	-12.7
Change in net international reserves (increase -)	-0.6	-0.3	0.7	-0.3	-0.3
External public debt (end of period)	11.8	12.9	12.8	14.1	14.5
Memorandum items: 4/					
Gross international reserves (end of period; millions of U.S. dollars)	860	885	829	855	884.8
In months of next year's G&S imports	2.4	2.3	2.1	2.1	2.1
In months of next year's non-FDI related G&S imports	4.5	4.5	4.0	4.0	3.9
In percent of reserve money	104	100	90	87	84
External debt-service ratio (in percent of exports of G&S)	11.2	8.1	7.5	5.9	4.8
GDP (in millions of Bahamian dollars)	7,771	7,788	8,040	8,318	8,682

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

1/ Revised national accounts data.
2/ The 2011 figure is based on November survey and the 2012 figure is based on May survey.
3/ The data refer to fiscal years ending on June 30.
4/ The data refer to calendar years.

Table 2. The Bahamas: Operations of the Central Government[1/]

(In millions of Bahamian dollars)

			Prel.	Staff Projections				
	FY09/10	FY10/11	FY11/12	FY12/13	FY13/14	FY14/15	FY15/16	FY16/17
Revenue and grants	**1,303**	**1,442**	**1,455**	**1,510**	**1,587**	**1,665**	**1,743**	**1,825**
Tax revenue	1,109	1,306	1,286	1,367	1,443	1,519	1,596	1,673
Taxes on international trade	566	637	712	752	790	835	874	914
Tourism taxes	96	144	145	151	156	165	174	185
Miscellaneous taxes	387	513	429	463	497	519	548	574
Other	60	12	0	0	0	0	0	0
Nontax revenue	193	136	150	143	144	146	147	152
Total expenditure	**1,647**	**1,790**	**1,918**	**1,991**	**2,039**	**2,056**	**2,142**	**2,241**
Current expenditure	**1,396**	**1,510**	**1,520**	**1,641**	**1,698**	**1,705**	**1,790**	**1,878**
Wages and salaries	580	582	585	622	646	675	706	739
Goods and services	265	313	352	368	365	355	372	389
Interest payments	178	197	191	184	203	221	237	254
Subsidies and transfers	373	419	392	467	483	453	474	496
Current balance	**-93**	**-69**	**-84**	**-131**	**-111**	**-40**	**-47**	**-53**
Capital expenditure	**251**	**279**	**398**	**350**	**341**	**351**	**352**	**363**
Capital formation	162	206	245	230	221	231	232	243
Capital transfers and net lending	89	73	152	120	120	120	120	120
Overall balance	**-345**	**-348**	**-463**	**-481**	**-452**	**-391**	**-399**	**-416**
Financing	**345**	**348**	**463**	**481**	**452**	**391**	**399**	**416**
Foreign financing	286	48	67	95	94	94	91	88
Domestic financing 2/	54	299	396	386	358	297	308	328
Memorandum items:								
Primary balance	-166	-151	-273	-297	-249	-170	-161	-162
Central government debt	3,401	3,553	3,900	4,381	4,833	5,224	5,623	6,039

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

1/ Fiscal year ends June 30.
2/ Includes statistical discrepancy.

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

(In percent of GDP)

	FY09/10	FY10/11	Prel. FY11/12	Staff Projections FY12/13	FY13/14	FY14/15	FY15/16	FY16/17
Revenue and grants	**16.8**	**18.5**	**18.4**	**18.5**	**18.7**	**18.7**	**18.8**	**18.8**
Tax revenue	14.3	16.8	16.3	16.7	17.0	17.1	17.2	17.2
Taxes on international trade	7.3	8.2	9.0	9.2	9.3	9.4	9.4	9.4
Tourism taxes	1.2	1.9	1.8	1.9	1.8	1.9	1.9	1.9
Miscellaneous taxes	5.0	6.6	5.4	5.7	5.8	5.8	5.9	5.9
Other	0.8	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Nontax revenue	2.5	1.7	1.9	1.7	1.7	1.6	1.6	1.6
Total expenditure	**21.3**	**23.0**	**24.2**	**24.3**	**24.0**	**23.1**	**23.0**	**23.0**
Current expenditure	**18.0**	**19.4**	**19.2**	**20.1**	**20.0**	**19.2**	**19.3**	**19.3**
Wages and salaries	7.5	7.5	7.4	7.6	7.6	7.6	7.6	7.6
Goods and services	3.4	4.0	4.5	4.5	4.3	4.0	4.0	4.0
Interest payments	2.3	2.5	2.4	2.3	2.4	2.5	2.6	2.6
Subsidies and transfers	4.8	5.4	5.0	5.7	5.7	5.1	5.1	5.1
Current balance	**-1.2**	**-0.9**	**-1.1**	**-1.6**	**-1.3**	**-0.5**	**-0.5**	**-0.5**
Capital expenditure	**3.2**	**3.6**	**5.0**	**4.3**	**4.0**	**4.0**	**3.8**	**3.7**
Capital formation	2.1	2.7	3.1	2.8	2.6	2.6	2.5	2.5
Capital transfers and net lending	1.2	0.9	1.9	1.5	1.4	1.4	1.3	1.2
Overall balance	**-4.4**	**-4.5**	**-5.9**	**-5.9**	**-5.3**	**-4.4**	**-4.3**	**-4.3**
Financing	**4.4**	**4.5**	**5.9**	**5.9**	**5.3**	**4.4**	**4.3**	**4.3**
Foreign financing	3.7	0.6	0.9	1.2	1.1	1.1	1.0	0.9
Domestic financing 2/	0.7	3.8	5.0	4.7	4.2	3.3	3.3	3.4
Memorandum items:								
Primary balance	-2.1	-1.9	-3.4	-3.6	-2.9	-1.9	-1.7	-1.7
Central government debt	43.9	45.7	49.3	53.6	56.9	58.8	60.5	62.1
Nominal GDP (in B$ millions)	7,744	7,779	7,914	8,179	8,500	8,883	9,295	9,726

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

1/ Fiscal year ends on June 30.
2/ Includes statistical discrepancy.

Table 4. The Bahamas: Public Debt

(In percent of GDP) 1/

	2007	2008	2009	2010	2011	2012
Central government debt	**31.7**	**33.5**	**43.0**	**47.9**	**48.9**	**52.5**
External	3.3	4.7	9.1	9.4	10.3	10.2
Domestic	28.4	28.9	33.9	38.5	38.6	42.3
Of which: in foreign currency	0.3	0.0	0.0	0.9	0.0	0.0
Public corporations' debt 2/	**8.7**	**10.5**	**12.0**	**13.5**	**14.1**	**14.4**
External	0.8	0.7	0.8	2.4	2.7	3.6
Domestic	8.0	9.8	11.2	11.1	11.5	10.8
Of which: in foreign currency	3.5	5.0	5.5	5.4	5.5	4.9
Total public sector 2/	**40.4**	**44.1**	**55.0**	**61.4**	**63.0**	**66.9**
External	4.0	5.4	9.9	11.8	12.9	13.9
Domestic	36.4	38.7	45.1	49.6	50.1	53.1
Of which: in foreign currency	3.8	5.1	5.5	6.3	5.5	4.9
Consolidated public sector 2/ 3/	**31.7**	**35.3**	**45.6**	**52.4**	**54.2**	**54.4**
External	4.0	5.4	9.9	11.8	12.9	13.8
Domestic 3/	27.6	30.0	35.7	40.6	41.3	40.5
Of which: in foreign currency	3.5	5.0	5.5	5.4	5.5	4.9

Source: Central Bank of The Bahamas.

1/ End of period. Data for 2012 are for end-June.
2/ Government-guaranteed debt only.
3/ Excludes holdings by public corporations.

