



THE BAHAMAS

2017 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

October 2017

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 2017 Article IV consultation with the Bahamas, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its September 8, 2017 consideration of the staff report that concluded the Article IV consultation with the Bahamas.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 8, 2017, following discussions that ended on July 25, 2017, 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 August 23, 2017.
- An **Informational Annex** prepared by the IMF staff.

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

Selected Issues

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IMF Executive Board Concludes 2017 Article IV Consultation with The Bahamas

On September 8, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with The Bahamas.

Economic activity remained weak in 2016. Hurricane Matthew, which hit The Bahamas in October last year, significantly impacted tourism activity in 2016 and early 2017. However, completion of the mega resort Baha Mar and post-hurricane reconstruction activity provided a boost to job creation with the unemployment rate declining to 9.9 percent in May 2017 (down from 11.6 percent in November 2016). The opening of Baha Mar in April increased employment further by creating 2,000 new jobs in the three months to July. Inflation remains low and stable.

The central government fiscal deficit is estimated to have reached 5.7 percent of GDP for the fiscal year ending in June, 2017, up from 3½ percent of GDP in FY2016, due to sharp increases in the wage bill, post-hurricane cleanup and reconstruction spending, temporary tax reliefs, and disruptions in revenue collection. The central government debt-to-GDP ratio is estimated to have increased to 73 percent of GDP in FY2017.

Commercial banks remain liquid and well capitalized. As of March, 2017, the average capital adequacy ratio stood at 27.8 percent, well above the regulatory requirement of 17 percent and liquid assets represented 25.6 percent of total assets. Nonperforming loans (NPLs) declined to 11.1 percent of total loans, down from 14.2 percent in 2015. However, banks have maintained a cautious lending attitude in an environment of low growth. Consequently, the total stock of credit to the private sector has remained flat.

Real GDP growth is projected to pick up to 1¾ percent in 2017 and to 2½ in 2018, driven by a stronger U.S. economy, the phased opening of Baha Mar, and related construction activity. Post-hurricane reconstruction and a pickup in FDI-financed investment should also support the recovery. However, medium-term growth would remain low, reflecting significant structural bottlenecks.

The current account deficit is estimated to have declined to 12.9 percent of GDP in 2016, down from 13.6 percent of GDP a year earlier, reflecting lower oil prices and a temporary increase in current transfers associated with payments of re-insurance claims from Hurricane Matthew.

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.

However, the deficit is expected to widen to 17¾ percent of GDP this year due to a surge in Baha Mar-related imports of goods and services to complete the resort. Over the medium term, the current account deficit is projected to narrow to 7.1 percent of GDP but would still be weaker than the level consistent with fundamentals and desirable policy settings.

Executive Board Assessment²

Executive Directors welcomed the expected pick up in near-term growth, driven by a stronger U.S. economy and the phased opening of the mega resort Baha Mar. However, they noted that the economy continues to face significant challenges, including from structural bottlenecks and rising public debt. Directors welcomed the authorities' strong commitment to fiscal discipline and agreed that continued strong fiscal consolidation and monetary and financial sector policies, as well as deeper structural reforms are necessary to generate stronger growth, improve competitiveness, tackle unemployment, and enhance resilience to natural disasters. Directors expressed solidarity with countries, including The Bahamas, that are bracing for or grappling with the impacts of Hurricane Irma.

Directors emphasized that restoring fiscal sustainability is a top priority. They encouraged the authorities to adhere to their fiscal consolidation plan to reduce the public debt burden and strengthen external buffers. Directors underscored that the consolidation effort should focus on cutting current expenditures, in particular, reducing the wage bill and making state-owned enterprises self-sufficient. They also underscored that reforming the National Insurance Board and the civil servants' pension system, should support fiscal adjustment and reduce long-term fiscal risks.

Directors commended the authorities' efforts to strengthen fiscal revenues. They highlighted that introducing a low-rate income tax over the medium-term would help make the system more progressive and protect the needed infrastructure and social spending. Directors advised against introducing exemptions from VAT and instead recommended taking advantage of the planned expenditure review to create space for better-targeted tools to protect vulnerable households.

Directors noted that adopting a fiscal rule, as part of a medium-term fiscal framework, should enhance fiscal discipline. To further strengthen fiscal and economic resilience, Directors also recommended integrating into the fiscal framework a well-designed savings arrangement as an additional buffer against recurring natural disaster shocks. They also underscored that finding a permanent solution for the Bank of Bahamas is necessary to reduce fiscal contingencies.

Directors called for a faster resolution of nonperforming loans to strengthen financial stability and support the economic recovery. They also noted that strong compliance with AML/CFT and tax transparency standards should help stem the withdrawal of correspondent banking relationships. Directors recommended reducing central bank holdings of government bonds to strengthen the credibility of the peg and support financial stability.

² 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 summing up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

Directors emphasized that stronger reforms are needed to improve competitiveness and lift medium-term growth. They encouraged the authorities to move forward with the introduction of a credit bureau, step up efforts to reform the energy sector, streamline administrative processes to improve the business environment, and reduce labor market inefficiencies.

The Bahamas: Selected Social and Economic Indicators

I. Social Indicators

GDP (US\$ millions), 2015	8,854	Poverty rate (percent), 2013	12.8
GDP per capita (US\$), 2015	24,310	Unemployment rate (percent), April 2017	9.9
Population (thousands), 2015	364	Infant mortality rate (per 1,000 live births), 2015	9.9
Life expectancy at birth (years), 2015	75.6	Human development index (rank), 2015	58
Adult literacy rate, 15 & up (percent), 2007	95.6		

II. Economic Indicators

	2013	2014	2015	Est.	Proj.	
				2016	2017	2018
(Annual percentage changes, unless otherwise indicated)						
Real sector						
Real GDP	0.0	-0.5	-1.7	-0.3	1.8	2.5
Nominal GDP	1.5	1.1	2.7	-1.5	4.7	4.2
Consumer price index (annual average)	0.4	1.2	1.9	0.8	2.4	2.2
Consumer price index (end of period)	1.0	0.2	2.0	0.8	2.4	2.2
Unemployment rate (in percent)	15.8	14.6	13.4	12.2	10.0	9.7
Saving rate (percent of GDP)	10.8	9.3	13.6	13.4	8.6	11.8
Investment rate (percent of GDP)	27.7	31.2	27.2	26.3	26.4	25.8
Financial sector						
Credit to the nonfinancial public sector	23.6	4.0	7.7	12.3	8.1	5.0
Credit to the private sector	-1.2	-2.8	-1.1	-2.0	-1.0	0.3
Liabilities to the private sector	0.2	1.2	-0.3	8.7	4.7	4.2
External sector						
Exports of goods and services	-1.3	-1.9	-4.0	-0.1	4.3	7.6
<i>Of which:</i> Travel receipts (gross)	-1.1	1.3	9.5	2.1	3.9	9.0
Imports of goods and services	-2.6	5.8	-16.6	3.5	10.7	-2.1
(In percent of GDP, unless otherwise indicated)						
Central government 1/						
Revenue and grants	16.0	16.9	19.5	22.0	21.8	22.7
Expenditure	22.4	22.5	24.4	25.5	27.5	26.4
Overall balance	-6.4	-5.6	-4.9	-3.5	-5.7	-3.7
Primary balance	-4.1	-3.1	-2.2	-0.4	-2.6	-0.6
Central government debt	55.4	60.2	64.5	68.0	72.7	73.3
External sector						
Current account balance	-16.9	-21.9	-13.6	-12.9	-17.8	-14.0
Change in net international reserves						
(Increase -)	0.8	-0.5	-0.3	-1.1	-0.6	-0.2
External public debt (end of period)	19.0	24.3	24.7	28.0	27.4	27.5
Memorandum items:						
Gross international reserves						
(End of period; millions of U.S. dollars)	742	788	812	904	960	982
In months of next year's G&S imports	1.8	2.2	2.2	2.2	2.4	2.5
In percent of reserve money	80	80	83	70	71	70
GDP (in millions of Bahamian dollars)	8,522	8,618	8,854	8,717	9,127	9,515

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

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



THE BAHAMAS

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

August 23, 2017

Context: A prolonged period of stagnation has resulted in declining income relative to neighboring countries, concerns about fiscal sustainability, and a severe household debt overhang problem. Elevated public debt, limited external buffers, and a pegged exchange rate regime, constrain the policy space to respond to shocks. A stronger U.S. economy and the opening of a mega resort are expected to lift real GDP growth to 1¾ percent this year and 2½ percent in 2018, but potential growth remains low, reflecting structural impediments. A new administration—in office since mid-May—has pledged a strong commitment to revive growth and restore fiscal accountability and discipline.

Key policy advice

Fiscal policy. Resuming fiscal consolidation, with a strong focus on reducing current expenditure, is critical to ensure that public debt remains sustainable and external buffers are strengthened. Introducing a fiscal rule, as part of a medium-term fiscal framework, should help enhance fiscal discipline. Increasing reliance on ex-ante insurance and mitigation policies against the risk of natural disasters should strengthen fiscal and economic resilience.

Structural reforms. Moving forward with the creation of a credit bureau should improve access to credit; energy sector reforms should help lower electricity costs and improve power supply reliability; streamlining administrative processes should improve the ease of doing business; and developing skills-matching databases and alternative dispute-resolution mechanisms should reduce labor market inefficiencies.

Monetary and financial policies. Reversing recent increases in central bank holdings of government bonds should strengthen the credibility of the peg; encouraging banks to step up efforts to restructure nonperforming loans should support the economic recovery; restructuring the state-owned Bank of Bahamas should reduce fiscal contingencies; and strong compliance with AML/CFT and tax transparency standards should help stem the withdrawal of correspondent banking relationships.

Approved By
Cheng Hoon Lim
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Duttagupta (SPR)

Discussions took place in Nassau during July 12-25, 2017. The team comprised F. Valencia (head), Q. Chen, M. Ronci (all WHD), and C. Faircloth (FIN). R. Young (OED) participated in the concluding meetings. The mission met with the Prime Minister, the Minister of Finance, the Central Bank Governor, and other government officials, representatives of the opposition, private sector, and civil society.

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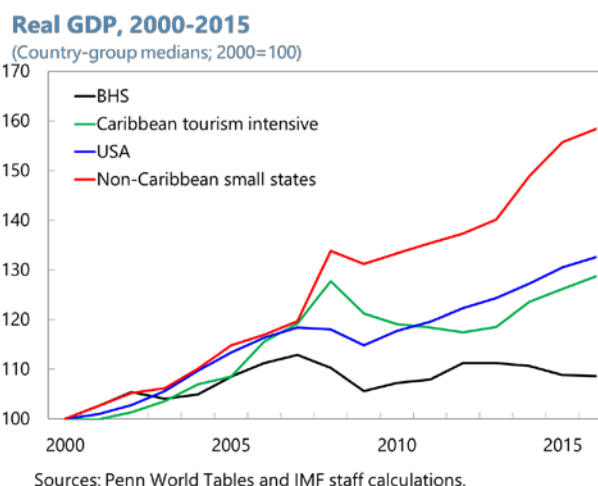
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ECONOMIC AND POLITICAL CONTEXT

1. The Bahamas has been struggling with a stagnant economy since 2012. Natural disasters, interruptions in the completion of the mega resort Baha Mar,¹ and eroding competitiveness, have resulted in declining real GDP and income relative to other Caribbean economies. Weak economic activity, compounded with high fiscal deficits, have led to a sharp increase in the public debt burden, and has also made it difficult to resolve banks' high level of nonperforming loans. The exchange rate peg to the US dollar, in the context of a Capital Flow Management System (CFM), has provided a measure of stability but imposes further policy constraints—particularly as the U.S. dollar has strengthened—and puts a premium on prudent fiscal policy and structural reforms to enhance resilience and competitiveness.



2. Confronted with these challenges, a new administration took office in mid-May with a strong mandate to change course. The Free National Movement (FNM) party won 35 out of 39 parliamentary seats in the May general elections with key mandates to revive economic growth, improve government accountability and transparency, and restore fiscal discipline. On the other hand, the new administration has also committed to providing affordable health care and introducing VAT-exemptions, which would need to be balanced against its objective to strengthen fiscal sustainability.

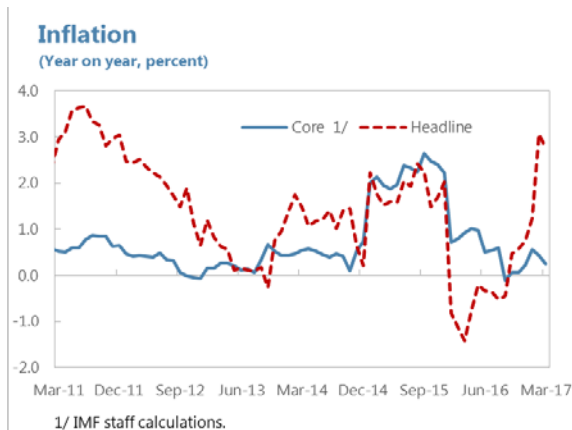
RECENT DEVELOPMENTS

3. Real GDP is estimated to have contracted ¼ percent in 2016. Hurricane Matthew, which hit The Bahamas in October last year, significantly impacted tourism activity in 2016 and early 2017. Air tourist arrivals—the most relevant indicator for growth—were flat in 2016, and declined 6 percent year on year in the first 5 months of 2017, as about 50 percent of hotel room capacity in the Grand Bahama island remains out of commission. Completion of Baha Mar and post-hurricane reconstruction activity provided a boost to job creation with the unemployment rate declining

¹ Originally conceived in 2005, the construction of Baha Mar, a US\$4 billion resort, broke ground in 2011. However, multiple delays in completing the project led to the developer declaring bankruptcy in the summer of 2015, leading to layoffs of more than 2,000 workers (about 1 percent of the labor force). A new owner resumed construction of the resort in late 2016 with its opening scheduled to happen in phases over April 2017-March 2018. Once fully open for business, the resort has the potential to create between 5,000-7,000 jobs.

to 9.9 percent in May 2017 (down from 11.6 percent in November 2016) (Figure 1). The opening of Baha Mar in April increased employment further by creating 2,000 new jobs in the three months to July.

4. Inflation remains low and stable. Inflation ended 2016 at 0.8 percent, down from 2 percent in 2015, as the one-off effects from the introduction of the Value-Added Tax (VAT) in January 2015 dissipated and oil prices fell. Inflation increased to 2.8 percent in March 2017, driven by an increase in housing and transportation services—which include components sensitive to fuel prices—as oil prices recovered.



5. The fiscal deficit increased sharply owing to Hurricane Matthew and higher spending in the run-up to the general elections.

The central government fiscal deficit reached 3.2 percent of GDP for the first 10 months of FY2017 (ending in June). The deficit is expected to reach 5.7 percent of GDP for the full fiscal year, up from 3½ percent of GDP in FY2016, due to sharp increases in the wage bill, post-hurricane cleanup and reconstruction spending, temporary tax reliefs, and disruptions in revenue collection (Figure 2). The central government debt-to-GDP ratio is estimated to have increased to 73 percent of GDP in FY2017. In early July, Moody's placed The Bahamas' sovereign rating under review for a further downgrade.²

6. Commercial banks remain liquid and well capitalized but resolving nonperforming loans continues to be challenging. Financial system assets are concentrated in the offshore sector, with strict firewalls between the domestic and offshore financial systems (Figure 3). Commercial banks dominate the domestic financial sector, and their balance sheets appear sound. As of March, 2017, the average capital adequacy ratio stood at 27.8 percent, well above the regulatory requirement of 17 percent and liquid assets represented 25.6 percent of total assets, more than double the minimum regulatory requirement.

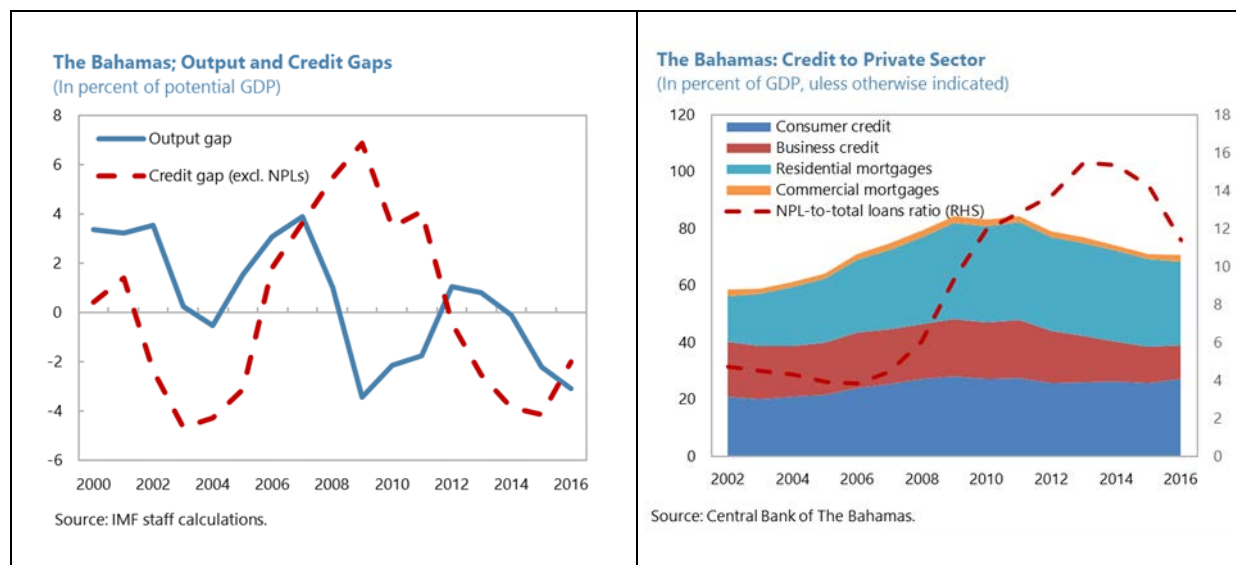
Financial Soundness Indicators (Domestic commercial banks)						
	2012	2013	2014	2015	2016	2017 ^{3/}
Capital/risk-weighted assets 1/	26.1	31.7	31.2	30.9	27.9	27.8
Excess liquid assets 2/	99.6	115.1	112.8	126.1	134.9	131.8
Liquid assets/deposits	41.2	45.7	49.8	55.0	57.9	58.3
NPLs/total loans	13.6	15.3	15.3	14.2	11.4	11.1
Provisions/NPLs	43.0	39.2	51.2	58.5	70.6	66.8
Return on assets	1.7	0.7	0.5	2.6	2.2	...
Return on equity	6.3	2.7	2.1	9.5	8.6	...

Sources: Central Bank of The Bahamas; and IMF staff calculations.
 1/ Central Bank's target is 17 percent.
 2/ In percent of statutory minimum requirement.
 3/ End of March 2017.

² Moody's downgraded the sovereign rating to Baa3 (lowest investment grade level) from Baa2 in August 2016 while S&P downgraded the sovereign rating of The Bahamas to BB+ (speculative grade) from BBB- (investment grade) in December 2016. The downgrades were the result of weak growth and increasing public debt burden.

Nonperforming loans (NPLs)—concentrated in mortgage loans—declined to 11.1 percent of total loans at end-March 2017, down from 14.2 percent in 2015. The decline in NPLs was due to the sale of part of one institution’s nonperforming mortgage portfolio, banks’ loan restructuring measures, and the Government’s Mortgage Restructuring Program (MRP).³ However, the financial position of the Bank of Bahamas, a majority state-owned commercial bank, continues to be beset by recurrent losses, triggering in late 2016 a new recapitalization by the government.

7. Despite ample capital and liquidity, banks remain reluctant to lend in an environment of low growth. Households have not been able to fully repair their balance sheets following the sharp economic contraction during the global financial crisis which turned many loans nonperforming. Bank household debt increased from about 40 percent of GDP in 2005 to a peak of 62 percent of GDP in 2011, declining only to 57 percent of GDP in 2016. Persistent weakness in economic activity and high unemployment since the global financial crisis have strained households’ debt-servicing capacity, constraining their access to credit.⁴ At the same time, weak economic activity has also affected businesses’ profitability. Therefore, banks have maintained a cautious lending attitude, particularly as the lack of a credit bureau and of a well-established book-keeping tradition have made it difficult to assess borrowers’ credit worthiness. These challenges have led banks to increase the risk premium on new lending, bringing intermediation spreads to levels much higher than those seen before the global financial crisis (Figure 4). Consequently, the total stock of credit to the private sector has remained flat, leading to a negative credit gap.



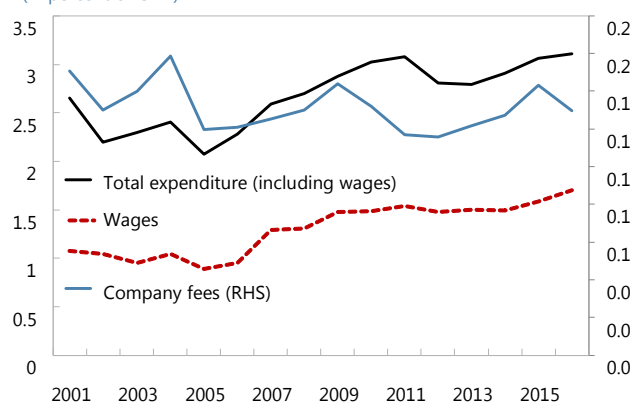
³ The program aims to reduce the mortgage payments of eligible borrowers by 20 to 25 percent. As of March 2017, 28.6 percent of eligible borrowers had enrolled in the program.

⁴ A central bank survey of bank lending conditions conducted quarterly since 2015 shows consistently an excessively high debt service ratio as the most common reason for rejecting loan applications.

8. The loss of correspondent banking relationships (CBR) has not resulted in major disruptions so far.

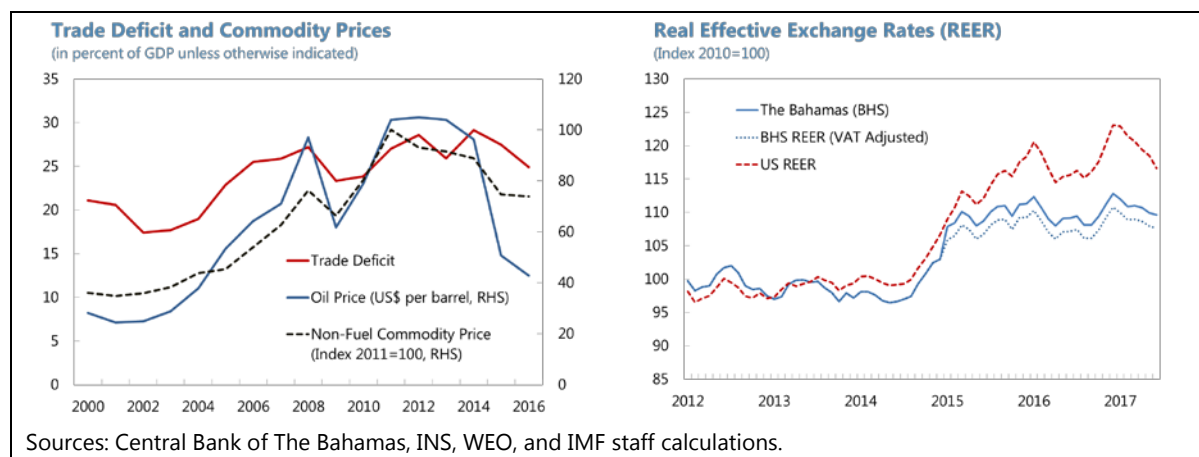
The latest central bank's survey on CBR, conducted in August, 2016, shows that about 26 percent of respondents indicated having faced restrictions or termination of at least one CBR. Affected institutions—mostly offshore banks—noted difficulties in finding replacements but could still conduct business through existing relationships or the parent company. They did not report any resulting dollar-value loss in the level of correspondent banking transactions. Moreover, 71 percent of respondents indicated that they had a contingency plan in place in case of further losses in CBR. Direct contributions from the offshore sector to the economy—measured as their wage bill, expenditure in local goods and services, and fees to the government—appear broadly stable at around 3 percent of GDP (Selected Issues Paper). Nevertheless, the full extent of the impact of pressures on CBR on the offshore sector remains unclear.

Offshore Banks Direct Contribution to the Economy
(in percent of GDP)



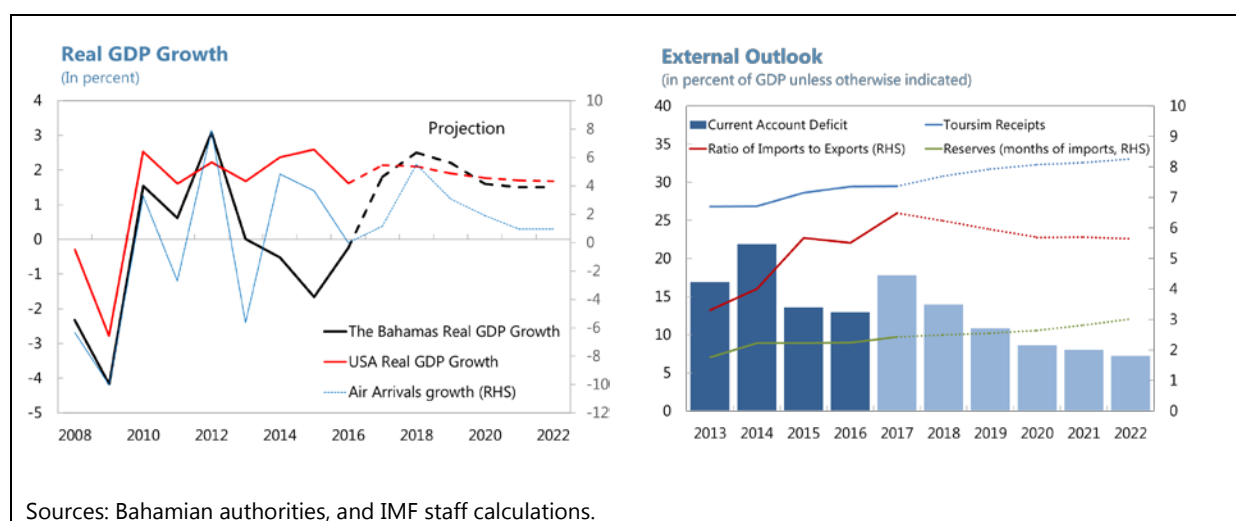
Sources: Central Bank of The Bahamas and IMF staff calculations.

