June 2009
IMF Country Report No. 09/189

The Bahamas: 2009 Article IV Consultation—Staff Report; Staff Supplement; and Public Information Notice on the Executive Board Discussion

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 2009 Article IV consultation with The Bahamas, the following documents have been released and are included in this package:

- The staff report for the 2009 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on April 3, 2009, 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 May 21, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff supplement of June 3, 2009, updating information on recent developments.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its June 5, 2009, discussion of the staff report that concluded the Article IV consultation.

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

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International Monetary Fund
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INTERNATIONAL MONETARY FUND

THE BAHAMAS

Staff Report for the 2009 Article IV Consultation

Prepared by the Staff Representatives for the 2009 Article IV Consultation
with The Bahamas

Approved by Patricia Alonso-Gamo and Aasim Husain

May 21, 2009

Economic and political setting. The Bahamas' economy, closely linked to that of the U.S., is being affected by the global economic and financial crisis. Growth contracted by 1.7 percent in 2008, and staff projects a further contraction of 3.9 percent in 2009, reflecting declines in tourism, foreign direct investment and offshore financial services activity. The country has relatively low debt (40 percent of GDP), providing some fiscal space for countercyclical policy, but the fixed exchange rate regime could pose a constraint on the level of borrowing.

Focus of consultation. The discussions focused on macroeconomic and financial policies to respond to the crisis, and measures to reduce vulnerability over the longer term. The authorities' fiscal plans strike a reasonable balance between accommodating the shock—maintaining essential expenditures in FY 2008/09 and FY 2009/10—and fiscal adjustment, particularly in light of the uncertain duration of the global slowdown. The authorities' plans to strengthen non-banking financial services supervision are also welcome.

Authorities' views. The authorities concurred that economic growth would be adversely impacted, but in their view real GDP growth may decline less than projected by the staff, emphasizing the resilience of foreign direct investment and measures to generate tourism receipts from non-traditional sources. They concurred that contingency policy measures to deal with fiscal revenue shortfalls for the next 1–2 years would be important. The authorities are committed to protecting the soundness of the financial sector and strengthening supervision and monitoring.

Exchange system. The Bahamas has accepted the obligations of the Article VIII, Sections 2, 3, and 4, and maintains an exchange system that is free of restrictions on payments and transfers for current international transactions. The exchange rate of the Bahamian dollar is pegged to the U.S. dollar at parity.

Mission. The team visited Nassau during March 24–April 3 and comprised Laure Redifer (head), Christopher Faircloth, Masahiro Nozaki (all WHD) and Werner Keller (AFR). Patricia Alonso-Gamo and Trevor Alleyne (both WHD) and Mr. Ladd (OED) participated in policy meetings.

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I. Background

1. **The Bahamas is a small open economy, based mainly on tourism, foreign direct investment, and offshore financial activities**. The one-to-one peg between the Bahamian and U.S. dollars has been in place for 36 years, and has provided a stable investment climate. The country has the third largest income per capita in the western hemisphere region, with a good track record of political stability, and a relatively high credit rating within the region. Tourism accounts for almost half of GDP, with over 80 percent of tourists from the United States. FDI, mostly related to tourism and second-home buyers, fuels construction, domestic employment and services. The financial sector, including the offshore sector, accounts for about 20 percent of economic activity. Exchange controls are maintained on capital transactions, narrowing the field of investment opportunities for local wealth, largely to real estate and government debt.

Selected Caribbean Countries—Key Economic, Social, and Political Indicators

	The Bahamas	Barbados	Jamaica	Trinidad & Tobago
Economic indicators				
GDP per capita (USD 2007)	19,736	13,605	4,172	15,905
S&P sovereign rating (forex long-term debt)	A-	BBB+	B-	A
Moody's sovereign (forex long-term debt)	A3	Baa2	B2	Baa1
Social indicators 1/				
Human Development Index (UNDP, rank)	49	37	87	57
Indicators of business climate and governance (World Bank) 1/				
Ease of doing business (rank)	55	n.a.	63	80
Governance indicators (percentile)				
Voice and Accountability	84	87	65	66
Political Stability and Absence of Violence	75	92	43	44
Government Effectiveness	84	85	60	66
Regulatory Quality	82	81	62	71
Rule of Law	85	88	32	49
Control of Corruption	91	90	39	55

Sources: IMF World Economic Outlook, World Bank Governance Indicators, World Bank Doing Business Indices, and UNDP.
1/ A low rank or high percentile indicate relative strength.

2. **Macroeconomic policy has historically been geared to maintaining fiscal sustainability, attracting investment, and supporting the exchange rate peg**. In the decade preceding the crisis, the central government had an overall fiscal deficit averaging around 2 percent, with a primary balance of zero. This helped maintain government debt low (33 percent of GDP at end-2006).[1] The authorities took corrective fiscal measures when necessary, as when tourism declined in 2001–03, leading to a sharp drop in revenues. In that case, after an initial fiscal impulse, spending cuts and administrative tax measures were introduced to contain the increase in the budget deficit. The tax regime in the Bahamas is largely based on import and real estate taxes, with numerous concessions for investment in the tourism industry.[2] The revenue base is narrow compared to other Caribbean islands, leaving revenue vulnerable to external cycles. The authorities have occasionally taken direct

[1] Central government debt. Consolidated public sector debt, which excludes public corporations' holdings of central government debt, was estimated at 32 percent of GDP for end-2006.

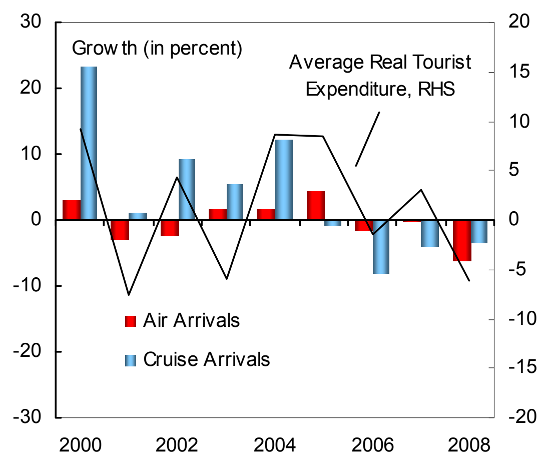
[2] Fund research suggests that such incentives regimes are potentially costly in terms of lost tax revenue, estimated to be in the range of 11 percent of GDP for the Caribbean region. See IMF publication *The Caribbean: Enhancing Economic Integration (2008).*

measures to defend the level of reserves and the exchange rate peg: in 2001–03, they imposed temporary bank credit ceilings to dampen private consumption and imports.

3. **Favorable external conditions prior to the onset of the global downturn led to strong growth in real GDP, credit, and investment**. Real GDP growth averaged 5 percent in 2005–06, reflecting a recovery in tourism and related FDI inflows after the 2001–03 shock. Private sector credit grew by an average of 14.3 percent, reflecting strong economic activity and pent-up demand unleashed by the removal of credit controls in August 2004. Real estate activity was particularly notable, with outstanding mortgage loans rising from 27 percent of GDP in 2003 to 37 percent in 2008. The external current account worsened due to an increase in consumer good imports and higher oil bills, and international reserves declined from 668 million to 454 million during 2004–07.

II. Recent Developments and Near-Term Outlook

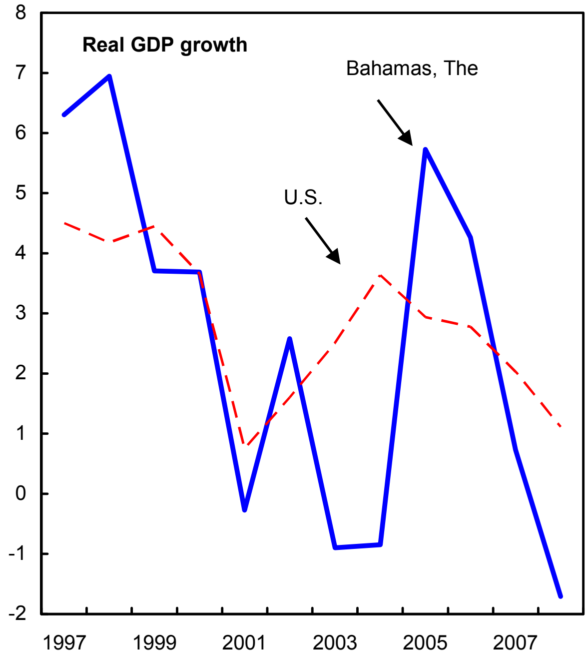
4. **Since mid-2008, the global downturn, particularly in the United States, has significantly affected economic activity in The Bahamas, but direct financial contagion has been limited** (Figure 1). Tourism began declining in September, also affected by the threat of Hurricane Ike, causing overall receipts to drop by 1.6 percent in 2008. Net FDI dropped by 6 percent, and private sector credit growth decelerated to 5 percent in 2008. As a result, real GDP is estimated to have contracted by 1.7 percent. The unemployment rate rose to 12–14.5 percent (preliminary March 2009 estimates) from 7.9 percent at end-2007, with hotel and construction accounting for most of the layoffs. The direct impact of the financial crisis on the domestic economy has been lessened by exchange controls, since Bahamians have limited foreign-currency denominated liabilities and have experienced less severe drops in asset wealth.



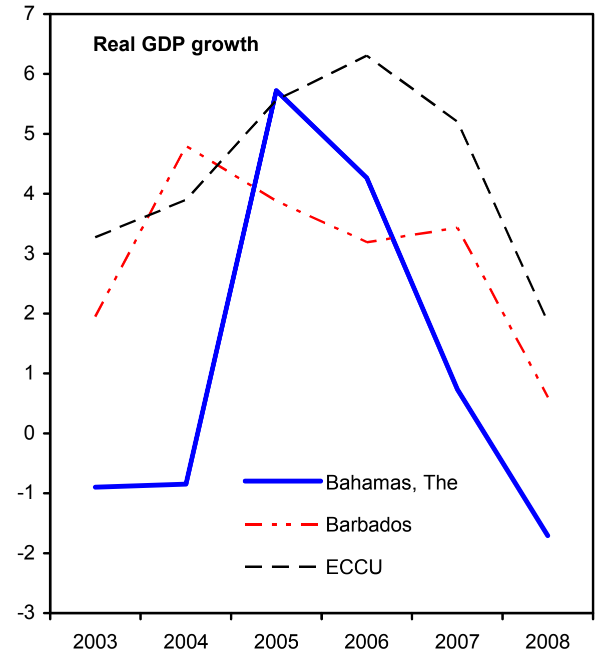
5. **Real GDP is projected to contract further in 2009–10, reflecting the impact of the U.S. and global downturn**. Growth developments in The Bahamas are strongly correlated with those in the United States, with U.S. shocks historically having an amplified and protracted impact (Box 1). Based on the sharp contraction and weak recovery projected for the United States, real GDP is projected to contract by 3.9 percent in 2009 and 0.5 percent in 2010. This assumes a drop in tourism receipts of 9 percent and 1.5 percent in 2009 and 2010, respectively. FDI is projected to drop by 30 percent in 2009, in line with the overall contraction in global credit. This decline is expected to have ripple effects for construction, real estate, and domestic financial services. Some large tourism-related projects have been cancelled or delayed, but activity in the market for second homes for non-Bahamians appears steady. The downturn has had a large impact on domestic revenue and this is expected to

Figure 1. The Bahamas: Real Sector Developments
(Annual percent change)

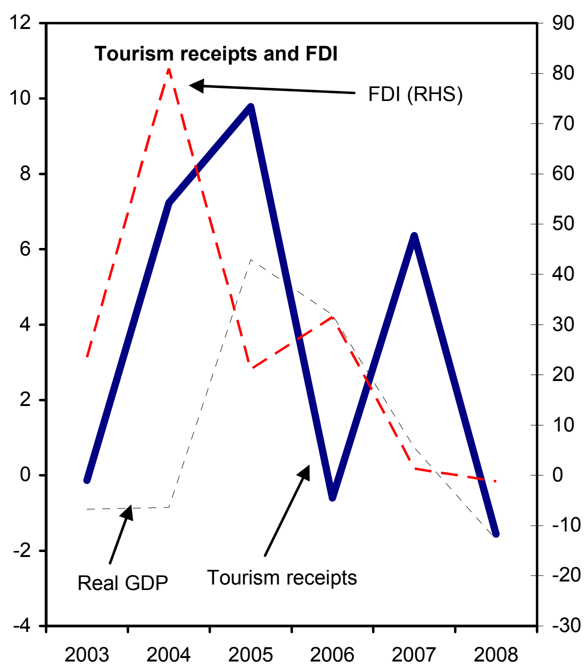
Growth in The Bahamas is strongly correlated with U.S. growth...



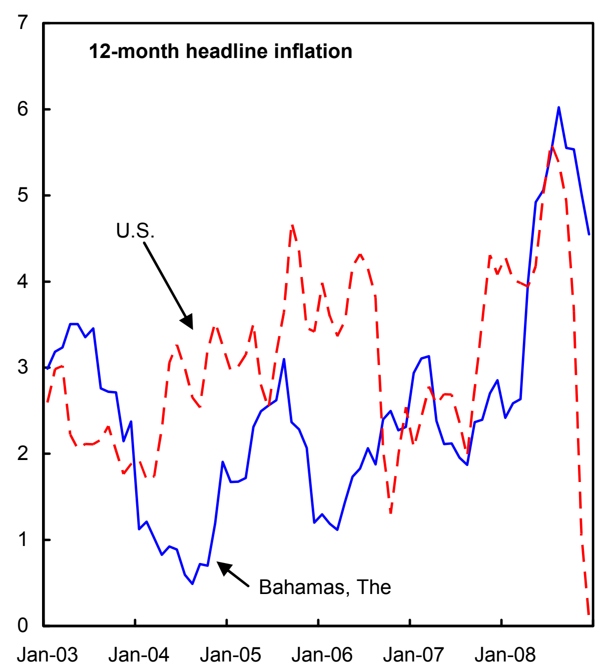
…along with other tourism dependent countries...



…and became negative recently as tourism and FDI weakened.



Due to high dependency on imports and the peg, inflation also tracks U.S. inflation.

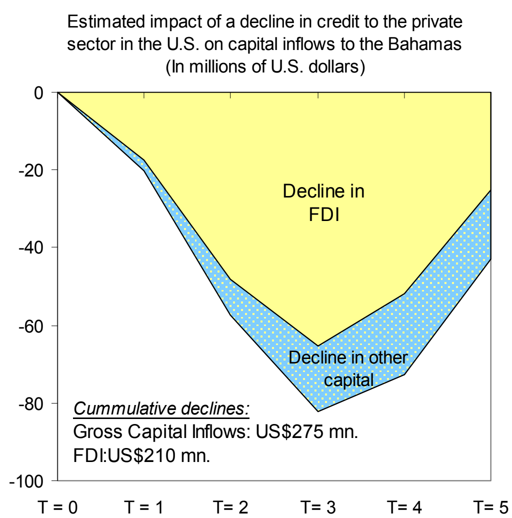


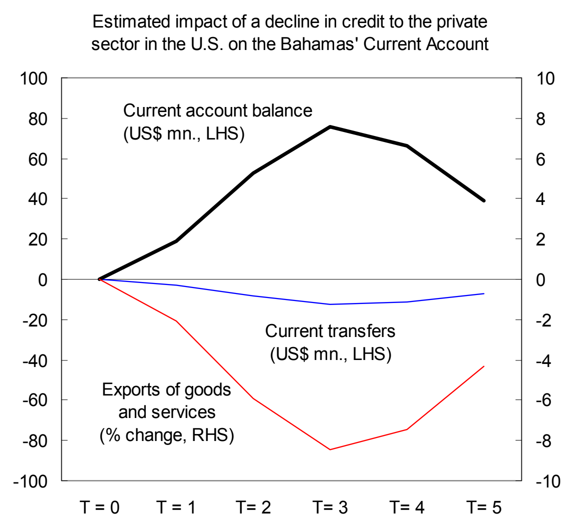
Sources: IMF, World Economic Outlook; Fund staff estimates; and the Central Bank of the Bahamas.