Table 5. The Bahamas: Balance of Payments

	2009	2010	2011	Est. 2012	Staff Projections 2013	2014	2015	2016	2017
	(In millions of U.S. dollars)								
Current account balance	**-809**	**-813**	**-1,090**	**-1,134**	**-1,134**	**-1,100**	**-983**	**-903**	**-893**
Goods (trade balance)	**-1,825**	**-1,888**	**-2,131**	**-2,367**	**-2,491**	**-2,598**	**-2,633**	**-2,669**	**-2,744**
Domestic exports	466	459	511	526	542	562	586	611	638
Domestic imports	-2,278	-2,332	-2,624	-2,874	-3,014	-3,140	-3,197	-3,258	-3,358
Oil	-423	-453	-482	-510	-523	-512	-510	-505	-505
Capital goods	-513	-758	-850	-1,025	-1,085	-1,130	-1,060	-1,030	-1,015
Other domestic imports	-1,342	-1,122	-1,292	-1,340	-1,406	-1,498	-1,627	-1,723	-1,837
Other net exports	-13	-15	-19	-19	-20	-21	-22	-23	-24
Services	**1,155**	**1,312**	**1,314**	**1,468**	**1,592**	**1,734**	**1,881**	**2,019**	**2,124**
Travel (net)	1,774	1,919	2,008	2,180	2,343	2,461	2,672	2,846	3,003
Travel (credit)	2,014	2,147	2,254	2,437	2,613	2,743	2,965	3,153	3,325
Travel (debit)	-240	-228	-246	-258	-270	-281	-294	-307	-321
Other services	-619	-607	-694	-712	-751	-727	-790	-827	-879
Of which:									
Construction services (net)	-21	-16	-163	-171	-176	-112	-111	-104	-102
Offshore companies local expenditure (net)	182	158	139	144	150	157	164	173	181
Income and transfers	**-139**	**-238**	**-272**	**-234**	**-236**	**-236**	**-231**	**-252**	**-273**
Capital and financial account	**1,115**	**1,141**	**952**	**1,078**	**1,161**	**1,129**	**1,043**	**970**	**940**
Capital transfers	-7	-4	-6	-6	-6	-6	-6	-7	-7
Long-term public sector 1/	504	148	94	37	138	88	30	84	98
Commercial banks' NFA	-22	24	-101	0	0	0	0	0	0
Foreign direct investment	664	872	667	705	728	748	741	694	677
Other private capital	-24	101	299	341	301	299	278	198	172
Overall balance	253	45	24	-56	27	29	60	67	48
Change in net international reserves (increase -)	**-253**	**-45**	**-24**	**56**	**-27**	**-29**	**-60**	**-67**	**-48**
	(In percent of GDP)								
Current account balance	**-10.5**	**-10.5**	**-14.0**	**-14.1**	**-13.6**	**-12.7**	**-10.8**	**-9.5**	**-9.0**
Goods (trade balance)	**-23.6**	**-24.3**	**-27.4**	**-29.4**	**-29.9**	**-29.9**	**-29.0**	**-28.1**	**-27.6**
Domestic exports	6.0	5.9	6.6	6.5	6.5	6.5	6.4	6.4	6.4
Domestic imports	-29.5	-30.0	-33.7	-35.8	-36.2	-36.2	-35.2	-34.3	-33.8
Oil	-5.5	-5.8	-6.2	-6.3	-6.3	-5.9	-5.6	-5.3	-5.1
Capital goods	-6.6	-9.7	-10.9	-12.7	-13.0	-13.0	-11.7	-10.8	-10.2
Other domestic imports	-17.4	-14.4	-16.6	-16.7	-16.9	-17.3	-17.9	-18.1	-18.5
Other net exports	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Services	**15.0**	**16.9**	**16.9**	**18.3**	**19.1**	**20.0**	**20.7**	**21.2**	**21.4**
Travel (net)	23.0	24.7	25.8	27.1	28.2	28.4	29.4	29.9	30.2
Travel (credit)	26.1	27.6	28.9	30.3	31.4	31.6	32.6	33.2	33.4
Travel (debit)	-3.1	-2.9	-3.2	-3.2	-3.2	-3.2	-3.2	-3.2	-3.2
Other services	-8.0	-7.8	-8.9	-8.9	-9.0	-8.4	-8.7	-8.7	-8.8
Income and transfers	**-1.8**	**-3.1**	**-3.5**	**-2.9**	**-2.8**	**-2.7**	**-2.5**	**-2.7**	**-2.7**
Capital and financial account	**14.4**	**14.7**	**12.2**	**13.4**	**14.0**	**13.0**	**11.5**	**10.2**	**9.5**
Capital transfers	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Long-term public sector 1/	6.5	1.9	1.2	0.5	1.7	1.0	0.3	0.9	1.0
Commercial banks' NFA	-0.3	0.3	-1.3	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment	8.6	11.2	8.6	8.8	8.8	8.6	8.2	7.3	6.8
Other private capital 2/	-0.3	1.3	3.8	4.2	3.6	3.4	3.1	2.1	1.7
Overall balance	**3.3**	**0.6**	**0.3**	**-0.7**	**0.3**	**0.3**	**0.7**	**0.7**	**0.5**
Change in net international reserves (increase -)	**-3.3**	**-0.6**	**-0.3**	**0.7**	**-0.3**	**-0.3**	**-0.7**	**-0.7**	**-0.5**
Memorandum items:									
Gross international reserves (in millions of US dollars)	816	860	885	829	855	885	944	1,012	1,060
Nominal GDP (millions of U.S. dollars)	7,717	7,771	7,788	8,040	8,318	8,682	9,084	9,505	9,946

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

1/ Includes SDR allocation in September 2009.

2/ Includes errors and omissions.

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

			Est.	Staff Projections	
	2010	2011	2012	2013	2014
(In millions of Bahamian dollars, end of period)					
Central Bank					
Gross international reserves	860	885	829	855	885
Net domestic assets	-35	-4	97	128	170
Credit to nonfinancial public sector (net)	255	292	393	424	466
Of which: Central Government	260	289	313	336	357
Other	-290	-296	-296	-296	-296
Reserve money	826	881	925	984	1,054
Currency held by the private sector	195	197	207	220	236
Liabilities with financial institutions	631	684	719	764	819
Financial system					
Net foreign assets	152	281	225	251	281
Of which :					
Held by commercial banks and OFIs	-708	-604	-604	-604	-604
Net domestic assets	6,039	6,030	6,402	6,791	7,269
Credit to nonfinancial public sector, net	1,437	1,493	1,635	1,784	1,932
Of which: Central Government	1,414	1,439	1,581	1,730	1,878
Credit to private sector	6,573	6,648	6,705	6,848	7,086
Other	-1,970	-2,111	-1,938	-1,841	-1,749
Liabilities to the private sector (broad money)	6,191	6,310	6,627	7,042	7,550
Money	1,335	1,435	1,507	1,601	1,717
Currency	195	197	207	220	236
Demand deposits	1,141	1,238	1,300	1,381	1,481
Quasi-money	4,856	4,876	5,120	5,441	5,833
(Change in percent of liabilities to the private sector at the beginning of the period)					
Net foreign assets	0.3	2.1	-0.9	0.4	0.4
Net domestic assets	2.3	-0.2	5.9	5.9	6.8
Credit to nonfinancial public sector	6.5	0.9	2.2	2.3	2.1
Credit to private sector	-0.4	1.2	0.9	2.2	3.4
Liabilities to private sector	2.6	1.9	5.0	6.3	7.2
Money	0.9	1.6	1.1	1.4	1.6
Quasi-money	1.8	0.3	3.9	4.8	5.6
(Annual percentage change)					
Net domestic assets	2.4	-0.2	6.2	6.1	7.0
Credit to nonfinancial public sector	37.5	4.0	9.5	9.1	8.3
Credit to private sector	-0.4	1.1	0.9	2.1	3.5
Liabilities to private sector	2.6	1.9	5.0	6.3	7.2
Money	4.0	7.5	5.0	6.3	7.2
Quasi-money	2.3	0.4	5.0	6.3	7.2

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

Table 7. The Bahamas: Indicators of External and Financial Vulnerability1

	2007	2008	2009	2010	2011
Financial indicators					
Broad money (12-month percentage change)	9.6	5.1	1.8	2.6	1.9
Private sector credit (12-month percentage change)	9.7	5.1	0.9	-0.4	1.1
Three-month treasury-bill rate (end of period)	3.0	2.7	2.6	2.3	1.3
Domestic public debt (in percent of GDP, end of period)	36.4	38.7	45.1	49.6	50.1
External indicators					
Exports of goods and services (12-month percentage change)	21.8	0.9	-20.4	4.4	7.6
Imports of goods and services (12-month percentage change)	4.6	1.5	-18.9	1.1	12.9
Current account balance (in percent of GDP)	-11.5	-10.6	-10.5	-10.5	-14.0
Capital account balance (in percent of GDP) 1/	12.8	14.7	14.4	14.7	12.2
Gross international reserves (end of period, millions of US$)	449	563	816	860	885
In months of merchandise imports	1.8	2.1	3.9	4.0	3.6
In months of next year's imports of goods and services	1.2	1.8	2.6	2.4	2.3
In months of next year's non-FDI related G&S imports	2.0	3.2	4.9	4.5	4.5
In percent of reserve money	66.8	87.3	117.5	104.2	100.4
In percent of broad money	8.0	9.5	13.5	13.9	14.0
Commercial banks, net foreign assets (end of period, millions of US$)	-704	-704	-682	-708	-604
External public debt (in percent of GDP)	4.0	5.4	9.9	11.8	12.9
External debt service (in percent of exports of goods and services)	6.0	6.0	24.7	11.2	8.1
Central government external debt service (in percent of government revenue)	3.7	3.4	20.4	4.5	8.1
REER appreciation (+) (end of period)	-3.9	13.0	-5.6	1.5	1.5
Banking sector risk indicators					
Foreign currency deposits, percent of total deposits	3.7	3.5	4.0	3.7	3.3
Deposits maturing within 3 months, percent of total deposits	20.7	19.7	21.5	20.9	25.2
Capital to risk-weighted assets ratio, percent	24.9	23.5	26.1	25.5	25.5
Nonperforming loans to total loans ratio, percent	4.3	6.1	9.3	11.9	12.7
Provisions to total loans ratio, percent	47.9	46.0	37.1	36.6	36.8
Pre-tax net revenue, percent of net worth	18.6	14.8	10.2	9.7	9.5
Administrative expenses, percent of total assets	3.1	3.3	3.2	3.4	3.5
Liquid assets to deposits ratio, percent	23.3	25.1	30.0	36.1	38.3
Average interest rate spread, percent	6.9	7.0	6.8	7.6	8.3

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

1/ Includes errors and omissions.