9. The external sector position has improved but remains weaker than suggested by fundamentals and desirable policy settings. The current account deficit declined to 12.9 percent of GDP in 2016, down from 13.6 percent of GDP a year earlier, reflecting lower oil prices and a temporary increase in current transfers (4 percent GDP) associated with payments of re-insurance claims from Hurricane Matthew (Figure 5). However, the deficit is expected to widen to 17¾ percent of GDP this year due to a surge in Baha Mar-related imports of goods and services to complete the resort. Over the medium term, the current account deficit is projected to narrow to 7.1 percent of GDP but would still be above the estimated norm (Annex I). The currency appreciated 11¼ percent in real effective terms on average between 2014 and 2015, reflecting a strengthening of the U.S. dollar and to a lesser extent the introduction of the VAT in January 2015. Since 2015, the real effective exchange rate (REER) has remained virtually flat. In staff's view, the currency is overvalued between 10 and 20 percent. The Bahamas' share of total tourism receipts among Caribbean countries that cater to the high-end tourism segment has been on a declining trend. At an estimated 2.4 months of next year's imports of goods and services, reserve coverage remains below traditional adequacy benchmarks.



OUTLOOK AND RISKS

10. Real GDP growth is projected to pick up to 1¾ percent in 2017 and 2½ percent in 2018 and to stabilize at around 1½ percent over the medium term. The baseline scenario is predicated on an expected acceleration in U.S. growth in 2017, the phased opening of Baha Mar, and related construction activity. Baha Mar is projected to contribute 2.5 percent to real GDP growth, cumulatively, over 2017-2019, through higher tourism activity, employment, and investment. Post-hurricane reconstruction and a pickup in FDI-financed investment should further boost growth and employment with spillovers to private consumption.⁵ However, medium-term growth would remain low, reflecting significant structural bottlenecks. Larger tourist receipts and fiscal consolidation would help narrow the current account deficit over the medium term.



11. The flow of credit to the private sector is expected to improve gradually in the baseline scenario. Stronger economic activity and further improvements in the labor market should improve household debt-servicing capacity as their income strengthens (Annex II). Commercial

⁵ Investment projects to be implemented during 2017-2022 amount to an estimated 8½ percent of GDP.

banks have the balance sheet space to support a pickup in credit demand. Improving economic conditions should support a faster reduction in banks' NPLs. Under the baseline scenario, bank credit provision to the private sector would slowly pick up to grow at annual rates of around 2.5–3.0 percent by 2021–2022, leading to a gradual closing of the credit gap.

12. Risks to the outlook are skewed to the downside (Annex III). Weaker-than-projected U.S. growth or boost from tourism activity would lead to lower economic activity. A tightening of global financial conditions could lead to lower-than-projected foreign investment inflows. A further appreciation of the U.S. dollar could further erode competitiveness. Natural disasters, an intensification of pressures on CBR, and the potential emergence of Cuba as a competitor for U.S. tourists are additional near- and medium-term risks. On the domestic side, risks from policy slippages are even more relevant. Failure to implement fiscal consolidation could undermine investor confidence and reduce projected foreign investment flows. On the upside, higher-than-projected U.S. growth, FDI flows, or boost from Baha Mar would lead to stronger growth.

Authorities' views

13. The authorities noted that staff projections were broadly in line with theirs. They also concurred with staff's assessment of risks but noted that they remain firmly committed to reduce the fiscal deficit and put debt on a downward trajectory.

POLICY DISCUSSIONS

A. Restoring Fiscal Sustainability

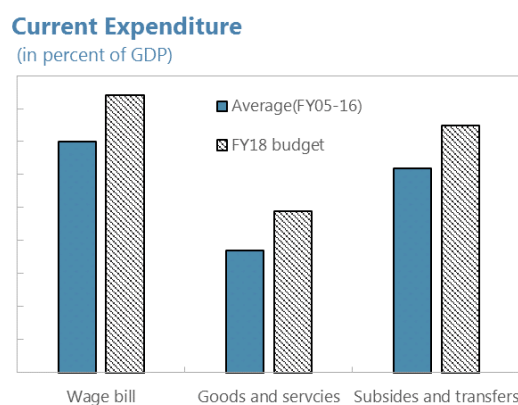
14. Sharp increases in public debt call for decisive fiscal consolidation efforts to ensure that public debt remains sustainable and external buffers are strengthened. In staff's baseline scenario, the sharp increase in the deficit to 5.7 percent of GDP would bring central government debt to 73 percent of GDP in FY2017 (up from 45 percent of GDP in FY2011). Under modest consolidation efforts, which would bring the fiscal deficit down to about 2¼ percent of GDP in the medium term, the debt would only stabilize at around 73 percent of GDP in 2022. This baseline scenario assumes dissipation of hurricane-related spending and expiration of temporary tax relief measures, restraints in current expenditure, and revenue increases from ongoing efforts to improve tax administration and collection. There are significant downside risks to the fiscal outlook with a combination of adverse shocks putting the debt on an upward trajectory (Annex IV). The debt sustainability heat map points to moderate to high risks to debt sustainability.

15. The FY2018 budget envisages a more ambitious consolidation effort for the medium term although specific measures still need to be identified. The new administration's first budget envisages a reduction in the deficit to 3½ percent of GDP in FY2018 and sets deficit targets of 2.3 percent and 1.1 percent of GDP for the two subsequent fiscal years. The deficit reduction for the current fiscal year would result primarily from the dissipation of one-off hurricane-related expenditure and revenue measures as well as revenue improvements from tax administration and collection reforms—albeit more optimistic than those in staff's baseline scenario. The administration

has announced a hiring freeze and across-the-board budget cuts, an in-depth expenditure review, and the intention to draft new legislation to improve governance and procurement rules, and fiscal discipline. If properly designed and implemented, these initiatives should support fiscal consolidation and strengthen fiscal discipline, accountability, and transparency over the medium term.

16. Staff recommended a fiscal consolidation strategy with a strong focus on reducing current expenditures. Staff noted that meeting the authorities’ fiscal deficit targets would put the central government debt ratio on a firmly downward trajectory, under the staff’s baseline outlook for growth. To meet these targets, staff recommended focusing on three areas:

- The public sector wage bill increased sharply in FY2017. Staff recommended reducing the wage bill to at most the level observed in FY2016, which would yield savings of 0.8 percent of GDP—relative to FY2018—including by reducing non-essential temporary workers (about 30-40 percent of public employees), enacting a hiring freeze, and capping compensation for re-hired pensioners.
- Sizable transfers to state-owned enterprises (SOEs)—reaching 2.1 percent of GDP in FY2016—continue to be a drain on the budget. SOEs represent also a significant contingent liability for the central government with their combined debt reaching 18 percent of GDP in 2016. Reducing subsidies and transfers to the historical average⁶ would yield savings of up to 1¼ percent of GDP relative to FY2018. To this end, staff recommended adjusting prices of services provided by SOEs to cost recovery levels and restructuring these corporations and other public entities to improve their efficiency. A first essential step is the establishment of effective financial oversight over these corporations.
- Civil servants have a non-contributory pension scheme. Pension payments have trended up to an estimated 1.1 percent of GDP in FY2017, and population aging will increase them further. Staff recommended transforming civil servants’ pension system into a contributory regime in the near term, with contributions commensurate with benefits, with a view to move to a defined-



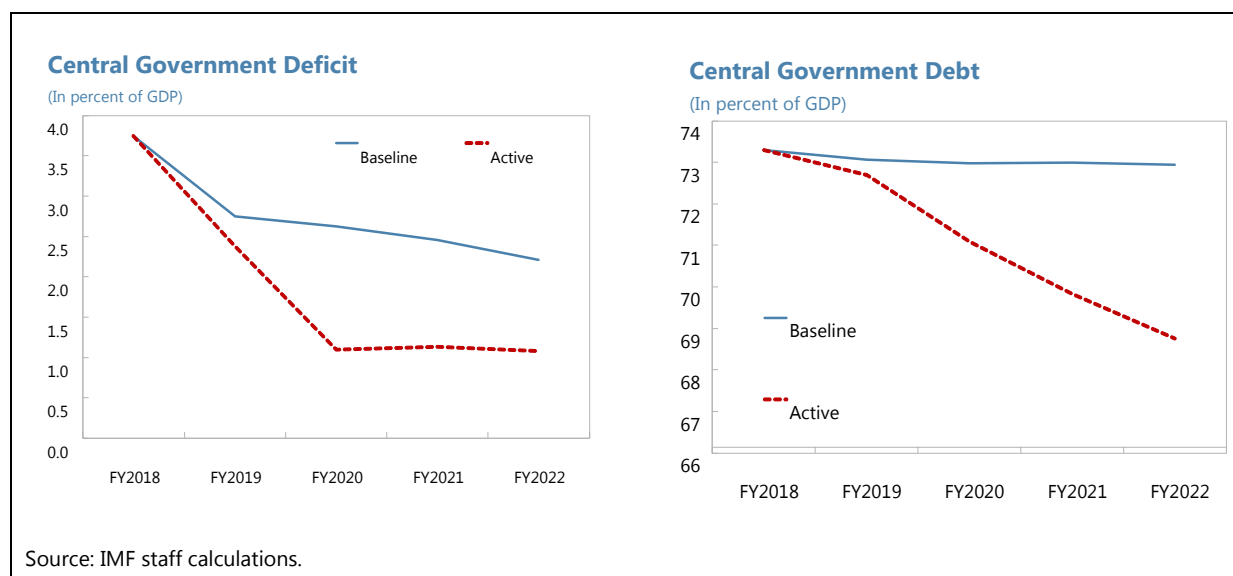
Sources: Ministry of Finance; and IMF staff calculations.

Measures	Savings (FY2018-FY2020)
Civil servants' pension reform	0.3
SOEs reform and tariff adjustment	up to 1.3
Wage bill rationalization	up to 0.8
Total	up to 2.4

Source: IMF staff calculations.

⁶ Defined as the average over FY2005-FY2016.

contribution scheme in the medium term. Setting contributions at 5 percent of wages for pensionable employees could yield revenues for 0.3 percent of GDP.



17. The authorities should continue strengthening fiscal revenues. Revenue administration reforms since 2015 are commendable and should support fiscal consolidation. Over the medium term, introducing a low-rate income tax as import duties are further reduced should make the tax system more progressive and help protect infrastructure and social spending. Staff advised against introducing exemptions from VAT and instead taking advantage of the planned expenditure review to create space for better-targeted tools to protect vulnerable households. Staff also noted that expanding coverage under the National Health Insurance (NHI) program is not affordable without new revenues to fund it.⁷

18. The National Insurance Board (NIB) requires immediate reform to ensure long run sustainability. NIB provides pensions, unemployment insurance, and other short-term benefits to insured employees. Total expenses in benefits surpassed total income in 2016 and under current policies, NIB's reserves would be depleted by 2029. Staff urged the authorities to adopt the recommendations included in the last actuarial report, which contains several parametric reforms to reduce imbalances at NIB. In addition, NIB should also consider raising the pension contribution ceiling to increase progressivity in the system and help safeguard pension reserves, with a view also to move toward a defined-contribution regime over the medium term.

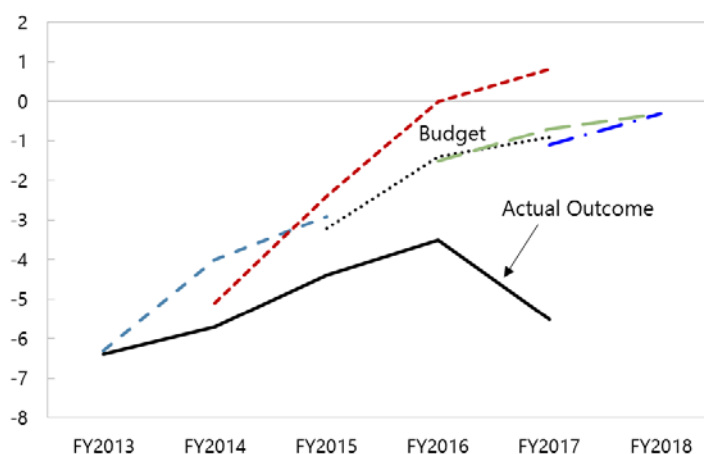
19. Staff welcome the authorities' intention to adopt a fiscal rule as part of a medium-term fiscal framework. Fiscal targets set in the budget have been repeatedly missed. Introducing a medium-term fiscal framework, enshrined in a fiscal responsibility law, would help enhance fiscal

⁷ NHI began providing free primary care to all legal citizens in May 2017 with the plan of expanding to full coverage within 5 years. The current administration capped the allocation to NHI in the FY2018 budget to BH\$40 million (about 0.4 percent of GDP). Expanding coverage could lead to annual fiscal costs in the range of 6½ and 10½ percent of GDP.

discipline and reduce fiscal policy uncertainty. Key elements of the framework should include a simple fiscal rule with a permanent ceiling on the deficit and a cap on current expenditure growth, consistent with keeping the public debt-to-GDP ratio on a downward trajectory; the requirement to incorporate in the budget process an assessment of relevant fiscal risks, particularly those associated with natural disasters, and mitigating policies; and the requirement to develop medium-term fiscal projections. To avoid procyclicality, the fiscal rule should

also include exceptional circumstances clauses to be triggered only when confronted with significant negative shocks. Completing ongoing reforms to modernize the public financial management system is a necessary first step towards an effective medium-term fiscal framework.

Fiscal Balance: Budget vs Actual
(In percent of GDP)



Source: Ministry of Finance of The Bahamas.

20. Increasing reliance on ex-ante insurance and mitigation policies against the risk of natural disasters should strengthen fiscal and economic resilience (Annex V). The Bahamas has traditionally absorbed frequent natural disaster shocks *ex post* through the public balance sheet. An increased reliance on ex-ante mitigation policies would help reduce and smooth the economic and fiscal impact of natural disasters. To this end, staff recommended integrating a well-designed natural disasters savings arrangement into the fiscal framework; insuring public assets through private natural disaster insurance and incentivizing the population to use these instruments more widely, including through targeted subsidies to improve affordability for low-income households;⁸ and making sure that building regulation, land use, and zoning guidelines are adequate and are reviewed and updated frequently.

Authorities' views

21. The authorities agreed on focusing consolidation on reducing current expenditure.

They acknowledged that turning SOE's self-sufficient requires pricing their services at cost recovery levels and expressed their commitment to improve the efficiency of SOE's and other public entities. To this end, they plan to appoint a committee to advise on the restructuring of these corporations. The authorities have also embarked on a public employees' verification exercise with a view to trim the wage bill. They also agreed with staff on the need to transform the public employees' pension system into a contributory regime. Overall, the authorities were confident that their several

⁸ Insurance penetration is relatively low in The Bahamas as public assets are largely uninsured and an estimated 60 percent of households are without insurance or underinsured.

announced initiatives, including the planned expenditure review, would allow them to identify savings to meet their deficit targets.

22. The authorities acknowledged that moving away from import duties will require continuing with efforts to strengthen revenues, and income tax is one alternative. However, they noted that for now their efforts are concentrated on strengthening revenue administration and compliance under the current tax system. Regarding VAT exemptions, they noted that this decision will ultimately be informed by a careful assessment of effectiveness and fiscal risks of various alternatives to provide aid to low-income households, with a view to avoid undermining the fiscal consolidation efforts. The authorities concurred with staff’s assessment that expanding coverage under NHI is not affordable without first identifying new revenues to fund it. For this reason, they have capped the allocation in the current budget to BH\$40 million (about 0.4 percent of GDP). The authorities agreed that NIB requires adopting reforms to ensure its sustainability and reduce fiscal contingent liabilities and noted that the last actuarial report will be sent to Parliament this fall.

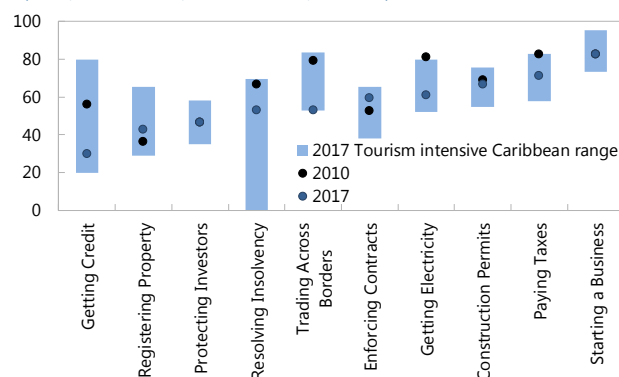
23. The authorities reaffirmed their commitment to introduce fiscal responsibility legislation and agreed with staff’s proposed elements. They will continue to work closely with the Fund, including through technical assistance, to develop draft legislation in the coming months. With regards to natural disaster resilience, they acknowledged the merits of a natural disaster saving fund. They clarified that risk mitigation is an ongoing process and are cognizant of regulatory gaps. In that context, the Ministry of Public Works is seeking to engage consultants to develop a storm-surge protection strategy. The country’s generally low-lying geography makes it difficult to identify “at-risks sites” but a coastal protection unit has been established to prioritize strategic ex-ante investment in mitigation infrastructure.

B. Unlocking Potential Growth

24. Structural impediments and an erosion of cost competitiveness have constrained growth in The Bahamas. The Bahamas ranks 121st place among 190 countries on the World Bank’s ease of doing business index, behind Caribbean peers and has seen relative performance deteriorate in most categories, notably onerous administrative processes (property and construction), inadequate access to credit, difficulties in trading across borders, and the lack of reliable and affordable electricity (Figure 6). From a cost perspective, The Bahamas is among the most expensive tourism destinations and its share in the “exclusive” Caribbean tourism market has been declining.⁹ The strength of the currency in real effective terms and real wages growing faster than productivity have further

The Bahamas: Doing Business Indicators

(Index, from 0 to 100, where 0: lowest; 100: best)



Sources: The World Bank Doing Business Database.

⁹ N. Laframboise, N. Mwase, J. Park, and Y. Zhou (2014), “Revisiting Tourism Flows to the Caribbean: What is Driving Arrivals”, IMF Working Paper 14/228.

eroded competitiveness (Figure 7). The Bahamas' high susceptibility to external shocks underscores the need to strengthen competitiveness as a complement to fiscal consolidation to enhance economic resilience.

25. Staff urged the authorities to address longstanding structural impediments to improve competitiveness and lift medium-term growth. Staff emphasized the following priorities:

- **Enhancing access to credit:** Moving forward with introducing a credit bureau should help address information asymmetries, improve the pricing of risk, and expand access to credit.
- **Reforming the energy sector (Box 1):** i) Upgrading infrastructure in electricity generation, transmission, and distribution; ii) incentivizing energy efficiency among businesses and the population; and iii) exploiting the potential for cleaner energy sources, including wind and solar power, should improve the reliability of electricity networks and reduce costs. To this end, moving ahead with the planned issuance of the rate-reduction bond¹⁰ by the electricity company alongside a rate adjustment to cost recovery levels are critical steps. Public-private partnerships, if done effectively, could help fund additional infrastructure in the energy sector and other areas more generally, particularly as SOE reforms move ahead. Assigning a leading role in planning and implementing energy policy to one institution would facilitate interagency coordination.
- **Improving the business environment:** Modernizing government registration/filing processes and establishing intra agency information exchange systems will improve efficiency and are necessary to establish a "one-stop shop" for businesses; streamlining the review and approval processes at The Bahamas Investment Authority; and rationalizing regulatory requirements for starting a business should also improve the ease of doing business. The new administration is developing plans to fight corruption and crime, which once implemented, should also help improve the business environment.¹¹
- **Reducing labor market inefficiencies:** Establishing a comprehensive skills-matching database to resolve information asymmetries between labor supply and demand; creating a streamlined arbitration process for labor disputes; and expanding vocational and apprenticeship programs—in schools and for displaced workers—would help reduce skills mismatch bottlenecks in specialized trade professions.

¹⁰ As part of the restructuring process of the state-owned electricity company, this entity plans to issue US\$600 million in rate reduction bonds (RRB) to refinance the company's legacy debts and fund new investment. The Electricity Rate Reduction Bond Act of 2015 stipulates the issuance of RRB backed with revenues from a bond fee charged directly to customers through their electricity bill.

¹¹ The new government pledged to table an anti-corruption law in the fall of 2017. They also intent to amend the Public Disclosure Act to include a campaign finance component, give the Office of the Auditor General more autonomy, and enact legislation to establish an independent Office of the Director of Public Prosecutions. The administration is also planning social intervention and training programs to combat crime along with good policing and a more efficient judicial system.

Authorities' views

26. The authorities agreed with the recommended priorities which are in line with the National Development Plan (NDP). The legislation for the credit bureau is ready and is expected to be submitted to Parliament this fall. With regards to energy, the government has established a committee with a view to come up with a concrete action plan over the next few months, particularly regarding the future role of the state-owned Bahamas Power and Light (BPL) in the sector. The authorities see some merit in assigning a clear leading role in carrying out energy policy effectively to one entity. They also noted that, going forward, they plan to rely on public-private partnerships where feasible to limit the impact of additional investment on the budget.

27. The authorities recently established an Ease of Doing Business Committee and agreed with the importance of enhancing vocational training programs and facilitating skills matching. The Ease of Doing Business Committee is working jointly with the Chamber of Commerce to advance “one-stop shop” yardsticks, including by reducing regulatory overreach. The Ministry of Labor is implementing two pilot programs for training and apprenticeship placement with a view to develop a national apprenticeship framework.

Box 1. Energy Reforms

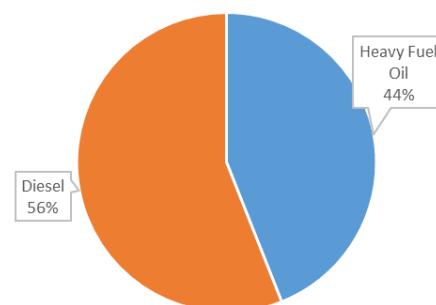
Electricity Sector: the state of play

Electricity generation in The Bahamas relies on imported diesel (56.5 percent) and heavy fuel oil (43.5 percent). Two entities concentrate 90 percent of generation capacity: the state-owned Bahamas Power and Light (BPL), which controls 438 megawatts (MW) of generation capacity and is responsible for transmission and distribution in New Providence and most of the Family Islands; and the privately-owned Grand Bahama Power Corporation (GBPC), which controls 98 MW and is responsible for transmission and distribution in Grand Bahama.

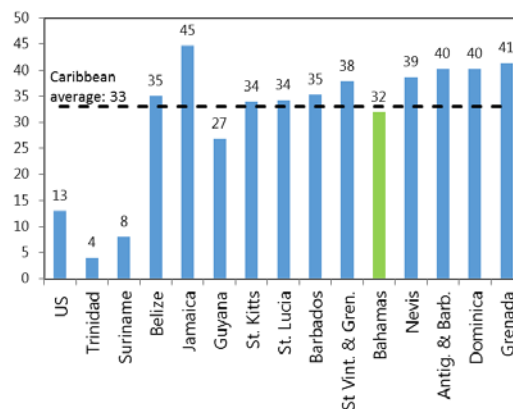
The cost of electricity in The Bahamas has remained persistently high owing to the dependence on relatively expensive fossil fuels for electricity generation and to high transmission and distribution losses — at 12.3 percent of generated electricity. The Bahamas has an average electricity cost of US\$ 0.32 per kilowatt-hour (kWh), about the average cost among Caribbean countries and well above the cost in the United States.

Over the years, The Bahamas has taken steps toward energy sector reform, including by developing a national energy policy that set renewable energy goals; a new legal framework (Electricity Act of 2015), which expanded the mandate of the Utilities Regulation and Competition Authority (URCA) to cover the energy sector. It also adopted the figure of “net billing,” allowing electricity users to sell excess power to BPL; and initiated the restructuring of the state-owned electricity company in 2016 with the signing of a management services agreement (MSA) with a private company to manage BPL, setting clear cost-reduction and reliability targets along with renewable energy and customer service initiatives.

Power Generation Mix



Residential Electricity Tariffs 1/ (In US ¢/kWh)



Sources: CARILEC Tariff Survey, US EIA, and country electricity companies. 1/ US (2017), The Bahamas and TOT (2015), Suriname and Jamaica (2013), others (2012).