Box 1. Spillovers of a U.S. Credit Contraction on The Bahamas

A contraction in credit to the private sector in the United States can be expected to put pressure on The Bahamas' external sector, particularly capital inflows and exports. This result is confirmed by a U.S. business cycle model used to examine the potential impact of the global financial crisis on The Bahamas. An econometric model linking the U.S. economy and the Bahamian external sector examines the impact of a hypothetical U.S. credit crunch—defined as a one year, two standard deviation contraction in real credit to the private sector—on Bahamian external sector variables. The impact is evaluated by comparing projections for Bahamian external sector variables under the "shock" scenario against a "no shock" baseline over a five-year period. The results are summarized as follows:

- *Capital inflows weaken, especially FDI.* Private capital inflows are projected to be weaker by US$275 million—two thirds is a decline in FDI.
- *Exports of goods and services decline sharply.* Lower exports of goods and services—about 70 percent tourism—are consistent with the expected contraction in tourism activity prompted by a weakening in U.S. growth and U.S. real incomes.





The findings imply that the current account largely accommodates a drop in capital inflows, but growth might be more profoundly affected. The impact on international reserves would likely be largely contained based on the above results. However, growth might be more severely affected. Indeed, tourism and FDI—two key growth drivers—would weaken significantly and the results show a high degree of persistence suggesting that the impact on growth could be prolonged and associated with a slow recovery. That said, the above results should be interpreted cautiously given that: (i) findings are based on historical relationships that may be limited in gauging the transmission of a historically unprecedented shock; and (ii) the simulated shock does not necessarily reflect current global conditions.

continue. Abated activity and lower commodity prices would lead to a decline in the inflation rate to 1.0 by end-2009 and 0.2 percent by end-2010.

6. **The projected decline in tourism receipts is significantly tempered by the impact of offsetting factors outlined by the authorities**. The government and the tourism industry have been working together to implement measures to counteract the potential decline in receipts. These include: launching a new promotional campaign; diversifying the tourism base by easing visa requirements for Latin Americans; working with airlines to provide increased airlift capacity at reduced prices; and providing more diversified products. There has been a five-year wage settlement for hotel employees that largely freezes nominal wages to help contain rising costs. There are, however, substantial downside risks to the forecast for tourism receipts.[3]

7. **The FY 2008/09 fiscal deficit is expected to increase to about 5 percent of GDP, owing to revenue shortfalls** (Figure 2). Revenues and grants for FY 2008/09 are expected to be 3.5 percent of GDP lower than budgeted due to lower imports and weak activity.[4] The authorities shifted the composition of spending to maintain capital spending and provide transitory means-tested unemployment benefits, while keeping total expenditure close to budgeted levels.[5] The fiscal deficit was financed by new external and domestic borrowing, including a US$200 million short-term (one year) foreign currency credit from domestic banks. Central government debt as a percent of GDP is expected to rise to over 40 percent by the end of FY 2008/09, implying that the authorities' earlier stated objective of reducing debt to GDP to 30 percent by 2012 will need to be postponed.

8. **The external current account improved in 2008, but private sector financing flows weakened significantly** (Figure 3). Lower construction-related imports and higher retained earnings reduced the external current account deficit from 17.5 percent to 13.2 percent of GDP, but private sector financing flows dropped by 6.6 percent of GDP. The government issued U.S. dollar-denominated bonds of $100 million to finance its capital program in FY 2007/08, which helped bolster international reserves to US$563 million at end-2008, about 87 percent of base money.

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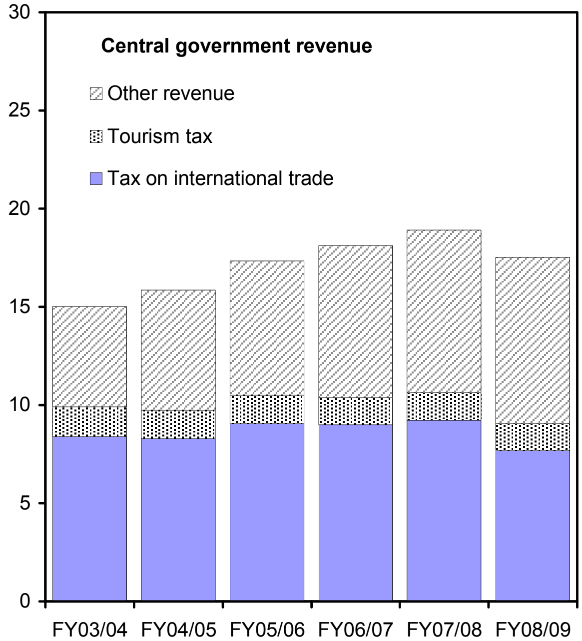
[3] Tourism arrivals data for the first two months of 2009 indicate a drop in tourism receipts of some 16–18 percent against January–February 2008.

[4] Estimates determined in the March mid-year budget review; introduction of mid-year budget reviews was encouraged in past Article IV consultations.

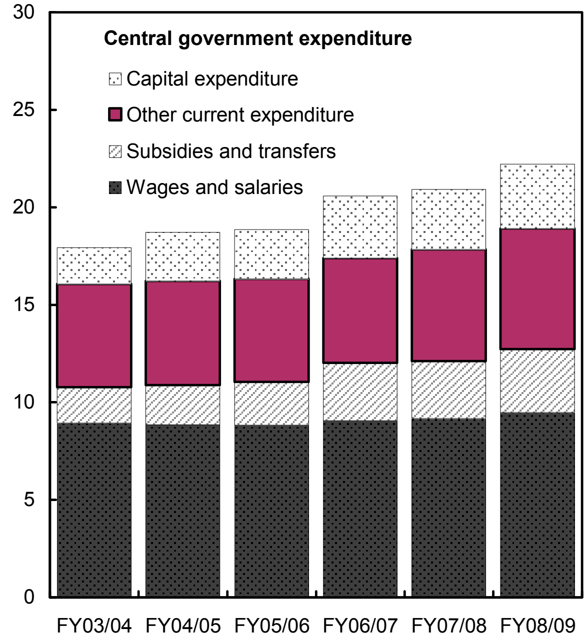
[5] The new benefits are administered by the National Insurance Board. The hotel industry also provides transitory social benefits for redundant workers.

Figure 2. The Bahamas: Fiscal Developments 1/
(In percent of GDP)

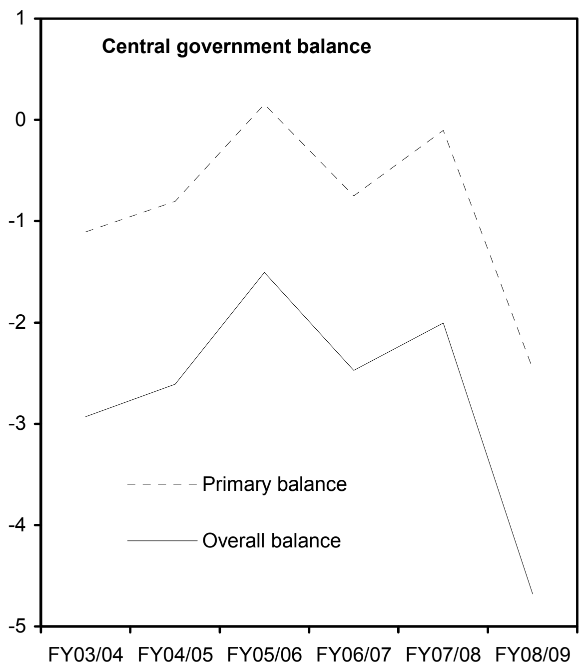
Revenue declined in the current fiscal year, as intake from import duties dwindled...



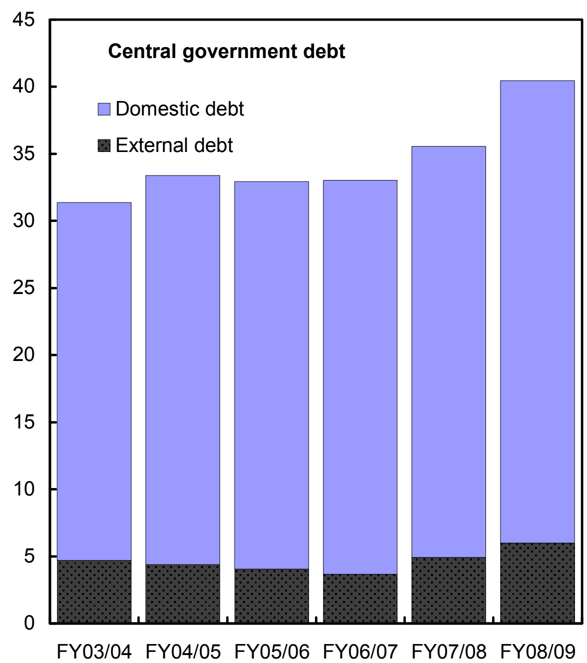
...while expenditure has risen over years in relation to GDP.



As a result, the fiscal balance deteriorated...

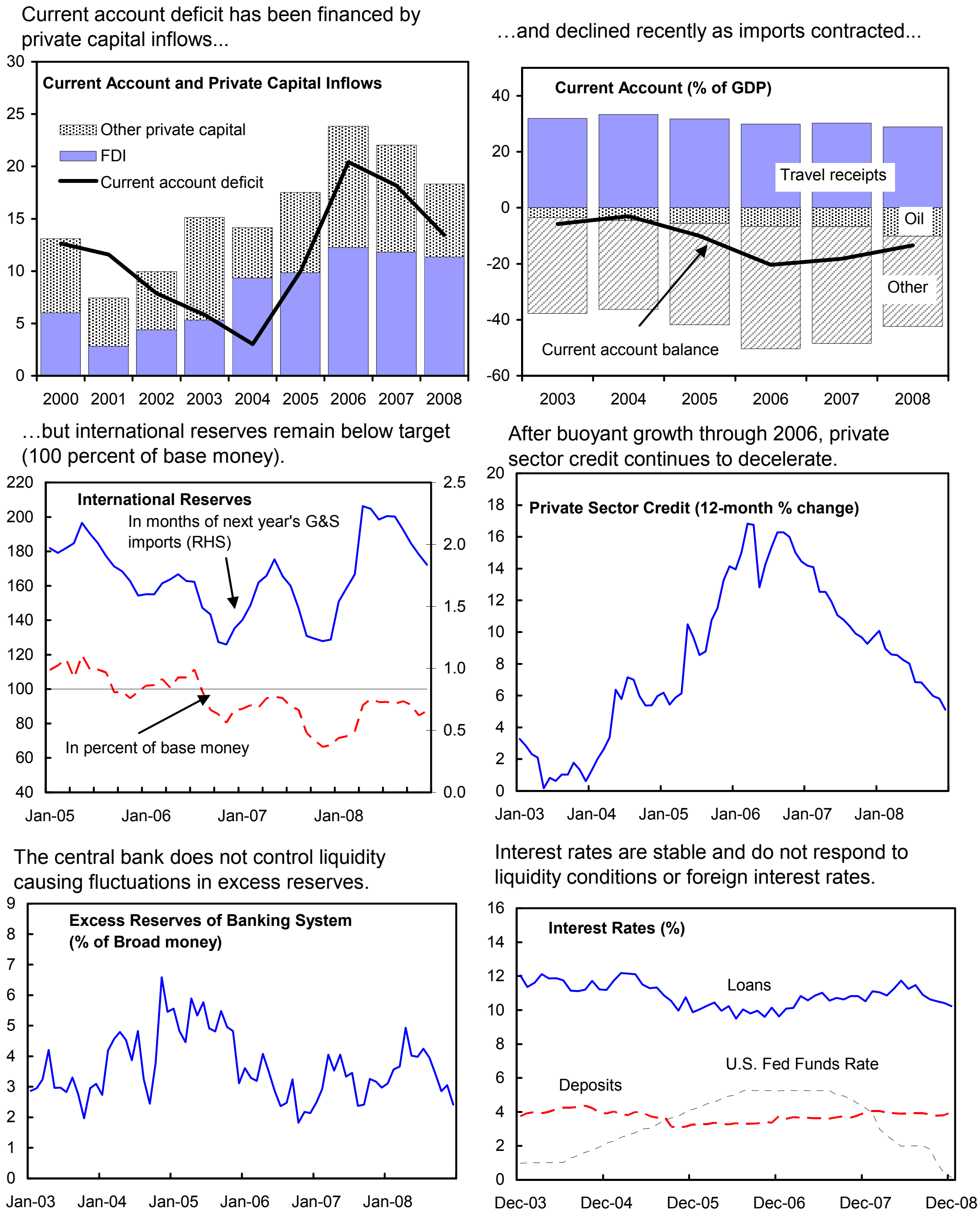


…and public debt increased; it still consists mainly of domestic debt.



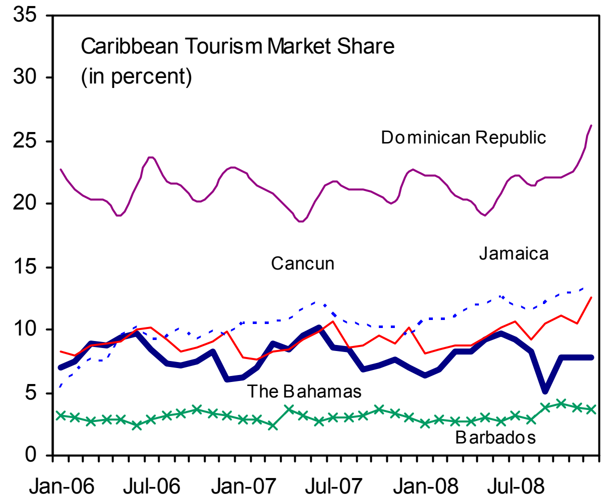
Source: The Bahamian authorities; and Fund staff estimates.
1/ Fiscal year ending June 30.

Figure 3. The Bahamas: External and Monetary Developments



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

9. **The Bahamian dollar appears broadly in line with fundamentals** (Figure 4). The sizable current account (CA) deficit in recent years partly reflects high oil prices and capital goods imports related to large FDI inflows. Over the medium term, assuming tourism receipts recover to their 2006–08 average, the CA deficit would stay at about 10 percent of GDP (5 percent excluding FDI-related imports), in line with the estimated CA norm of 6–10 percent of GDP.[6] Staff analysis suggests that the real effective exchange rate (REER) remains broadly in line with its estimated equilibrium value (computed from a panel regression for CARICOM countries), despite nominal appreciation of the Bahamian dollar along with the U.S. dollar in late 2008. Tourism indicators do not suggest a loss of competitiveness: The Bahamas' Caribbean market share has remained broadly stable at around 8 percent since 2004, including in the latter half of 2008 (with drop in September due to Hurricane Ike).