Table 8. The Bahamas: Public Sector Debt Sustainability Framework, 2007–2017

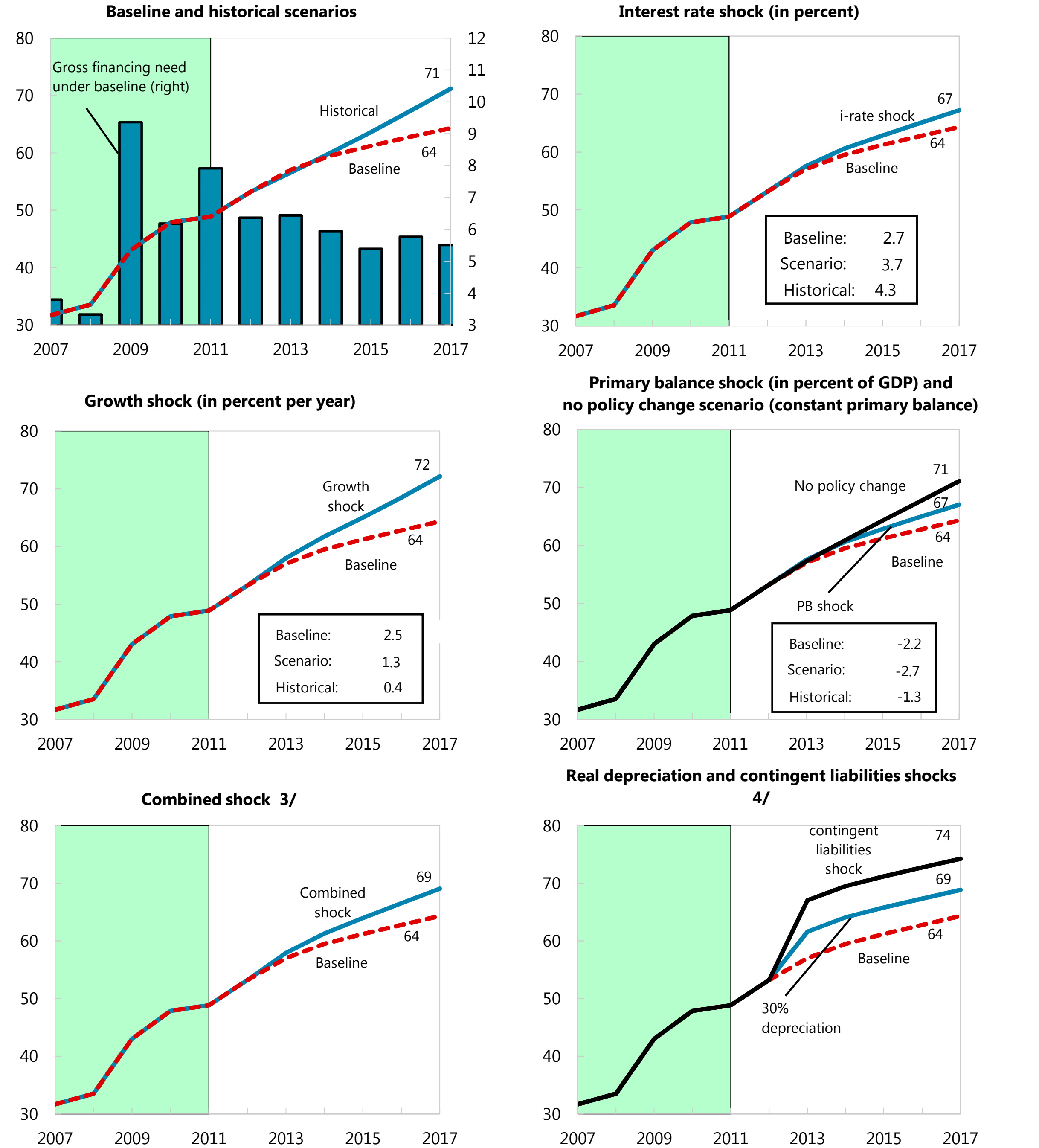
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	31.7	33.5	43.0	47.9	48.9	**53.2**	**57.0**	**59.5**	**61.2**	**62.8**	**64.3**	**-0.1**
o/w foreign-currency denominated	3.6	4.7	9.1	10.3	9.9	10.1	10.1	10.0	9.9	9.8	9.6	
Change in public sector debt	1.8	1.9	9.5	4.8	1.0	4.3	3.8	2.5	1.7	1.6	1.5	
Identified debt-creating flows (4+7+12)	1.4	2.5	7.5	4.5	2.4	4.3	3.8	2.5	1.7	1.6	1.5	
Primary deficit	1.0	0.4	3.1	2.4	2.7	3.5	3.3	2.4	1.8	1.7	1.7	
Revenue and grants	16.0	17.4	17.3	16.1	18.6	18.4	18.6	18.7	18.8	18.8	18.8	
Primary (noninterest) expenditure	17.0	17.9	20.4	18.5	21.3	22.0	21.9	21.1	20.6	20.5	20.4	
Automatic debt dynamics 2/	0.4	2.1	4.4	2.2	2.4	0.8	0.5	0.1	-0.1	-0.1	-0.1	
Contribution from interest rate/growth differential 3/	0.4	2.1	4.4	2.2	2.4	0.8	0.5	0.1	-0.1	-0.1	-0.1	
Of which contribution from real interest rate	0.8	1.3	2.7	2.2	3.2	2.0	1.9	1.4	1.3	1.3	1.4	
Of which contribution from real GDP growth	-0.4	0.7	1.7	-0.1	-0.8	-1.2	-1.4	-1.4	-1.4	-1.5	-1.5	
Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	-2.7	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	-2.7	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	0.3	-0.7	2.0	0.3	-1.4	0.0	0.0	0.0	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	198.0	192.7	249.3	297.1	262.8	288.6	306.4	317.8	326.4	334.5	342.8	
Gross financing need 6/	3.8	3.3	9.4	6.2	7.9	6.4	6.4	5.9	5.4	5.8	5.5	
in billions of U.S. dollars	316.0	274.5	722.1	480.2	616.0	512.0	535.2	516.2	489.9	548.1	547.5	
Scenario with key variables at their historical averages 7/						**53.2**	**56.6**	**60.0**	**63.6**	**67.3**	**71.2**	**2.7**
Scenario with no policy change (constant primary balance) in 2012-2017						**53.2**	**57.3**	**60.9**	**64.3**	**67.7**	**71.1**	**-0.2**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	1.3	-2.3	-4.9	0.2	1.6	2.5	2.7	2.5	2.5	2.5	2.5	
Average nominal interest rate on public debt (in percent) 8/	5.7	5.7	5.9	5.8	5.2	4.9	4.5	4.5	4.4	4.4	4.4	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	2.8	4.2	7.5	5.2	6.6	4.2	3.8	2.6	2.4	2.3	2.3	
Nominal appreciation (increase in US dollar value of local currency, in percent)	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	2.9	1.5	-1.6	0.5	-1.4	0.7	0.7	1.8	2.1	2.1	2.1	
Growth of real primary spending (deflated by GDP deflator, in percent)	8.3	2.4	8.6	-9.1	17.1	5.7	2.3	-1.1	-0.2	2.0	2.2	
Primary deficit	1.0	0.4	3.1	2.4	2.7	3.5	3.3	2.4	1.8	1.7	1.7	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
9/ 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.