Box 1. Energy Reforms (Concluded)

The way forward

Improving the reliability and affordability of electricity in The Bahamas requires moving forward with energy sector reform through complementary actions: Assigning a clear leading role in carrying out energy policy effectively to one entity; ensuring the proper functioning of the regulatory framework and licensing system; exploiting the potential for renewable energy by developing solar power facilities in the Family Islands and incentivizing the use of cost-effective renewable energy alternatives among the population and business community. Steps in this direction should also be complemented with facilitating the use of net billing opportunities provided by the new regulatory framework, including revisiting caps on private sector's solar power production; promoting the adoption of saving energy technologies through building codes and energy consumptions standards and incentivizing energy efficiency more generally; considering cost effective public-private partnerships to enhance electricity generation capacity through cleaner sources at a larger scale; and completing the restructuring of the state-owned electricity company, including by moving forward with the issuance of the rate-reduction bond to facilitate the upgrade of its infrastructure and resolution of its legacy debt.

Potential impact

A study conducted by the IADB shows that if The Bahamas were to increase its reliance on renewable energy to 30 percent of total electricity generation, fuel imports could fall by 17 percent, electricity prices could decline by 11 percent, and real GDP could increase by 1 percent over the medium- to long-term. Relatedly, McIntyre and others (2016) estimate that a 10 percent improvement in energy efficiency (measured as a reduction in consumption of energy per unit of GDP) is associated with a 2-percent increase in real GDP in the long term.

C. Strengthening Monetary and Financial Stability

28. The mission noted that reducing central bank holdings of government bonds would strengthen the credibility of the peg. Following the passage of Hurricane Matthew, the Central Bank of The Bahamas (CBOB) increased its holdings of long-term government bonds in BH\$200 million, about 2 percent of GDP, breaching statutory limits. However, CBOB's main target—on maintaining a level of reserves of at least 50 percent of the monetary base—continued to be met, albeit with smaller margins than in the past. Staff noted that increases in these holdings should be reversed to ensure compliance with statutory limits.

29. Staff recommended encouraging banks to intensify efforts to restructure nonperforming loans and addressing permanently the challenges at the Bank of Bahamas. Additional restructuring of distressed debt, including through the government's Mortgage Relief Program, would help reduce the household debt overhang problem and would free up additional balance sheet space to support the economic recovery. The recent transfer of a large fraction of NPLs from the Bank of Bahamas to a special purpose vehicle (SPV) is a welcome first step.¹² However, a permanent solution is still needed to reduce fiscal contingencies, which should include pursuing a resolution of NPLs in the SPV, stepping up efforts to restructure remaining NPLs at the

¹² As of end-2016, the total amount of NPLs at the Bank of Bahamas reached about 2.5 percent of GDP, with loan loss reserves reaching 1.1 percent of GDP. On August 3, the authorities announced the transfer of about 70 percent of total NPLs to a government-owned special purpose vehicle (SPV) at gross book value in exchange for promissory notes issued by the SPV.

Bank of Bahamas, strengthening the bank's capital and liquidity, and restructuring the institution with a view to isolate its business decisions from political interference.

30. Staff welcome progress in implementing FSAP recommendations (Box 2, Annex VI).

The latest stress tests conducted by the central bank continue to show resilience of the banking sector to significant adverse shocks. CBOB has continued to improve its risk-based supervisory framework; it has implemented Basel II and is now making progress toward implementation of Basel III; CBOB is also in the process of enhancing the legislative framework for bank resolution to finalize a crisis management plan. The Insurance Commission has developed a risk-based capital regime with implementation expected to be completed by end-2017.

31. Strong compliance with AML/CFT and tax transparency standards should help mitigate the withdrawal of CBR and safeguard the integrity of the financial sector.

Staff noted that it is critical to work closely with the CFATF and the FATF to swiftly address the strategic deficiencies in the AML/CFT regime identified in the recent Mutual Evaluation Report (MER) and avoid being publicly listed as noncompliant. Heightened global focus on tax transparency also calls for efforts to promptly comply with international standards (such as the OECD's Common Reporting Standard).

Authorities' views

32. The authorities noted that CBOB plans to reduce holdings of government bonds.

They argued that these holdings increased due to emergency financing needs of the government, following the passage of Hurricane Matthew. They also noted that they have prepared draft amendments to the central bank law to introduce stricter limits on central bank holdings of government securities, which they intend to submit to Parliament by end-2017.

33. The authorities acknowledged the need for a permanent solution for the Bank of Bahamas.

They noted that the recent transfer of NPLs is a first step in this direction with a view to ultimately privatize the bank.

34. The authorities are taking steps to address FATF recommendations.

CBOB published an updated guidance note to ensure compliance with FATF recommendations and has also stepped up monitoring and engagement efforts to ensure banks clean up some remaining low-risk, low-value unverified accounts, with the intention to remediate this issue fully by next year. CBOB, the Securities Commission, and the Insurance Commission are working together on developing a penalties regime for AML/CFT breaches, which is one of the areas identified in the MER as in need for improvement.

Box 2. Financial Sector Regulation and Supervision: Update

CBOB has continued strengthening its regulatory and supervisory framework and making progress towards implementation of the Basel II and III frameworks. CBOB's recent stress tests continue to show resilience of the banking system to large shocks.

- **Risk-based supervisory framework.** The CBOB has continued to improve its risk-based supervisory framework. CBOB introduced the concept of “evergreening” to enhance the risk assessment process, intended to map the risk outlook of financial institutions and establish triggers for supervisory action. The framework is expected to be fully implemented by August 2017.
- **Crisis management.** The CBOB progressed further on proposals to enhance the legislative framework for bank resolution to finalize a National Financial Crisis Management Plan, incorporating recommendations from the 2013 FSAP and IMF and World Bank technical assistance. The CBOB has prepared draft amendments to various laws to align The Bahamas' framework with recommended international standards. The amendments are expected to be enacted by end-2017.
- **Banks' stress tests.** Stress tests conducted by the CBOB suggest that, even under the most severe scenario of a 200 percent increase in the level of nonperforming loans for 3 years, the banking system's capital adequacy ratio would remain above the 17 percent regulatory minimum, but outcomes differ across banks. Liquidity stress tests show no material impact on banks' balance sheets because of excess liquidity in the banking system.
- **Basel II/III.** Implementation of Basel II/III started in early 2016. The CBOB has completed implementation of Basel II. CBOB has implemented the capital component of Basel III with commercial banks subject to Basel III capital reporting since 2013. During the first quarter of 2016, the Bank conducted its second-round Quantitative Impact Study to assess the effects of the Basel II/III framework on banks' capital base. Assuming full implementation of the capital conservation buffer (CCB) and total eligible capital, only one bank would fall short. CBOB is now considering implementation of the countercyclical capital buffer and liquidity coverage ratio, although a timeline has not been formalized yet.
- **Insurance sector risk-based capital regime.** The Insurance Commission has strengthened onsite inspections and introduced a risk-based capital regime with implementation expected to be completed by end-2017.

D. Other

35. Improving the quality and ensuring the timely dissemination of data should help enhance monitoring and transparency. Efforts should include producing quarterly GDP and labor market data; developing an estimate of the International Investment Position; and moving forward with the adoption of the International Public Sector Accounting Standards (IPSAS) on an accrual basis and producing general government fiscal accounts.

36. Advice from previous Article IV Consultations: In line with past Fund advice, the authorities successfully introduced value-added-tax (VAT) in 2015, implemented key FSAP recommendations, and strengthened tax revenues through enhanced enforcement and revenue administration reforms.

STAFF APPRAISAL

37. Growth is projected to pick up in the near term, but The Bahamas still confronts significant macroeconomic challenges. After 4 years of stagnation, growth is projected to pick up to 1¾ percent this year and to 2½ percent in 2018, driven by a stronger U.S. economy and the phased opening of Baha Mar—a mega resort with the potential to employ 2 percent of the labor force. However, despite this expected near-term growth acceleration, the economy faces significant challenges. Largely unaddressed structural bottlenecks continue to constrain medium-term growth. At the same time, persistently weak economic activity over the past years, compounded with high fiscal deficits, have led to a sharp increase in the public debt burden, and has also made it difficult to resolve banks' high level of nonperforming loans. Finally, the external position remains weaker than suggested by fundamentals and desirable policy settings.

38. Adhering to the announced fiscal consolidation path is critical to put the public debt-to-GDP ratio firmly on a downward trajectory and strengthen external buffers. Fiscal consolidation should focus on cutting current expenditures with an emphasis on reducing the wage bill and turning state-owned enterprises self-sufficient to reduce their drain on the budget. On the revenue side, turning the civil servants' pension system into a contributory regime should be a critical element of the fiscal consolidation strategy. The National Insurance Board should adopt parametric reforms to ensure sustainability of the pension system and reduce long term fiscal risks with a view to move toward a defined-contribution scheme over the medium term.

39. Efforts to strengthen revenues should continue. Revenue administration reforms are commendable and should support fiscal consolidation. Over the medium term, introducing a low-rate income tax as import duties are further reduced should make the tax system more progressive and help protect infrastructure and social spending. Introducing exemptions from VAT should be avoided. Instead, the intended expenditure review should help create space for better-targeted tools to protect vulnerable households.

40. Adopting a fiscal rule in the context of a medium term fiscal framework should enhance fiscal discipline, transparency, and accountability. A fiscal rule with constraints on current expenditure growth and the headline deficit, with escape clauses to confront significant negative shocks should enhance fiscal discipline. The rule should be part of a framework requiring the preparation of medium-term fiscal projections and an assessment of relevant fiscal risks. In this regard, integrating into the framework a well-designed savings arrangement as an additional buffer against recurring natural disaster shocks should enhance fiscal and economic resilience. Incentivizing the use of ex-ante private insurance and risk mitigation investments should reduce fiscal contingencies. A permanent solution for the Bank of Bahamas is also necessary to reduce fiscal contingencies.

41. Significant structural impediments call for urgent action to improve competitiveness and lift medium-term growth. The exchange rate peg puts a premium on prudent fiscal policy and structural reforms to enhance resilience and competitiveness. In this context, moving forward with introducing a credit bureau to enhance access to credit; stepping up efforts to reform the energy

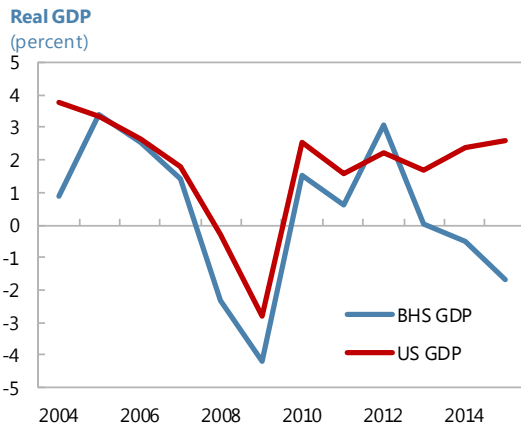
sector to improve the reliability of electricity networks and reduce costs; streamlining administrative processes to improve the business environment; and reducing labor market inefficiencies, should be key policy priorities.

42. A faster resolution of nonperforming loans should strengthen financial stability and support the recovery. Additional restructuring of distressed debt, including through the government's Mortgage Relief Program, would help reduce the household debt overhang problem and would free up additional balance sheet space to support the economic recovery. While the loss of CBR has not led to major disruptions so far, strong compliance with AML/CFT and tax transparency standards should help stem their withdrawal. Reducing central bank holdings of government bonds would strengthen the credibility of the peg and support financial stability.

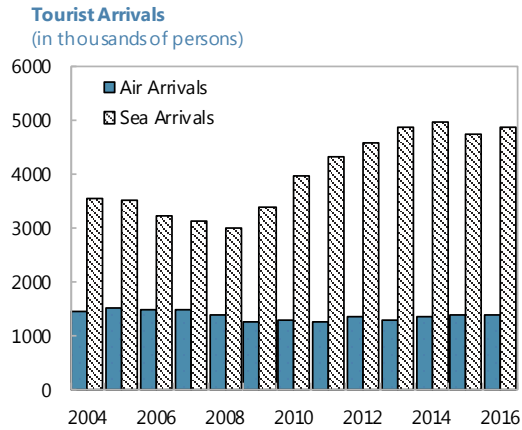
43. It is proposed that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. The Bahamas: Growth, Inflation, and Labor Markets

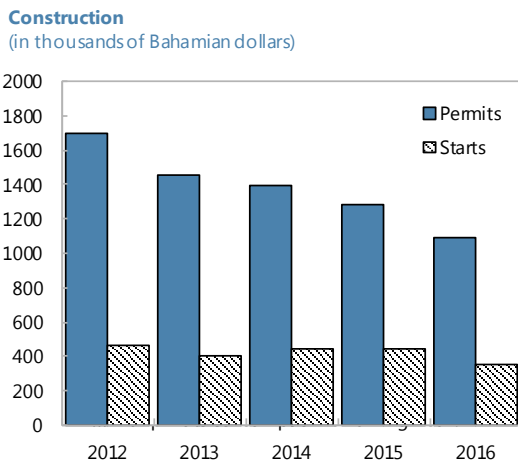
Real GDP has contracted since 2012...



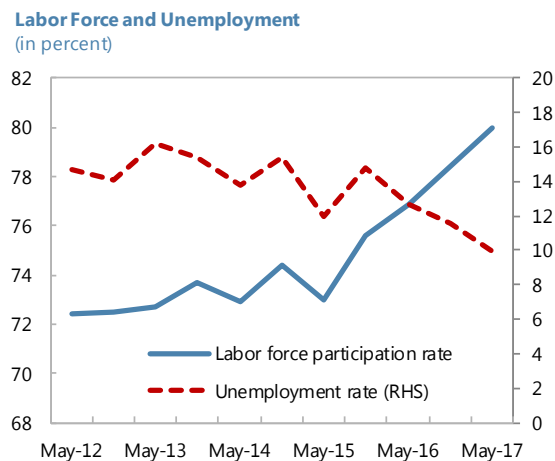
...reflecting in part weak growth in tourist arrivals



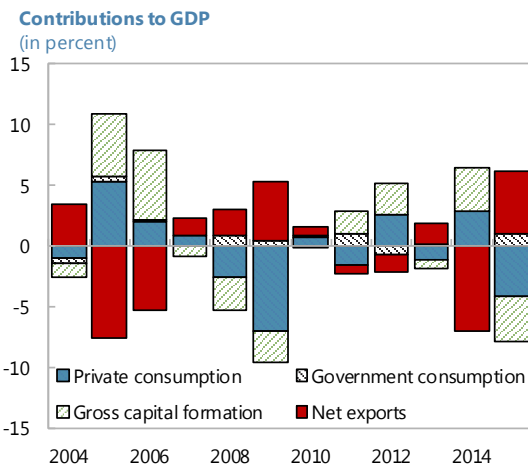
Construction starts and permits suggest weak activity extended to 2016...



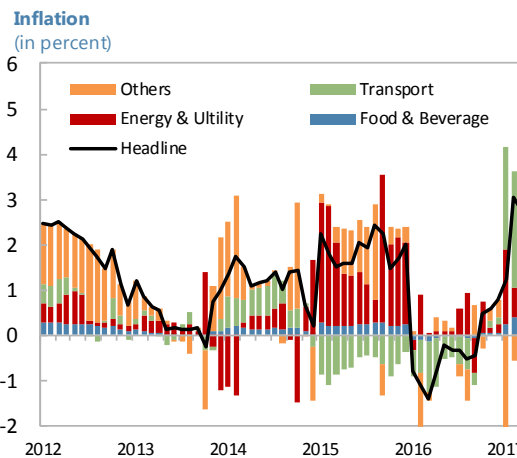
...while unemployment remains high...



...and private consumption weak.



Inflation declined following the dissipation of one-off effects of the VAT and lower oil prices, but rebounded as oil prices recovered.

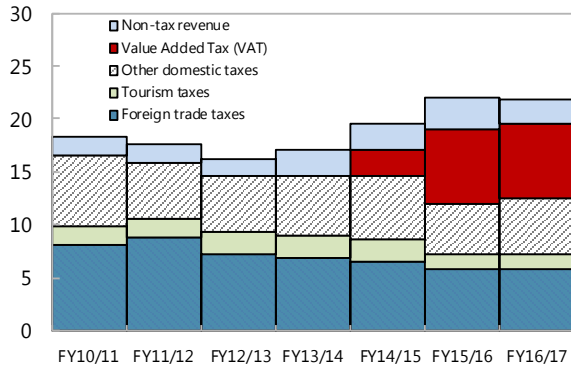


Sources: Bahamian authorities, IMF World Economic Outlook and IMF staff calculations.

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

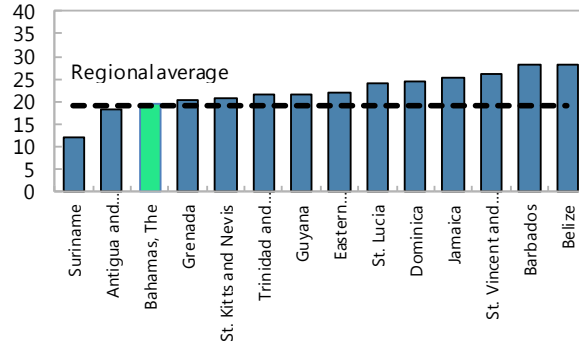
The successful implementation of VAT boosted tax revenue...

Revenue
(percent of GDP)



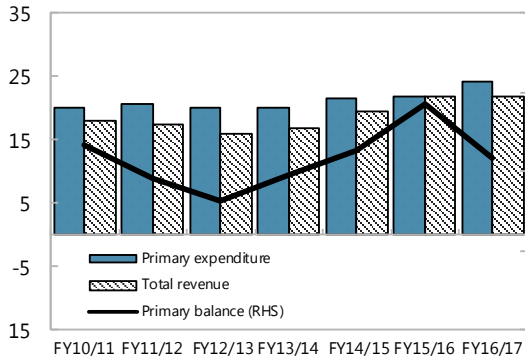
...bringing it closer to the regional average...

Tax Revenues, 2017
(percent of GDP)



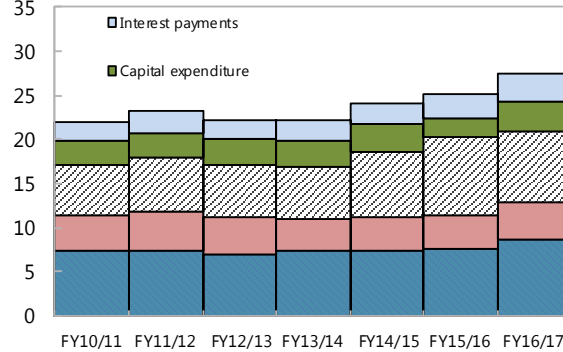
...and helped lower primary deficits...

Contribution to the primary balance
(percent of GDP)



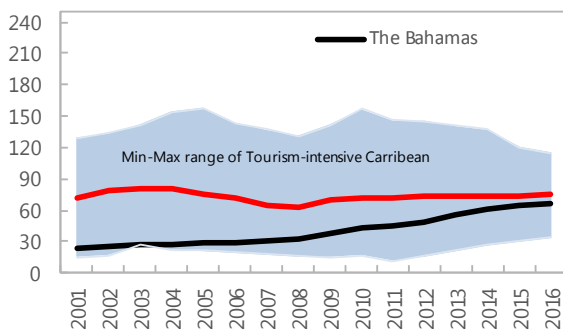
...despite increases in spending.

Expenditure
(percent of GDP)



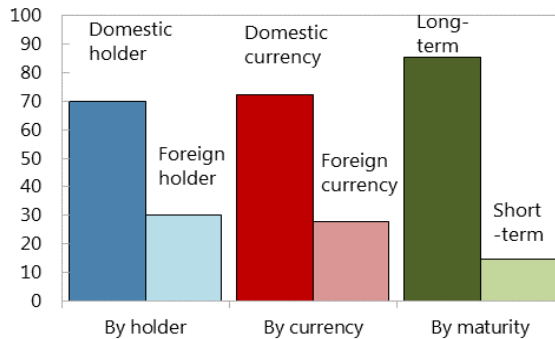
Central government debt rose faster than in peers...

Public Debt in Tourism-Intensive Caribbean



... but the debt profile remains skewed towards domestic holders and currency, and long term.

Debt Profiles, 2016

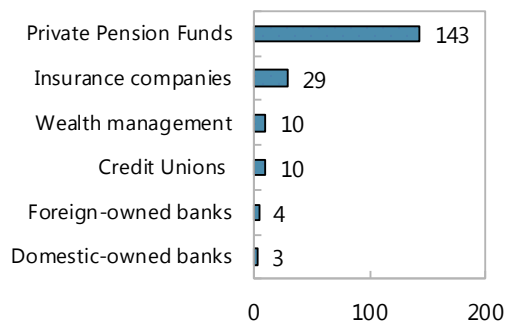


Sources: The Bahamian authorities; and IMF staff calculations.
1/ Central government fiscal year ending June 30.
2/ FY16/17 estimates.

Figure 3. The Bahamas: Financial System Structure

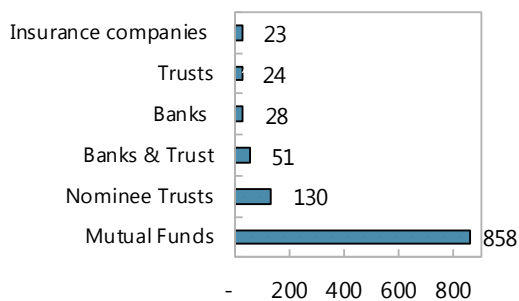
The onshore financial sector has a smaller number of players...

Onshore financial system 1/
(number)



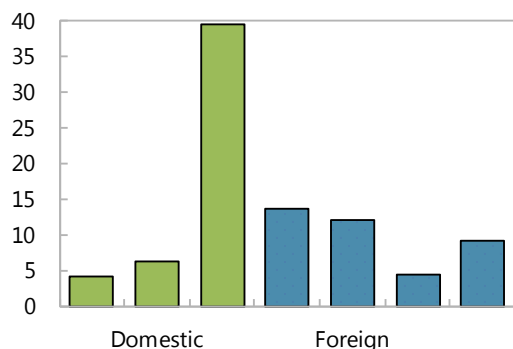
The offshore sector comprises a diverse and large number of players...

Offshore financial system
(number)



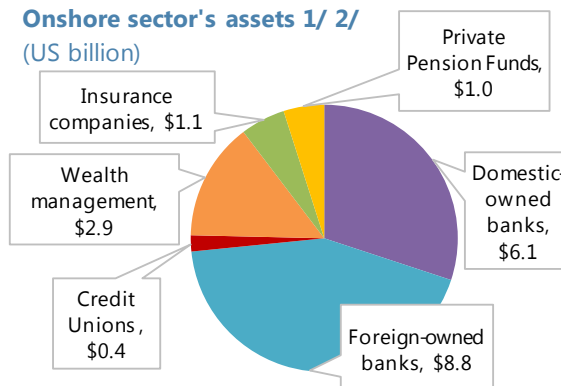
Three banks out of 7 have NPLs above 10 percent...

NPL ratios by bank, end-2016



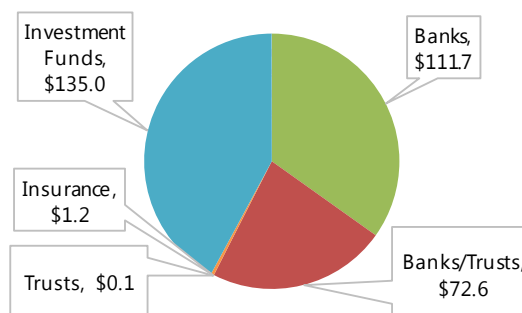
...with assets estimated at US\$20 billion in 2016.

Onshore sector's assets 1/ 2/
(US billion)



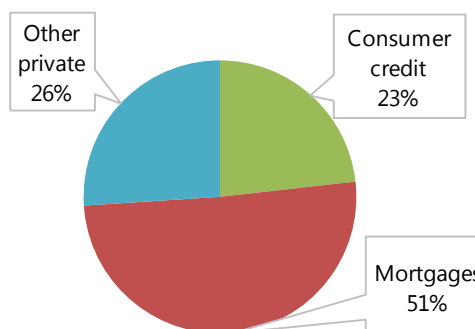
... with assets estimated at US\$ 385 billion in 2015.

Offshore sector's assets
(US billion)



...NPLs are concentrated in mortgages.