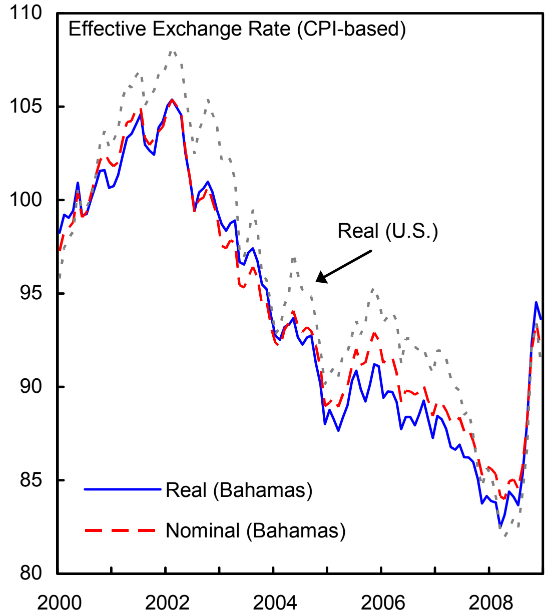
10. **Financial soundness indicators of domestic banks have deteriorated, but the banks remain well capitalized** (Box 2 and Figure 5). The share of nonperforming loans has been increasing, given the downturn and rising loan-to-value ratios during the credit boom. Banks have been proactively restructuring troubled consumer and mortgage loans, while increasing retained earnings, and the central bank has enhanced monitoring. Nevertheless, the capital position of domestic banks remains relatively strong, and the central bank's preliminary stress tests suggest that NPLs would have to spike sharply before banks would encounter capital adequacy problems. Private sector credit growth decelerated from 9.7 in 2007 to 5.1 percent in 2008, reflecting weaker demand and tighter lending standards by banks.

11. **Supervision of the banking sector is more stringent than that of the nonbanking financial sector**. Both domestic and offshore banks are supervised by the central bank, while insurance, credit unions and pension funds are supervised by other entities and are less tightly regulated, with different provisioning rules. A law was passed by Parliament in 2005 to bring insurance supervision in line with international norms, but has not yet been implemented.

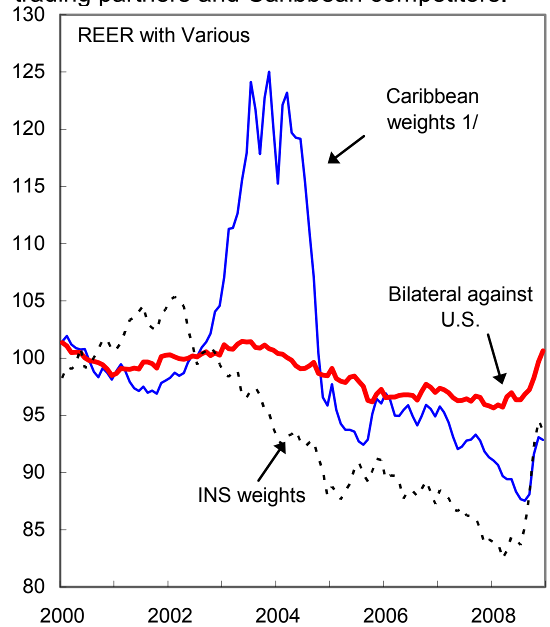
[6] The CA norm and equilibrium REER are computed from the panel regressions in "Assessing Exchange Rate Competitiveness in the Eastern Caribbean Currency Union" (IMF Working Paper) by Pineda, Cashin, and Sun, IMF Working Paper 09/78.

Figure 4. Exchange Rate Assessment

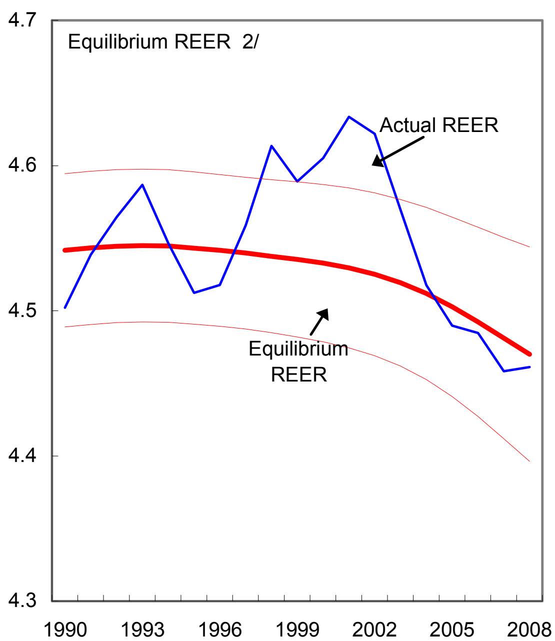
Under the peg and with strong trade ties, the REER has tracked that of the U.S...



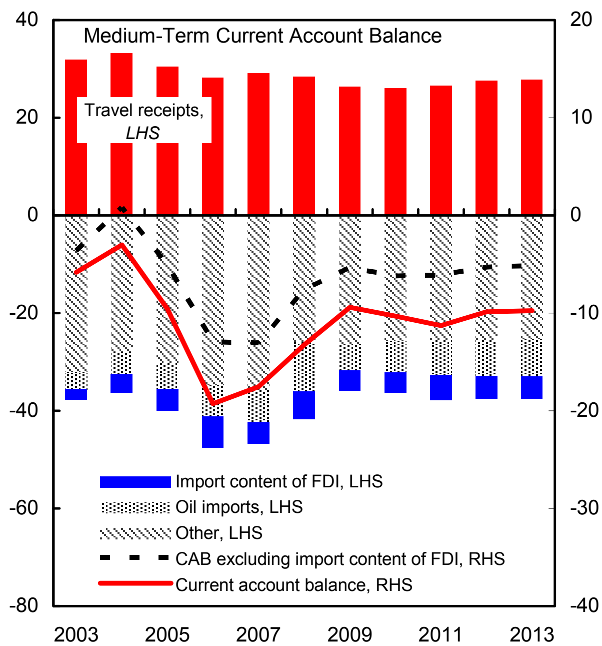
...and depreciated in recent years vis-à-vis trading partners and Caribbean competitors.



The REER is broadly in line with its equilibrium value...



...and the CA balance is projected to be stable over the medium term.



Sources: IMF, Information Notice System; and IMF Working Paper 09/78.

1/Weighted by main competitors in the Caribbean tourism market in 2006.

2/ Based on data for the ECCU countries (Antigua & Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines), Barbados, Bahamas, Belize, and Jamaica.

Box 2. The Domestic Financial System of The Bahamas

The Bahamian domestic financial system is dominated by banks, with private sector credit and domestic deposits amounting to 86 percent and 75 percent of GDP, respectively. Deposit insurance covers 95 percent of deposits. Although dominated by U.S. and Canadian subsidiaries and branches, its activities are financed by domestic deposits and bank capital rather than external borrowing. The National Insurance Board (NIB) administers the national pension and social safety net schemes. In 2007, the NIB, private pension funds, and insurance companies had assets amounting to about 19.3 percent, 14.8 percent, and 11.9 percent of GDP, respectively. Credit unions have assets of only 3 percent of GDP, but their membership covers about 10 percent of the population.

The deterioration of the Bahamian economy has put negative pressure on the quality of the banks' credit portfolio. Arrears over 30 days or more reached 12.5 percent of total loans in end-2008, up by 5 percentage points since end-2006, and NPLs were 6 percent to total loans by end-2008. However, banks have large capital buffers, and indicators of asset liquidity have also improved.

The Bahamas: Core Set of Financial Soundness Indicators 1/

	2003	2004	2005	2006	2007	2008
(In percent)						
Average net worth to risk weighted assets	19.3	22.6	22.6	24.8	24.9	23.9
Nonperforming loans net of provisions to capital	22.1	20.1	23.4	17.7	23.0	30.8
Nonperforming loans to total gross loans	5.1	4.8	4.4	4.1	4.3	6.0
Return on assets	2.1	2.7	3.4	3.9	3.6	2.4
Return on equity	11.9	15.0	19.6	20.4	18.6	11.7
Interest margin to gross income	92.0	92.0	92.5	93.4	93.5	93.4
Noninterest expenses to gross income	83.9	55.8	58.8	55.8	58.7	67.1
Liquid assets to total assets (liquid asset ratio)	13.1	14.5	12.9	11.2	12.0	12.8
Liquid assets to short-term liabilities	19.7	21.4	19.1	17.2	18.4	20.0

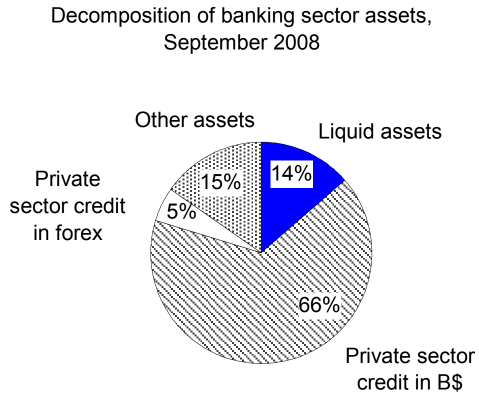
Source: the Central Bank of the Bahamas.

1/ For domestic commercial banks and other local financial institutions combined.

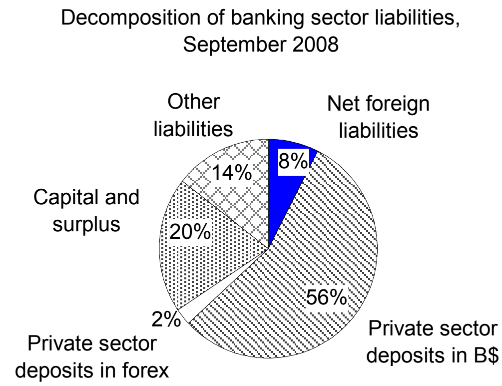
The failure of CLICO Bahamas, an insurance company with total liabilities of about 1 percent of GDP, highlights the need to strengthen insurance sector supervision. In February 2009, the insurance regulator initiated a process to liquidate the company after it became insolvent mainly due to investment in Florida real estate, guided by the strategy of its parent regional conglomerate. Although the regulator had raised concerns in the past, the issue of risk concentration had not been corrected. The Central Bank of The Bahamas has stated publicly that the failure of CLICO Bahamas does not pose a threat to the domestic financial system.

Figure 5. The Bahamas: Financial Sector Developments

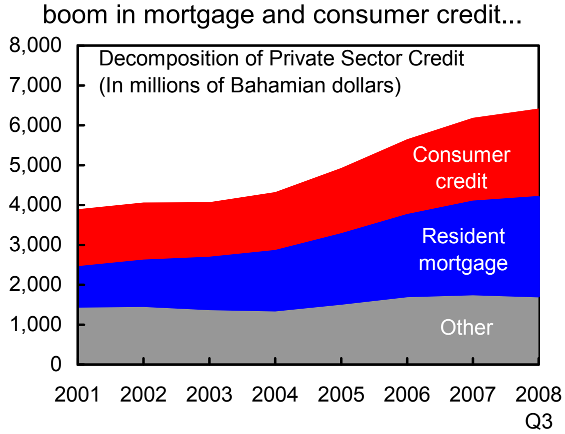
Banking sector assets concentrate on domestic credit...



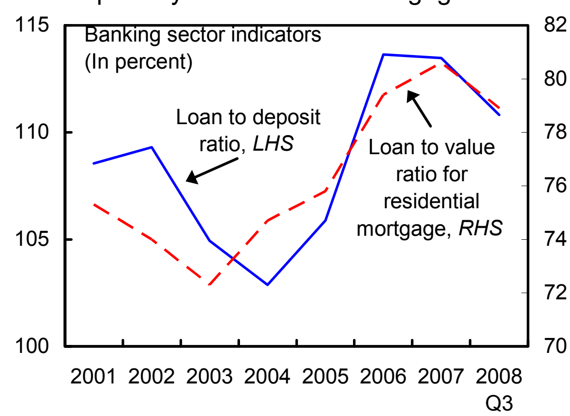
...financed mainly by deposits and capital.



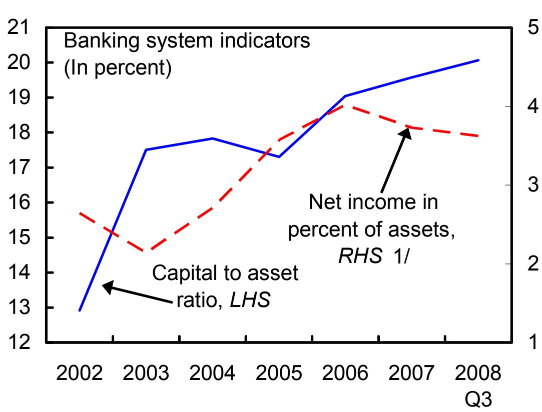
Lifting of the 2004 credit freeze led to a boom in mortgage and consumer credit...



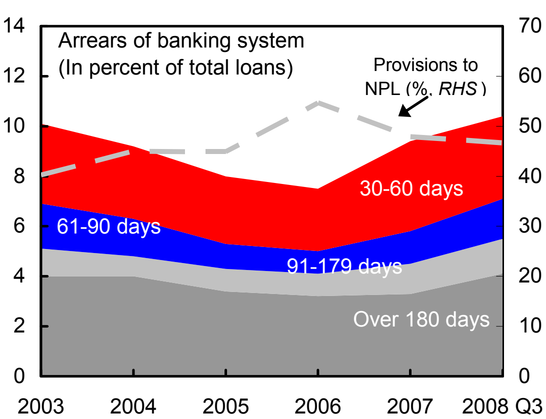
…with rising loan-to-value ratios, especially for residential mortgages.



Capital ratios have improved, but profitability has faltered recently...



...and arrears are rising.



Source: The Central Bank of The Bahamas.
1/ 2008 data is for the first half of 2008.

12. **Negative spillovers from the offshore financial sector to the domestic financial sector appear limited so far**. The offshore financial sector, comprising about 250 banks and trust companies with estimated total assets of over $300 billion in 2007, dwarfs the domestic financial sector. However, the sector accounts for only 1–2 percent of total employment and the linkages to the domestic economy are limited to employment and consumption. Offshore banks report that assets under management and profits are dropping substantially in line with global conditions, but that local employment has not yet been affected, though compensation has. Exchange controls and restrictions on net open foreign exchange positions of domestic commercial banks limit their asset and liability exposure to global markets, limiting the impact on the domestic economy. The authorities indicated that, because of the limited links, the impact of a cyclical weakening on the OFC sector on the domestic economy would be moderate.