Figure 4. The Bahamas: Public Debt Sustainability: Bound Tests 1/ 2/

(Public debt in percent of GDP)



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

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

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

4/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP

Table 9. The Bahamas: External Debt Sustainability Framework, 2007–2017

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2007	2008	2009	2010	2011			2012	2013	2014	2015	2016	2017	Debt-stabilizing non-interest current account 6/
Baseline: External debt	**4.0**	**5.4**	**9.9**	**11.8**	**12.9**			**12.8**	**14.1**	**14.5**	**14.2**	**14.4**	**14.8**	**-6.8**
Change in external debt	-0.1	1.3	4.6	1.8	1.2			-0.1	1.2	0.4	-0.3	0.3	0.3	
Identified external debt-creating flows (4+8+9)	2.3	0.2	2.2	-0.8	5.4			5.0	4.5	3.7	2.3	1.9	1.8	
Current account deficit, excluding interest payments	11.2	10.3	10.1	9.8	13.4			13.3	12.8	11.9	10.1	8.8	8.3	
Deficit in balance of goods and services	8.7	9.2	8.7	7.4	10.5			11.2	10.8	9.9	8.3	6.8	6.2	
Exports	45.8	46.6	39.7	41.1	44.2			45.6	46.6	46.5	47.3	47.6	47.7	
Imports	54.5	55.8	48.4	48.5	54.7			56.8	57.4	56.4	55.6	54.4	53.9	
Net non-debt creating capital inflows (negative)	-9.0	-10.4	-8.6	-11.2	-8.6			-8.8	-8.8	-8.6	-8.2	-7.3	-6.8	
Automatic debt dynamics 1/	0.1	0.3	0.7	0.6	0.6			0.5	0.5	0.5	0.4	0.4	0.3	
Contribution from nominal interest rate	0.2	0.3	0.4	0.6	0.6			0.8	0.9	0.8	0.8	0.7	0.7	
Contribution from real GDP growth	-0.1	0.1	0.3	0.0	-0.2			-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	
Contribution from price and exchange rate changes 2/	-0.1	-0.1	0.1	-0.1	0.2			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-2.5	1.1	2.3	2.7	-4.3			-5.1	-3.3	-3.3	-2.6	-1.6	-1.5	
External debt-to-exports ratio (in percent)	8.8	11.5	25.0	28.6	29.3			28.1	30.2	31.2	30.0	30.3	31.0	
Gross external financing need (in billions of US dollars) 4/	**1.0**	**0.9**	**0.9**	**0.9**	**1.1**			**1.1**	**1.2**	**1.1**	**1.0**	**0.9**	**0.9**	
in percent of GDP	11.9	10.8	11.2	11.5	14.2			14.3	14.1	12.8	11.0	9.7	9.2	
Scenario with key variables at their historical averages 5/						10-Year Historical Average	10-Year Standard Deviation	**12.8**	**11.7**	**10.6**	**10.2**	**10.8**	**11.5**	**-7.2**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	1.4	-2.3	-4.9	0.2	1.6	0.4	2.6	2.5	2.7	2.5	2.5	2.5	2.5	
GDP deflator in US dollars (change in percent)	2.9	1.5	-1.6	0.5	-1.4	1.4	2.1	0.7	0.7	1.8	2.1	2.1	2.1	
Nominal external interest rate (in percent)	6.0	6.8	6.2	6.4	5.1	6.1	0.5	6.8	6.9	6.0	5.6	5.4	5.0	
Growth of exports (US dollar terms, in percent)	21.8	0.9	-20.4	4.4	7.6	5.0	10.7	6.6	5.8	4.0	6.5	5.3	4.8	
Growth of imports (US dollar terms, in percent)	4.6	1.5	-18.9	1.1	12.9	5.2	11.7	7.3	4.6	2.5	3.0	2.5	3.6	
Current account balance, excluding interest payments	-11.2	-10.3	-10.1	-9.8	-13.4	-9.3	4.5	-13.3	-12.8	-11.9	-10.1	-8.8	-8.3	
Net non-debt creating capital inflows	9.0	10.4	8.6	11.2	8.6	7.7	2.7	8.8	8.8	8.6	8.2	7.3	6.8	

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

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

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

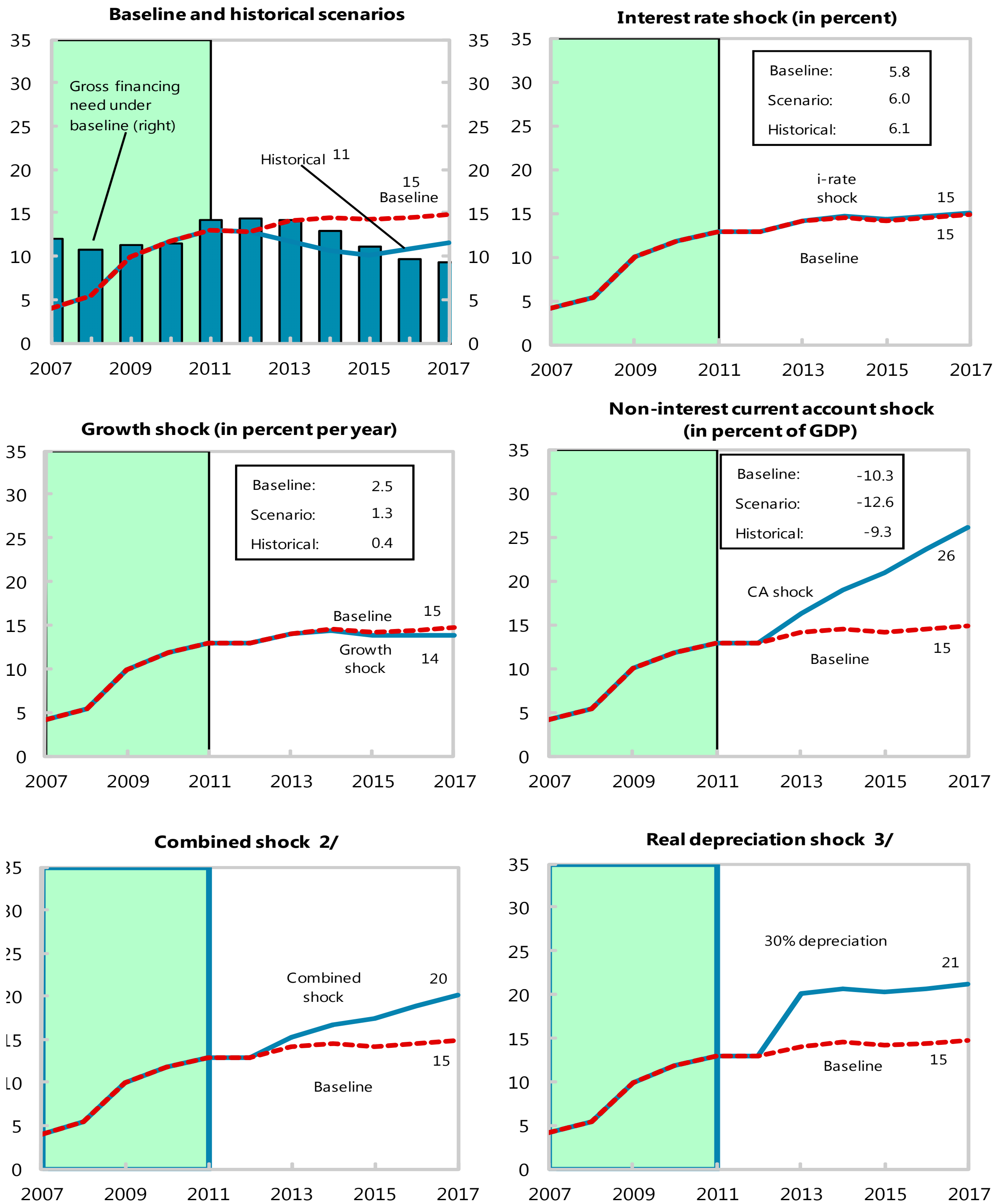
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

Figure 5. The Bahamas: External Debt Sustainability: Bound Tests 1/

(External debt, in percent of GDP)



Sources: International Monetary Fund, Country desk data, and Fund staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2010.

Appendix I: Illustrative Scenario for Fiscal Consolidation

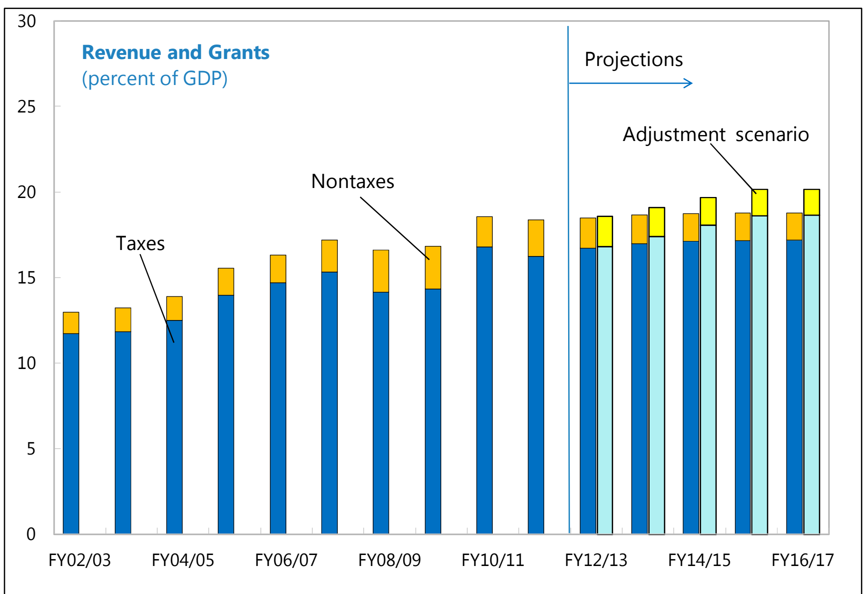
A feasible scenario for placing public debt on a sustainable downward trajectory is illustrated. It raises revenues and reins in non-interest current spending, while preserving fiscal space for important investments in infrastructure and human capital.