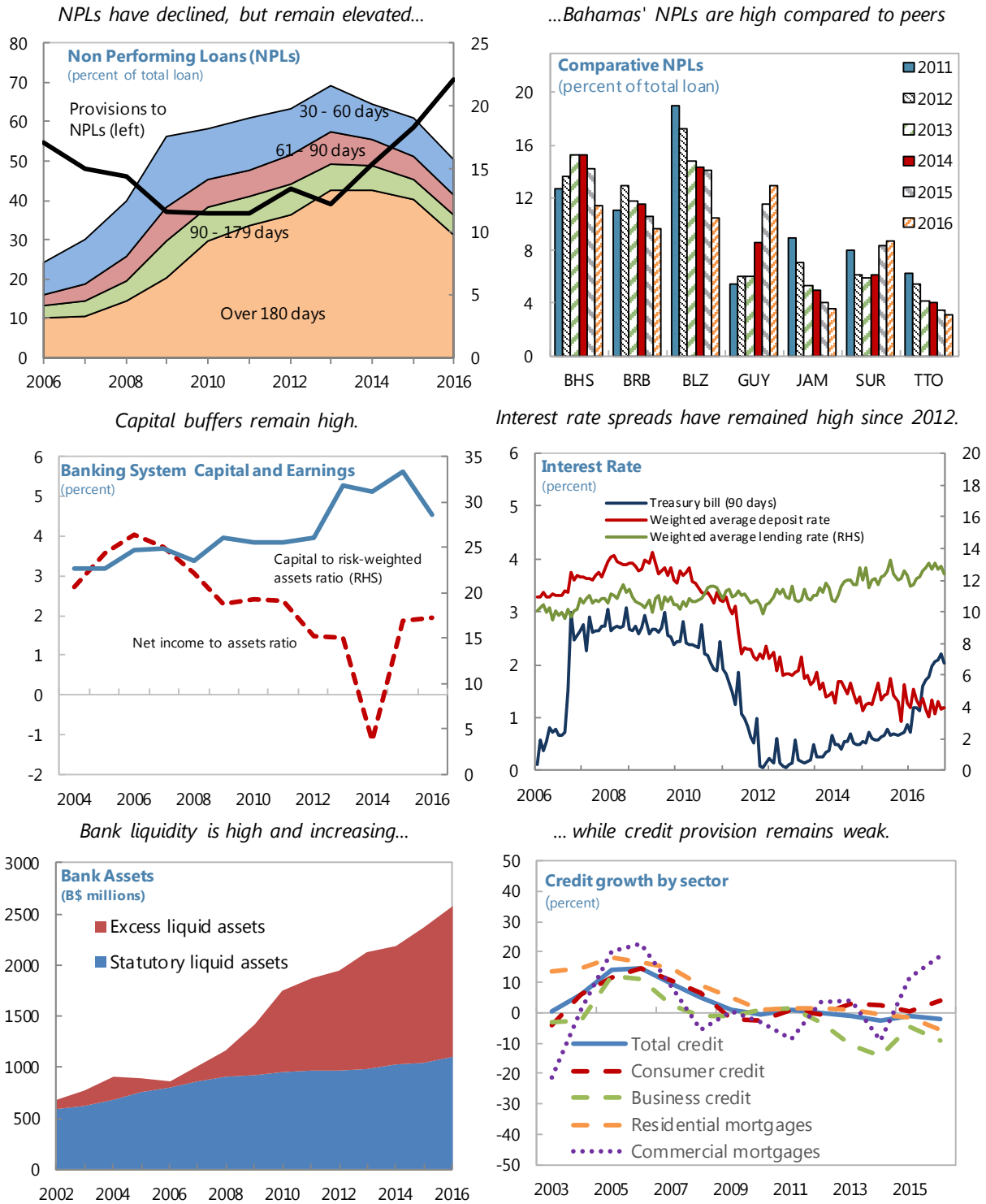
NPLs composition, end-2016



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

1/ Includes only domestic banks and subsidiaries of foreign banks.

Figure 4. The Bahamas: Monetary and Financial Developments

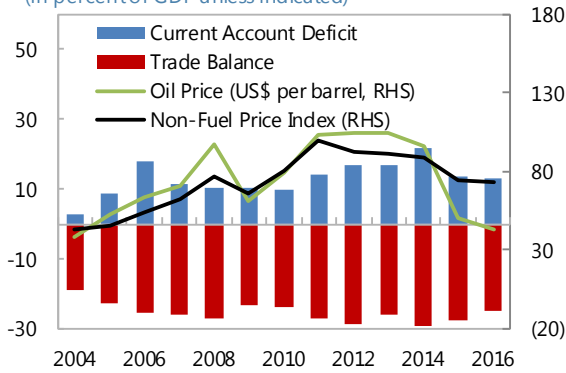


Sources: The Bahamian authorities; and IMF staff calculations.

Figure 5. The Bahamas: External Sector Developments

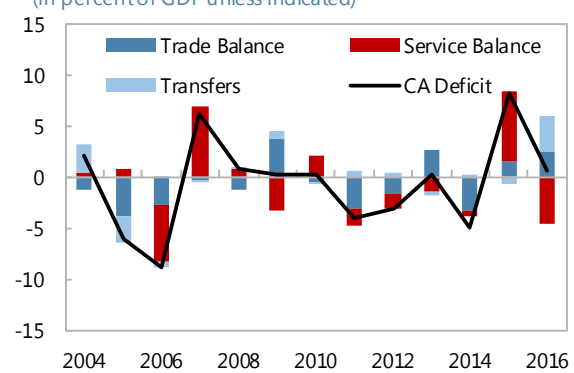
Lower commodity prices and...

External Sector Developments
(in percent of GDP unless indicated)



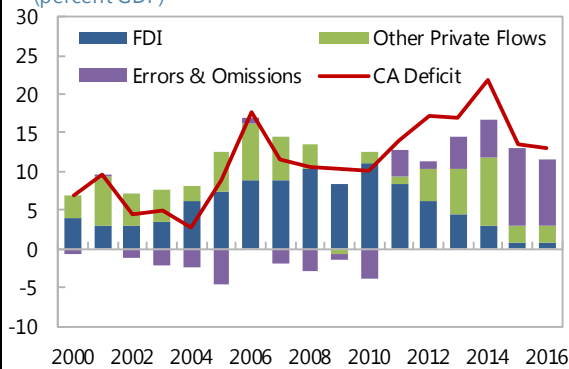
temporary insurance reflows have reduced the CA deficit...

External Sector Developments
(in percent of GDP unless indicated)

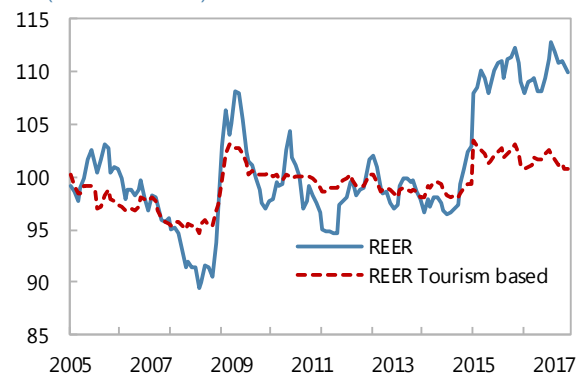


but an increased reliance on volatile capital flows...

Current Account Balance and Capital Flows
(percent GDP)

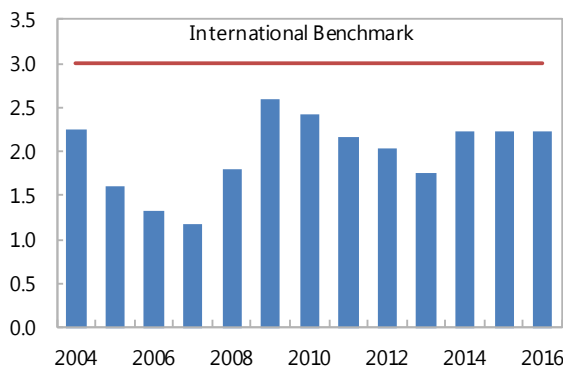


Real Effective Exchange Rate
(Index 2005=100)

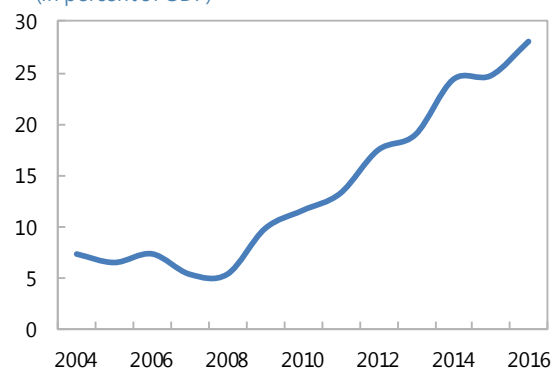


have left reserves below standard adequacy metrics...

International Reserves
(in months of next year's imports)



External Public Debt
(in percent of GDP)



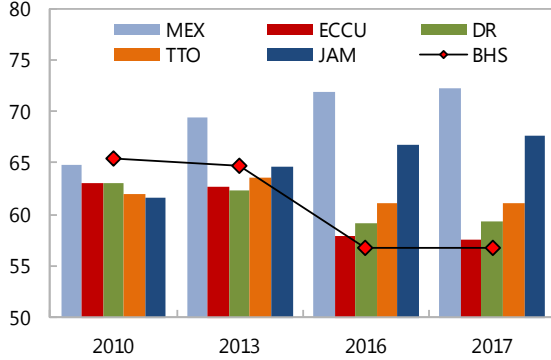
Sources: The Bahamian authorities, International Financial Statistics, the World Bank's Doing Business Database, and IMF staff calculations.

Figure 6. The Bahamas: Doing Business Indicators

The business environment has steadily lost ground...

Ease of Doing Business Indicator

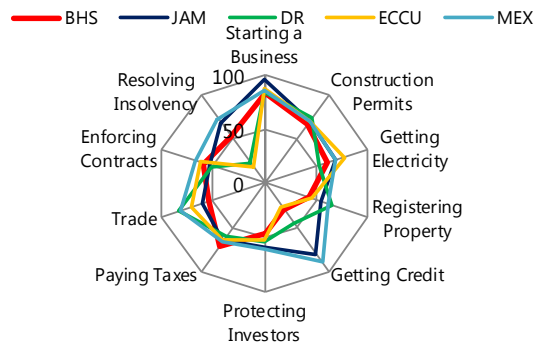
(Distance to Frontier; 100 is highest rank)



across a broad range of areas.

Business Environment Indicators, 2017

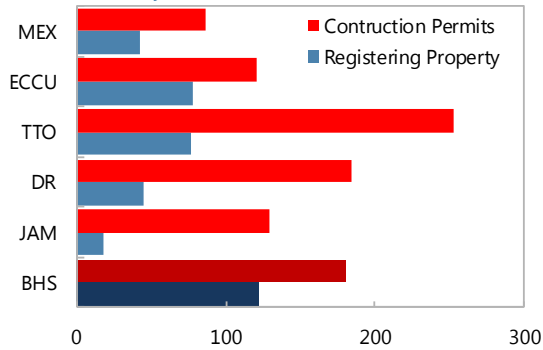
(Score from 1-100; 100 is highest)



The administrative process is long...

Administrative Process

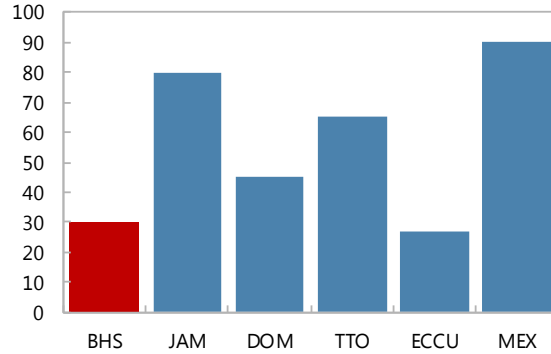
(Number of days)



and accessing credit is difficult..

Accessing Credit Indicator

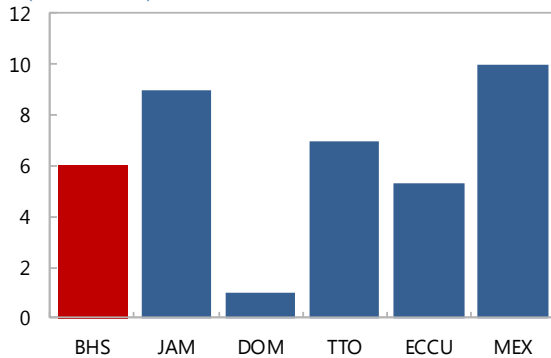
(Score from 1-100; 100 is highest)



with scope to strengthen legal rights...

Strength of Legal Rights

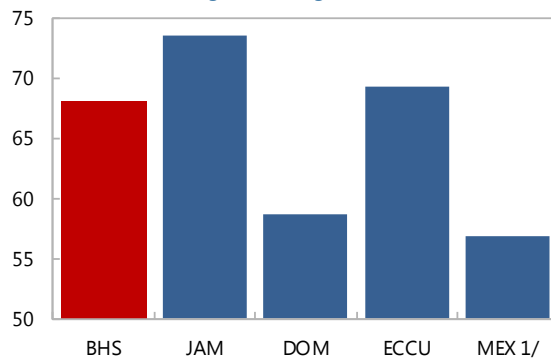
(Index 0 to 12)



and enhance institutional flexibility.

Labor Market Rigidity

(Index with 100 being the least rigid)

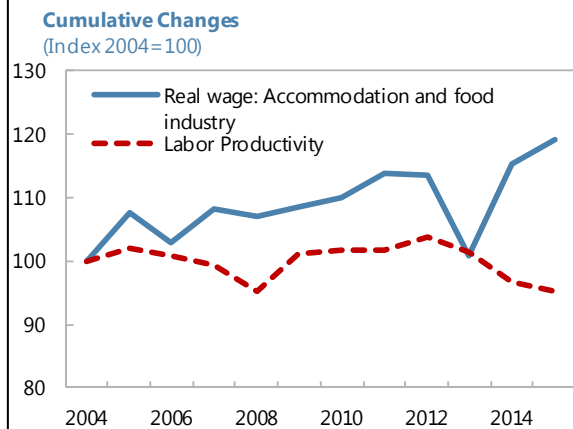


1/ Index for Mexico City.

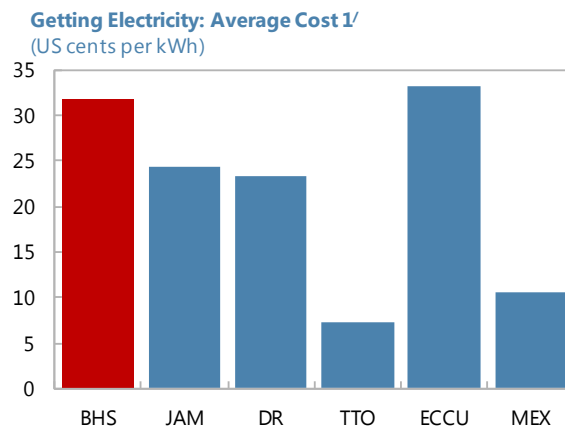
Sources: The World Bank's Doing Business Database and IMF staff calculations.

Figure 7. The Bahamas: Cost Competitiveness Indicators

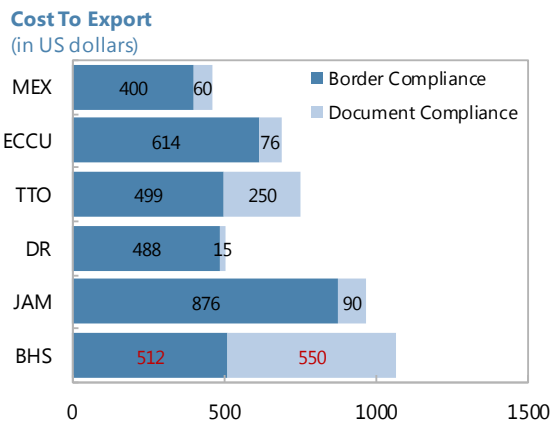
Wages have outpaced labor productivity gains...



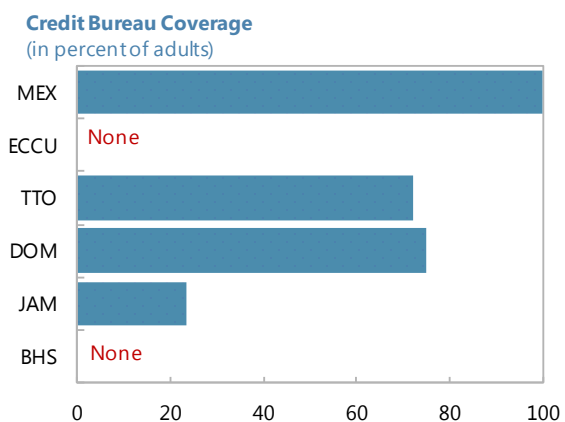
while electricity costs...



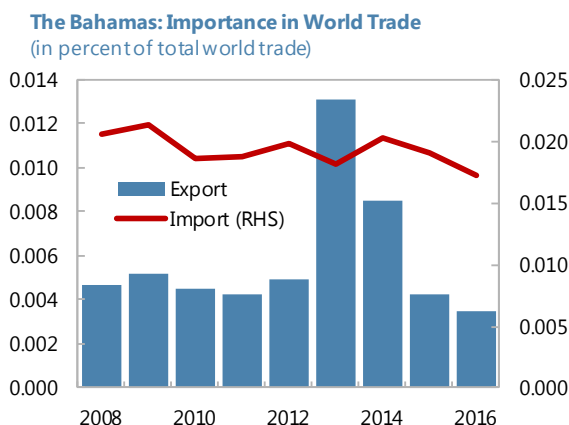
and costs of trade are relatively high...



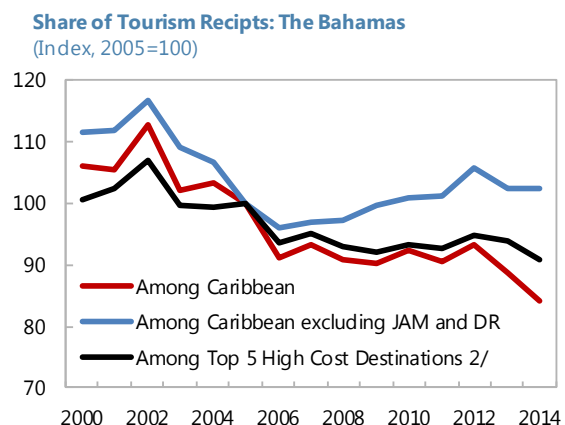
with information asymmetries that increase risk premiums.



These factors underlie decreasing shares of good...



and tourism exports.



1/ Average of cost as reported in 2016 and 2017 Ease of Doing Business reports.

2/ Includes Grenada, Jamaica, St. Kitts and Nevis, St. Lucia, and The Bahamas.

Sources: The Bahamian authorities, Caribbean Tourism Organisation, Doing Business database (World Bank), DoT database (IMF), and IMF staff calculations.

Table 1. The Bahamas: Selected Social and Economic Indicators

I. Social Indicators										
GDP (US\$ millions), 2015	8,854				Poverty rate (percent), 2013					12.8
GDP per capita (US\$), 2015	24,310				Unemployment rate (percent), April 2017					9.9
Population (thousands), 2015	364				Infant mortality rate (per 1,000 live births), 2015					9.9
Life expectancy at birth (years), 2015	75.6				Human development index (rank), 2015					58
Adult literacy rate, 15 & up (percent), 2007	95.6									
II. Economic Indicators										
	2013	2014	2015	Est. 2016	Projections					
					2017	2018	2019	2020	2021	2022
(Annual percentage changes, unless otherwise indicated)										
Real sector										
Real GDP	0.0	-0.5	-1.7	-0.3	1.8	2.5	2.2	1.6	1.5	1.5
Nominal GDP	1.5	1.1	2.7	-1.5	4.7	4.2	4.2	3.6	3.4	3.0
Consumer price index (annual average)	0.4	1.2	1.9	0.8	2.4	2.2	2.6	2.3	2.2	2.2
Consumer price index (end of period)	1.0	0.2	2.0	0.8	2.4	2.2	2.6	2.3	2.2	2.2
Unemployment rate (in percent)	15.8	14.6	13.4	12.2	10.0	9.7	9.6	9.6	9.5	9.5
Saving rate (percent of GDP)	10.8	9.3	13.6	13.4	8.6	11.8	14.8	16.5	17.9	19.1
Investment rate (percent of GDP)	27.7	31.2	27.2	26.3	26.4	25.8	25.6	25.1	25.8	26.2
Financial sector										
Credit to the nonfinancial public sector	23.6	4.0	7.7	12.3	8.1	5.0	4.4	4.7	4.3	3.8
Credit to the private sector	-1.2	-2.8	-1.1	-2.0	-1.0	0.3	1.5	2.0	2.4	3.2
Broad money	0.2	1.2	-0.3	8.7	4.7	4.2	4.2	3.6	3.4	3.0
External sector										
Exports of goods and services	-1.3	-1.9	-4.0	-0.1	4.3	7.6	6.4	5.0	4.2	4.2
<i>Of which:</i> Travel receipts (gross)	-1.1	1.3	9.5	2.1	3.9	9.0	7.2	5.4	4.4	4.4
Imports of goods and services	-2.6	5.8	-16.6	3.5	10.7	-2.1	-0.1	0.2	3.4	2.9
(In percent of GDP, unless otherwise indicated)										
Central government 1/										
Revenue and grants	16.0	16.9	19.5	22.0	21.8	22.7	23.0	22.7	22.6	22.6
Expenditure	22.4	22.5	24.4	25.5	27.5	26.4	25.7	25.4	25.1	24.8
Overall balance	-6.4	-5.6	-4.9	-3.5	-5.7	-3.7	-2.7	-2.6	-2.5	-2.2
Primary balance	-4.1	-3.1	-2.2	-0.4	-2.6	-0.6	0.6	0.6	0.8	1.0
Central government debt	55.4	60.2	64.5	68.0	72.7	73.3	73.1	73.0	73.0	72.9
External sector										
Current account balance	-16.9	-21.9	-13.6	-12.9	-17.8	-14.0	-10.9	-8.5	-7.9	-7.1
Change in net international reserves (increase -)	0.8	-0.5	-0.3	-1.1	-0.6	-0.2	-0.3	-0.8	-1.1	-1.3
External public debt (end of period)	19.0	24.3	24.7	28.0	27.4	27.5	26.4	25.9	25.4	24.8
Memorandum items:										
Gross international reserves										
(End of period; millions of U.S. dollars)	742	788	812	904	960	982	1,010	1,089	1,204	1,349
(In months of next year's G&S imports)	1.8	2.2	2.2	2.2	2.4	2.5	2.6	2.7	2.9	3.1
(In percent of reserve money)	80	80	83	70	71	70	69	72	77	83
GDP (in millions of Bahamian dollars)	8,522	8,618	8,854	8,717	9,127	9,515	9,915	10,267	10,613	10,935
Output gap (percent)	0.8	-0.1	-2.2	-3.1	-1.3	-0.9	-0.7	-0.4	-0.2	0.0

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

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

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

			Budget	Budget	Staff Projections						
	FY14	FY15	FY16	FY17	FY18	FY17	FY18	FY19	FY20	FY21	FY22
(In millions of Bahamian dollars)											
Revenue	1,451	1,702	1,930	2,169	2,139	1,943	2,114	2,233	2,294	2,364	2,439
Tax revenue	1,246	1,500	1,676	1,968	1,941	1,738	1,899	2,009	2,062	2,123	2,191
Taxes on international trade	595	578	506	648	602	514	570	565	561	571	589
Tourism taxes	170	172	135	143	145	135	155	186	193	199	206
Other taxes	489	532	407	526	534	469	503	560	581	601	621
Value added tax (VAT)		219	628	652	662	620	671	699	727	752	776
Other revenue	205	201	253	200	197	205	215	224	232	240	248
Expenditure	1,927	2,130	2,240	2,266	2,460	2,452	2,463	2,500	2,560	2,620	2,677
Expense	1,678	1,853	2,055	2,024	2,232	2,142	2,232	2,263	2,317	2,372	2,424
Wages and salaries	624	640	665	734	780	765	780	793	812	829	847
Goods and services	308	330	341	359	458	390	458	428	438	448	457
Interest payments	212	233	275	272	292	280	292	321	330	342	348
Subsidies and transfers 2/	533	650	774	661	701	707	701	720	737	754	771
Capital expenditure	250	277	185	242	231	310	231	237	242	248	253
Overall balance	-477	-428	-310	-98	-321	-508	-349	-267	-265	-256	-238
Net incurrence of liabilities	477	428	310	98	321	508	349	267	265	256	238
Domestic	50	296	124	13	312	407	105	214	212	205	190
Foreign	426	133	186	85	10	102	244	53	53	51	48
(In percent of GDP)											
Revenue	16.9	19.5	22.0	24.3	22.9	21.8	22.7	23.0	22.7	22.6	22.6
Tax revenue	14.5	17.2	19.1	22.1	20.9	19.5	20.4	20.7	20.4	20.3	20.3
Taxes on international trade	6.9	6.6	5.8	7.3	6.5	5.8	6.1	5.8	5.6	5.5	5.5
Tourism taxes	2.0	2.0	1.5	1.6	1.6	1.5	1.7	1.9	1.9	1.9	1.9
Other taxes	5.7	6.1	4.6	5.9	5.7	5.3	5.4	5.8	5.8	5.8	5.8
Value added tax (VAT)		2.5	7.1	7.3	7.1	6.9	7.2	7.2	7.2	7.2	7.2
Other revenue	2.4	2.3	2.9	2.2	2.1	2.3	2.3	2.3	2.3	2.3	2.3
Expenditure	22.5	24.4	25.5	25.4	26.4	27.5	26.4	25.7	25.4	25.1	24.8
Expense	19.6	21.2	23.4	22.7	23.9	24.0	23.9	23.3	23.0	22.7	22.5
Wages and salaries	7.3	7.3	7.6	8.2	8.4	8.6	8.4	8.2	8.0	7.9	7.9
Goods and services	3.6	3.8	3.9	4.0	4.9	4.4	4.9	4.4	4.3	4.3	4.2
Interest payments	2.5	2.7	3.1	3.0	3.1	3.1	3.1	3.3	3.3	3.3	3.2
Subsidies and transfers 2/	6.2	7.4	8.8	7.4	7.5	7.9	7.5	7.4	7.3	7.2	7.2
Capital expenditure	2.9	3.2	2.1	2.7	2.5	3.5	2.5	2.4	2.4	2.4	2.3
Overall balance	-5.6	-4.9	-3.5	-1.1	-3.4	-5.7	-3.7	-2.7	-2.6	-2.5	-2.2
Net incurrence of liabilities	5.6	4.9	3.5	1.1	3.4	5.7	3.7	2.7	2.6	2.5	2.3
Domestic	0.6	3.4	1.4	0.1	3.6	4.6	1.1	2.3	2.3	2.2	2.0
Foreign	5.0	1.5	2.1	1.0	0.1	1.1	2.6	0.6	0.6	0.5	0.5
Memorandum items											
Primary balance (In millions of B\$)	-265	-195	-35	174	-29	-228	-56	54	65	86	110
In percent of GDP	-3.1	-2.2	-0.4	2.0	-0.3	-2.6	-0.6	0.6	0.6	0.8	1.0
Central government debt (In millions of B\$)	5,160	5,638	5,974	na	na	6,483	6,832	7,099	7,364	7,620	7,858
In percent of GDP	60.2	64.5	68.0	na	na	72.7	73.3	73.1	73.0	73.0	72.9
Nominal GDP (In millions of B\$)	8,570	8,736	8,785	8,922	9,321	8,922	9,321	9,715	10,091	10,440	10,774

Sources: Ministry of Finance; and Fund staff projections.