13. **Following the London G20 summit, the authorities reaffirmed their 2002 commitment to adopt OECD standards on tax transparency and information exchange**. The authorities concluded a Tax Information Exchange Agreement with the United States in 2002 and have announced that negotiations with Canada are underway. Moreover, the authorities reiterated their commitment to adhere to international standards to regulate the offshore financial industry. The AML/CFT related regulatory framework has been strengthened significantly since 2000, and AML/CFT guidelines are being revised, following an evaluation by the Caribbean Financial Action Task Force.

III. Policy Discussions

14. **Discussions focused on macroeconomic policy measures to respond to the impact of the global slowdown and measures to reduce longer term vulnerability**. Regarding the short-term impact, there were two main themes of discussion: (i) the extent of fiscal adjustment vs. financing to compensate for the drop in fiscal revenue; and (ii) containing the impact on the domestic financial sector. The discussions also focused on how to reduce vulnerabilities over the medium term.

A. Macroeconomic Policy Responses to the Shock

15. **The decline in U.S. growth will lead to a significant contraction in economic activity in 2009**. The authorities and staff concurred that economic growth would be adversely impacted, but, in the authorities' view, real GDP growth may decline less than projected by the staff, and they emphasized the resilience of foreign direct investment and intended measures to generate tourism receipts from non-traditional sources.

16. **The authorities agreed with the importance of contingency planning should the downturn prove worse than expected**. The authorities have a solid track record of prudent fiscal policy management, and clearly stated their determination to respond to the downturn so as to preserve fiscal and debt sustainability.

Fiscal policy

17. **The authorities envisage both revenue and expenditure measures to contain the fiscal deficit in FY 2009/10**. On the basis of unchanged policies, there was broad agreement that gross financing needs would have reached about 7 percent of GDP in FY 2009/10.[7] In order to contain the deficit, the authorities are taking measures to improve tax compliance and revenue administration including by: introducing electronic declarations and other customs reforms to limit leakage for non-reporting and underreporting; reducing arrears in real estate taxes and other fees; and updating procedures for conducting property value assessments.

18. **The authorities aim at streamlining expenditure while protecting priority areas**. Unemployment insurance introduced in FY 2008/09 was temporary, but consideration is being given to extending the benefits, and the authorities want to protect public investment to the extent possible. They identified some measures to contain spending: strictly limiting overtime pay for public sector employees—a key factor in the 25 percent real increase in public sector wages since FY 2000/01; maintaining strict caps on transfers to public sector entities, in light of persistent losses of a few large public corporations; auditing transfers to regional entities; and public tendering for procurement contracts. The measures discussed during the mission would help contain the overall deficit to 5.8 percent of GDP. Moreover, the authorities stated that additional consolidation measures might be adopted in the FY 2009/10 to bring down the deficit further. The staff agreed that such a stance struck a reasonable balance between avoiding an excessive contraction of domestic demand and preserving medium-term sustainability.

19. **The authorities intend to finance the FY 2009/10 fiscal deficit with privatization proceeds and new borrowing**. They will implement ongoing plans to privatize 51 percent of The Bahamas Telecommunications Company (BTC). Despite the adverse global environment, there continue to be interested buyers due to the company's profitability.[8] They plan to refinance the US$200 million credit line with domestic banks through an external sovereign bond offering in 2010. The remainder of the deficit would be financed by domestic borrowing, which should be easily placed given limited domestic investment vehicles.[9] The staff agreed that, in the near term, weak private sector credit demand implied that the risk of crowding out private sector recovery should be low. Additional borrowing would increase central government debt to 47 percent of GDP by the end of FY 2009/10, of which external debt would account for a still low 10 percent of GDP.

[7] On the basis of revenues determined by GDP and import projections, capital spending constant in real terms, wage growth in line with historical averages, and other current spending constant as a share of GDP.

[8] Privatization is expected to generate exceptional receipts from the sale of mobile phone licenses in FY10/11.

[9] The NIB could purchase the debt, and faces no legal restrictions to do so.

External and monetary policies

20. **Planned official borrowing and privatization receipts would contribute to offset other pressures on the balance of payments in 2009–10, allowing some build-up of foreign exchange reserves**. The current account is expected to improve significantly, as a result of a large drop in fuel prices and lower imports of consumption and capital goods. While private sector capital inflows are anticipated to continue to drop by a relatively larger amount, government external borrowing, domestic borrowing in foreign currency, and privatization receipts would mitigate pressures on foreign exchange reserves.

21. **The central bank intends to introduce quarterly balance of payments forecasts and consult regularly with the central government to identify any nascent BOP pressures**. The current slack demand for private sector credit and the plans for public sector financing in foreign currency make the need for any private sector credit controls, along the lines of those after the 2001 shock, unlikely in the near term. The current shock has been unfolding more slowly than in the previous shock, and private consumption demand has already been declining.

B. Financial Sector Policies

22. **Staff welcomed the authorities' ongoing efforts and plans to strengthen further bank monitoring and supervision**.[10] The authorities plan to enhance stress testing, tailored to specific risks to The Bahamas, and have requested Fund technical assistance. CARTAC has just concluded an assessment of the Banking Supervision Department, and is planning to send an expert on stress testing to The Bahamas in the near future. They introduced quarterly reporting requirements on credit risk in December 2008, and are strengthening regional cooperation under the Caribbean Group of Banking Supervisors. The authorities have also requested technical assistance to establish automated procedures for data transmittal from banks; revisions to anti-money laundering guidance documents; and revisions to credit assessment procedures.

23. **The authorities and staff agreed that steps should be taken to strengthen supervision for the nonbank financial sector, and to ensure that provisioning is adequate**. For credit unions, the government has requested that the central bank assume supervisory responsibility, currently handled by the Agriculture Ministry, and plans are being discussed. The authorities have made it an immediate priority to put into effect the law passed by Parliament in 2005 to bring insurance supervision and provisioning in line with international norms. They plan to request Fund TA for help in implementing the new law and its regulations.

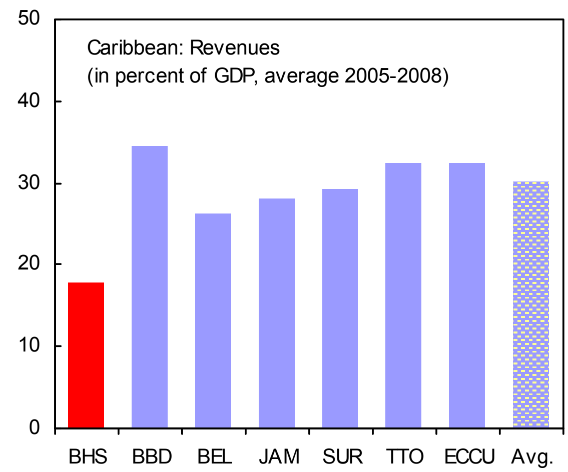
[10] Institutions for banking supervision were strengthened substantially in recent years: an IMF assessment of banking regulation and supervision, including of the offshore sector, found compliance with 21 out of 25 Basel Core Principles for Effective Banking Supervision.

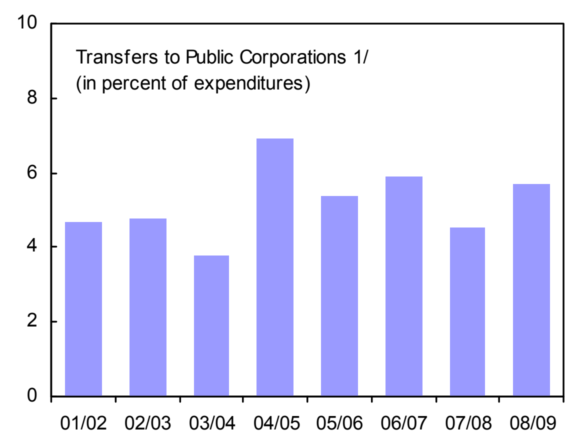
C. Contingency Planning and Risks

24. **While supporting the authorities' macroeconomic policy stance, the staff underscored the importance of further contingency planning**. Risks to the growth forecast remain on the downside. For instance, tourism could remain subdued, demand for imports could be higher than anticipated, and private capital inflows could drop more sharply than forecast. Moreover, short-term fiscal consolidation plans hinge heavily on administrative revenue measures and privatization receipts, which may fall short or take longer to materialize. In that case, additional financing and/or expenditure adjustment might be required. Finally, the financial sector could be more vulnerable than expected, in light of rising NPLs and weak supervision of the nonbank financial sector.

D. Reducing Vulnerability over the Medium Term

25. **Preliminary fiscal debt sustainability analysis suggests that, given limits to expenditure containment, further revenue measures would be needed to put the central government debt-to-GDP ratio back on a declining trajectory**. Within the Caribbean, The Bahamas is a relatively low-tax jurisdiction (17 percent of GDP compared with a regional average of 30 percent), revenue being largely reliant on international trade taxes. Even with the planned administrative revenue measures in FY 2009/10, revenue is expected to remain relatively weak in the medium term. Without further measures, debt is projected to increase to 54 percent by 2014 and remain on a rising trajectory based on historical deficits and the carrying costs of the debt accrued to finance the shock. Past Fund TA recommended several measures to strengthen revenue, including reevaluating whether tax exemptions for investment are too generous and introducing a value-added tax (Box 3). The authorities are not convinced that a value-added tax is needed, and indicated that, in any case, modernizing and strengthening customs administration is a prerequisite to any shift towards any broad-based sales tax.





Source: Authorities and Staff Estimates
1/ Includes sundry expenditures and Airport Authority subsidies between FY 05/06 and 07/08.

26. **The authorities plan to reduce costs of loss-making public enterprises and envisage moving forward with privatization plans**. To enhance accountability and expenditure discipline among loss-making public enterprises,

Box 3. Revenue Reform Priorities

There is scope to increase revenue in The Bahamas. A Fund TA mission in 2002 concluded that the tax system is excessively reliant on trade taxes on goods, which increases vulnerability, given the unpredictability of tourism and elasticity of imports. The mission recommended detailed measures to strengthen administration of existing property and trade taxes, review FDI incentives, and shift the tax base to domestic consumption—endorsing the adoption of a broad-based VAT—in order to broaden it, reduce cyclicality and distortions, and provide a more predictable revenue source.

The authorities have acted on some of the recommendations, but there is scope for further action. The authorities have: (i) introduced a taxpayer identification number; (ii) encouraged arrears payments through an amnesty on penalties; (iii) increased the floor on exempt property values; and, (iii) enforced payment of property tax arrears following home sales. Property tax arrears, however, remain large (an estimated 4 percent of GDP) and the property tax re-assessment mechanism is cumbersome. The authorities are exploring options to improve assessments, and have outlined a multi-year plan to modernize customs administration, beginning with the introduction of an electronic declarations system this fiscal year.

Additional revenue reforms will likely be needed to stem a rising debt trajectory, given constraints to expenditure consolidation. Including the revenue measures proposed for FY 2009/10, the debt ratio would continue to rise through FY 2014/15, in the absence of further measures to increase tax revenue. Staff estimates that increasing revenue by an average of 1¾ percent of GDP between FY 2011/12 and FY 2013/14 would help stabilize the debt ratio at 50 percent in FY 2011/2 and help it revert to its present level (around 40 percent of GDP) by FY 2014/15. Sustainable revenue-enhancing measures, including a VAT, would be needed to reduce debt to 30 percent of GDP over the medium term.

the authorities subjected public entities to hard budget constraints in the FY 2008/09 budget, which were generally adhered to. A restructuring plan for the Bahamas Air is underway, and consideration may be given to subcontracting domestic routes to smaller local charter companies. Along with the planned privatization of 51 percent of BTC in 2010, there is long-standing consideration to privatize the Bahamas Electric Company (BEC), which has historically operated free of government transfers. Government-imposed rate reductions and customer relief programs have contributed to growing operational losses since 2006.[11] Discussions of a rate increase to cost recovery levels are on the government's agenda for the coming year.

27. **The authorities intend to transition to market-oriented monetary instruments**. Despite the fixed exchange rate regime, controls provide some room for monetary policy. Current monetary control relies on moral suasion and credit restrictions, which hampers efficient credit allocation. The central bank is developing a strategic plan to modernize

[11] Operational losses were $3 million and $11 million in 2006 and 2007, respectively, and in late 2008, the government capped surcharges at a cost of $3.7 million and introduced a relief program for customer payment arrears.

monetary policy instruments, consistent with 2007 Fund TA recommendations, including by introducing a market-based auction mechanism for placing government debt and repurchasing operations. Supporting changes would involve improving: (i) forecasting capacity for economic, liquidity, and balance of payments developments; (ii) fiscal and monetary policy coordination; and (iii) payment systems. The authorities are considering some gradual liberalization of exchange controls, but only once global market conditions are more conducive.

28. **The authorities are continuing efforts to promote further diversification of the economy, reducing the reliance on tourism**. In light of the crisis, the Prime Minister has urged the tourism sector to make more use of local products, especially fish and produce, to strengthen downstream linkages. Beyond tourism, the authorities are promoting shipping, agriculture, and the second home market, particularly for non-Bahamians.

IV. Staff Appraisal

29. **Solid macroeconomic policy management in the past has positioned The Bahamas relatively well for dealing with the difficult economic environment**. The projected contraction of economic activity will put stress on fiscal and external positions for the next two-three years, requiring proactive policy intervention. Further increases in unemployment and social needs are to be expected. In staff's view, given the economy's strong dependence on U.S. growth prospects, the risks to growth remain on the downside.

30. **The authorities' plans to undertake some countercyclical policies and support priority expenditures through the downturn appear appropriate**. Particularly important are increased social spending through the National Insurance Board to protect those most vulnerable to the downturn, as well as public infrastructure investment projects to sustain employment in the construction sector.

31. **At the same time, staff welcomes the authorities' efforts to rationalize spending through more rigorous oversight given uncertainties about the duration of the global slowdown**. The authorities plan to reduce costs of loss-making public sector enterprises; tender openly for procurement of public contracts; audit transfers; and streamline overtime payments. Early implementation of the planned review of non-targeted electricity subsidies will facilitate cost recovery and contribute to the necessary strengthening of the finances of a key public enterprise. Overall, the authorities' plans strike a reasonable balance between financing a temporary shock and preserving vital spending while seeking to maintain medium-term fiscal sustainability. Moreover, the expenditures targeted for reduction will increase the overall efficiency of government service delivery.

32. **The authorities' plans to limit the budgetary financing needs in FY 2009/10 hinge importantly on increasing revenues through administrative measures and privatization proceeds**. In staff's view, the planned yield from administrative improvements is uncertain both in terms of magnitude and timing, particularly for Customs. Thus, any delays in privatization plans could lead to financing shortfalls. Staff encouraged the authorities to prepare a revised medium-term fiscal consolidation path, specifying additional

contingency measures in the event that they are needed. While a temporary delay in fiscal consolidation plans was needed, defining a new path will help anchor expectations.

33. **The fixed exchange rate regime and parity with the U.S. dollar continue to serve the country well**. The small and open Bahamian economy, tied tightly to U.S. economic and financial activity, argues for maintaining the peg which continues to foster long-term growth through a stable investment climate. As the peg limits policy flexibility in the face of shocks, supportive macroeconomic policies become more important in the current difficult environment.