Revenue measures

While the focus in the short-to-medium term would be on tax revenue, nontax revenue could be improved in the long run, once the financial health of state-owned enterprises has been strengthened and they become profitable. It is therefore assumed that tax collections would be enhanced by about 1½ percentage points of GDP over the next 5 years (i.e., relative to the baseline scenario in FY 2016/17) by:

- Adjusting current tax rates (such as on taxes on tourism or excises); and
- Introducing new tax sources, possibly through a new income/corporate tax or a broad-based consumption tax (such as a VAT).

These illustrative projections also assume that the introduction of new revenue measures (or improving tax administration) would required 2–3 years to be fully effective.



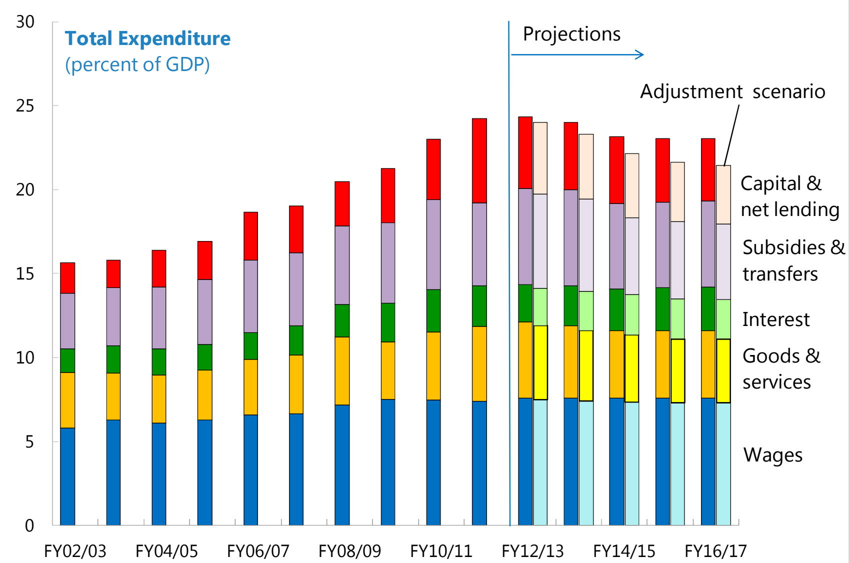
Sources: The Bahamian authorities, and IMF staff estimates and projections.

Expenditure measures

Discretionary spending could be reduced by about 1⅓ percentage points of GDP relative to the levels in FY 2016/17. These savings could come from:

- wages (0.3percent of GDP);
- goods and services (0.2 percent); as well as
- transfers and subsidies (0.6 percent) and net lending (0.2 percent), as a result of efficiency gains in the operations of state-owned enterprises through better management and appropriate tariff adjustments.

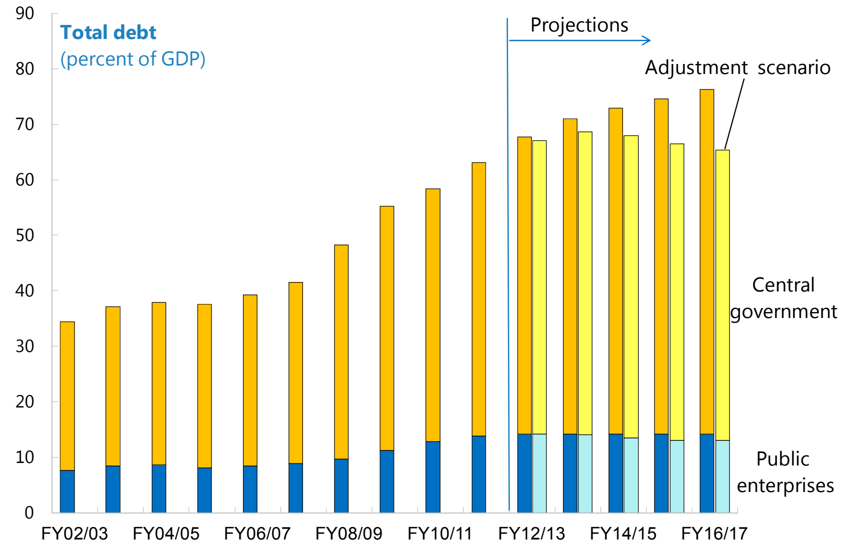
An additional ¼ percent of GDP could be saved in interest rate payments, from an improvement in the debt dynamics (i.e., lower debt stock and lower interest rates).



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

Debt

If these or similar measures are introduced at an early stage, legislated, and implemented with determination, the illustrative projections suggest that the growth of total debt would be slowed substantially. Thus, rather than steadily increasing through FY 2016/17 to over 62 percent of GDP, the central government debt would peak in FY 2014/15 at about 54½ percent of GDP and thereafter decline gradually to about 52½ percent of GDP at end-FY 2016/17 (almost 10 percentage points of GDP lower than under the baseline scenario). In this context, it is also assumed that by the end of the projection period the stock of debt at the public enterprises would decline by about one percentage point of GDP, mainly through efficiency gains. Accordingly, total debt in FY 2016/17 would be about 11 percent of GDP lower than under the baseline scenario.

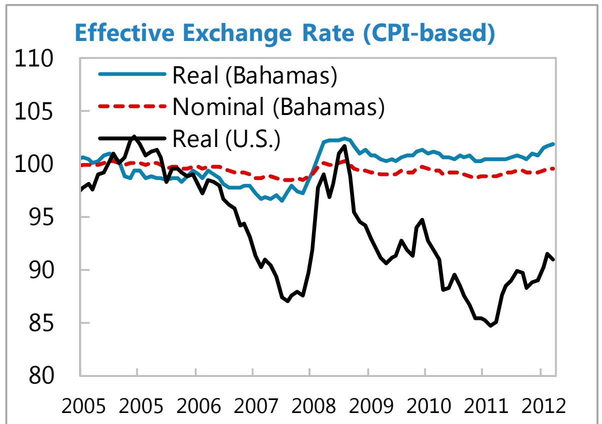


Sources: The Bahamian authorities, and IMF staff estimates and projections.

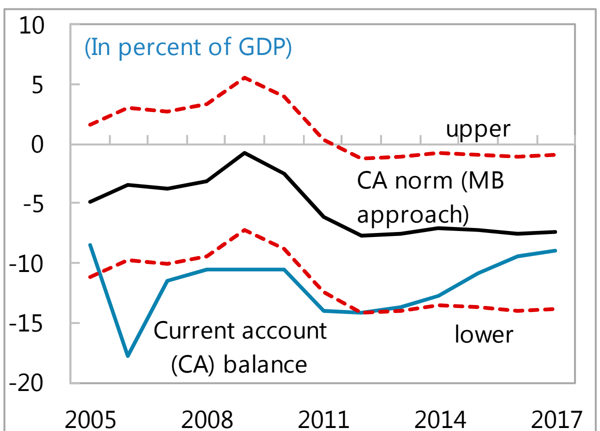
Appendix II: External Stability and Competitiveness Assessment

The real effective exchange rate has remained stable and CGER-type analyses suggest that The Bahamas' exchange rate has remained in line with fundamentals. Near-term current account deficits are high, mainly due to imports for FDI-related projects, but projected to stabilize over the medium term. The Bahamian dollar remains competitive when compared with the currencies of other tourism-intensive economies in the Caribbean. Nevertheless, the global competition is increasing in the tourism industry, and The Bahamas will need to overcome its specific challenges of high access cost to the Family Islands, inefficient delivery of utilities, and high dependence on U.S. economy.

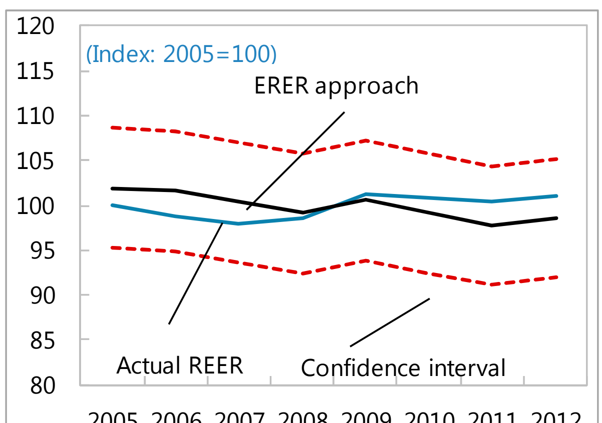
Based on the staff's current account projections, The Bahamas' exchange rate remains in line with medium-term fundamentals. The peg to the U.S. dollar has fostered strong linkages with the United States economy, and contributed to relatively low inflation. As a result, both the nominal and real effective exchange rates (NEER and REER) have remained stable. The CGER-type analyses also suggest that the exchange rate has not deviated substantially from its equilibrium level. Estimates from the macro-balance (MB) approach suggest that the projected medium-term current account deficit for The Bahamas is close to the estimated current account "norm," while the equilibrium real exchange rate (ERER) approach suggests that the current level of the REER is broadly in line with fundamentals.



Source: IMF staff estimates.