1/ Fiscal year ends June 30.

2/ Includes a reclassification of capital transfers to public entities for about 1 percent of GDP into current transfers.

Table 3. The Bahamas: Outstanding Stock of Public Debt
(In Percent of GDP) 1/

	2009	2010	2011	2012	2013	2013	2014	2015	2016
Central government debt	42.5	47.0	48.2	52.4	58.5	58.5	64.7	66.8	72.4
External	9.0	9.2	10.1	12.4	14.0	14.0	18.2	18.6	20.0
Domestic	33.5	37.8	38.1	40.0	44.5	44.5	46.5	48.2	52.4
<i>Of which: in foreign currency</i>	0.0	0.9	0.0	0.0	1.5	1.5	0.0	0.4	0.0
Public corporations' debt	12.1	13.6	14.5	16.3	16.0	16.0	17.6	17.5	17.9
External	0.8	2.4	3.1	5.0	5.0	5.0	6.1	6.0	7
Domestic	11.3	11.3	11.4	11.3	11.0	11.0	11.5	11.5	10.7
<i>Of which: in foreign currency</i>	5.5	5.5	5.3	5.1	4.7	4.7	4.1	4.1	3.1
Total public sector	54.6	60.7	62.7	68.7	73.0	73.0	82.3	83.9	88.8
External	9.8	11.6	13.2	17.4	19.0	19.0	24.3	24.7	28.0
Domestic	44.7	49.1	49.5	51.3	54.0	54.0	58.0	59.2	60.8
<i>Of which: in foreign currency</i>	5.5	6.4	5.3	5.1	4.7	4.7	4.1	4.1	2.6
Consolidated public sector 2/	45.3	51.8	54.0	60.0	66.4	66.4	74.6	77.0	83.5
External	9.8	11.6	13.2	17.4	19.0	19.0	24.3	24.7	27.2
Domestic 2/	35.5	40.2	40.8	42.6	47.5	47.5	50.3	52.3	56.3
<i>Of which: in foreign currency</i>	5.5	5.5	5.3	5.1	4.7	4.7	4.1	4.1	3.1

Source: Central Bank of The Bahamas.

1/ Calendar year basis.

2/ Excludes central government debt holdings by public corporations.

Table 4. The Bahamas: Balance of Payments

				Est.		Staff Projections				
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
(In millions of U.S. dollars)										
Current account balance	-1,439	-1,885	-1,203	-1,126	-1,626	-1,330	-1,076	-875	-839	-771
Goods (trade balance)	-2,211	-2,510	-2,434	-2,171	-2,821	-2,772	-2,726	-2,690	-2,790	-2,856
Domestic exports	574	524	372	357	370	383	396	410	425	440
Domestic imports	-2,763	-3,012	-2,790	-2,517	-3,180	-3,143	-3,110	-3,087	-3,202	-3,282
Oil	-485	-488	-332	-330	-383	-390	-410	-429	-447	-465
Capital goods	-657	-720	-615	-615	-1,153	-1,016	-875	-758	-785	-765
Other domestic imports	-1,621	-1,804	-1,843	-1,573	-1,643	-1,736	-1,825	-1,900	-1,970	-2,053
Other net exports	-22	-22	-16	-11	-11	-12	-12	-13	-13	-13
Services	1,046	997	1,618	1,202	1,532	1,853	2,058	2,219	2,340	2,453
Travel (net)	2,022	2,105	2,299	2,237	2,351	2,578	2,774	2,930	3,062	3,202
Travel (credit)	2,285	2,317	2,537	2,566	2,693	2,934	3,145	3,315	3,461	3,614
Travel (debit)	-263	-212	-238	-329	-341	-356	-371	-385	-398	-412
Other services	-976	-1,108	-681	-1,034	-820	-725	-716	-711	-722	-748
<i>Of which:</i>										
Construction services (net)	-483	-645	-137	-58	-143	-129	-91	-62	-68	-60
Offshore companies local expenditure (net)	180	201	166	169	175	182	189	196	204	211
Income and transfers	-274	-372	-387	-158	-337	-412	-408	-404	-389	-369
Capital and financial account	1,371	1,931	1,228	1,219	1,682	1,352	1,104	954	954	916
Capital transfers	-10	-9	-19	-14	-14	-15	-16	-16	-17	-17
Long-term public sector	144	505	101	219	164	319	-5	81	80	90
Commercial banks' NFA	62	-162	30	-306	-141	-146	-153	-150	-150	-144
Foreign direct investment	382	251	76	74	290	403	506	345	377	336
Other private capital 1/	792	1,346	1,040	1,247	1,383	791	772	695	664	652
Overall balance	-69	46	24	92	56	22	28	79	115	145
Change in net international reserves (increase -)	69	-46	-24	-92	-56	-22	-28	-79	-115	-145
(In percent of GDP)										
Current account balance	-16.9	-21.9	-13.6	-12.9	-17.8	-14.0	-10.9	-8.5	-7.9	-7.1
Goods (trade balance)	-25.9	-29.1	-27.5	-24.9	-30.9	-29.1	-27.5	-26.2	-26.3	-26.1
Domestic exports	6.7	6.1	4.2	4.1	4.1	4.0	4.0	4.0	4.0	4.0
Domestic imports	-32.4	-35.0	-31.5	-28.9	-34.8	-33.0	-31.4	-30.1	-30.2	-30.0
Oil	-5.7	-5.7	-3.8	-3.8	-4.2	-4.1	-4.1	-4.2	-4.2	-4.3
Capital goods	-7.7	-8.4	-6.9	-7.1	-12.6	-10.7	-8.8	-7.4	-7.4	-7.0
Other domestic imports	-19.0	-20.9	-20.8	-18.0	-18.0	-18.2	-18.4	-18.5	-18.6	-18.8
Other net exports	-0.3	-0.3	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Services	12.3	11.6	18.3	13.8	16.8	19.5	20.8	21.6	22.1	22.4
Travel (net)	23.7	24.4	26.0	25.7	25.8	27.1	28.0	28.5	28.9	29.3
Travel (credit)	26.8	26.9	28.7	29.4	29.5	30.8	31.7	32.3	32.6	33.1
Travel (debit)	-3.1	-2.5	-2.7	-3.8	-3.7	-3.7	-3.7	-3.7	-3.8	-3.8
Other services	-11.5	-12.9	-7.7	-11.9	-9.0	-7.6	-7.2	-6.9	-6.8	-6.8
<i>Of which:</i>										
Construction services (net)	-5.7	-7.5	-1.6	-0.7	-1.6	-1.4	-0.9	-0.6	-0.6	-0.6
Income and transfers	-3.2	-4.3	-4.4	-1.8	-3.7	-4.3	-4.1	-3.9	-3.7	-3.4
Capital and financial account	16.1	22.4	13.9	14.0	18.4	14.2	11.1	9.3	9.0	8.4
Capital transfers	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Long-term public sector	1.7	5.9	1.1	2.5	1.8	3.4	-0.1	0.8	0.8	0.8
Commercial banks' NFA	0.7	-1.9	0.3	-3.5	-1.5	-1.5	-1.5	-1.5	-1.4	-1.3
Foreign direct investment	4.5	2.9	0.9	0.8	3.2	4.2	5.1	3.4	3.6	3.1
Other private capital 1/	9.3	15.6	11.7	14.3	15.2	8.3	7.8	6.8	6.3	6.0
Overall balance	-0.8	0.5	0.3	1.1	0.6	0.2	0.3	0.8	1.1	1.3
Change in net international reserves (increase -)	0.8	-0.5	-0.3	-1.1	-0.6	-0.2	-0.3	-0.8	-1.1	-1.3
Memorandum items:										
Gross international reserves										
(End of period; millions of U.S. dollars)	742	788	812	904	960	982	1,010	1,089	1,204	1,349
(In percent of base money)	85.7	80.3	82.8	70.0	70.9	69.6	68.7	71.5	76.5	83.2
(In months of next year's G&S imports)	1.8	2.2	2.2	2.2	2.4	2.5	2.6	2.7	2.9	3.1
Nominal GDP (millions of U.S. dollars)	8,522	8,618	8,854	8,717	9,127	9,515	9,915	10,267	10,613	10,935
Sources: Central Bank of The Bahamas; Department of Statistics; and Fund staff projections.										
1/ Includes errors and omissions.										

Table 5. The Bahamas: Summary Accounts of the Central Bank and the Financial System

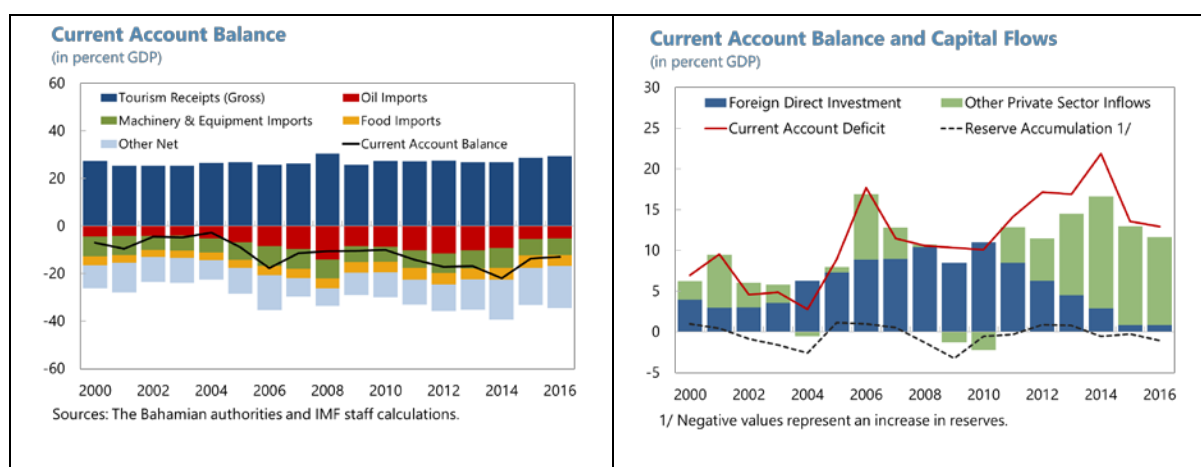
	2012	2013	2014	2015	Est. 2016	Staff Projections 2017	Staff Projections 2018
(In millions of Bahamian dollars, end of period)							
Central Bank							
Gross international reserves	810	742	788	812	904	960	982
Net domestic assets	89	183	193	168	388	393	429
Credit to nonfinancial public sector (net)	390	488	504	485	713	718	753
<i>Of which:</i> Central Government	395	490	521	494	717	651	601
Other	-301	-305	-310	-317	-325	-325	-325
Reserve money	899	925	981	980	1,292	1,353	1,410
Currency held by the private sector	344	353	375	389	426	446	465
Liabilities with financial institutions	555	572	606	591	866	907	946
Financial system							
Net foreign assets	208	46	286	280	679	875	1,043
<i>Of which:</i>							
Held by commercial banks and OFIs	-602	-695	-502	-532	-225	-84	62
Net domestic assets	6,095	6,271	6,105	6,094	6,252	6,381	6,521
Credit to nonfinancial public sector, net	1,715	2,121	2,206	2,376	2,668	2,883	3,028
<i>Of which:</i> Central Government	1,592	1,943	2,021	2,198	2,551	2,767	2,911
Credit to private sector	6,629	6,552	6,367	6,300	6,171	6,109	6,124
Other	-2,249	-2,402	-2,468	-2,583	-2,587	-2,612	-2,631
Liabilities to the private sector (broad money)	6,304	6,317	6,390	6,374	6,931	7,256	7,564
Money	1,575	1,641	1,996	2,071	2,461	2,576	2,686
Currency	217	214	233	247	281	294	306
Demand deposits	1,358	1,427	1,763	1,825	2,180	2,283	2,380
Quasi-money	4,729	4,676	4,394	4,303	4,470	4,680	4,878
(Change in percent of liabilities to the private sector at the beginning of the period)							
Net foreign assets	-1.1	-2.6	3.8	-0.1	6.2	2.8	2.3
Net domestic assets	1.0	2.8	-2.6	-0.2	2.5	1.9	1.9
Credit to nonfinancial public sector	3.5	6.4	1.4	2.7	4.6	3.1	2.0
Credit to private sector	-0.3	-1.2	-2.9	-1.1	-2.0	-0.9	0.2
Liabilities to private sector (broad money)	-0.1	0.2	1.2	-0.3	8.7	4.7	4.2
Money	2.2	1.1	5.6	1.2	6.1	1.7	1.5
Quasi-money	-2.3	-0.8	-4.5	-1.4	2.6	3.0	2.7
(Annual percentage change)							
Net domestic assets	1.1	2.9	-2.6	-0.2	2.6	2.1	2.2
Credit to nonfinancial public sector	14.9	23.6	4.0	7.7	12.3	8.1	5.0
Credit to private sector	-0.3	-1.2	-2.8	-1.1	-2.0	-1.0	0.3
Liabilities to private sector (broad money)	-0.1	0.2	1.2	-0.3	8.7	4.7	4.2
Money	9.8	4.2	21.6	3.8	18.8	4.7	4.2
Quasi-money	-3.0	-1.1	-6.0	-2.1	3.9	4.7	4.2
Sources: Central Bank of The Bahamas; and Fund staff projections.							

Annex I. External Sector Assessment

Staff assesses the 2016 external sector position as weaker than suggested by fundamentals and desirable policy settings. Hurricane shocks and deteriorating competitiveness, in part due to an appreciated U.S. dollar have collectively affected reserve accumulation, leaving the level of foreign reserves below what most adequacy metrics deem as suitable. While the Capital Flow Management (CFM) regime helps contain risks, the country would benefit from a strengthening of external buffers given its exposure to external shocks, including natural disasters. Given The Bahamas' strong commitment to a currency peg, structural reforms to improve competitiveness alongside fiscal consolidation are the primary policy tools to strengthen external buffers.

A. Context and Recent Developments

1. The Bahamas carries sizable current account deficits owing to its relatively narrow economic base. As a small open service economy, it relies heavily on imports to meet its infrastructure and development needs. Goods imports have steadily increased to nearly six times that of exports, resulting in trade deficits above 25 percent of GDP in recent years. Machinery & equipment and manufactured goods imports—a significant portion of which constitute inputs to investment and infrastructure projects—comprise about half of all imports, while oil and food imports amount to another 30 percent. On the services side, net inflows, mainly tourism receipts, have averaged about 15 percent of GDP. Consequently, The Bahamas' current account deficit has ranged between 10 and 22 percent of GDP during the past decade, with financing shifting away from FDI in favor of other private capital inflows in recent years. Since 2014, reserve accumulation has been modest.



2. The current account deficit narrowed in 2016, notwithstanding a disruption to tourism activities due to Hurricane Matthew. The current account deficit has been on a declining trend since 2014 when Baha Mar-related construction activities pushed the deficit to a peak of 22 percent of GDP. In 2016, the current account deficit declined to 12.9 percent of GDP due to a slower pace of construction activity, significant food and oil price declines—which helped reduce the trade balance by 2½ percent of GDP—and a temporary sharp increase in current transfers (4 percent GDP) associated with sizable re-insurance proceeds after Hurricane Matthew. These developments more

than offset a 1½ percent contraction in net tourism receipts. At the same time, overall capital and financial inflows increased by 1¼ percent of GDP, which resulted in a modest accumulation of reserves of \$92 million or 1 percent of GDP.

3. The external accounts are expected to strengthen gradually over the medium-term.

Notwithstanding a period of increased imports (related to post-hurricane reconstruction, the completion of Baha-Mar, and new FDI projects), the anticipated boost in tourism receipts related to the opening of Baha Mar and stronger U.S. growth will provide an important offset. An expected modest recovery in oil and commodity prices will also help keep the trade balance in check over the medium-term. While the growth impulse from Baha Mar is temporary, tourism receipts are expected to continue strengthening as FDI projects currently in the pipeline come on stream. On balance, the current account deficit is projected to gradually converge to around 7 percent of GDP over the medium term, contributing to a gradual improvement in reserve coverage to 3-months of projected imports by 2022.

B. External Stability Assessments

4. Model-based estimates point to an external position that is weaker than suggested by fundamentals and desirable policy settings.

The findings are based on two panel regressions of the current account and real exchange rate respectively that estimate “norm” values consistent with economic fundamentals and desirable policies.¹ Results from these separate EBA-lite regression approaches point to an overvalued currency, although models differ on the magnitude of overvaluation with estimates ranging between 8.8 and 17.6 percent (Table 1).

	CA Approach Adjusted	REER Approach
Actual CA 1/	-6.6%	
Cyclically adjusted CA	-7.1%	
CA norm	-4.0%	
Cyclically adjusted CA norm	-4.5%	
CA gap	-2.6%	
o/w Policy gap	1.6%	
Residual	-4.2%	
Elasticity	-0.30	
REER gap	8.8%	17.6%

1/ Adjusted to exclude FDI-related goods and service imports.

C. The Current Account (CA) Model

5. The CA model is limited in its ability to analyze countries that are heavily dependent on tourism income. The model does not effectively capture potentially strong and sustained future tourism inflows that justify relatively large infrastructure-driven CA deficits in the near-term.² To

¹ The external sustainability approach is not used owing to the lack of official net international investment position data. The EBA-lite approaches use an estimate of the net foreign asset (NFA) position derived from capital account flows and estimates of external indebtedness. Given the small elasticity for NFA in the panel regressions results are relatively insensitive to alternative estimates.

² The limitations of the model are reflected in the poor fit of the panel CA estimation for The Bahamas and, consequently, the results from the standard CA model are not reported.

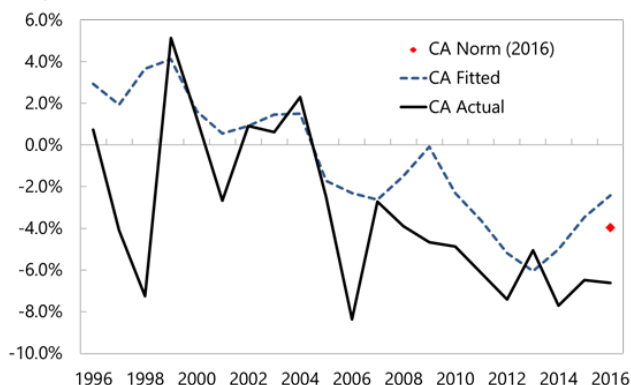
correct for this, FDI-related goods and services imports are excluded, leading to an adjusted CA deficit of 6½ percent of GDP in 2016.³

6. After accounting for Bahamas-specific factors, the cyclically-adjusted CA balance and cyclically-adjusted norm are estimated at - 7.1 and - 4.5 percent of GDP respectively.

The resulting CA gap is - 2.6 percent of GDP, after accounting for desirable macroeconomic policies, where the policies include fiscal consolidation, a modest accumulation of reserves, increased financial deepening, and a modest relaxation of the CFM system. The model estimates that a REER adjustment of 8.8 percent is needed to align the current account balance with economic fundamentals.

External Stability Assessment: CA Model

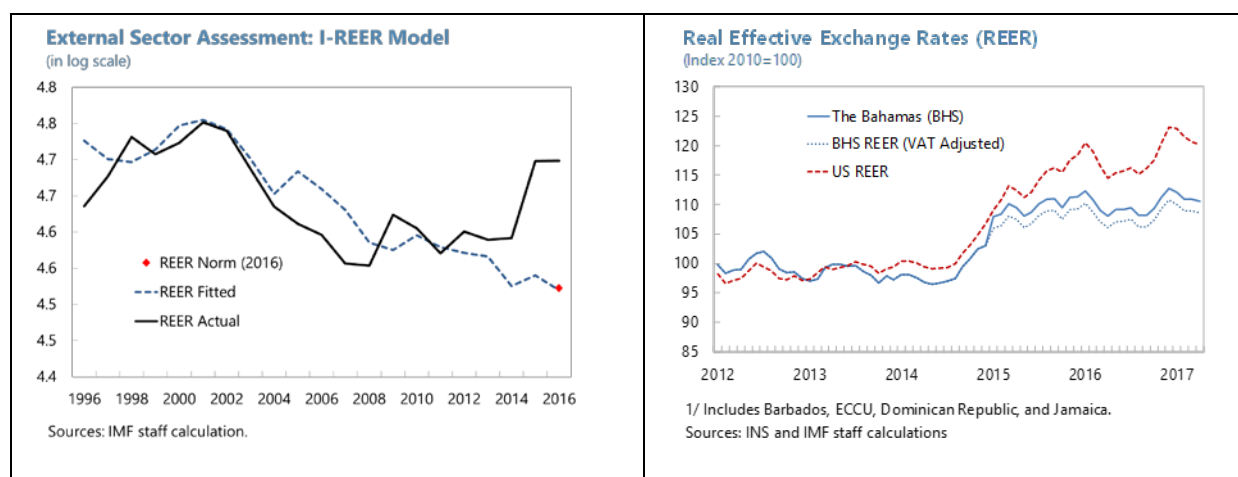
(in percent GDP)



Sources: IMF staff calculations.

D. The Real Effective Exchange Rate Index (I-REER) Model:

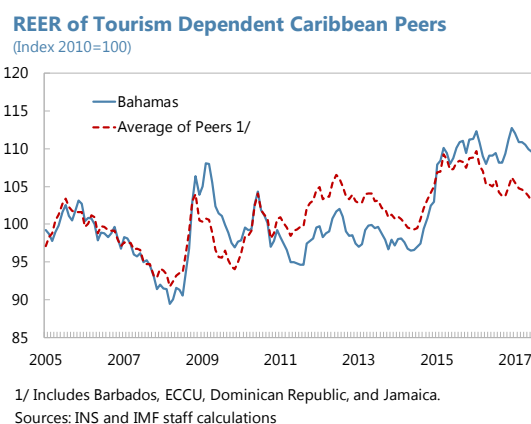
7. Overall, staff assess the REER to be overvalued by around 9 to 18 percent in 2016. The model finds that the REER is 17.6 percent stronger in 2016 than the level deemed consistent with fundamentals and desired policies. The Bahamian dollar appreciated 11¼ percent in real effective terms on average during 2014-2016 attributed in large part to the appreciation of the U.S. dollar. The introduction of the VAT in early 2015 was also a factor accounting for about 2 percentage points of the strengthening of the REER. The current level of the REER is around 11 percent higher than the long-term average.



³ The adjustment assumes that 80 percent of capital goods imports and 100 percent of construction services imports are related to FDI.

E. Cost and Structural Competitiveness

8. Several indicators point to an erosion in cost and structural competitiveness in recent years (Figures 6 and 7). From a cost perspective, the value of The Bahamas' REER is relatively high compared to key tourism competitors (Jamaica and the Dominican Republic) with more flexible exchange rate arrangements. The risks to tourism competitiveness are mitigated somewhat by the large share of US tourists in total arrivals. Indeed, the REER based only on tourism weights has been more stable and has increased only 2 percent since 2014 (Figure 5). However:



- Estimates of the “Week at the Beach” index indicate that the nominal costs of an average one week beach holiday in The Bahamas are among the highest in the world.⁴
- Although the country remains an attractive high-end tourism destination, its share in the Caribbean tourism market that focuses on more exclusive tourism experience has been declining.
- Real wages in The Bahamas have been rising faster than labor productivity in recent years and the costs of electricity are relatively high.
- Finally, the World Bank’s “Doing Business Indicators” suggests that The Bahamas has steadily lost ground from a business climate perspective relative to key competing tourism markets. The country ranks poorly in administrative processes, infrastructure, access to credit, ease of trading across borders, and protecting minority investors.