34. **Staff welcomes the central bank's multi-year strategy to modernize monetary policy tools**. Introducing an auction mechanism to place government securities would help develop a secondary market, enabling central bank repurchasing operations to manage liquidity better. Gradual relaxation of exchange controls in the future as conditions permit, according to a well-sequenced implementation plan that safeguards reserve adequacy, would contribute to capital market development and enhanced economic efficiency.

35. **Staff also welcomes the authorities' intention to make strengthening financial supervision an immediate priority**. Measures to align further legal and regulatory compliance with international norms, and improve stress testing for banking system capital adequacy are welcome. The recent insolvency of an insurance company reinforces the need to implement the pending insurance law to bring regulatory, supervisory and prudential standards to international norms. The authorities' plans to transfer supervisory responsibility for the credit unions to the central bank are also welcome.

36. **While the outlook is subject to risks, the authorities have a strong record of prudent economic management, and are committed to medium-term sustainability**. They are thus ready to take additional measures as needed in order to maintain macroeconomic stability in the coming period and lay the basis for a growth recovery as the global economic conditions improve. The authorities also reiterated their commitment to bring debt down to 30 percent of GDP in the medium term.

37. **The downturn provides an opportunity to address structural issues at the root of the fiscal deficits of the past decade**. Revenue and spending structures should enable the government to provide the goods and services necessary to maintain high living standards, protect the most vulnerable, and invest in physical and human capital for robust growth. Thus, for the medium term, the staff encourages consideration of more fundamental reforms, particularly rendering the revenue structure more efficient and less distortionary, which would facilitate efforts to diversify economic activity. Current FDI concessions should be reviewed to ensure they are not more generous than necessary, while the coverage and type of taxes should distribute the burden more evenly on all economic activity, including services. Strengthened administrative capacity would lay the groundwork for eventually introducing a goods and services or value added tax that would reduce the burden on consumption/cycle-dependent taxes on imports of goods. Such measures are needed to facilitate a path toward gradually achieving the authorities' debt objective.

38. **The Bahamas will return to a 12-month Article IV consultation cycle**. The Bahamas was placed on the 24 month cycle in the 1999 Article IV consultation staff report, consistent with the 1997 decision. In light of the risks posed by the global economic and financial situation, and the benefits of enhanced policy dialogue, it is thus proposed that the next Article IV consultation with The Bahamas take place on the standard 12-month cycle.

Table 1. The Bahamas: Selected Economic Indicators

	2006	2007	Est. 2008	Proj. 2009	2010	2011	2012	2013
	(Annual percentage changes, unless otherwise indicated)							
Real sector 1/								
Real GDP	4.3	0.7	-1.7	-3.9	-0.5	1.5	3.0	2.0
Nominal GDP	7.1	3.0	0.9	-2.1	0.1	1.7	3.4	3.0
Consumer price index (annual average)	1.8	2.5	4.5	1.8	0.6	0.2	0.4	1.0
Consumer price index (end of period)	2.3	2.9	4.5	1.0	0.2	0.1	0.6	1.3
Unemployment rate (in percent)	7.6	7.9	8.7	…	…	…	…	…
Financial sector								
Credit to the nonfinancial public sector	8.4	13.8	17.0	18.9	-9.9	11.0	1.6	2.5
Credit to the private sector	14.4	9.7	5.1	2.1	3.0	2.2	3.2	2.6
Liabilities to the private sector	6.5	9.6	5.1	3.7	5.1	2.7	3.4	3.0
External sector								
Exports of goods and services	3.5	8.3	2.2	-12.3	1.0	3.3	5.8	3.5
Of which								
Travel receipts (gross)	-0.6	6.4	-1.6	-9.2	-1.4	3.9	7.3	3.7
Imports of goods and services	22.7	3.6	-2.5	-16.7	2.4	4.6	2.8	3.1
	(In percent of GDP, unless otherwise indicated)							
Central government 2/								
Revenue	17.4	18.1	18.9	17.5	17.0	18.2	18.6	18.4
Current expenditure	16.3	17.4	17.8	18.9	19.5	19.3	18.9	18.7
Capital expenditure and net lending	2.5	3.2	3.1	3.3	3.3	3.3	3.2	3.2
Primary balance	0.2	-0.8	-0.1	-2.5	-3.3	-1.8	-1.1	-0.9
Overall balance	-1.5	-2.5	-2.0	-4.7	-5.8	-4.4	-3.6	-3.4
Central government debt	32.9	33.0	35.6	40.5	44.3	48.0	50.4	52.3
External sector								
Current account balance	-19.3	-17.5	-13.2	-9.4	-10.3	-11.3	-9.9	-9.7
Overall balance	-1.1	-0.6	1.4	1.4	0.3	-1.2	-0.3	-0.2
External public debt (end of period)	4.6	4.4	5.7	6.9	9.9	10.1	10.2	10.2
Memorandum items:								
Net international reserves								
(end of period; millions of U.S. dollars)	499.8	454.2	563.1	665.8	690.1	597.5	576.7	561.6
In months of next year's imports of G. and S.	1.3	1.2	1.8	2.1	2.1	1.8	1.7	1.6
External debt-service ratio 3/	1.4	2.0	2.0	0.9	8.2	3.3	3.3	3.4
GDP (in millions of Bahamian dollars)	7,280	7,498	7,564	7,403	7,409	7,532	7,786	8,020

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

1/ Recently revised national accounts data account for the difference with the April 2009 WEO.

2/ Corresponds to the fiscal year ending June 30.

3/ In percent of exports of goods and services. The increase in 2010 reflects repayment of internal forex loan of US$200 million to domestic banks.

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

	FY 06/07	Budget FY 07/08	FY 07/08	Budget FY 08/09	Proj. FY 08/09	Proj. FY 09/10	Proj. FY 10/11
	(In million of B$)						
Revenue	**1,338**	**1,484**	**1,424**	**1,569**	**1,312**	**1,260**	**1,363**
Tax revenue	1,205	1,352	1,267	1,417	1,106	1,099	1,192
Taxes on international trade	665	806	694	762	575	565	645
Tourism taxes	103	105	107	116	102	99	100
Miscellaneous taxes	420	425	456	521	418	425	437
Other	17	16	10	17	10	10	10
Nontax revenue	134	122	157	142	206	161	172
Grants and capital revenue	0	10	0	10	0	0	0
Total expenditure	**1,521**	**1,610**	**1,575**	**1,735**	**1,662**	**1,692**	**1,692**
Current expenditure	**1,286**	**1,385**	**1,344**	**1,484**	**1,415**	**1,446**	**1,445**
Wages and salaries 2/	669	702	690	733	710	718	727
Goods and services	270	306	289	331	297	289	276
Interest payments	127	142	143	165	166	190	195
Subsidies and transfers 2/	219	235	222	256	242	249	246
Current balance	**53**	**88**	**80**	**75**	**-104**	**-186**	**-82**
Capital expenditure	**235**	**224**	**231**	**251**	**247**	**246**	**247**
Capital formation	161	...	172	...	157	171	172
Capital transfers and net lending	74	...	59	...	89	75	75
Overall balance	**-183**	**-126**	**-151**	**-166**	**-350**	**-432**	**-329**
Financing	**183**	**126**	**151**	**166**	**350**	**432**	**329**
Foreign financing	-17	...	100	...	78	402	52
Domestic financing	200	...	51	...	272	30	277
Memorandum items:							
Primary balance	-55	16	-8	...	-184	-242	-133
Central government debt	2,441	...	2,678	...	3,028	3,284	3,588

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

1/ Fiscal year ends June 30.

2/ Reclassifies central government transfers to the Public Hospitals Authority (PHA), College of The Bahamas, the Public Utilities commission, and the Ministry of Tourism in wages.

Table 3. The Bahamas: Operations of the Central Government 1/
(In percent of GDP)

	FY 06/07	Budget FY 07/08	FY 07/08	Budget FY 08/09	Proj. FY 08/09	FY 09/10	FY 10/11
Revenue	**18.1**	**19.7**	**18.9**	**21.0**	**17.5**	**17.0**	**18.2**
Tax revenue	16.3	17.9	16.8	18.9	14.8	14.8	16.0
Taxes on international trade	9.0	10.7	9.2	10.2	7.7	7.6	8.6
Tourism taxes	1.4	1.4	1.4	1.5	1.4	1.3	1.3
Miscellaneous taxes	5.7	5.6	6.1	7.0	5.6	5.7	5.8
Other	0.2	0.2	0.1	0.2	0.1	0.1	0.1
Nontax revenue	1.8	1.6	2.1	1.9	2.7	2.2	2.3
Grants and captial revenue	0.0	0.1	0.0	0.1	0.0	0.0	0.0
Total expenditure	**20.6**	**21.4**	**20.9**	**23.2**	**22.2**	**22.8**	**22.6**
Current expenditure	**17.4**	**18.4**	**17.8**	**19.8**	**18.9**	**19.5**	**19.3**
Wages and salaries 2/	9.1	9.3	9.2	...	9.5	9.7	9.7
Goods and services	3.7	4.1	3.8	...	4.0	3.9	3.7
Interest payments	1.7	1.9	1.9	...	2.2	2.6	2.6
Subsidies and transfers 2/	3.0	3.1	2.9	...	3.2	3.4	3.3
Current balance	**0.7**	**1.2**	**1.1**	**1.0**	**-1.4**	**-2.5**	**-1.1**
Capital expenditure	**3.2**	**3.0**	**3.1**	**3.4**	**3.3**	**3.3**	**3.3**
Capital formation	2.2	...	2.3	...	2.1	2.3	2.3
Capital transfers and net lending	1.0	...	0.8	...	1.2	1.0	1.0
Overall balance	**-2.5**	**-1.7**	**-2.0**	**-2.2**	**-4.7**	**-5.8**	**-4.4**
Financing	**2.5**	**1.7**	**2.0**	**2.2**	**4.7**	**5.8**	**4.4**
Foreign financing	-0.2	...	1.3	...	1.0	5.4	0.7
Domestic financing	2.7	...	0.7	...	3.6	0.4	3.7
Memorandum items:							
Primary balance	-0.8	...	-0.1	...	-2.5	-3.3	-1.8
Central government debt	33.0	...	35.6	...	40.5	44.3	48.0
Nominal GDP (in B$ millions)	7,389	7,531	7,531	7,484	7,484	7,406	7,471

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

1/ Fiscal year ends June 30.

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

Table 4. The Bahamas: Public Debt
(In percent of GDP)

	2003	2004	2005	2006	2007	Est. 2008
Central government debt	**31.3**	**33.9**	**32.9**	**32.8**	**35.1**	**36.5**
External	4.7	4.6	4.2	4.0	3.6	5.1
Domestic	26.6	29.3	28.7	28.8	31.5	31.5
Of which : in foreign currency	0.0	0.0	0.0	0.1	0.3	0.0
Public corporations' debt 1/	**10.1**	**9.5**	**8.9**	**9.8**	**9.6**	**11.1**
External	1.2	1.0	0.8	0.6	0.7	0.6
Domestic	8.9	8.5	8.1	9.2	8.8	10.5
Of which : in foreign currency	4.1	3.8	3.2	4.1	3.9	5.3
Total public sector 1/	**41.4**	**43.4**	**41.8**	**42.6**	**44.7**	**47.7**
External	5.9	5.6	5.0	4.6	4.4	5.7
Domestic	35.5	37.8	36.8	38.0	40.4	42.0
Of which : in foreign currency	4.1	3.8	3.2	4.2	4.2	5.4
Consolidated public sector 1/	**30.5**	**31.8**	**30.5**	**32.0**	**35.0**	**38.1**
External	5.9	5.5	4.9	4.6	4.4	5.7
Domestic	24.6	26.2	25.5	27.5	30.6	32.4
Of which : in foreign currency	4.1	3.8	3.2	4.1	4.2	5.4

Source: Central Bank of The Bahamas.

1/ Government-guaranteed debt only.

Table 5. The Bahamas: Balance of Payments

	2006	2007	Est. 2008	Proj. 2009	2010	2011	2012	2013
	(In millions of U.S. dollars)							
Current account balance	**-1,404**	**-1,315**	**-1,001**	**-696**	**-764**	**-850**	**-770**	**-781**
Goods (trade balance)	**-2,063**	**-2,155**	**-2,116**	**-1,573**	**-1,672**	**-1,801**	**-1,839**	**-1,895**
Domestic exports	454	503	601	537	543	563	589	616
Domestic imports	-2,515	-2,635	-2,711	-2,105	-2,210	-2,359	-2,422	-2,506
Oil	-460	-489	-754	-404	-486	-533	-573	-601
Capital goods	-664	-690	-626	-395	-400	-524	-507	-525
Other domestic imports	-1,392	-1,456	-1,331	-1,306	-1,324	-1,303	-1,343	-1,379
Other net exports	-2	-22	-6	-6	-6	-6	-6	-6
Services	**825**	**1,020**	**1,170**	**937**	**978**	**1,035**	**1,148**	**1,198**
Travel (net)	1,671	1,810	1,849	1,661	1,632	1,699	1,831	1,896
Travel (credit)	2,056	2,187	2,153	1,955	1,928	2,003	2,150	2,229
Travel (debit)	-385	-377	-305	-294	-296	-305	-320	-333
Other services	-846	-790	-679	-724	-654	-663	-683	-698
Of which:								
Construction services (net)	-214	-176	-25	-16	-18	-21	-21	-22
Offshore companies local expenditure (net)	188	210	219	172	222	226	234	241
Income and transfers	**-166**	**-180**	**-55**	**-59**	**-70**	**-84**	**-79**	**-84**
Capital and financial account	**1,325**	**1,269**	**1,110**	**798**	**788**	**758**	**749**	**766**
Capital transfers	-64	-76	-76	-76	-76	-76	-76	-76
Long-term public sector	-4	-6	104	79	402	53	29	25
Commercial banks' NFA	143	-87	23	200	-200	0	0	0
Foreign direct investment	707	713	672	429	492	559	573	592
Other private capital 1/	542	724	387	168	170	222	223	226
Overall balance	-79	-46	109	103	24	-93	-21	-15
Change in net international reserves (increase -)	**79**	**46**	**-109**	**-103**	**-24**	**93**	**21**	**15**
	(In percent of GDP)							
Current account balance	**-19.3**	**-17.5**	**-13.2**	**-9.4**	**-10.3**	**-11.3**	**-9.9**	**-9.7**
Goods (trade balance)	**-28.3**	**-28.7**	**-28.0**	**-21.3**	**-22.6**	**-23.9**	**-23.6**	**-23.6**
Domestic exports	6.2	6.7	8.0	7.3	7.3	7.5	7.6	7.7
Domestic imports	-34.5	-35.1	-35.8	-28.4	-29.8	-31.3	-31.1	-31.2
Oil	-6.3	-6.5	-10.0	-5.5	-6.6	-7.1	-7.4	-7.5
Capital goods	-9.1	-9.2	-8.3	-5.3	-5.4	-7.0	-6.5	-6.5
Other domestic imports	-19.1	-19.4	-17.6	-17.6	-17.9	-17.3	-17.2	-17.2
Other net exports	0.0	-0.3	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Services	**11.3**	**13.6**	**15.5**	**12.7**	**13.2**	**13.7**	**14.7**	**14.9**
Travel (net)	23.0	24.1	24.4	22.4	22.0	22.6	23.5	23.6
Travel (credit)	28.2	29.2	28.5	26.4	26.0	26.6	27.6	27.8
Travel (debit)	-5.3	-5.0	-4.0	-4.0	-4.0	-4.0	-4.1	-4.1
Other services	-11.6	-10.5	-9.0	-9.8	-8.8	-8.8	-8.8	-8.7
Income and transfers	**-2.3**	**-2.4**	**-0.7**	**-0.8**	**-0.9**	**-1.1**	**-1.0**	**-1.0**
Capital and financial account	**18.2**	**16.9**	**14.7**	**10.8**	**10.6**	**10.1**	**9.6**	**9.6**
Capital transfers	-0.9	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Long-term public sector	0.0	-0.1	1.4	1.1	5.4	0.7	0.4	0.3
Commercial banks' NFA	2.0	-1.2	0.3	2.7	-2.7	0.0	0.0	0.0
Foreign direct investment	9.7	9.5	8.9	5.8	6.6	7.4	7.4	7.4
Other private capital 1/	7.4	9.7	5.1	2.3	2.3	2.9	2.9	2.8
Overall balance	**-1.1**	**-0.6**	**1.4**	**1.4**	**0.3**	**-1.2**	**-0.3**	**-0.2**
Memorandum items:								
Net international reserves (in millions of U.S. dollars)	499.8	454.2	563.1	665.8	690.1	597.5	576.7	561.6
Nominal GDP (in millions of U.S. dollars)	7,280.1	7,497.9	7,564.1	7,403.2	7,409.4	7,531.9	7,785.8	8,019.9

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

1/ Includes net errors and omissions.