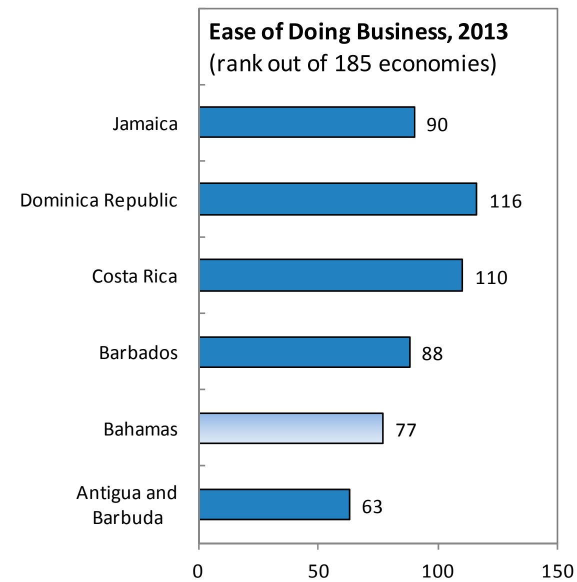


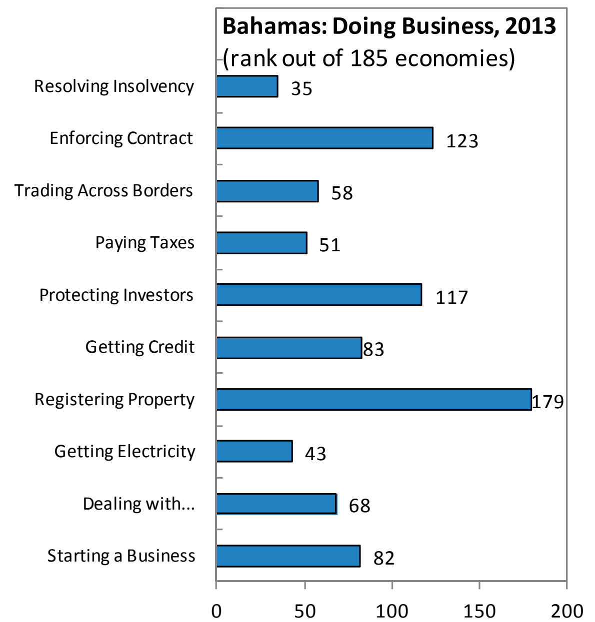
Sources: IMF staff estimates and projections.



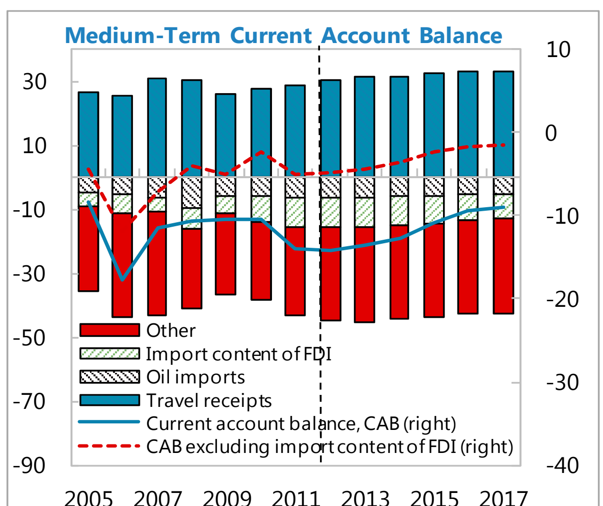
Source: IMF staff estimates.

Non-price measures suggest room for improving competitiveness. The Bahamas' standing in the World Bank's *Doing Business Index* (DBI) has weakened—it ranked 77th out of 185 countries in the 2013 report, down from a ranking of 71st in 2012. The report attributed the lower ranking mainly to deteriorations in the ease of *Starting a Business* and *Dealing with Construction Permits*. The ranking placed The Bahamas 6th amongst the Caribbean countries surveyed, after St. Lucia, Antigua and Barbuda, Dominica, Trinidad and Tobago, and St. Vincent and the Grenadines. The Bahamas visibly underperformed in *Registering Property*, *Enforcing Contracts*, and *Protecting Investors*.





The external current account is projected to stabilize over the medium term. Widened current account deficits (outside of the confidence interval for the CA norm) in the recent years reflect a number of factors, including the shock from the global crisis, weak recovery of U.S. economy, and need for more diversification. While the near-term current account deficits are substantial, a significant part of imports relate to the large Baha Mar and other public investment projects. These FDI-financed imports mirror the construction phase of these outsized transformative projects and are not projected to continue at those levels after the completion of the projects. A modest reduction in the current account deficit is thus expected under the baseline projection, with imports of goods and services tapering off over the

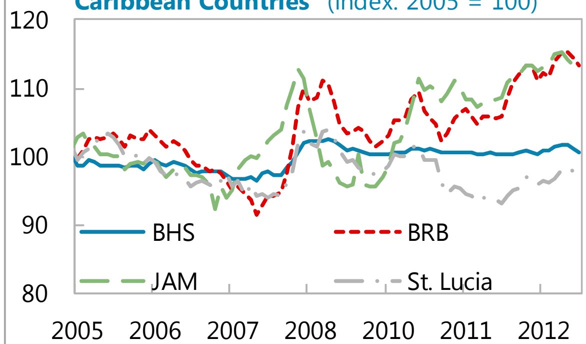


Sources: IMF staff estimates and projections.

medium term to a more normal pattern, and exports benefiting from a pickup in tourism services starting in 2015 when the Baha Mar Resort opens.

The Bahamian dollar remains competitive when compared with the currencies of other tourism-intensive economies in the Caribbean. Its REER has remained at a stable level while some competitors (e.g., Barbados and Jamaica) have seen the real value of their currencies appreciate markedly in the recent years. The stability of the Bahamian dollar has been supported by a track record of prudent macroeconomic policies, comparatively low levels of government debt, and close linkages with the U.S. economy. In addition, compared with regional peers, The Bahamian inflation rate has been low historically, averaging around 2½ percent over the past 10 years.

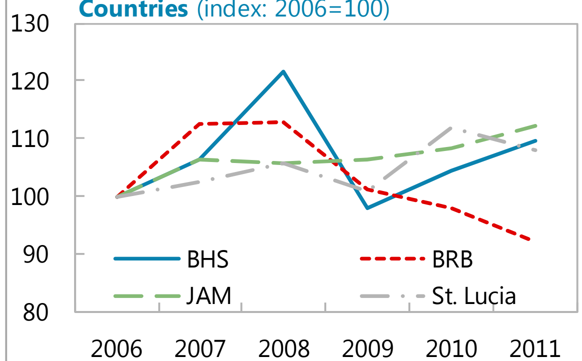
Real Effective Exchange Rate of Selected Caribbean Countries (index: 2005 = 100)



Sources: Country authorities, and IMF staff estimates.

The recent performance of the tourism sector suggests that The Bahamas has maintained competitiveness in that sector compared to its regional peers. The Bahamas has benefited from its close proximity to the United States, the strong brand recognition of the Atlantis Resort, and the country's position as one of the largest cruise ship destinations in the world. While The Bahamas experienced a large drop in tourism receipts in the wake of the global financial crisis, it also achieved a much stronger recovery thereafter, compared to its peers, underscored by continuing strong inflows of tourism-related FDI.

Tourism Receipts of Selected Caribbean Countries (index: 2006=100)



Sources: Country authorities, and IMF staff estimates.

The Bahamas still needs to face rising competition at the global level, as well as overcome its specific challenges. Air access to The Bahamas, particularly the Family Islands, is quite expensive, despite its proximity to the United States. Further, operating expenses for tourist resorts are quite high, because of their remoteness and the high cost of delivery of utilities, especially electricity. To mitigate these challenges, policy is focused on promoting tourism in The Bahamas as a high-end, unique, but differentiated experience, providing support for projects on Nassau and Paradise Island, redeveloping Grand Bahama Island and repositioning its brand name, and enhancing awareness of the Family Islands through well-targeted marketing campaigns.

INTERNATIONAL MONETARY FUND

THE BAHAMAS

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 18, 2013

Prepared by

Western Hemisphere Department
(In consultation with other departments)

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FUND RELATIONS

(As of October 31, 2012)

Membership Status:
Joined August 21, 1973; Article VIII

General Resources Account:

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

SDR Department:

	SDR Millions	Percent of Quota
Net cumulative allocation	124.41	100.00
Holdings	114.13	92.03

Outstanding Purchases and Loans: None

Latest Financial Arrangements: None

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

			Forthcoming		
	2012	**2013**	**2014**	**2015**	**2016**
Principal					
Charges/ Interest	0.00	0.01	0.01	0.01	0.01
Total	**0.00**	**0.01**	**0.01**	**0.01**	**0.01**

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

Last Article IV Consultation:
The Bahamas is on a 12-month consultation cycle. The last Article IV consultation was concluded on November 2, 2011.