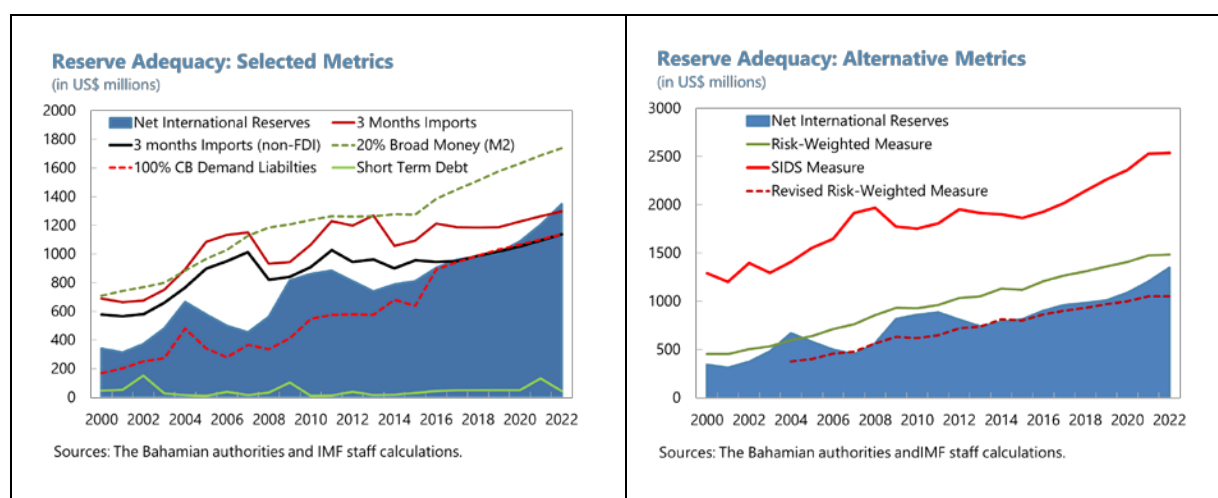
F. Reserve Adequacy

9. Reserves are below several adequacy metrics, particularly when considering small island vulnerabilities to external shocks and natural disasters. From this perspective, structural reforms to improve the business climate and cost competitiveness, together with continued fiscal consolidation, are a policy priority. Specifically:

- International reserves stood at US\$904 million (2.2 months of next-year’s imports) at end-2016. This level falls short of widely accepted international benchmarks of 3-months of next year’s goods and services imports and 20 percent of broad money (US\$1.4 billion). However, reserves coverage is estimated to reach 3-months of imports when FDI-related goods and services imports are excluded. They are also well above 100 percent of short-term debt.

⁴ N. Laframboise, N. Mwase, J. Park, and Y. Zhou (2014): “Revisiting Tourism Flows to the Caribbean: What is Driving Arrivals”, IMF Working Paper 14/228.

- The Fund’s risk-weighted metric, which attempts to measure the adequacy of reserves in avoiding crises and reducing their severity, requires coverage against medium and long-term external liabilities, in addition to coverage of short-term debt and broad money. Reserves are at around 75 percent of the suggested level.
- The CFM system mitigates risks.⁵ Accounting for CFM, the revised risk-weighted measure assesses reserve coverage at 105 percent, just within the recommended 100-150 percent range.
- The framework proposed by Mwase (2012),⁶ which considers challenges specific to small island developing states (SIDS) and their exposure to natural disasters, suggests reserves are less than half of recommended levels.



⁵ Apart from 2009, when they briefly fell to zero, net portfolio investment and other private capital flows have always been positive, thus supporting reserves accumulation. All outward capital transfers require Exchange Control approval, and outflows on resident-owned capital are restricted. In principle, inward investment in shares and other securities by nonresident is unrestricted. However, the Central Bank’s approval is required for the sale and issuance of capital and money market instruments by nonresidents in the local market.

⁶ Mwase, N. (2012): “How Much Should I Hold? Reserve Adequacy in Emerging Markets and Small Islands”, IMF Working Paper 12/205.

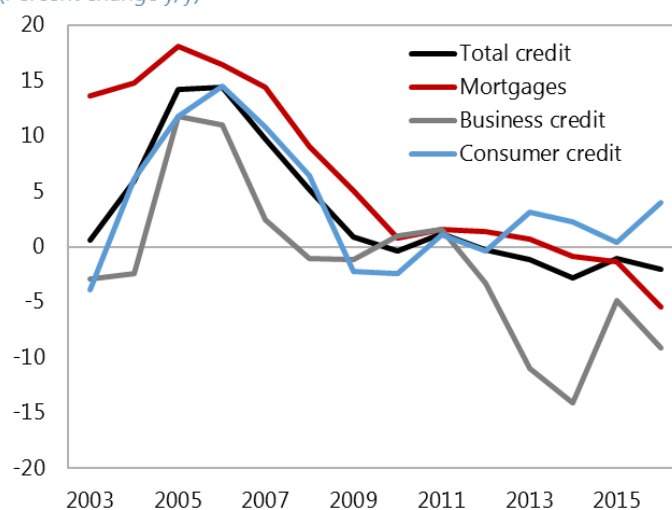
Annex II. The Domestic Banking System and The Real Economy

Credit to the private sector in The Bahamas contracted sharply during the global financial crisis and nonperforming loans (NPLs) rose significantly. Weak economic activity in the aftermath of the crisis has led to a stagnation of credit and to a persistently high level of nonperforming loans, likely also inducing a self-reinforcing negative loop between credit and growth. Reversing this process requires a sustained rebound in economic activity and sentiment. To this end, policies should be oriented toward strengthening confidence with decisive action on fiscal consolidation and structural reforms. In addition, encouraging banks to step up efforts to restructure nonperforming loans and introducing a credit bureau to facilitate banks' screening of borrowers would further support the recovery.

Rise and Fall of Commercial Bank Credit to The Private Sector

1. Credit to the private sector expanded rapidly prior to the global financial crisis. Total credit grew at an average annual rate of 10 percent over 2002–2008. The expansion was particularly pronounced in household credit, with residential mortgage lending and consumer credit growing at average annual rates of 20 and 9 percent, respectively. Business lending, with only a small fraction going into commercial mortgages, expanded only modestly at average annual rates of 3 percent, although it temporarily accelerated to slightly above 10 percent in 2005 and 2006. The rapid acceleration in household credit led to a significant increase in household leverage: household debt (mortgages and consumer loans) increased from 37 percent of GDP in 2002 to 58 percent in 2008.

The Bahamas: Credit to Private Sector Growth
(Percent change y/y)



Sources: Central Bank of The Bahamas.

2. The global financial crisis led to a sharp contraction in economic activity and a credit bust in The Bahamas. Given the tight links with the U.S. economy, real GDP in The Bahamas declined by 4.2 percent and the unemployment rate rose to 14.2 percent in 2009. Massive layoffs and deteriorating household debt-servicing capacity together with weaker business profitability were followed by a sharp increase in commercial banks' nonperforming loans from about 3.9 percent of total loans in 2006 to about 12 percent in 2010.

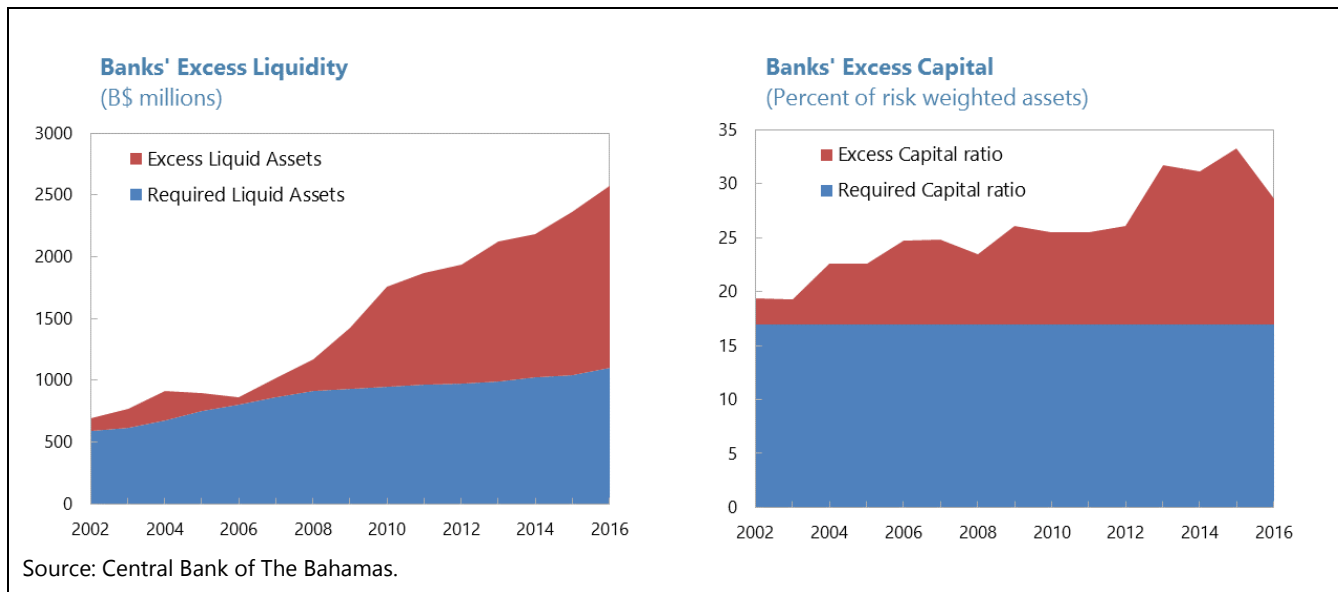
3. Weak economic activity in the aftermath of the global financial crisis kept borrowers' debt-servicing capacity weak and nonperforming loans high. Real GDP growth and the unemployment rate averaged 0.4 percent and 14.3 percent over 2010-2016, respectively. In this environment, nonperforming loans rose further and peaked at 15.4 percent in 2014. A depressed real estate market in a weak economic environment made it difficult to resolve the high level of nonperforming loans, which are concentrated in mortgages.

4. Faced with subdued economic performance, banks were cautious in granting new credit. In an environment with a deteriorated average quality of borrowers and no credit bureau to facilitate the screening of borrowers by banks, intermediation spreads rose significantly above pre-crisis levels, reflecting increased risk premiums on lending. With only a limited pool of creditworthy borrowers that would qualify for new loans, outstanding credit to the private sector continued to fall. More recently, banks' loan restructuring efforts, the government's mortgage relief program, and some distressed loan disposals by a large bank helped reduce nonperforming loans to 11.1 percent of total loans by March 2017.

Commercial Bank Credit and The Real Economy

5. Weak real economic activity has been the main driver of weak credit, but as banks became reluctant to lend, a self-reinforcing feedback loop likely emerged. Establishing causality between credit and economic activity is difficult, but several pieces of evidence point to a stronger role for demand rather than supply factors, therefore suggesting a stronger feedback from real GDP growth to credit than the other way around:

- A central bank survey of bank lending conditions, conducted quarterly since 2015, shows consistently an excessively high debt service ratio as the most common reason for banks' decision to reject loan applications.
- Commercial banks have consistently maintained capital and liquidity levels significantly above minimum regulatory requirements. However, consistent with a "flight-to-quality" effect, banks shored up their liquidity buffers in response to the deterioration in borrowers' quality. This evidence suggests that banks have not been constrained in terms of balance sheet capacity to grant more credit to the private sector.



- A panel regression using domestic banks data over 2002-2016, suggest a highly statistically significant coefficient on various measures of economic activity¹ explaining growth in outstanding credit. The regressions also show no statistically significant coefficient on capital levels, consistent with the view that there are no balance sheet constraints obstructing credit supply. Increases in the risk premium—proxied by intermediation spreads—are statistically significant and negative.
- Finally, Granger causality tests indicate that real GDP growth cause credit and NPLs, while credit and NPLs growth do not cause real GDP growth.

¹ Economic activity indicators include real GDP growth in The Bahamas, or U.S. real GDP growth, which is chosen as to rule out reverse causality.

The Bahamas: Determinants of Credit Growth				
VARIABLES	$\Delta \log(\text{CREDIT})_t$ 1/ 2/			
	(1) FE	(2) GMM-IV	(3) FE	(4) GMM-IV
$\Delta \log(\text{CREDIT})_{t-1}$	0.258 (0.141)	0.271** (0.131)	0.265 (0.144)	0.277** (0.134)
$\Delta \log(\text{GDP_BHS})_{t-1}$ 3/	0.436** (0.125)	0.429*** (0.113)		
$\Delta \log(\text{GDP_US})_{t-1}$			0.657** (0.216)	0.655*** (0.194)
$\Delta \log(\text{NPL})_{t-1}$	-0.006 (0.009)	-0.006 (0.009)	-0.005 (0.014)	-0.005 (0.013)
$\Delta \text{Leverage (capital/assets)}_{t-1}$	-0.002 (0.002)	-0.003 (0.002)	-0.003 (0.002)	-0.003* (0.002)
$\Delta \text{Leverage (capital/assets)} * (\text{dummy2009})_{t-1}$	-0.003 (0.004)	-0.003 (0.004)	-0.002 (0.004)	-0.002 (0.003)
$\text{risk_premium}_{t-1}$	-0.008 (0.004)	-0.008** (0.004)	-0.010* (0.004)	-0.010** (0.004)
dummy_q1 4/	-0.000 (0.005)	-0.000 (0.004)	-0.004 (0.004)	-0.004 (0.003)
dummy_q2 4/	0.013** (0.004)	0.013*** (0.004)	0.007 (0.004)	0.007** (0.004)
dummy_q3 4/	0.006 (0.003)	0.006* (0.003)	0.003 (0.003)	0.003 (0.003)
foreign-owned bank		-0.005* (0.003)		-0.005* (0.003)
Constant	0.024* (0.010)	0.027*** (0.007)	0.028** (0.010)	0.030*** (0.008)
Observations	357	357	357	357
R-squared	0.155		0.153	
Number of bank	7	7	7	7

1/ Credit excludes NPLs.
2/ Robust standard errors in parentheses: *** p<0.01, ** p<0.05, * p<0.1.
3/ The Bahamas' real GDP was interpolated using electricity consumption.
4/ Seasonal dummies.

6. Reversing the direction of this feedback loop requires a solid improvement in economic activity. As unemployment declines and growth picks up, the pool of creditworthy borrowers will increase. Therefore, improving confidence by resuming fiscal consolidation and by addressing structural impediments to growth are key to reverse the negative feedback loop between credit and growth. Financial sector policies, such as encouraging banks to step up efforts to restructure distressed loans, including through the government mortgage relief program, will help speed up the process as it frees up additional balance sheet capacity to lend. Introducing a credit bureau would facilitate the screening of borrowers and the pricing of risk by banks, mitigating any future perverse feedback loop of the same type.

Annex III. Risk Assessment Matrix¹

Potential Deviations from Baseline				
Source of Risk	Up/ Downside	Relative Likelihood ¹	Impact ¹	Policy Response
Tighter global financial conditions. Fed normalization and tapering by ECB increase global rates and term premia, strengthen the U.S. dollar and the euro vis-à-vis the other currencies, and correct market valuations.	↓	High	H	Structural reforms to increase competitiveness and fiscal consolidation to strengthen fiscal and external buffers.
Reduced financial services by correspondent banks. Significant curtailment of cross-border financial services in emerging and developing economies.	↓	High	L	Strengthen compliance with AML/CFT and tax transparency standards and ensure effective implementation, including for the offshore sector; Continue monitoring the status of CBRs; Effectively communicate efforts undertaken by banks and authorities to address perceived risks.
Weaker-than-expected global growth: Significant China slowdown and its spillovers.	↓	Medium	L	Structural reforms to increase competitiveness and fiscal consolidation to strengthen fiscal and external buffers.
Structurally weak growth in key advanced economies.	↓	High	H	
Stronger-or weaker-than projected impact of Baha Mar on tourist arrivals	↕	Medium	M	Structural reforms to increase competitiveness and attract new FDI-financed investments and fiscal consolidation to strengthen fiscal and external buffers.
Natural disasters	↓	High	H	Enhance <i>ex-ante</i> risk mitigation mechanisms, including by prioritizing spending and establishing a savings fund to ensure a timely and targeted response while minimizing impact on fiscal sustainability
Emergence of Cuba as a competitor	↓	High	L	Continue building a broader tourist base. Structural reforms to increase competitiveness and attract new FDI-financed investments

1/ Low (L), Medium (M), High (H).

¹ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Annex IV. Public and External Sector Debt Sustainability Analysis¹

The central government debt-to-GDP ratio has risen more rapidly than in other Caribbean tourism-intensive economies. A projected sharp increase in the fiscal deficit in FY 2017, due partially to post-hurricane reconstruction expenditure, and large increases in the wage bill, would push central government debt to 73 percent of GDP and would stay around this level over the medium-term under modest consolidation efforts. The debt sustainability heat map points to moderate to high risks to debt sustainability, with a combination of adverse shocks putting the debt on an upward trajectory. Risks to debt sustainability, including due to sizable fiscal contingencies, underscore an urgent need to implement fiscal consolidation, complemented with structural reforms to lift potential growth.

1. Debt stock and gross financing requirements. Central government debt reached 68 percent of GDP in FY2016 (ending in June) up from 45 percent in FY2011, owing to tepid economic growth and weaker than budgeted fiscal consolidation. The increase in debt prompted downgrades by two rating agencies last year and a review for a further downgrade in July. Under the baseline scenario, staff projects debt to peak at 73.3 percent of GDP in FY2018, reflecting the impact of a category 4 hurricane and lax expenditure control before the general elections in May, and only to fall by ½ percentage point over the medium term under modest consolidation efforts. Gross financing requirements are projected to decline from 7.7 percent of GDP in FY2016 to about 4.3 percent of GDP in the medium term due to lower fiscal deficits and amortization needs in the medium term.

2. Debt profile and vulnerabilities. Despite continued increases in debt, its composition remains favorable. 77 percent of total debt is denominated in local currency, while short-term debt remains low at 16 percent of total debt. Short-term debt is entirely denominated in Bahamian dollars. The weighted average maturity for the government's domestic and external bonds are 12.5 and 9.3 years, respectively. Ample liquidity in the domestic banking system and a captive investor base mitigates rollover concerns. However, under staff's baseline scenario, the total debt level would remain above 70 percent of GDP over the projection period, and a combination of adverse shocks could put the debt on an upward trajectory. External financing requirements are close to the benchmark for emerging market comparators, due to a still sizable current account deficit, and remain a significant risk to the debt profile. Overall, the heat map points to moderate to high risks to debt sustainability underscoring the urgent need for fiscal consolidation, complemented with structural reforms to lift potential growth.

3. Realism of baseline assumptions. Staff projects real GDP growth to average 1.7 percent over the medium term. Inflation is expected to remain low (average 1.7 percent), while the primary balance is projected to gradually improve to 1 percent of GDP at the end of the forecast period. Staff's recent growth forecast errors do not show a systematic bias. Meanwhile, past projections for the primary balance appear to have been relatively optimistic, while inflation has turned out better than expected. Staff's projected primary balance path is feasible, as the projected primary deficit reduction between 2017 and 2022 is lower than the reduction observed between 2013 and 2016.

¹ Growth numbers have been translated from calendar to fiscal year basis for the public debt sustainability analysis for consistency with fiscal numbers.

4. Macro–fiscal stress test. Shocks to the baseline macro–fiscal variables could significantly worsen the debt path, while the gross financing needs would only increase moderately. Staff simulated four shock scenarios, i.e. a real GDP growth shock, a primary balance shock, real interest rate shock, and real exchange rate shock.² The first three shocks yield similar results with debt reaching about 78 percent of GDP at the end of projection period, compared with the baseline projection of around 73 percent of GDP. However, exposure to real exchange rate shocks remains the least significant, with debt rising to 75.7 percent of GDP as the bulk of debt is denominated in local currency. Gross financial requirements are, however, most sensitive to the real interest rate. A combined macro–fiscal shock would raise debt to close to 84.3 percent of GDP, and gross financing requirements to 8.3 percent of GDP in FY2022.

Additional adverse scenarios.

5. Staff considered several additional adverse scenarios: related to (1) failure to implement fiscal consolidation, (2) persistent weakness in the economy together with lack of fiscal consolidation, (3) occurrence of natural disasters, and (4) materialization of contingent liability risks:

- **Failure to consolidate and persistent economic weakness.** Staff considered two scenarios: (1) a constant primary balance and, (2) primary balance and growth equal to their historical averages. Under the first approach, the primary balance is assumed to remain at the projected level for FY2017 (-2.6 percent of GDP), with the other variables, except the real effective interest rate, remaining at the same levels as in the baseline scenario. In this scenario, debt would rise to 91 percent of GDP in FY2022. Under the second approach, real GDP growth and the primary balance are set equal to the average for the past decade of -0.1 percent and -2.1 percent of GDP, respectively, from FY2018 onwards. In this scenario, the real effective interest rate is also assumed to increase by 122 basis points, which corresponds to the difference between the historical average and projected average under the baseline scenario. Under this severe adverse scenario, the debt burden would rise sharply to close to 100 percent of GDP over the medium term with gross financing requirements also rising to 11 percent of GDP.
- **Natural disasters.** Given the exposure of The Bahamas to natural disasters, staff simulated a shock more drastic than Hurricane Matthew. Staff assumed a temporary reduction in real GDP growth of 0.5 percent for FY2018 and FY2019. With lower tax revenue and larger fiscal spending due to post-hurricane reconstruction, the primary balance would worsen by 3.7 percent and 0.8 percent of GDP over the same period, and the debt would increase to 81 percent of GDP by FY2022.
- **Fiscal contingent liabilities.** The analysis has focused on the central government sector due to lack of consolidated general government and public sector data. Nonetheless, fiscal risks emanating from public entities and the public pension system are significant, and could affect the debt path if they materialize. Debt of public entities amounted to 18.8 percent of GDP in FY2016, of which 8.5 percent of GDP are guaranteed by the central government. Staff assumed a

² The three shocks include: 1) a half-standard deviation reduction in real GDP growth, 2) a one-standard deviation increase in the primary deficit, 3) 400 basis points increase in projected interest rates from the average for the past 6 years, and 4) a one-percent real exchange rate shock.

contingent liability shock of 2.5 percent of GDP in FY2018, which is equivalent to the entire stock of nonperforming loans at the Bank of Bahamas as of end-2016 or to slightly less than a third of SOE debt guaranteed by the central government. The materialization of this shock would push central government debt to about 75 percent of GDP in FY2018 while gross financing needs would rise to 11.2 percent of GDP. The latest actuarial report for the National Insurance Board (NIB), the public pension system, indicates that without reform, the reserve of the NIS will be depleted within 10 years, further increasing government contingent liabilities under passive policies.

6. External Debt.³ The stock of public external debt has increased by 6½ percentage points since 2012, to an estimated 28 percent of GDP at end 2016. This was driven by the increase in Central Government debt by nearly 19 percent of GDP during this period, which comprises about 87 percent of public external debt. Under the baseline scenario, external debt is projected to remain relatively low reaching 27½ percent of GDP in 2018 and decreasing modestly to 25 percent of GDP at the end of the forecast horizon. Bounds test results suggest that the external public debt profile is moderately sensitive to shocks to the non-interest current account and real depreciation shock. Indeed, a permanent increase in non-interest current account deficit by 1.8 percent of GDP relative to the baseline beginning in 2018 would put the public external debt ratio on an increasing trajectory reaching 34 percent of GDP by 2020. A permanent one-time 30 percent real depreciation in 2018 would shift the external debt level up by 12½ percent of GDP relative to the baseline over the projection period.

³ Defined as central government and public corporate debt as the stock of private-sector external debt is not available.

The Bahamas: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

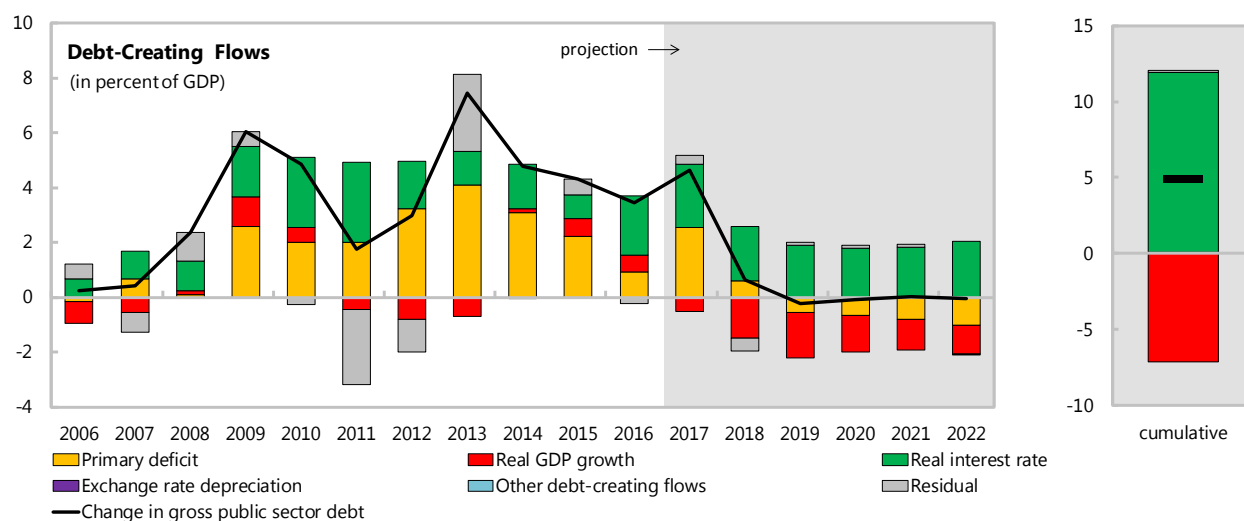
(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators ^{1/}

	Actual			Projections						As of December 21, 2016		
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022			
Nominal gross public debt	42.5	64.5	68.0	72.7	73.3	73.1	73.0	73.0	72.9	Sovereign Spreads Spread (bp) 2/ 366 CDS (bp) n.a.		
Public gross financing needs	6.4	8.2	7.7	8.8	8.6	5.4	5.5	5.9	4.3			
Real GDP growth (in percent)	0.4	-1.1	-1.0	0.8	2.2	2.3	1.9	1.5	1.5			
Inflation (GDP deflator, in percent)	1.2	3.1	1.5	0.8	2.3	1.8	1.9	1.9	1.7	Ratings	Foreign	Local
Nominal GDP growth (in percent)	1.7	1.9	0.6	1.6	4.5	4.2	3.9	3.5	3.2	Moody's	Baa1	Baa3
Effective interest rate (in percent) ^{3/}	5.5	4.5	4.9	4.2	5.2	4.6	4.5	4.5	4.6	S&Ps	BB+	BB+
										Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{8/}
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022		
Change in gross public sector debt	3.4	4.3	3.5	4.7	0.6	-0.2	-0.1	0.0	-0.1	4.9	
Identified debt-creating flows	3.4	3.8	3.7	4.3	1.1	-0.3	-0.2	-0.1	0.0	4.8	
Primary deficit	2.0	2.2	0.9	2.6	0.6	-0.6	-0.6	-0.8	-1.0	0.1	1.0
Primary (noninterest) revenue and grants	16.8	19.5	22.0	21.8	22.7	23.0	22.7	22.6	22.6	135.5	
Primary (noninterest) expenditure	18.7	21.7	22.9	24.3	23.3	22.4	22.1	21.8	21.6	135.6	
Automatic debt dynamics ^{4/}	1.5	1.5	2.8	1.8	0.5	0.2	0.5	0.7	1.0	4.6	
Interest rate/growth differential ^{5/}	1.5	1.5	2.8	1.8	0.5	0.2	0.5	0.7	1.0	4.6	
Of which: real interest rate	1.6	0.9	2.2	2.3	2.0	1.9	1.8	1.8	2.0	11.8	
Of which: real GDP growth	-0.2	0.6	0.6	-0.5	-1.5	-1.7	-1.3	-1.1	-1.1	-7.2	
Exchange rate depreciation ^{6/}	0.0	0.0	0.0	...	...	...	...	...	...	...
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other debt-creating flows (specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes ^{7/}	0.0	0.6	-0.2	0.3	-0.4	0.1	0.1	0.1	0.0	0.2	



Source: Fund Staff Calculations.