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

	2006	2007	Est. 2008	Proj. 2009	2010
	(In millions of Bahamian dollars, end of period)				
Central bank					
Net international reserves	500	454	563	666	690
Net domestic assets	70	219	82	3	13
Credit to nonfinancial public sector (net)	175	334	200	121	131
Of which : central government	185	336	199	120	130
Other	-105	-115	-118	-118	-118
Reserve money	570	673	645	669	703
Currency held by the private sector	202	224	206	214	224
Liabilities with financial institutions	367	449	439	456	479
Financial system					
Net foreign assets	-255	-214	-141	-238	-14
Of which					
Held by commercial banks and OFIs	-754	-668	-704	-904	-704
Net domestic assets	5,400	5,851	6,065	6,384	6,472
Credit to nonfinancial public sector, net	727	827	968	1,151	1,037
Of which: central government	677	867	924	1,107	993
Credit to private sector	5,669	6,218	6,537	6,673	6,876
Other	-996	-1,194	-1,440	-1,440	-1,440
Liabilities to the private sector (broad money)	5,145	5,637	5,924	6,146	6,459
Money	1,251	1,300	1,275	1,322	1,390
Currency	202	224	206	214	224
Demand deposits	1,049	1,077	1,069	1,109	1,165
Quasi-money	3,894	4,337	4,650	4,824	5,069
	(Change in percent of liabilities to the private sector at the beginning of the period)				
Net foreign assets	-4.6	0.8	1.3	-1.6	3.7
Net domestic assets	11.1	8.8	3.8	5.4	1.4
Credit to nonfinancial public sector	1.2	1.9	2.5	3.1	-1.9
Credit to private sector	14.8	10.7	5.6	2.3	3.3
Liabilities to private sector	6.5	9.6	5.1	3.7	5.1
Money	0.1	1.0	-0.5	0.8	1.1
Quasi-money	6.4	8.6	5.5	2.9	4.0
	(Annual percentage change)				
Net domestic assets	11.0	8.4	3.7	5.3	1.4
Credit to nonfinancial public sector	8.4	13.8	17.0	18.9	-9.9
Credit to private sector	14.4	9.7	5.1	2.1	3.0
Liabilities to private sector	6.5	9.6	5.1	3.7	5.1
Money	0.3	3.9	-2.0	3.7	5.1
Quasi-money	8.7	11.4	7.2	3.7	5.1
	(In percent of GDP)				
Credit to the private sector	77.9	82.9	86.4	90.1	92.8
Money	17.2	17.3	16.8	17.9	18.8
Liabilities to the private sector	70.7	75.2	78.3	83.0	87.2
Memorandum item:					
Central bank credit to the public sector in percent of reserve money	30.7	49.6	31.0	18.2	18.7

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

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

	2004	2005	2006	2007	2008
Financial indicators					
Broad money (12-month percentage change)	11.6	9.2	6.5	9.6	5.1
Private sector credit (12-month percentage change)	6.0	14.2	14.4	9.7	5.1
Three-month treasury-bill rate (end of period)	0.3	0.4	3.0	3.0	2.9
Domestic public debt (in percent of GDP, end of period)	37.8	36.8	38.0	40.4	42.0
External indicators					
Exports of goods and services (12-month percentage change)	9.7	11.5	3.5	8.3	2.2
Imports of goods and services (12-month percentage change)	10.1	18.8	22.7	3.6	-2.5
Current account balance (in percent of GDP)	-5.4	-9.6	-19.3	-17.5	-13.2
Capital account balance (in percent of GDP) 1/	8.6	8.3	18.2	16.9	14.7
Net international reserves (end of period, millions of US$)	668	579	500	454	563
In months of merchandise imports	4.2	3.0	2.2	1.8	2.2
In months of next year's imports of G. and S.	2.2	1.6	1.3	1.2	1.8
In percent of reserve money	104.5	98.5	87.7	67.5	87.3
In percent of broad money	15.1	12.0	9.7	8.1	9.5
Commercial banks, net foreign assets (end of period, millions of US$)	-564	-611	-754	-668	-704
External public debt (in percent of GDP)	5.6	5.0	4.6	4.4	5.7
External debt service (in percent of exports of goods and services)	1.6	1.3	1.4	2.0	2.0
Central Government External debt service (in percent of government revenue)	2.8	1.9	1.7	3.8	1.8
REER appreciation (+) (end of period) 2/	-6.2	3.5	-4.2	-3.6	11.3
Financial soundness indicators 3/					
Foreign currency deposits, percent of total deposits	2.4	3.1	2.6	3.7	3.5
Deposits maturing within 3 months, percent of total deposits	24.2	22.3	21.4	20.7	19.7
Average Net Worth to Risk Weighted Assets	22.6	22.6	24.8	24.9	23.9
Nonperforming loans net of provisions to capital	20.1	23.4	17.7	23.0	30.8
Nonperforming loans to total gross loans	4.8	4.4	4.1	4.3	6.0
Return on assets	2.7	3.4	3.9	3.6	2.4
Return on equity	15.0	19.6	20.4	18.6	11.7
Interest margin to gross income	92.0	92.5	93.4	93.5	93.4
Noninterest expenses to gross income	55.8	58.8	55.8	58.7	67.1
Liquid assets to total assets (liquid asset ratio)	14.5	12.9	11.2	12.0	12.8
Liquid assets to short-term liabilities	21.4	19.1	17.2	18.4	20.0

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

1/ Includes errors and omissions.

2/ Information Notice System.

3/ For domestic commercial banks and other local financial institutions combined.

Table 8. The Bahamas: Cental Government Debt Sustainability Framework, 2004-2014

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2004	2005	2006	2007	2008			2009	2010	2011	2012	2013	2014	
								I. Baseline Projections						**Debt-stabilizing primary balance 10/**
1 **Public sector debt 1/**	33.9	32.9	32.8	35.1	36.5			**43.1**	**45.9**	**49.1**	**50.8**	**52.7**	**54.4**	**1.0**
Of which : foreign-currency denominated	4.6	4.2	4.0	3.9	5.1			9.0	9.3	9.5	9.6	9.6	9.6	
2 Change in public sector debt	2.6	-1.0	-0.1	2.4	1.4			6.6	2.8	3.1	1.7	1.9	1.7	
3 Identified debt-creating flows (4+7+12)	3.3	-0.6	-1.0	2.1	2.2			6.6	5.2	3.5	1.7	1.9	1.7	
4 Primary deficit	1.5	0.6	-0.4	1.3	0.5			3.3	2.6	1.7	0.8	0.8	0.7	
5 Revenue and grants	15.4	16.5	17.9	17.6	19.0			17.2	17.7	18.2	18.6	18.3	18.3	
6 Primary (noninterest) expenditure	16.9	17.1	17.5	18.9	19.5			20.5	20.3	19.9	19.4	19.2	19.1	
7 Automatic debt dynamics 2/	1.8	-1.2	-0.6	0.9	1.7			3.2	2.6	1.8	0.9	1.1	1.0	
8 Contribution from interest rate/growth differential 3/	1.8	-1.2	-0.6	0.9	1.7			3.2	2.6	1.8	0.9	1.1	1.0	
9 Of which contribution from real interest rate	1.6	0.5	0.7	1.1	1.1			1.8	2.4	2.5	2.3	2.1	1.9	
10 Of which contribution from real GDP growth	0.3	-1.8	-1.3	-0.2	0.6			1.5	0.2	-0.7	-1.4	-1.0	-0.9	
11 Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
12 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	0.0	
13 Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2-3)	-0.7	-0.4	0.9	0.2	-0.8			0.0	-2.4	-0.3	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	220.6	199.7	183.2	199.4	192.5			250.5	259.3	269.2	273.0	287.2	296.8	
Gross financing need 5/	4.4	3.4	2.6	4.4	3.6			6.7	8.9	5.4	4.3	4.7	4.7	
in billions of U.S. dollars	271.8	230.7	189.3	326.3	274.6	10-Year Historical Average	10-Year Standard Deviation	497.1	659.5	407.2	335.0	378.6	387.4	Projected Average
Key Macroeconomic and Fiscal Assumptions														
Real GDP growth (in percent)	-0.8	5.7	4.3	0.7	-1.7	1.7	2.6	-3.9	-0.5	1.5	3.0	2.0	1.8	1.6
Average nominal interest rate on public debt (in percent) 6/	5.9	5.8	5.2	5.7	5.7	6.0	0.4	6.6	6.2	5.6	5.2	5.3	5.3	5.5
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	5.0	1.9	2.5	3.5	3.0	3.0	1.2	4.7	5.6	5.5	4.9	4.3	3.8	4.8
Nominal appreciation (increase in US dollar value of local currency, in percent)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Inflation rate (GDP deflator, in percent)	0.9	3.9	2.7	2.2	2.6	2.9	1.4	1.8	0.6	0.2	0.4	1.0	1.5	0.7
Growth of real primary spending (deflated by GDP deflator, in percent)	7.4	7.1	6.6	9.0	1.3	4.1	3.6	1.3	-1.8	-0.4	0.3	0.8	1.3	0.0
Primary deficit	1.5	0.6	-0.4	1.3	0.5	0.3	1.0	3.3	2.6	1.7	0.8	0.8	0.7	1.3
								II. Stress Tests for Public Debt Ratio						**Debt-stabilizing primary balance 10/**
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2009-2014 7/								**43.1**	**41.7**	**42.3**	**43.2**	**44.1**	**45.0**	**0.6**
A2. No policy change (constant primary balance) in 2009-2014								**43.1**	**46.7**	**51.5**	**55.8**	**60.3**	**64.8**	**1.2**
B. Bound Tests														
B1. Real interest rate is at baseline plus one standard deviations								**43.1**	**46.2**	**49.6**	**51.6**	**53.9**	**55.9**	**1.4**
B2. Real GDP growth is at baseline minus one-half standard deviation								**43.1**	**46.8**	**51.1**	**54.3**	**58.0**	**61.8**	**2.0**
B3. Primary balance is at baseline minus one-half standard deviation								**43.1**	**46.4**	**50.1**	**52.3**	**54.8**	**57.0**	**1.1**
B4. Combination of B1-B3 using one-quarter standard deviation shocks								**43.1**	**46.6**	**50.5**	**52.9**	**55.6**	**58.2**	**1.6**
B5. One time 30 percent real depreciation in 2010 9/								**43.1**	**50.0**	**53.3**	**55.1**	**57.1**	**58.9**	**1.1**
B6. 10 percent of GDP increase in other debt-creating flows in 2010								**43.1**	**55.9**	**59.5**	**61.3**	**63.5**	**65.4**	**1.2**

1/ Central government gross debt.

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

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.

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

5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

6/ Derived as nominal interest expenditure divided by previous period debt stock.

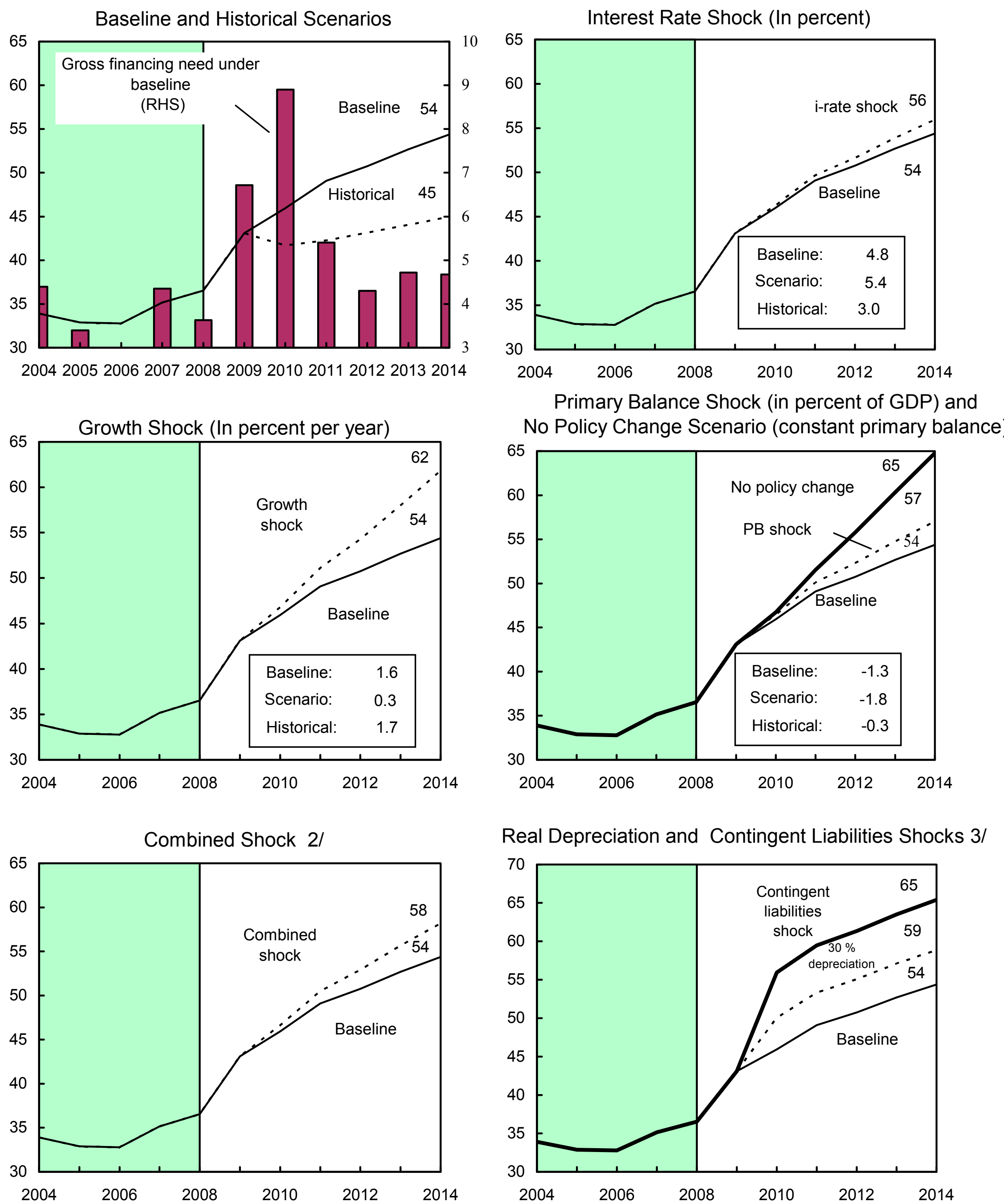
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ The implied change in other key variables under this scenario is discussed in the text.