Technical Assistance

Department	Dates	Purpose
STA	January 2010	Consumer Price Index
STA	January 2010	Export/Import Price Index
CARTAC	March 2010	Macroeconomic Forecasting
STA	May 2010	Consumer Price Index
CARTAC	January 2011	CPI Revision
CARTAC	April 2011	Revenue Mod./Forecasting
CARTAC	May 2011	PFM Reform Action Plan
STA	October 2011	Government Finance Statistics
LEG	February 2012	Central Bank of The Bahamas Act
MCM	February-March 2012	Public Debt Management
STA	June 2012	Quarterly National Accounts
LEG	July 2012	Payment System Laws

Resident Representative: None

FINANCIAL RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

Recent Country Strategy

The current Country Strategy (CS) for 2010–2014 supports the efforts the government of The Bahamas to increase productivity and growth by improving infrastructure and enhancing competitiveness of Small and Medium Enterprises (SMEs). The CS priority areas are: energy, water and sanitation, transport, and SME development. As of October 2012, the Inter-American Development Bank's (IADB) sovereign-guaranteed portfolio had an average age of 1.9 years and had grown from two loans totaling US$113 million in 2010 to eight loans totaling US$333 million. The envelope of US$195 million was exceeded, primarily due to the need to provide countercyclical support to the government's efforts to counteract the economic downturn that was triggered by the international financial crisis. Private sector support has been provided primarily via four multilateral investment fund operations, totaling US$852,764.

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

Based on discussions between the government and the IADB, the bank is in the process of elaborating a new Country Strategy for the period 2013–2017.

Active Loans as of September 30, 2012
(In millions of U.S. dollars)

Project	Name	Approval Date	Approved	Disbursed	Available
BH-L1003	Investing in Students and Programs for the Innovative Reform of Education (INSPIRE)	Nov30, 2005	12.9	7.8	5.1
BH-L1024	Supplementary Financing for New Providence Transport Program	May 22,2008	100.0	97.1	2.9
BH-L1027	Air Transport Reform Program (PBL)	Dec 14, 2011	47.5	15.0	32.5
BH-L1027	Air Transport Reform Program (TC Loan)	Dec 14, 2011	2.5	0.3	2.2
BH-L1028	WSC Support Program—New Providence Water Supply and Sanitation Systems Upgrade	Nov 16, 2011	81.0	6.8	74.2
BH-L1016	Trade Sector Support Program	Jul 18, 2012	16.5	0.0	16.5
BH-L1029	New Providence Transport Program Supplementary Financing II	Sep 04, 2012	65.0	0.0	65.0
BH-L1030	Social Safety Net Reform Program	Jul 18, 2012	7.5	0.0	7.5
Total Loans 8			**333.4**	**127.0**	**205.9**

Net Flow of IADB Convertible Currencies
(In millions of U.S. dollars)

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

STATISTICAL ISSUES

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

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

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

New export-import price indices (XMPI) for goods and major services were developed with technical assistance from CARTAC. Procedures for systematic re-sampling and re-weighting were modified in order to keep the market basket representative of what is being measured. The Bahamas does not compile data on the country's international investment position (IIP).

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

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

The Bahamas: Table of Common Indicators Required for Surveillance

(As of November 30, 2012)

	Date of Latest Observation (mm/yy)	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	Fixed				
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	09/12	11/12	M	M	M
Reserve/Base Money	09/12	11/12	M	M	M
Broad Money	09/12	11/12	M	M	M
Central Bank Balance Sheet	09/12	11/12	M	M	M
Consolidated Balance Sheet of the Banking System	06/12	10/12	M	M	Q
Interest Rates[2]	09/12	11/12	M	M	M
Consumer Price Index	08/12	10/12	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	NA	NA	NA	NA	NA
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	06/12	10/12	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	06/12	10/12	Q	Q	Q
External Current Account Balance	03/12	10/12	Q	Q	Q
Exports and Imports of Goods and Services	03/12	10/12	Q	Q	Q
GDP/GNP	2011	10/12	A	A	A
Gross External Debt	06/12	10/12	Q	Q	Q
International Investment Position[6]	NA	NA	NA	NA	NA

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

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

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

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

[5] Including currency and maturity composition.

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

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

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 13/16
FOR IMMEDIATE RELEASE
February 12, 2013

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

IMF Executive Board Concludes 2012 Article IV Consultation with The Bahamas

On February 4, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with The Bahamas.[1]

Background

Economic activity grew by about 1½ percent of Gross Domestic Product (GDP) in 2011, up from near-zero in 2010, on improved tourism activity and ongoing investment projects, including the large US$3.5 billion private Baha Mar project. However, unemployment remained high at 16 percent, and inflation more than doubled to 3 percent, mainly due to higher world oil prices. The fiscal deficit in FY2011/12 (July to June) is estimated to have increased to about 6 percent of GDP, up from 4½ percent in the previous fiscal year.

Despite higher exports in the wake of the gradual global recovery, the external current account deficit widened in 2011. This is due to higher imports, which reflect a surge in foreign direct investment (FDI)-related imports and high world oil prices. At the same time, large FDI and other private capital inflows helped support gross international reserves, which remained at a modest level of 2.3 months of imports at end-2011. However, measured in terms of non-FDI imports, reserves were much higher at about 4.6 months cover. The real effective exchange rate has remained broadly stable over the past four years.

Looking forward, the outlook foresees stronger growth and a weaker debt position. Real GDP growth of 2½ percent in 2012 is projected to exceed trend growth (2 percent), driven by strong tourism and construction activity. Growth could increase further over the medium term if new projects and trade initiatives materialize. Inflation is likely to stay low—projected at over 2 percent (year on year) at end-2012—but reducing the high level of unemployment will remain a challenge. Pressures are projected to continue from a large external current account deficit and a rising government fiscal deficit. The risks to the outlook, however, are tilted to the downside, given

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[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. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

uncertainty about prospects for the U.S. recovery and global food and fuel prices, and, on the domestic front, about the pace of fiscal consolidation and implementation of structural reforms.

Executive Board Assessment

Executive Directors welcomed the gradual recovery of The Bahamas economy, supported by a rebound in tourism and ongoing investment projects. However, unemployment remains high and the economy faces downside risks from an uncertain external environment, while fiscal and external imbalances have widened. Directors agreed that the main challenge is to strengthen the fiscal and external positions, rebuild macroeconomic buffers, and implement policies to enhance medium-term growth.

Directors emphasized that the key policy priority is to strengthen public finances. They acknowledged the need to balance fiscal consolidation with efforts to support growth and employment. At the same time, they noted that delayed fiscal consolidation could pose risks to long-term debt and external sustainability. Directors, therefore, encouraged the authorities to embark on a credible medium-term strategy to strengthen revenue mobilization and improve tax administration, rationalize expenditure, and place public enterprises on a sound financial footing.

Directors agreed that the fixed exchange rate regime continues to serve the country well. They noted the staff's assessment that the level of the exchange rate remains broadly in line with medium-term macroeconomic fundamentals. Nonetheless, there is room to improve non-price competitiveness and build up buffers. In this regard, Directors welcomed the authorities' commitment to boost foreign exchange reserves and to strengthen competitiveness and the external position.

Directors welcomed the authorities' growth strategy, and looked forward to sustained implementation. They emphasized the importance of measures to improve the business environment, develop infrastructure, enhance human capital, and promote economic diversification.

Directors welcomed the finding of the Financial Sector Stability Assessment that there are no immediate threats to financial stability. Stress tests indicate that the onshore banks can withstand severe shocks to solvency and liquidity. Directors encouraged the authorities to strengthen the monitoring of credit risk in light of high nonperforming loan ratios. They noted that financial system oversight has strengthened, and encouraged the authorities to compile and disseminate more information regarding the offshore financial sector. They looked forward to continued improvements in the crisis management and financial safety net framework.

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

			Est.	Proj.	
	2010	2011	2012	2013	2014
(Annual percentage changes, unless otherwise indicated)					
Real sector 1/					
Real GDP	0.2	1.6	2.5	2.7	2.5
Nominal GDP	0.7	0.2	3.2	3.5	4.4
Consumer price index (annual average)	1.3	3.2	2.3	2.0	2.0
Consumer price index (end of period)	1.5	3.2	2.3	2.0	2.0
Unemployment rate (in percent) 2/	…	15.9	14.7	…	…
Financial sector					
Credit to the nonfinancial public sector	37.5	4.0	9.5	9.1	8.3
Credit to the private sector	-0.4	1.1	0.9	2.1	3.5
Liabilities to the private sector	2.6	1.9	5.0	6.3	7.2
External sector					
Exports of goods and services	4.4	7.6	6.6	5.8	4.0
Of which: Travel receipts (gross)	6.6	5.0	8.1	7.2	5.0
Imports of goods and services	1.1	12.9	7.3	4.6	2.5
(In percent of GDP, unless otherwise indicated)					
Central government 3/					
Revenue and grants	16.8	18.5	18.4	18.5	18.7
Current expenditure	18.0	19.4	19.2	20.1	20.0
Capital expenditure and net lending	3.2	3.6	5.0	4.3	4.0
Primary balance	-2.1	-1.9	-3.4	-3.6	-2.9
Overall balance	-4.4	-4.5	-5.9	-5.9	-5.3
Central government debt	43.9	45.7	49.3	53.6	56.9
External sector 4/					
Current account balance	-10.5	-14.0	-14.1	-13.6	-12.7
Change in net international reserves					
(increase -)	-0.6	-0.3	0.7	-0.3	-0.3
External public debt (end of period)	11.8	12.9	12.8	14.1	14.5
Memorandum items: 4/					
Gross international reserves					
(end of period; millions of U.S. dollars)	860	885	829	855	884.8
In months of next year's G&S imports	2.4	2.3	2.1	2.1	2.1
In months of next year's non-FDI related G&S imports	4.5	4.5	4.0	4.0	3.9
In percent of reserve money	104	100	90	87	84
External debt-service ratio (in percent of exports of G&S)	11.2	8.1	7.5	5.9	4.8
GDP (in millions of Bahamian dollars)	7,771	7,788	8,040	8,318	8,682

Sources: Central Bank of The Bahamas; Department of Statistics; Ministry of Finance; UNDP Human Development Report; CIA World Factbook and IMF staff projections.
1/ Revised national accounts data.
2/ The 2011 figure is based on November survey and the 2012 figure is based on May survey.
3/ The data refer to fiscal years ending on June 30.
4/ The data refer to calendar years.