1/ Public sector is defined as central government.

2/ Bond Spread over U.S. Bonds.

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

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

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

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

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

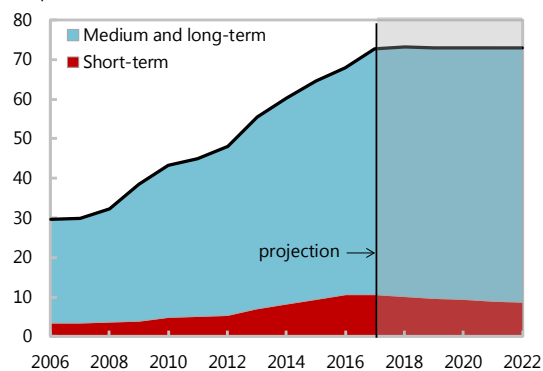
8/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

The Bahamas: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

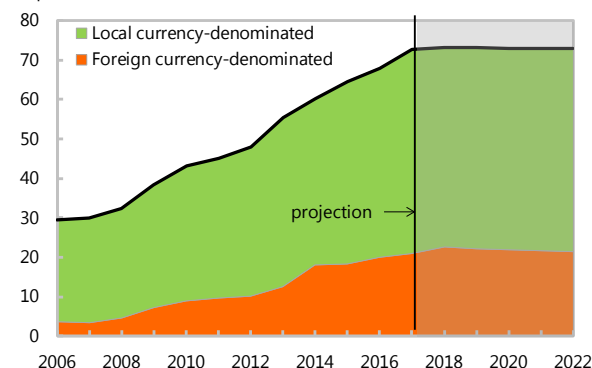
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)



Alternative Scenarios

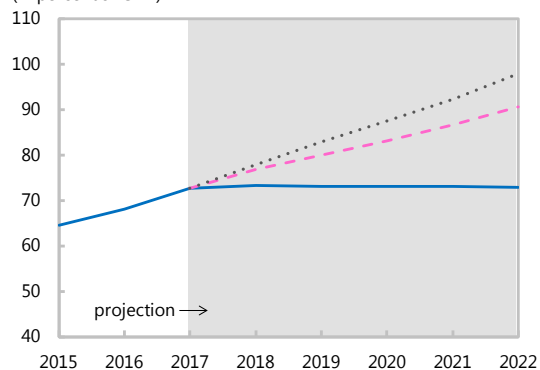
— Baseline

..... Historical

- - - Constant Primary Balance

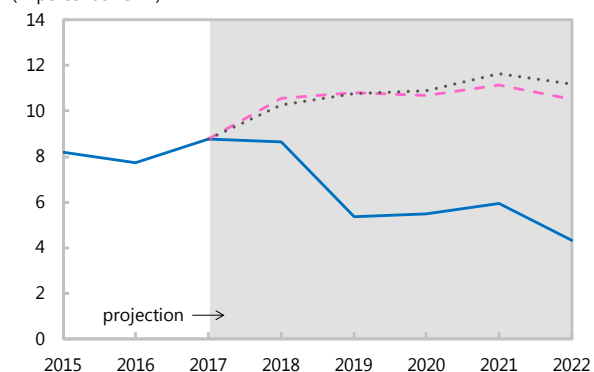
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	0.8	2.2	2.3	1.9	1.5	1.5
Inflation	0.8	2.3	1.8	1.9	1.9	1.7
Primary Balance	-2.6	-0.6	0.6	0.6	0.8	1.0
Effective interest rate	4.2	5.2	4.6	4.5	4.5	4.6
Constant Primary Balance Scenario						
Real GDP growth	0.8	2.2	2.3	1.9	1.5	1.5
Inflation	0.8	2.3	1.8	1.9	1.9	1.7
Primary Balance	-2.6	-2.6	-2.6	-2.6	-2.6	-2.6
Effective interest rate	4.2	5.1	4.5	4.6	4.7	4.8

Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	0.8	-0.1	-0.1	-0.1	-0.1	-0.1
Inflation	0.8	2.3	1.8	1.9	1.9	1.7
Primary Balance	-2.6	-2.1	-2.1	-2.1	-2.1	-2.1
Effective interest rate	4.2	5.1	4.7	4.9	5.1	5.4

Source: Fund Staff calculations.

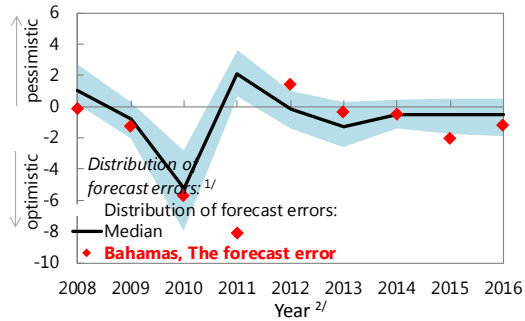
The Bahamas: Public DSA – Realism of Baseline Assumptions

Forecast Track Record, versus all countries

Real GDP Growth

(in percent, actual-projection)

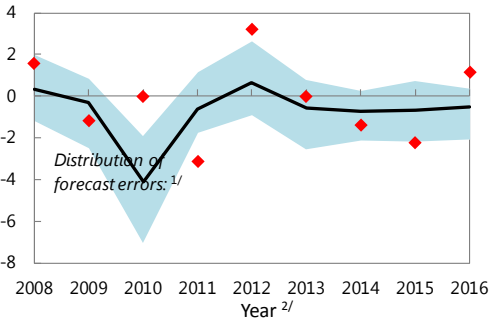
Bahamas, The median forecast error, 2008-2016: **-1.21**
Has a percentile rank of: **18%**



Primary Balance

(in percent of GDP, actual-projection)

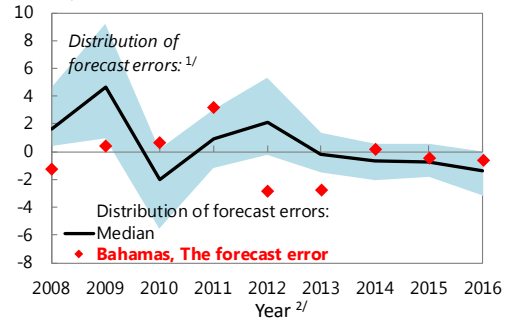
Bahamas, The median forecast error, 2008-2016: **0.00**
Has a percentile rank of: **49%**



Inflation (Deflator)

(in percent, actual-projection)

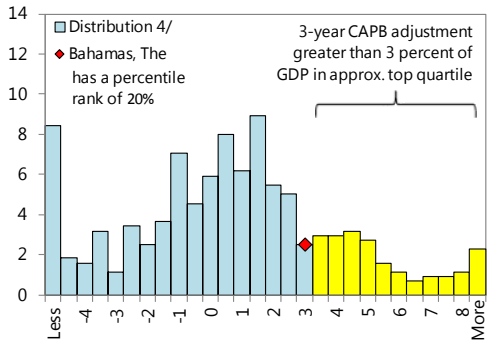
Bahamas, The median forecast error, 2008-2016: **-0.42**
Has a percentile rank of: **20%**



Assessing the Realism of Projected Fiscal Adjustment

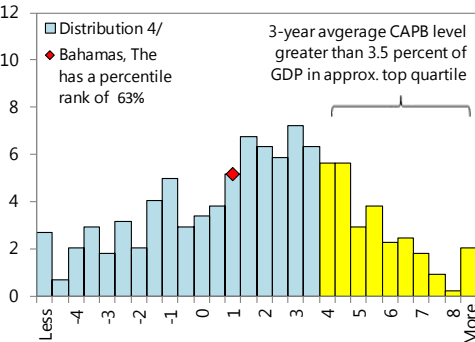
3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)

(Percent of GDP)



3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)

(Percent of GDP)

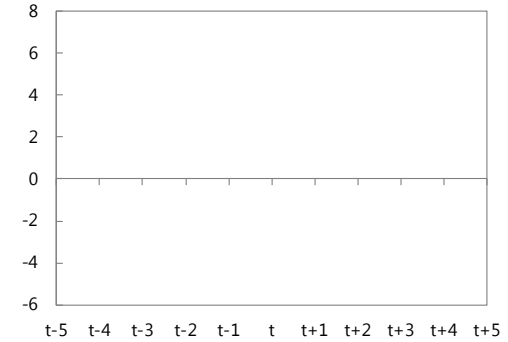


Boom-Bust Analysis^{3/}

Real GDP growth

(in percent)

— Bahamas, The



Source: Fund Staff calculations.

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

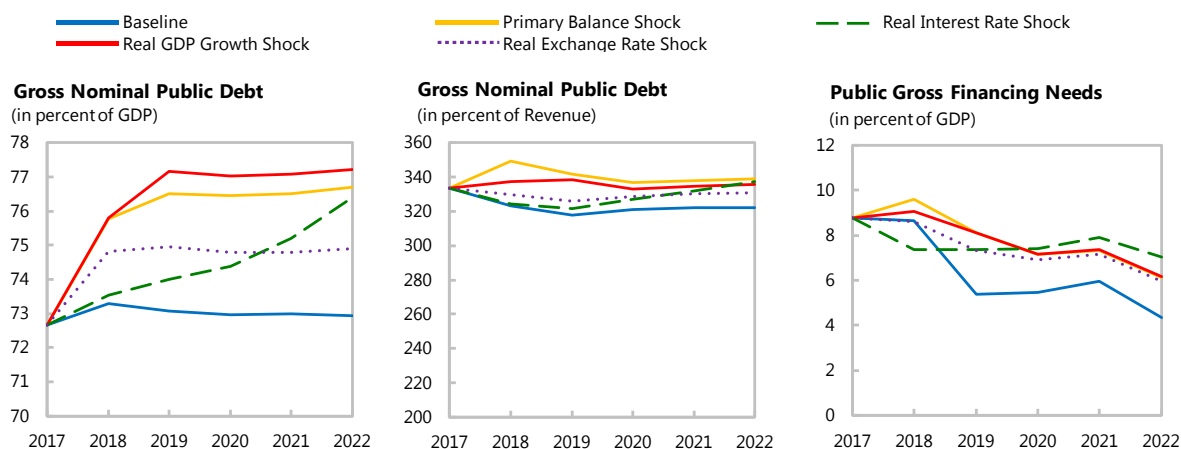
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Bahamas, The.

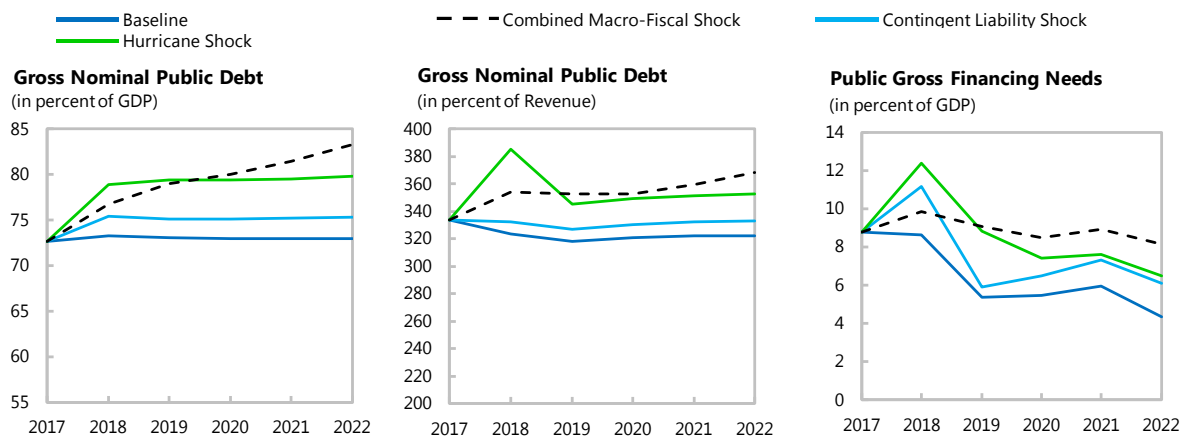
4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.□

The Bahamas: Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions (in percent)

	2017	2018	2019	2020	2021	2022
Primary Balance Shock						
Real GDP growth	0.8	2.2	2.3	1.9	1.5	1.5
Inflation	0.8	2.3	1.8	1.9	1.9	1.7
Primary balance	-2.6	-1.6	0.0	0.6	0.8	1.0
Effective interest rate	4.2	5.1	4.5	4.6	4.7	4.8
Real Interest Rate Shock						
Real GDP growth	0.8	2.2	2.3	1.9	1.5	1.5
Inflation	0.8	2.3	1.8	1.9	1.9	1.7
Primary balance	-2.6	-0.6	0.6	0.6	0.8	1.0
Effective interest rate	4.2	5.1	4.9	5.3	5.7	6.2
Combined Shock						
Real GDP growth	0.8	1.3	1.5	1.9	1.5	1.5
Inflation	0.8	2.3	1.8	1.9	1.9	1.7
Primary balance	-2.6	-1.8	-0.4	0.2	0.5	0.7
Effective interest rate	4.2	5.1	5.1	5.5	5.9	6.4
Real GDP Growth Shock						
Real GDP growth	0.8	1.3	1.5	1.9	1.5	1.5
Inflation	0.8	2.3	1.8	1.9	1.9	1.7
Primary balance	-2.6	-1.0	0.0	0.6	0.8	1.0
Effective interest rate	4.2	5.1	4.5	4.6	4.6	4.8
Real Exchange Rate Shock						
Real GDP growth	0.8	2.2	2.3	1.9	1.5	1.5
Inflation	0.8	2.5	1.8	1.9	1.9	1.7
Primary balance	-2.6	-0.6	0.6	0.6	0.8	1.0
Effective interest rate	4.2	5.1	4.5	4.5	4.6	4.8
Contingent Liability Shock						
Real GDP growth	0.8	2.2	2.3	1.9	1.5	1.5
Inflation	0.8	2.3	1.8	1.9	1.9	1.7
Primary balance	-2.6	-3.1	0.6	0.6	0.8	1.0
Effective interest rate	4.2	5.2	4.5	4.5	4.6	4.8

Source: Fund staff calculations.

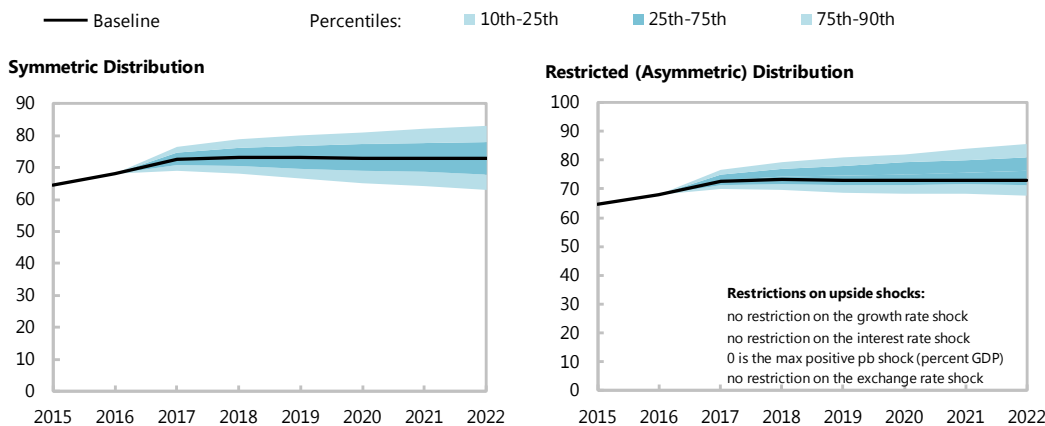
The Bahamas: Public DSA Risk Assessment

Heat Map

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

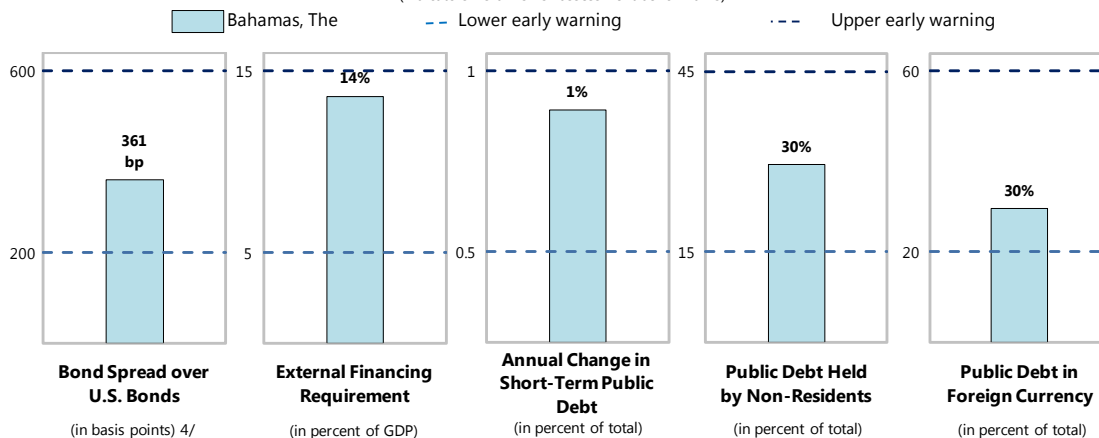
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)



Source: Fund staff calculations.

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

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

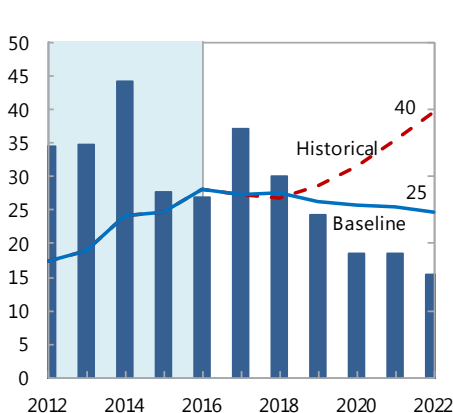
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant,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

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

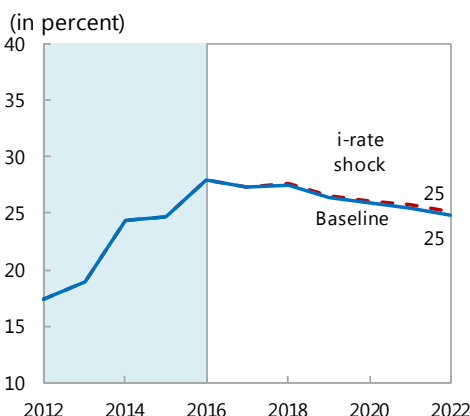
4/ An average over the last 3 months, 22-Sep-16 through 21-Dec-16.

The Bahamas: External Debt Sustainability: Bound Tests 1/ 2/ (External debt in percent of GDP)

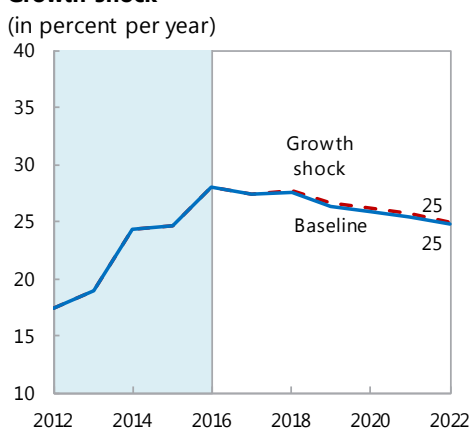
Baseline and historical scenarios



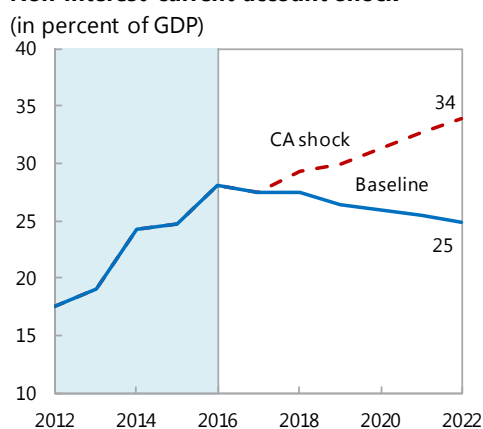
Interest rate shock



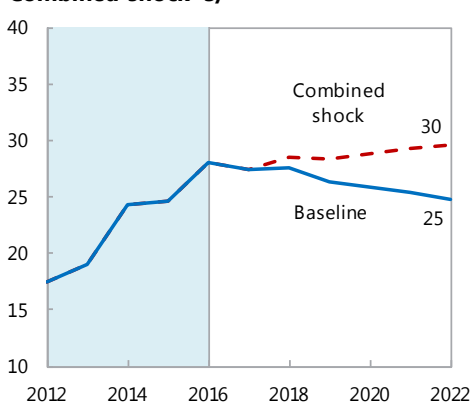
Growth shock



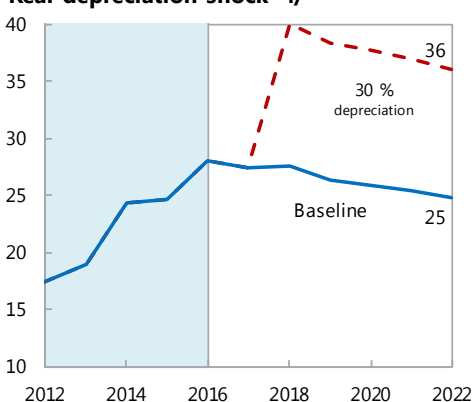
Non-interest current account shock



Combined shock 3/



Real depreciation shock 4/



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 current account balance.

4/ One-time real depreciation of 30 percent occurs in 2018.

The Bahamas: External Debt Sustainability Framework, 2012–2022

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/ -2.6	
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022		
Baseline: External debt	17.4	19.0	24.3	24.7	28.0	27.4	27.5	26.4	25.9	25.4	24.8		
Change in external debt	4.2	1.5	5.3	0.4	3.3	-0.6	0.1	-1.2	-0.5	-0.4	-0.6		
Identified external debt-creating flows (4+8+9)	10.2	12.3	19.0	12.3	12.7	14.4	9.3	5.4	5.0	4.2	3.8		
Current account deficit, excluding interest payments	16.3	16.0	20.8	12.4	11.6	16.4	12.7	9.6	7.4	6.8	6.1		
Deficit in balance of goods and services	14.8	13.7	17.6	9.2	11.1	14.1	9.7	6.7	4.6	4.2	3.7		
Exports	43.8	42.6	41.3	38.6	39.1	39.0	40.2	41.1	41.7	42.0	42.5		
Imports	58.6	56.3	58.9	47.8	50.2	53.1	49.9	47.8	46.2	46.2	46.2		
Net non-debt creating capital inflows (negative)	-6.1	-4.3	-2.7	-0.6	-0.6	-2.9	-4.0	-4.9	-3.2	-3.4	-2.9		
Automatic debt dynamics 1/	0.0	0.6	0.8	0.6	1.8	0.9	0.6	0.6	0.7	0.7	0.6		
Contribution from nominal interest rate	0.8	0.9	1.0	1.2	1.4	1.4	1.3	1.2	1.1	1.1	1.0		
Contribution from real GDP growth	-0.4	0.0	0.1	0.4	0.1	-0.5	-0.7	-0.6	-0.4	-0.4	-0.4		
Contribution from price and exchange rate changes 2/	-0.4	-0.2	-0.3	-1.0	0.3	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	-6.0	-10.8	-13.6	-11.9	-9.4	-15.0	-9.2	-6.5	-5.5	-4.6	-4.4		
External debt-to-exports ratio (in percent)	39.8	44.5	58.9	64.0	71.6	70.2	68.4	64.2	62.1	60.5	58.4		
Gross external financing need (in billions of US dollars) 4/	1.5	1.5	1.9	1.2	1.2	1.7	1.4	1.2	0.9	1.0	0.8		
in percent of GDP	17.3	17.3	22.1	13.8	13.4	10-Year	10-Year	18.6	15.0	12.1	9.2	9.3	7.7
Scenario with key variables at their historical averages 5/						27.4	26.7	28.6	31.6	35.5	39.6	-4.3	
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation						
Real GDP growth (in percent)	3.1	0.0	-0.5	-1.7	-0.3	-0.2	2.1	1.8	2.5	2.2	1.6	1.5	1.5
GDP deflator in US dollars (change in percent)	3.3	1.5	1.7	4.5	-1.3	1.2	2.0	2.9	1.7	2.0	1.9	1.8	1.5
Nominal external interest rate (in percent)	6.6	5.2	5.5	5.1	5.5	5.6	0.5	5.3	4.9	4.6	4.5	4.2	4.0
Growth of exports (US dollar terms, in percent)	10.5	-1.3	-1.9	-4.0	-0.1	1.4	10.8	4.3	7.6	6.4	5.0	4.2	4.2
Growth of imports (US dollar terms, in percent)	15.6	-2.6	5.8	-16.6	3.5	0.7	11.1	10.7	-2.1	-0.1	0.2	3.4	2.9
Current account balance, excluding interest payments	-16.3	-16.0	-20.8	-12.4	-11.6	-13.2	3.6	-16.4	-12.7	-9.6	-7.4	-6.8	-6.1
Net non-debt creating capital inflows	6.1	4.3	2.7	0.6	0.6	6.1	3.8	2.9	4.0	4.9	3.2	3.4	2.9

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 (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.