9/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

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

Figure 6. The Bahamas: Public Debt Sustainability: Bound Tests 1/
(Central Government debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 9. The Bahamas: External Debt Sustainability Framework, 2004-2014

(In percent of GDP, unless otherwise indicated)

		Actual					Projections						
		2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	**Debt-stabilizing non-interest current account 6/**
1	**Baseline: External debt**	5.5	5.0	4.6	4.4	5.7	**6.9**	**9.9**	**10.1**	**10.2**	**10.2**	**10.2**	**-7.3**
2	Change in external debt	-0.4	-0.6	-0.4	-0.2	1.3	1.2	3.1	0.2	0.0	0.0	0.0	
3	Identified external debt-creating flows (4+8+9)	-4.4	0.8	9.2	7.9	4.3	3.8	3.7	3.7	2.2	2.2	2.2	
4	Current account deficit, excluding interest payments	2.4	9.3	19.0	17.3	12.9	9.2	10.0	10.7	9.3	9.1	9.3	
5	Deficit in balance of goods and services	4.5	7.8	17.0	15.1	12.5	8.6	9.4	10.2	8.9	8.7	8.8	
6	Exports	44.0	44.6	43.1	45.4	45.9	41.2	41.5	42.2	43.2	43.4	43.2	
7	Imports	48.5	52.5	60.1	60.5	58.5	49.7	50.9	52.4	52.1	52.1	52.1	
8	Net nondebt creating capital inflows (negative)	-7.2	-8.3	-9.7	-9.5	-8.9	-5.8	-6.6	-7.4	-7.4	-7.4	-7.6	
9	Automatic debt dynamics 1/	0.3	-0.2	0.0	0.1	0.3	0.4	0.4	0.5	0.3	0.4	0.5	
10	Contribution from nominal interest rate	0.3	0.3	0.3	0.3	0.3	0.2	0.3	0.6	0.6	0.6	0.6	
11	Contribution from real GDP growth	0.1	-0.3	-0.2	0.0	0.1	0.2	0.0	-0.1	-0.3	-0.2	-0.2	
12	Contribution from price and exchange rate changes 2/	-0.1	-0.2	-0.1	-0.1	-0.1	...	...	...	...	...	...	
13	Residual, incl. change in gross foreign assets (2-3) 3/	4.0	-1.4	-9.6	-8.1	-3.0	-2.7	-0.6	-3.5	-2.2	-2.2	-2.2	
	External debt-to-exports ratio (in percent)	12.6	11.1	10.6	9.6	12.4	16.7	23.9	24.0	23.6	23.5	23.5	
	Gross external financing need (in billions of U.S. dollars) 4/	194.3	664.4	1414.2	1350.6	1013.1	713.3	783.3	878.7	798.2	811.0	852.3	
	in percent of GDP	3.1	9.8	19.4	18.0	13.4	9.6	10.6	11.7	10.3	10.1	10.3	
	Scenario with key variables at their historical averages 5/						**6.9**	**10.1**	**10.8**	**12.7**	**14.8**	**16.9**	**-5.7**
	Key Macroeconomic Assumptions Underlying Baseline												
	Real GDP growth (in percent)	-0.8	5.7	4.3	0.7	-1.7	-3.9	-0.5	1.5	3.0	2.0	1.8	
	GDP deflator in U.S. dollars (change in percent)	0.9	3.9	2.7	2.2	2.6	1.8	0.6	0.2	0.4	1.0	1.5	
	Nominal external interest rate (in percent)	5.7	6.0	6.1	5.8	7.1	2.8	4.6	6.1	6.3	6.4	6.4	
	Growth of exports (U.S. dollar terms, in percent)	9.7	11.5	3.5	8.3	2.2	-12.3	1.0	3.3	5.8	3.5	2.8	
	Growth of imports (U.S. dollar terms, in percent)	11.3	18.8	22.7	3.6	-2.5	-16.7	2.4	4.6	2.8	3.1	3.2	
	Current account balance, excluding interest payments	-2.4	-9.3	-19.0	-17.3	-12.9	-9.2	-10.0	-10.7	-9.3	-9.1	-9.3	
	Net nondebt creating capital inflows	7.2	8.3	9.7	9.5	8.9	5.8	6.6	7.4	7.4	7.4	7.6	

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

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

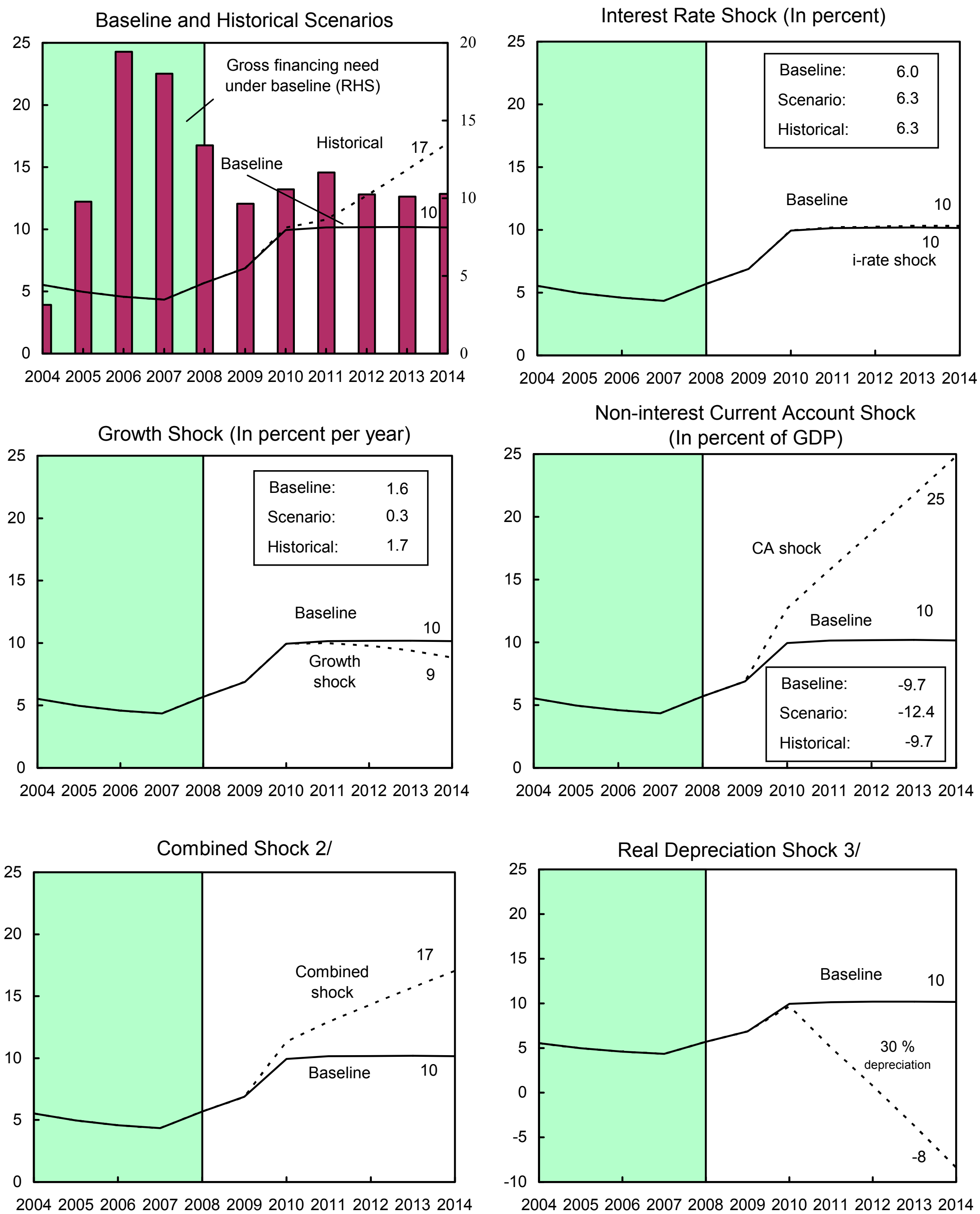
3/ For projection, line includes the impact of price and exchange rate changes.

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

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

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

Figure 7. The Bahamas: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2009.

Appendix I. Background and Summary of Informational Annexes

Discussions. The 2009 Article IV consultation discussions were held in Nassau during March 24-April 3, 2009. The mission met with Prime Minister Hubert Ingraham, Finance Minister of State Zhivargo Laing, Governor Wendy Craigg, Acting Financial Secretary Ehurd Cunningham, other senior officials, representatives of the private sector, and the opposition. The team visited Nassau during March 24–April 3 and comprised Laure Redifer (head), Christopher Faircloth, Masahiro Nozaki (all WHD) and Werner Keller (AFR). Patricia Alonso-Gamo and Trevor Alleyne (both WHD) and Mr. Ladd (OED) participated in policy meetings.

Exchange arrangement. The Bahamas has accepted the obligations of the Article VIII, Sections 2, 3, and 4, and maintains an exchange system that is free of restrictions on payments and transfers for current international transactions. The exchange rate of the Bahamian dollar is pegged to the U.S. dollar at parity.

Fund relations. The Bahamas has no outstanding purchases or loans.

Technical assistance. In 2005, STA provided assistance in balance of payments and external debt accounting, and government finance statistics. In 2007, STA assisted in the compilation of the new national accounts series. Immediately following the 2007 Article IV consultation mission, an MCM/CARTAC mission provided advice on the adoption of market-oriented monetary instruments. CARTAC provided advice in three TA missions in 2009 on banking and credit union supervision, and has three TA missions in the pipeline on stress testing, credit assessment and anti-money laundering.

Statistical issues. There has been progress in the timeliness and quality of economic data, although weaknesses remain. The Department of Statistics (DOS) revised and rebased in 2007 and again in 2008 incorporating information from the latest economic census. A preliminary version of the revised national accounts was released in April 2009 in line with the FY 2009/10 budget cycle. The operations of public corporations are not compiled into consolidated set of public sector accounts. While Statistical data are adequate for surveillance purposes, the posting of data and reports on the DOS' website occurs with long delays, implying that the central bank is the main source of data. The DOS has also embarked on an ambitious program to conduct comprehensive socio-economic surveys.

Relations with the Inter-American Development Bank (IDB). As of April 6, 2009, the active portfolio of the IDB stood at US$174 million, of which US$42 million were outstanding. The IDB is in the final stages of preparing a new strategy for 2008-12. During the period the Bank seeks to reposition itself as an important source of financing for the critical investment needs of The Bahamas. In order to cushion adverse aspects of the downturn, build resilience to exogenous factors, position the economy for long term growth, and given the identified priorities of Government, the new strategy will focus on two strategic pillars: (i) Infrastructure for Growth and Environmental Sustainability; and (ii) Institutions for Competitiveness and Social Sustainability.

INTERNATIONAL MONETARY FUND

THE BAHAMAS

Staff Report for the 2009 Article IV Consultation—Informational Annex

Prepared by the Western Hemisphere Department

May 21, 2009

Contents Page

Annexes

Annex I. The Bahamas—Fund Relations

(As of March 31, 2009)

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

A. Financial Relations

II. General Resources Account:

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

III. SDR Department:

	SDR Million	Percent Allocation
Net cumulative allocation	10.23	100.0
Holdings	0.05	0.46

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements: None

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

	Forthcoming				
	2007	**2008**	**2009**	**2010**	**2011**
Principal					
Charges/interest	0.03	0.04	0.04	0.04	0.04
Total	**0.03**	**0.04**	**0.04**	**0.04**	**0.04**

B. Nonfinancial Relations

VII. Exchange Rate Arrangement:

The Bahamian dollar is 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.

VIII. Last Article IV Consultation:

The Bahamas has been on a 24-month consultation cycle, and will return to a 12 month cycle. The last Article IV consultation was concluded on November 26, 2007.

IX. Technical Assistance:

Department	**Dates**	**Purpose**
STA	February 2005	BOP and external debt
STA	April 2005	Government finance
STA	July 2007	National accounts
MCM	October 2007	Monetary policy

X. Resident Representative:

None.

Annex II. The Bahamas—Financial Relations with the Inter-American Development Bank (IDB)

A. Active Loans as of April 6, 2009

(in U.S. dollar millions)

Purpose	Approval Date	Amount	Amount Disbursed
New Providence Transport Program	5/30/2001	43.4	33.4
Land use policy and administration project	11/17/2004	3.5	2.8
Transforming education and training	11/30/2005	18	2.9
Supplementary Financing for the New Providence Transport Program	5/22/2008	100	3
Masterplan for Coastal Zone Management*	11/15/2006	3.8	0
Natural Risks Preventive Management*	12/6/2006	5	0
Total		**173.7**	**42.1**

**Loans pending official cancellation and removal from active portfolio*

Source: The Inter-American Development Bank

B. Net Flow of Convertible Currencies

(in U.S. dollar millions)

	2006	2007	2008	Proj. 2009
Loan approvals	8.8	0	100	50
Loan disbursements	7.1	9.5	16.2	77.5
Repayments (principal)	4.9	5.4	6.1	8.5
Net loan flow	**2.2**	**4.1**	**10.1**	**69**
Interest and charges	3.6	5.4	4.9	6.4
Net cash flow	**-1.5**	**-1.3**	**5.2**	**62.6**

Source: The Inter-American Development Bank.

Recent Country Strategy:
The IDB is in the final stages of the preparing a new strategy for 2008–12. During the period the Bank seeks to reposition itself as an important source of financing for the critical investment needs of The Bahamas. As a result of the present global crisis, and as highlighted by the analytical work carried out by the Bank, the major challenges facing The Bahamas during the next strategy period will be the need to: (i) cushion the adverse impacts and build resilience to exogenous factors; and (ii) position the economy for long-term sustainable growth. Within this context, and given the identified priorities of Government, the new strategy will focus on two strategic pillars (i) **Infrastructure for Growth and Environmental Sustainability** and (ii) **Institutions for Competitiveness and Social Sustainability**.
The IDB's strategy for 2003–07 was to focus on: (i) supporting private sector development; (ii) promoting social development and equity enhancement; (iii) environmental protection and natural resource sustainability; and (iv) improving public sector management. A key feature of the strategy has been to focus on relatively small projects with a high technical assistance content.