Statement by Thomas Hockin, Executive Director for The Bahamas
and Carlos Alberto de Resende, Alternate Executive Director
February 4, 2013

On behalf of our Bahamian authorities, we continue to appreciate the policy discussions with the Fund. We welcome the thorough and balanced assessment of the country's economic situation and financial system made by the Article IV and FSAP mission. We are particularly satisfied with the recognition of the country's strong bank supervision framework and that risks to financial stability are minimal.

Although we broadly agree with the staff's assessment of the medium-term challenges facing the authorities, we emphasize the need for a balanced approach between fiscal sustainability and policies to foster inclusive growth and diversification of the economy. This is particularly important in light of the high unemployment rate and the high-cost infrastructural development that is typical of economies based in geographically dispersed archipelagos, such as The Bahamas.

The report outlines a sensible set of policy options, mostly in tune with initiatives already being implemented or in the process of being implemented by the authorities, such as the tax and public financial management reforms.

The Economic Environment

The Bahamian economy continues to recover from the weak global environment on account of a rebound in tourism and, mainly, large domestic investment projects. These large projects are not only sustaining aggregate demand in the short run, but will also boost the tourism productive capacity and increase job opportunities. These factors, in combination with the broad government's strategy for growth (outlined below), are expected to generate positive spillovers to other sectors.

Despite the increase in 2011, inflation has been under control -- in line with trends in the major trading partners --, allowing monetary policy to remain supportive. Although the current account remains in deficit, reflecting FDI-related imports, more than 90 percent of the negative balance is financed by non-debt creating capital inflows, implying that the overall balance of payments does not pose immediate risks to the country. Accordingly, despite some reduction in 2012, the level of reserves remains adequate when measured in terms of non-FDI imports and other standard metrics, and the real exchange rate is in line with fundamentals.

However, partially as a result of: the supportive initiatives in response to the global crisis, the slow economic activity, and higher capital expenditures, fiscal strains are expected to persist for longer and the public debt is trending upward. Although authorities are mindful of these challenges and are committed to discipline, they note that the taxable base of economic activities will increase notably once the large-scale tourism developments become fully operational and the global economy improves.

Fiscal Policies

The authorities' medium-term fiscal objective remains focused on rebuilding the buffers that allowed the effective countercyclical policy response to the global recession. However, given an external environment that is still uncertain, the very high level of unemployment, and the infrastructure needs, the authorities are careful not to undermine the flexibility of fiscal operations. Differently from staff, the authorities do not yet see the current fiscal imbalances as a drag to growth and, therefore, do not think that a heavily frontloaded fiscal consolidation is needed at this juncture. Nevertheless, they are committed to an eventual return to a lower level of government sector debt-to-GDP ratio, whereby a combination of sustained economic growth and primary surpluses will be needed. The authorities agree that improving revenue yields from overall economic activity is paramount to consolidation and are currently discussing possible avenues for structural changes in the tax system, as well as working to further enhance tax administration though strengthening both compliance and enforcement and improving public finance management. In this regard, a white paper on tax reform has been approved at the policy level and will be released shortly, moving to the stage of public consultation. An important part of the envisaged tax reform is the introduction of a Value Added Tax (VAT). In addition, work is already underway to implement the Central Revenue Authority (CRA), which will consolidate tax collection functions performed by several separate agents and increase the overall efficiency of tax administration. Other initiatives include: the e-government portal, which is increasing the scope for efficient interaction with tax payers; measures being taken since 2011 to improve customs collection (the largest single revenue component); more risk-based and non-discretionary frameworks to strengthen collections; and significant efforts to increase real property tax compliance. The authorities are also working to further streamline tax concessions and will explore how best to achieve this, guided by IMF and IDB Technical Assistance. All tax and revenue collection initiatives being discussed, however, take into account their possible effects on the country's relative appeal to attract FDI.

Regarding state-owned enterprises (SOEs), the authorities note the challenges associated with providing uniform and affordable services to all islands in the archipelago, given the high cost and low scope for economies of scale. They agree with the continuous need for improving efficiency and transparency of operations, not only to minimize the budget implications of SOE's but to increase overall productivity of the countries' production factors and reduce production costs in the economy. In light of these goals, current operations of SOEs are fully monitored and subject to independent external audits, which must be annually reported to Parliament. The authorities' general guiding principle regarding SOEs is the need for more discipline and good corporate practices to cope with less automatic and direct support from the central government. The reform recently implemented in the Water and Sewerage Company (WSC) is a clear example of the authorities' commitment to best governance practices in public enterprises.

Monetary and Financial Sector Policies

Monetary policy remains effective in ensuring sustainable domestic credit trends and maintaining the fixed exchange rate, which have been instrumental in reducing uncertainty to foreign investors and providing a credible nominal anchor. Credit expansion is moderate and is not projected to accelerate considerably in the near term due to both supply- and demand-side considerations. Macro-prudential measures to manage credit expansion will continue to be geared towards improving asset quality within the banking system. In line with the goal of rebuilding buffers, the CBOB will continue to ensure that credit trends are consistent with an adequate evolution of foreign reserves over the medium term.

The authorities are pleased with the results from the recent FSSA. They particularly note the Fund's acknowledgment of the substantial progress made in strengthening The Bahamas' financial sector regulatory infrastructure, including the insurance sector. They also welcome the Fund's positive assessment of the resilience of both onshore and offshore financial sectors to a wide range of shocks, the limited risk of spillovers between them, and the overall conclusion that the country faces no immediate risk to financial stability. Despite the Fund's recognition of the authorities' successful approach to financial stability, the FSAP also provides further basis for improvement.

Although well capitalized, profitable, and liquid, the banking system shows relatively high ratios of non-performing loans (NPL). The authorities are convinced that the effective framework put in place to oversee the financial system, with the close monitoring by authorities of the trends in NPL, is able to flag and anticipate any potential negative effects of NPLs on the capital adequacy of the banking system. Moreover, the stricter capital adequacy standards and limits to both household leverage and exposure to foreign exchange risks introduced since the start of the global financial crisis are important mitigating factors to NPL and similar indebtedness-related risks.

Other initiatives, such as the National Financial Crisis Management Plan, a risk-based approach to the supervision of both onshore and offshore operations, a framework for regulation and supervision of credit unions, and efforts to further clarify the rules governing the Deposit Insurance Corporation, have been or are being implemented with the objective of improving the financial stability safety network in the country. With regard to improving the regulatory framework for the insurance sector and securities, the authorities also envisage substantial progress over the medium term, coinciding with the recommendations of the FSAP mission.

Growth Strategies

The Bahamian authorities are mindful of the challenges they face to boost potential growth amidst a tight fiscal situation, headwinds from the global economy, and the unavoidable geographic constraints. The strategy continues to be broadly focused on boosting the medium-term growth potential while developing a more resilient and diversified economic base that exploits the potential synergies that exist between the main economic activities – financial services and tourism – and other sectors, including a wide range of professional services (legal, consultants, etc.), agribusiness, manufacturing, and craft and artistic industries. The authorities are very focused on fulfilling the necessary steps for WTO accession and to improve on their records regarding indicators of a business-friendly environment: an aggressive policy towards reducing crime, swift administration of justice, better corporate legislation, and protection of intellectual property rights. All these initiatives have important implications not only for the flourishing of new domestic business opportunities, but are also geared towards enhancing the already established comparative advantage the country has to attract FDI. Investments in public infrastructure and education, continued emphasis on labor force productivity, and work force training are important complements to this strategy.

Conclusion

Our Bahamian authorities remain vigilant to the uncertain external environment and are committed to maintaining appropriately timed and disciplined fiscal policies, as more permanent reforms to tax revenues and public financial management are implemented. The goal is to return public debt to a downward trend, while policies to diversify and strengthen economic growth potential and reduce the high unemployment rate are carefully put in place. Initiatives to continue the successful approach to stability in the financial sector will also be upheld.