Annex V. Mitigating Natural Disaster Risks and Enhancing Economic Resilience

The Bahamas is disproportionately exposed to natural disasters—both in terms of frequency and associated economic costs. The potential intensification of future disaster events owing to climate change puts a premium on policies to bolster preparedness and ex-ante risk reduction to reduce and smooth out the consequences of natural disasters. Policies in this direction should include bolstering investment in risk reduction, increasing reliance on market-based insurance, and rebuilding fiscal and external buffers, including through a dedicated savings arrangement.

Context

1. Over the last 20 years, The Bahamas has faced larger damages and more frequent natural disasters than the Caribbean region average. The annual damage averaged about 2.0 percent of GDP for The Bahamas compared to an average of 1¼ percent of GDP for the Caribbean region.¹ The probability of a storm disaster in any given year is also elevated at 30 percent relative to a 20 percent for the Caribbean region.

2. Natural disasters can have severe macroeconomic consequences. The recurrent destruction of a country's productive assets constitutes an implicit tax on capital that tends to deter investment, lowers productivity, and income. Natural disasters also worsen external trade balances and fiscal balances, often leading to a rapid accumulation of debt. The erosion of these policy buffers entail broader risks to economic stability. Therefore, investment in risk reduction, increased use of risk transfer mechanisms, and maintaining adequate fiscal and external buffers are critical to reduce and smooth out the economic consequences of natural disasters.

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Investment in Risk Reduction

3. Sturdy infrastructure is a first line of defense against natural disasters. Public infrastructure programs should adequately prioritize effective sea walls along urban coastlines, adequate maintenance and reinforcement of public infrastructure, and seek to “build back better” following disaster events.

Natural Disaster Damage for the Caribbean Region 1/ (in percent GDP)

	Averages		
	1990-2016	2000-2016	2010-2016
The Bahamas	1.8	2.0	1.2
Barbados	0.0	0.0	0.0
Belize	2.3	3.7	0.0
Jamaica	0.5	0.8	0.2
Dominican Republic	0.4	0.1	0.0
Trinidad and Tobago	0.0	0.0	0.0
ECCU	3.7	2.5	2.3
Caribbean average	1.2	1.3	0.5

Sources: EM-DAT, WEO, and IMF staff calculations.

1/ Reports on damages due to storm disasters.

¹ Average includes both disaster and non-disaster years. Adjusting for under-reporting, Acevedo (2016) found that damages for the Caribbean could be 1½ to 3½ times larger than reported in the EM-DAT database.

4. Adequate regulatory and property rights frameworks are central pillars of infrastructure risk mitigation. Targeted fiscal incentives, such as subsidies for retrofitting properties, can spur private investment in disaster resilience. However, regulatory and property rights frameworks are central to risk mitigation. Building codes in The Bahamas are generally adequate to ensure that building structures withstand wind damage but the lack of regulatory protections against storm surge constitutes a clear gap given the countries' low-lying geography. Regulations should be expanded in this area—including by establishing height and minimum building set-backs and sea wall requirements—potentially by drawing on regulatory guidance in similar vulnerable jurisdictions. Establishing systems that mandate regular reviews and updates of land use and zoning rules with limited exemptions, would further boost resilience to natural disasters.

Risk Transfer

5. The Bahamas has a relatively well-developed natural disaster insurance market. There are eight active locally capitalized personal and commercial insurance companies representing a total of \$300 million in gross premiums (3½ percent of GDP) with proven processes for managing disasters. The fallout of Hurricane Matthew on the insurance sector was relatively modest, with losses totaling 1 percent of gross premiums.² About 90-95 percent of claims following Hurricane Matthew had been resolved as of July, 2017.

6. Notwithstanding these advantages, 60 percent of households have no insurance or are underinsured. Insurance on public assets has also lapsed in recent years. Empirical research has shown that countries with more private and public insurance penetration experience far lower output and income losses from disasters.³ Penetration is weak, especially among the most vulnerable segments of the population. The cost of obtaining insurance is regarded as the main obstacle to entry among the population of uninsured/underinsured, reflecting in part the legacy of consecutive years of weak economic activity. This gap in coverage constitutes a contingent liability for the public sector in terms of ex-post direct and indirect social support and rehabilitation expenses.

7. Market-based insurance could be better leveraged to minimize and smooth revenue and expenditures impacts, thus laying the groundwork for a timely disaster response that reduces the potential economic dislocation. To that end, the authorities should consider insuring public assets, at least on a selective basis. Policies should also be developed to broaden insurance coverage by reducing the costs of insurance plans on a targeted basis, informed by cost-benefit analyses. One possibility is to provide means-tested subsidies to low-income households for micro-insurance disaster instruments. Mandatory property insurance, supplemented by targeted subsidies, could also decrease the cost of insurance plans by expanding the premium base.

² The sector makes extensive use of international reinsurance markets which helps minimize aggregate payout risks. Costs associated with Hurricane Matthew are estimated at 6¾ percent of GDP with about 4 percent of GDP of insurance reflows received by end-2016.

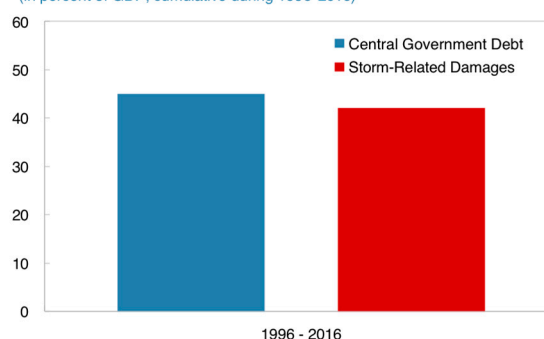
³ Prompt insurance compensation reduces downtime for productive assets and indemnifies producers for income losses. See for example Melecky and Raddatz (2011), von Peter and Saxena. (2012), and Munich Re (2013).

8. Regional approaches can also be pursued to enhance risk transfer. Administrative economies of scale can be achieved by adopting regional regulatory standards and/or by establishing regional administrative bodies.⁴ Furthermore, the pooling of regional funds can finance regional insurance schemes.⁵ The Bahamas is a member of the Caribbean Catastrophe Risk Insurance Facility (CCRIF) but membership provides only limited protection owing to The Bahamas' geographic diversity. Claims are evaluated based on damage to public infrastructure—which is concentrated in New Providence—leaving the bulk of the country underinsured in practice, which calls for enhanced use of market-based insurance, complemented with self-insurance.

Self-Insuring via Fiscal and External Buffers

Fiscal Buffers: The Bahamas has relied on the public balance sheet's capacity to absorb disaster shocks *ex post* through the accumulation of debt. The rapid increase in public debt—which has doubled in the past decade—calls for rebuilding fiscal buffers to respond to future shocks. The budget should include an allocation for natural disaster response as part of annual fiscal planning. This allocation should be saved in an arrangement subject to strict rules governing inflows, outflows, and allocation of resources as well as to transparency and accountability requirements. In addition, legal provisions in the intended fiscal responsibility legislation could mandate depositing revenue surprises into this fund, or using them to reduce debt, to strengthen fiscal buffers faster.

Accumulated Public Debt and Natural Disaster Costs
(in percent of GDP; cumulative during 1996-2016)



Sources: EM-DAT, WEO, and Staff calculations

External buffers: The impact of natural disasters on the balance of payments of small states tends to be proportionately higher as a share of GDP. Indeed, reconstruction activities have a significant import content, calling for maintaining adequate reserve buffers. At 2.4 months of next year's imports, reserve coverage in The Bahamas is below conventional metrics. Reforms to improve the business environment and cost competitiveness, alongside sustained fiscal consolidation, will help strengthen reserve buffers. Measures to reduce dependency on imports, such as initiatives to support the development of domestic agricultural and industrial production, through education and improved access to credit, would also help strengthen external buffers.

⁴ In the Caribbean, the Caribbean Disaster Emergency Management Agency (CDEMA) coordinates regional disaster responses and establishes codes of good practice, including for building construction.

⁵ While *ex ante* all these economies are exposed to the same risk, the realization of the risk does not affect all countries equally, allowing some room for risk sharing.

Annex VI. Progress on 2013 FSAP Recommendations

Recommendations	Status
Banking sector	
Recruit additional staff with emphasis on specialists.	Completed.
Amend legislation so that if Governor is removed, reasons would be publicly disclosed.	Draft amendment in Parliament.
Implement, as planned, draft guidance on bank responsibilities for managing operational, interest rate, and market risk.	Completed.
Develop guidelines on the scope and methods of consolidated supervision.	Completed.
Insurance and Pensions	
Introduce a standard methodology for the valuation of long-term insurer liabilities.	Guideline on minimum standards in place.
Implement fully the 3-year plan towards risk-based supervision (RBS). Onsite comprehensive examinations should be initiated without delay.	In progress, to be completed in 2017.
Develop support for consumer complaint handling. Consider establishing ombudsman.	Complain filing process has been strengthened and an independent arbitration process will be launched in 2017.
Amend legislation to specifically require intermediaries to establish a premium payment trust account separate from the intermediary's account.	Pending.
Introduce staggered terms for Insurance Commission of The Bahamas (ICB) Board and publish reasons for removal of Board members or the Superintendent.	Pending.
Develop regulations for appropriate group supervision, corporate governance and risk management standards, processes and procedures and conduct onsite reviews in accordance with Insurance Core Principle (ICP) 23.	No regulations; ICB cooperates with other regulators under MOU's and colleges
Promulgate regulation for new pension fund legislation without delay.	Pending.
Capital Markets	
Replace current Investment Funds Act 2003 (IFA) and its regulations.	In progress.
Delete the exclusion in the Securities Industry Act 2011 (SIA) which permits selling investment fund shares to clients without a license if that is the only securities business a person undertakes.	Pending; to be addressed as part of IFA overhaul.
Subject all locally resident related parties to full due diligence check in licensing investment fund. Subject managers/advisers, operators and custodians to ongoing oversight.	In progress; To be completed in 2017.
Consider appointing a public interest oversight body for the auditing profession and The Bahamas Institute of Chartered Accountants (BICA), possibly giving the role to the Securities Commission of The Bahamas (SCB).	Pending.
Develop a plan, possibly as part of the NFCMP, to deal with the failure of a licensee.	Pending.
Safety Net and Crisis Management	
Prepare crisis management plan draft for Ministry of Finance (MoF).	In progress.
Implement crisis management plan.	In progress.
Develop a category of 'systemic banks' narrowed to those eligible for solvency support or extraordinary intervention, consistent with international practice.	Completed.
Develop a target ratio for Deposit Insurance Corporation (DIC) equity capital and determine primary and secondary borrowing sources.	In progress.



THE BAHAMAS

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION— INFORMATIONAL ANNEX

August 23, 2017

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

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FUND RELATIONS

(As of July 31, 2017)

Membership Status: Joined August 21, 1973; Article VIII

General Resources Account:

	SDR Millions	Percent of Quota
Quota	182.40	100.00
Fund holdings of currency	163.12	89.43
Reserve position in the Fund	19.29	10.57

SDR Department:

	SDR Millions	Percent of Quota
Net cumulative allocation	124.41	100.00
Holdings	53.99	43.40

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				
	2017	2018	2019	2020	2021
Principal					
Charges/					
Interest	0.21	0.42	0.42	0.42	0.42
Total	0.21	0.42	0.42	0.42	0.42

Exchange Rate Arrangement

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

Assessment of Data Adequacy for Surveillance:

Data provision is broadly adequate for surveillance. All critical macroeconomic data, including comprehensive central government finance statistics, are regularly published in the Central Bank of the Bahamas' *"Monthly Economic and Financial Developments"* and *"Quarterly Statistical Digest"*. However, the timeliness of data could improve. At the same time, the authorities have yet to develop the institutional capacity for the compilation of international investment position (IIP) statistics and general government accounts data. Also, The Bahamas has still not started compiling balance of payments statistics consistent with the *Balance of Payments Manual 6*. Staff continues to support the authorities' efforts towards addressing data gaps, including continuing technical assistance to compile and publish quarterly national accounts and IIP statistics.

Last Article IV Consultation

The Bahamas is on a 12-month consultation cycle. The last Article IV consultation was concluded by the Executive Board on June 8, 2016 (IMF Country Report No. 16/224).

Technical Assistance		
Department	Dates	Purpose
CARTAC	January 2011	CPI Revision
CARTAC	April 2011	Revenue Mod./Forecasting
CARTAC	May 2011	PFM Reform Action Plan
STA	October 2011	Government Finance Statistics
LEG	February 2012	Central Bank of The Bahamas Act
MCM	February/March 2012	Public Debt Management
STA	June 2012	Quarterly National Accounts
LEG	July 2012	Payment System Laws
STA	Jan 2013	Government Finance Statistics
MCM	February 2013	Financial Stability Reporting
FAD	April 2013	Tax Reforms for Increased Buoyancy
CARTAC	April 2013	Draft VAT Bill
MCM	May 2013	Basel II Implementation
CARTAC	May/September 2013	Central Revenue Agency
CARTAC	July 2013	Support for Customs and Excise Department's Preparation of VAT
FAD	January/February 2014	Revenue Administration
FAD	March 2014	Tax Administration Readiness to Successfully Launch and Administer VAT
FAD	March 2014	Goods and Services Tax
FAD	March 2014	VAT Revenue Projection

Technical Assistance (Concluded)		
FAD	April 2014	Revenue Impact of Implementing VAT
MCM	March 2014	Financial Crisis Management Planning
MCM	April 2014	Debt Management
CARTAC	June 2014	Price Statistics
CARTAC	August 2014	Balance of Payment and International Investment Position
FAD	September/October 2014	Revenue Administration
FAD	October 2014	Preparation to Launch a Value Added Tax
CARTAC	November 2014	Quarterly National Accounts
CARTAC	December 2014	Price Statistics
CARTAC	December 2014	Risk-Based Supervision of the Securities Market
LEG	March 2015	Strengthening the Legal Framework for Bank Resolution and Crisis Management
CARTAC	August/September 2015	Quarterly National Accounts
FAD	February/March 2016	Assessment of VAT Launch and Administration
CARTAC	August 2016	National Accounts Statistics

Resident Representative: None

FINANCIAL RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of June 30, 2017)

Country Strategy with The Bahamas 2013–2017

The current Country Strategy supports the Government of The Bahamas (GoBH) efforts to ensure macroeconomic sustainability, social stability and employment, while focusing on resilience to mitigate the negative impact of natural disasters and climate change. The Bank is: (i) supporting the implementation of fiscal and debt sustainability reforms with an impact on public finances and public financial management; (ii) assisting with fostering social cohesion, with an emphasis on preventing crime and violence and strengthening the criminal justice system; (iii) assisting with modernizing the electricity sector and diversification of the energy matrix; (iv) facilitating diversification of both the economy and trading partners by enhancing areas of comparative advantage and removing constraints to private sector activity; and (v) building resilience to natural disasters through improved coastal zone management, incorporating disaster risk reduction and climate change adaptation measures in development planning, control and monitoring. The support is focused on the following priority areas: (1) Public Finances and Management; (2) Citizen Security and Justice; (3) Energy; (4) Private Sector Development; and (5) Coastal Risk Management and Climate Change Adaptation. Interventions will contribute to stemming the erosion of per capita incomes by protecting public investment and promoting growth. Efforts are made to generate non-sovereign guaranteed (NSG) lending that is closely aligned to the development and diversification of the private sector, as well as direct financing for alternative energy and energy efficiency. In addition, the IDB aims to support interventions in sectors where additional financial and non-financial resources may be leveraged.

Other areas for future dialogue. In addition to the priority areas identified above, the Bank is supporting diagnostic and analytical work in the following dialogue areas: (a) Education: The provision of quality education services: (i) via strengthening capacity at the secondary education level to improve the transition from school to work, including potential areas for PPPs, and (ii) for special needs children and youth at all levels of the educational system and with an emphasis on the transition from school to work; (b) Food Security: Analyzing options to increase domestic food production and consumption of local goods, given the country's heavy dependence on food imports; (c) Transport: An analysis of (i) the impact and opportunities from the completion of the Panama Canal, (ii) greater connectivity: how inter-island mobility could be made more efficient across the 28 inhabited islands; (iii) enhancing trade links with the rest of the Caribbean and Latin America; and (d) Informal Immigration.

Active Loans as of JUNE 30, 2017

(In millions of U.S. dollars)

Project	Name	Approval Date	Approved	Disbursed	Available
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	2.5	0.0
BH-L1028	WSC Support Program—New Providence Water Supply and Sanitation Systems Upgrade	Nov 16, 2011	81.0	64.9	16.1
BH-L1016	Trade Sector Support Program	Jul 18, 2012	16.5	11.1	5.4
BH-L1029	New Providence Transport Program Supplementary Financing II	Sep 04, 2012	65.0	65.0	0.0
BH-L1030	Social Safety Net Reform Program	Jul 18, 2012	7.5	3.9	3.6
BH-L1033	Citizen Security and Justice Program	Jul 7, 2015	20.0	2.4	17.6
BH-L1035	Performance Monitoring and Public Financial Management Reform	Nov 19, 2014	33.0	0.0	33.0
BH-L1037	Skills for Current and Future Jobs	Nov 2, 2016	25.0	0.0	25.0
BH-L1041	Airport Infrastructure Program	Jan 30, 2017	35.0	0.0	35.0
Total			33.5	164.8	168.7

Net Flow of IADB Convertible Currencies

(In millions of U.S. dollars)

Net Flow of IADB Convertible Currencies (US\$ million)							
	2011	2012	2013	2014	2015	2016	2017 (P)
a. Loan Disbursements	57.0	61.9	49.4	30.4	11.0	18.6	13.6
...PBL disbursements	15.0	0	0	0	0	0	0
b. Repayments principal	9.4	11.7	14.0	14.2	16.6	16.4	23.5
c. Net Loan Flow (a-b)	47.6	50.2	35.4	16.2	-5.6	2.2	-9.9-9.9
d. Subscriptions & Contributions	0.3	0.9	1.0	0.8	0	0	0
e. Interests & Charges	5.7	6.5	6.8	6.7	6.6	8.5	8.4
f. Net Cash Flow (c-d-e)	41.6	42.8	27.6	8.7	-12.2	-6.3	-18.3
(p) Projected.							

FINANCIAL RELATIONS WITH THE CARIBBEAN DEVELOPMENT BANK

(As of July 18, 2017)

Country Strategy with The Bahamas 2013-2017

The overriding aim of the CDB's current Strategy for The Bahamas is to support the country's advancement as a progressively stable and vibrant economy, as well as an increasingly safe society with enhanced opportunities for productive employment and improved living standards. An indicative program of assistance was proposed to help the country achieve faster, more inclusive and environmentally sustainable development, buttressed by macroeconomic stability and citizen security. The Country Strategy responds to The Bahamas' development priorities and is aligned with the Bank's strategic objectives of (1) supporting inclusive and sustainable growth and development, and (2) promoting good governance. The Bank is supporting six development priorities: (i) improved access to, and quality of climate-resilient social and economic infrastructure; (ii) enhanced access to quality, and demand-driven post-secondary and tertiary education; (iii) increased social inclusion and citizen security; (iv) strengthened productive and managerial capacities of micro, small and medium-sized enterprises; (v) improved public finances and planning; and (vi) strengthened resilience to climate change and improved disaster risk management (DRM). Several projects, along with associated technical assistance, are being taken forward to address these priorities.

Other areas for future dialogue: The Bank has already conducted a mid-term review of the existing strategy. This will inform the next strategy, due to commence in 2018. Discussions are likely to focus on consolidating the work of the existing strategy, with focus on the development needs in the Family Islands

Loans as of July 18, 2017 (In millions of U.S. dollars)					
Project	Name	Approval Date	Approved	Disbursed	Available
Active Loans					
9/OR-BHA	Family Islands Transport Sector Enhancement Project	Mar 11, 2010	10.1	7.0	3.1
02/SFR-BHA	NDM – Immediate Response – Hurricane Sandy	May 02, 2013	0.7	0.7	0
11/OR-BHA	Water Supply improvement project	Dec 10, 2015	28.3	2.9	25.4
Active Loans 3			39.1	10.6	28.5
Pending Loans					
	Technical and Vocational Institute Enhancement Project	Dec 11, 2014	4.7	0	4.7
	Immediate Response Loan Hurricane Joaquin	Apr 21, 2016	0.8	0	0.8
	TA – Geomatics Capacity Enhancement for Disaster Risk Management	Dec 8, 2016	2.9	0	2.9
Pending Loans 3			8.4	0	8.4
Total Loans 6			47.5	10.6	36.9

Net Flow of CDB Convertible Currencies (In millions of U.S. dollars)							
	2010	2011	2012	2013	2014	2015	2016
a. Loan Disbursements	0	0.06	5.06	0.72	1.15	0.11	2.59
...PBL disbursements	0	0	0	0	0	0	0
b. Repayments principal	0.90	0.90	0.69	0.48	0.80	0.02	0.79
c. Net Loan Flow (a–b)	-0.90	-0.85	4.37	0.24	0.35	0.08	1.80
d. Subscriptions & Contributions	1.47	3.36	3.36	3.36	3.36	3.36	1.47
e. Interests & Charges	0.15	0.17	0.19	0.28	0.89	0.39	0.33
f. Net Cash Flow (c–d–e)	-2.52	-4.39	0.82	-3.40	-3.90	-3.67	0

STATISTICAL ISSUES

Statistical data are broadly adequate for surveillance purposes, but some weaknesses remain in both coverage and timeliness, partly reflecting capacity constraints. 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.

The Department of Statistics (DoS) is receiving technical assistance from CARTAC to produce quarterly GDP estimates. During an August 2016 mission, CARTAC reviewed and provided advice to further improve the methodologies to estimate GDP. In addition, advice was provided on the methodology and source data to be used in compiling the supply and use tables (SUT) for 2012 and in rebasing the GDP. CARTAC also provided training to the DoS staff on the recommended changes in data sources and methodologies, and prepared a medium-term action plan to improve and expand the national accounts aggregates. There is scope to improve the GDP methodologies, including implementing the *2008 SNA* recommendation for calculating and allocating financial intermediation services indirectly measured; work-in-progress approach for agriculture and construction; discontinuing the use of fixed intermediate consumption (IC) to output ratios for current price estimates; improving deflation/reflation of IC; fully implementing the *International Standard Industry Classification Revision 4 (ISIC Rev.4)*; and use of volume extrapolation at a more detailed level to derive taxes on products in constant prices.

The Bahamas does not prepare data covering the economy-wide external debt position, nor an international investment position (IIP). In June 2017, a CARTAC mission identified a wide range of improvements that can be addressed in the short-term horizon in this area. The new IIP survey and revisions to other surveys introduced earlier in the year had flaws and the mission recommended revisions based on the report forms in the *BPM6 Compilation Guide*. The mission developed new surveys for the financial sector (direct investment in banks and foreign assets of mutual funds) and identified several administrative sources of information for ESS compilation. It is expected that by October 2017, the following benchmarks would be met: (i) record balance of payments in *BPM6* framework for 2013–16; (ii) revise survey form on financial flows and external positions, focusing on IIP data; and review with ECD the methodology for consolidating information from ECD and surveys conducted by the BOP Unit.

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 July 31, 2017)					
	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	05/17	07/17	M	M	M
Reserve/Base Money	03/17	05/17	M	M	M
Broad Money	03/17	05/17	M	M	M
Central Bank Balance Sheet	05/17	07/17	M	M	M
Consolidated Balance Sheet of the Banking System	03/17	05/17	M	M	Q
Interest Rates ²	03/17	05/17	M	M	M
Consumer Price Index	03/17	07/17	M	I	I
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	04/17	07/17	M	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	03/17	07/17	Q	Q	Q
External Current Account Balance	03/17	06/17	Q	Q	I
Exports and Imports of Goods and Services	03/17	06/17	Q	Q	Q
GDP/GNP	2015	06/16	A	A	A
Gross External Debt	03/17	07/17	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).