Annex III. The Bahamas—Statistical Issues

There has been progress in the timeliness and quality of economic data, although weaknesses remain. The Department of Statistics (DOS) has embarked on a series of initiatives to improve national accounts information. The national accounts were revised and rebased (2006=100) in 2007 and again in 2008 incorporating information from the latest economic census. The census revealed that certain non-traditional sectors (land, marine, and storage) were undercounted in previous national accounts, while the contribution of others, including real estate, hotels, and education, were over-estimated.[12] A preliminary version of the revised national accounts was released in April 2009 in line with the FY 2009/10 budget cycle. In addition, the central bank produces annual, quarterly, and monthly reports summarizing macroeconomic developments, monetary and fiscal data, and a weekly brief of key monetary data is available to staff. The operations of public corporations are not compiled into consolidated set of public sector accounts. While Statistical data are adequate for surveillance purposes, the posting of data and reports on the DOS' website is erratic and occurs with long delays, implying that the central bank is the main source of data.

The DOS has embarked on an ambitious program to conduct comprehensive socio-economic surveys. (i) A household expenditure survey with a poverty assessment module has been completed but delays in processing the data has precluded the production poverty assessment (now scheduled for end-2009); (ii) a survey on social conditions will provide MDG data (modified to fit the local circumstances); (iii) an occupational survey will update the labor force statistics, which the authorities have begun to publish on a bi-annual basis given the recent deterioration in economic conditions; and (iv) a survey is planned to update and revise the CPI basket (last updated in 1994).

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

[12] The census excluded the banking/insurance, fisheries, and agriculture sectors.

The Bahamas: Table of Common Indicators Required for Surveillance

(As of April 29, 2009)

	Date of latest observation	Date received	Frequency of Data[5]	Frequency of Reporting[5]	Frequency of publication[5]
Exchange Rates	Fixed	…	…	…	…
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	4/1/2009	4/2009	W	W	M
Reserve/Base Money	4/1/2009	4/2009	W	W	M
Broad Money	4/1/2009	4/2009	W	W	M
Central Bank Balance Sheet	2/2009	3/2009	W	W	M
Consolidated Balance Sheet of the Banking System	12/2008	2/2009	M	M	Q
Interest Rates[2]	4/1/2009	4/2009	W	W	M
Consumer Price Index	12/2008	2/2009	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	12/2008	2/2009	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt[4]	12/2008	2/2009	Q	Q	Q
External Current Account Balance	12/2008	2/2009	Q	Q	Q
Exports and Imports of Goods and Services	12/2008	2/2009	Q	Q	Q
GDP/GNP	2008	4/2009	A	A	A
Gross External Debt	3/2009	4/2009	M	M	M

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[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] Including currency and maturity composition.
[5] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

INTERNATIONAL MONETARY FUND

THE BAHAMAS

Staff Report for the 2009 Article IV Consultation with The Bahamas Supplementary Information

Prepared by the Staff Representatives for the 2009 Consultation with The Bahamas

Approved by Patricia Alonso-Gamo and Aasim Husain

June 3, 2009

This supplement provides information that has become available since the staff report was issued. The new information does not alter the broad conclusions and policy recommendations of the staff appraisal.

1. **The proposed FY 2009/2010 budget maintains essential spending, but reflects further revenue measures that would reduce the overall budget deficit from 5.8 to 3.9 percent of GDP**. The FY 2009/2010 budget was submitted to Parliament on May 27, 2009. Macroeconomic assumptions underlying the budget are consistent with the Article IV discussions as presented in the staff report (SM/09/140).

- **Revenues**. Revenues are projected at $1411 million, $151 million higher than originally assumed. The higher revenue projections are based on: further extensive legal and administrative improvements for Customs, real property taxes and business licensing ($114 million); a dividend payment from The Bahamas

The Bahamas: Operations of the Central Government 1/

	FY 08/09 proj.	FY09/10 Staff Report	FY09/10 Budget
	(In million of B$)		
Revenue	**1,312**	**1,260**	**1,411**
Tax revenue	1,106	1,099	1,197
Taxes on international trade	575	565	457
Tourism taxes	102	99	97
Miscellaneous taxes	418	425	642
Other	428	435	643
Nontax revenue and grants	206	161	214
Total expenditure	**1,662**	**1,692**	**1,697**
Current expenditure	**1,415**	**1,446**	**1,442**
Wages and salaries 2/	710	718	721
Goods and services 2/	297	289	292
Interest payments	166	190	177
Subsidies and transfers 2/	242	249	252
Capital expenditure	**247**	**246**	**255**
Overall balance	**-350**	**-432**	**-286**
Financing	**350**	**432**	**286**
New financing 3/	429	703	574
Amortization	-79	-272	-288
Memo:			
Overall balance % of GDP	-4.7%	-5.8%	-3.9%

Sources: Ministry of Finance and Fund staff projections.

1/ Fiscal year ends June 30.
2/ FY09/10 budget is presented as functional classification: economic classification is estimated.
3/ New borrowing and privatization proceeds.

Telecommunications Company (BTC) ($30 million) prior to privatization; and a transfer of profits from the central bank ($7 million).[13]

- **Expenditures**. Expenditures ($1697 million) are in line with the Article IV discussions and the staff report. The government introduced unemployment benefits in April 2009, and the budget provisions for an extension of these benefits.[14] In the first four weeks, the program disbursed some $2.4 million, benefiting 5,711 claimants. Recently enacted amendments to the scheme will make eligible an additional 400 claimants.

- **Financing**. The resulting deficit is 3.9 percent of GDP, financed by the proceeds from BTC privatization and new borrowing.

2. **The fiscal stance remains appropriate, but the yield from planned revenue measures appears uncertain, given the reliance on improvements in tax administration**. If revenues/privatization receipts are lower than planned or take longer to materialize, additional expenditure adjustment may be required in order to contain the deficit at 5.8 percent of GDP or below, as discussed during the Article IV consultation.

3. **Structural revenue measures are needed to buttress medium-term debt sustainability**. For the medium term, the budget presents multi-annual fiscal projections which set a course to reduce the overall deficit an additional 1.5 percent of GDP (by FY 2011/2012), mainly through curtailed expenditure increases. While this level of expenditure containment would flatten the increase of the debt trajectory, it would not change medium-term debt dynamics. Given the need to protect priority social and infrastructure spending, and rigidities in the public sector wage bill, a structural change on the revenue side would likely still be needed to achieve the authorities' medium-term objective of reducing debt back to 30–35 percent of GDP.

4. **The growth forecast for 2009 remains reasonable, but heavy risks remain on the downside**. Data for tourism arrivals in January–April, comprising the peak of the season, remain broadly consistent with staff's forecasted 9.2 percent contraction in tourism receipts for 2009. First quarter data for FDI suggest the staff's forecast of a 30 percent contraction remains realistic.

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[13] Customs reforms include measures discussed in the staff report, along with significant management changes recently undertaken. Improvements to collection of real property taxes and business licenses will be effected through new legislation.

[14] The additional budgetary cost of the unemployment benefits will be limited in the near term since they are being financed by a transfer of a surplus in the medical infrastructure fund managed by the National Insurance Board. Contributions to the Unemployment Fund will commence in 2010 through a payroll levy on employers and employees, with the Government contributing as an employer.

- **Tourism**. Sea arrivals were up by 5.5 percent over the same period last year, partly reflecting increased demand for shorter and cheaper cruise trips. However, tourists arriving by air—who spend three times as much daily as cruise tourists and stay six times longer—dropped by 15.5 percent. On May 26, the Four Seasons Hotel in Exuma closed, resulting in the termination over one-half of its 500 employees, with further lay-offs pending.

- **FDI**. The number of commercial property acquisitions by non-Bahamians dropped 36 percent compared to the first quarter of 2008, with the total value ($70 million) declining by 65 percent. Similarly, the number of residential property purchases by non-Bahamians dropped by 19 percent, with a decline in total value of 25 percent.

5. **The authorities are implementing legislation to align insurance supervision in The Bahamas with international norms**. In May, Parliament passed a new External Insurance Act and amendments to the 2005 Insurance Act: these are in the process of gaining assent by the Governor General and then will be put into force. The authorities will request CARTAC assistance with implementation.

Public Information Notice (PIN) No. 09/78
FOR IMMEDIATE RELEASE
June 17, 2009

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

IMF Executive Board Concludes Article IV Consultation with The Bahamas

On June 5, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with The Bahamas.[1]

Background

Since mid-2008, the global downturn has significantly affected economic activity in The Bahamas. Tourism began declining in September and a number of foreign direct investment projects were postponed or cancelled due to the downturn or financing difficulties. As a result, real GDP is estimated to have contracted by 1.7 percent after having grown 2.5 percent per year in 2006–07, and unemployment rose to 12–14.5 percent (preliminary March 2009 estimates) from 7.9 percent at end-2007, with hotel and construction accounting for most of the layoffs. Inflation for the twelve months ending in March stood at 4.9 percent. Private sector credit growth decelerated to 5.1 percent in 2008 from almost 10 percent a year earlier, reflecting weaker demand and tighter lending standards by banks. Direct exposure to the global financial crisis has been limited by exchange controls that cap Bahamian residents' foreign-currency denominated assets and liabilities.

The external current account balance improved in 2008, mainly reflecting lower construction-related imports and higher retained earnings. Although private sector financing flows dropped substantially, government borrowing in foreign currency to finance capital expenditures helped

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

bolster international reserves, which stood at US$563 million at end-2008, about 87 percent of base money.

The FY 2008/09 overall fiscal deficit is expected to increase to about 5 percent of GDP, reflecting shortfalls in revenues associated with the downturn. The authorities maintained budgeted expenditure levels, while shifting spending to provide transitory means-tested unemployment benefits. The fiscal deficit is being financed by new external and domestic borrowing, increasing central government debt to around 40 percent by the end of FY 2008/09, still low relative to the regional average.

Domestic banks remain well capitalized, despite an increase in non-performing loans as a result of the downturn. Banks have proactively restructured troubled consumer and mortgage loans, and the central bank has enhanced monitoring. Negative spillovers from the offshore financial sector to the domestic financial sector appear limited so far, due to exchange controls and restrictions on net open foreign exchange positions of domestic banks. The linkages to the domestic economy are limited to employment and consumption of services by the sector. A large insurance company, CLICO Bahamas, was placed into liquidation in February 2009 after it became insolvent due to real estate investments in the United States, but its demise has not had systemic implications for the domestic financial system. In May, the authorities tabled amendments to put into effect a law to align insurance supervision with international standards.

Executive Board Assessment

Executive Directors commended the Bahamian authorities' strong track record of prudent macroeconomic management. They noted that the global economic downturn has put significant stress on the Bahamian economy because of the latter's strong ties to the U.S. economy, and that downside risks to the outlook remain. However, they considered that the Bahamas' low debt ratios provide the authorities with room for maneuver to cope with the current difficult economic environment, and noted the authorities' readiness to adapt their policy agenda as economic conditions warrant.

Directors welcomed the authorities' efforts to strike a reasonable balance between countercyclical fiscal policy and fiscal adjustment to contain the adverse impact of the shock on medium-term sustainability. They supported the authorities' plans to maintain priority spending and expand targeted social benefits, despite dwindling fiscal revenues, while streamlining non-essential spending, introducing administrative and legal reforms to enhance revenue collection, and strengthening the public enterprise sector to reduce its burden on the public finances. Directors noted, however, that the attainment of budgetary objectives would depend importantly on privatization proceeds and increased revenue, both of which are uncertain in terms of magnitude and timing. They cautioned that if receipts fell short, additional adjustment measures might be needed.

Directors concurred that the fixed exchange rate regime has served the Bahamas well by contributing to a stable investment climate. They stressed that macroeconomic policies would need to be supportive of the peg under the current difficult environment. They noted the staff analysis indicating that the real exchange rate appears broadly in line with fundamentals and that, despite the recent appreciation, tourism indicators do not suggest a loss of competitiveness.

Directors noted that the direct financial impact of the global downturn and negative spillover from the offshore financial sector appear limited thus far. They observed that, despite increases in non-performing loans, domestic banks remain liquid and well capitalized with healthy margins. Directors welcomed the authorities' enhanced bank monitoring and plans to strengthen supervision of credit unions and the insurance sector, and encouraged further regional coordination of bank supervision. They highlighted the authorities' commitment to adhere to international standards for offshore financial regulation, strengthen the framework for Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT), and adopt Organization for Economic Cooperation and Development (OECD) standards on tax information exchange.

Directors welcomed the authorities' plans to shift from credit controls to more market-based monetary policy instruments, including by introducing an auction mechanism for government securities to allocate credit more efficiently and to provide a vehicle for liquidity management. Directors concurred that gradual relaxation of exchange controls, under a well-sequenced implementation plan, once the global environment becomes more supportive, would help deepen domestic capital markets.

Directors encouraged the authorities to implement structural reforms to promote economic diversification and private-sector-led growth over the medium term. In particular, they stressed the need to diversify tourism exports, and to broaden the domestic tax base in order to help finance priority spending, reduce distortions, and increase the resilience of revenues to shocks. Strengthened administrative capacity could facilitate the eventual introduction of a goods and services tax, which in turn would help achieve the authorities' objective of reducing the debt to 30–35 percent of GDP over the medium term.

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

The Bahamas: Selected Economic Indicators

	2006	2007	Est. 2008	Proj. 2009
Real sector 1/				
Real GDP	4.3	0.7	-1.7	-3.9
Nominal GDP	7.1	3.0	0.9	-2.1
Consumer price index (annual average)	1.8	2.5	4.5	1.8
Consumer price index (end of period)	2.3	2.9	4.5	1.0
Unemployment rate (in percent)	7.6	7.9	8.7	…
Financial sector				
Credit to the nonfinancial public sector	8.4	13.8	17.0	18.9
Credit to the private sector	14.4	9.7	5.1	2.1
Liabilities to the private sector	6.5	9.6	5.1	3.7
External sector				
Exports of goods and services	3.5	8.3	2.2	-12.3
Of which				
Travel receipts (gross)	-0.6	6.4	-1.6	-9.2
Imports of goods and services	22.7	3.6	-2.5	-16.7
Central government 2/				
Revenue	17.4	18.1	18.9	17.5
Current expenditure	16.3	17.4	17.8	18.9
Capital expenditure and net lending	2.5	3.2	3.1	3.3
Primary balance	0.2	-0.8	-0.1	-2.5
Overall balance	-1.5	-2.5	-2.0	-4.7
Central government debt	32.9	33.0	35.6	40.5
External sector				
Current account balance	-19.3	-17.5	-13.2	-9.4
Overall balance	-1.1	-0.6	1.4	1.4
External public debt (end of period)	4.6	4.4	5.7	6.9
Memorandum items:				
Net international reserves				
(end of period; millions of U.S. dollars)	499.8	454.2	563.1	665.8
In months of next year's imports of G. and S.	1.3	1.2	1.8	2.1
External debt-service ratio 3/	1.4	2.0	2.0	0.9
GDP (in millions of Bahamian dollars)	7,280	7,498	7,564	7,403

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

1/ Recently revised national accounts data account for the difference with the April 2009 WEO.

2/ Corresponds to the fiscal year ending June 30.

3/ In percent of exports of goods and services. The increase in 2010 reflects repayment of internal forex loan of US$200 million to domestic banks.