INTERNATIONAL MONETARY FUND

IMF Country Report No.11/338

THE BAHAMAS

2011 ARTICLE IV CONSULTATION

December 2011

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 2011 Article IV consultation with The Bahamas, the following documents have been released and are included in this package:

- **Staff Report** for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on July 26, 2011, 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 October 20, 2011. 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.
- **Informational Annex** prepared by the IMF.
- **Public Information Notice** (PIN)
- **Executive Director's Statement**

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

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

International Monetary Fund
Washington, D.C.

THE BAHAMAS

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION

October 20, 2011

KEY ISSUES

Context. The economy is beginning to recover. Real GDP is projected to grow at about 2 percent in 2011, owing to an improvement in tourism and the start of large investment projects. Government revenue remains low. Substantial projected foreign direct investment (FDI)-related imports and higher oil prices will widen the external current account, but the reserves position will remain reasonably strong.

Policy challenges. The key policy priority is implementing a sustained fiscal consolidation. The public debt-to-GDP ratio is projected to reach 69 percent by end FY 2015/16, from 44 percent in FY 2008/09.

- **Fiscal consolidation.** The deficit of the central government is projected to average about 4¼ percent of GDP during FY 2011/12–2015/16. Reforms to the tax system and in public finance management, containing expenditures, and strengthening of the financial position and transparency of public enterprises, are necessary to reverse the deterioration of the fiscal position.

- **Enhancing medium-term growth prospects.** Sustaining high employment will require removing key impediments to growth. Efforts should focus on improving the business environment, enhancing the provision of government services, fostering linkages across sectors and among islands, and encouraging innovations in downstream value-added activities.

- **Strengthening regulatory and supervisory frameworks.** Although banking-sector capital adequacy ratios remain high, the elevated level of non-performing loans and relatively limited provisioning calls for strong monitoring. The establishment of the proposed credit bureau, that will help assess credit-worthiness, as well as reforms to strengthen the regulatory and supervisory frameworks for the non-banking system, including by bringing credit unions under the supervision of the central bank, are welcome.

Approved By
Miguel A. Savastano and Claire Waysand

Discussions took place in Nassau during July 13–26. Staff representatives comprised G. Leon (Chief), G. El-Masry, and C. Macario (All WHD). Mr. Rolle (OED) attended the meetings.

CONTENTS

BACKGROUND

1. The diversity of economic characteristics and the large number of islands that comprise The Bahamas presents unusual challenges for providing government services and for formulating development strategies. The archipelago has about 30 inhabited islands. The country's economy has two main drivers, tourism and financial services, with the tourism product differentiated across the islands from large resorts to small boutique-type properties. Financial services span both offshore and onshore activity: activity in the offshore center is linked with onshore financial services;[1] the onshore financial system has 276 banks and trust companies (eight commercial banks, with a strong presence of Canadian banks).

2. The Bahamas enjoys a stable democracy. Elections must be scheduled by May 2012. The Free National Movement (FNM), currently in power, and the Progressive Liberal Party (PLP) are expected to run campaigns, focused on the economy, jobs, and stopping crime. Doubt about the strength of the U.S. recovery will exacerbate political uncertainty in the run-up to the elections.

3. Despite slow growth since the beginning of the decade, the country was well positioned at the beginning of the crisis. With one of the highest per-capita income levels in the Caribbean and a relatively low public debt-to-GDP ratio for the region,[2] the Bahamas has had a strong sovereign credit rating, reaffirmed in May 2011 by Standard and Poor's as BBB+ with a stable outlook.[3]

4. The Bahamas was strongly hit by the crisis. Tourism collapsed following the recession in the United States (the main source of tourists). As a result, GDP shrank by about 1½ percent in 2008 and 5½ percent in 2009. To mitigate the impact of the contraction, the authorities strengthened the social safety net with temporary unemployment programs and increased public investment. At the same time, the Trinidad and Tobago-based CL Financial Group failed in January 2009, and the conglomerate's local insurance company, CLICO-Bahamas, was put under judicial management. Difficulties in liquidating CLICO's assets hindered a resolution, leading the authorities to issue government guarantees to facilitate the sale of the traditional life-insurance policies.

5. In concluding the 2010 Article IV Consultation, Executive Directors commended the Bahamian authorities for their commitment to medium-term fiscal adjustment. Directors welcomed the revenue and spending measures in the budget for FY 2010/11 (July to June), but noted that broader reforms to the tax system and public finance management were needed over the medium term to improve the fiscal position. They also encouraged the authorities to build up foreign reserves to support the longstanding exchange peg to the U.S. dollar and commended the authorities for their efforts to strengthen the financial system.

[1] Offshore operations in The Bahamas are mostly conducted through International Business Corporations (IBCs)—non-financial legally established entities permitted to carry out business outside The Bahamas. These vehicles operate under the IBC Act, 2000. IBCs support employment in financial (banking and trust operations) and corporate service providers, the securities industry, and the legal and accounting professions; and contribute to government revenues through fees for incorporation and annual registrations.

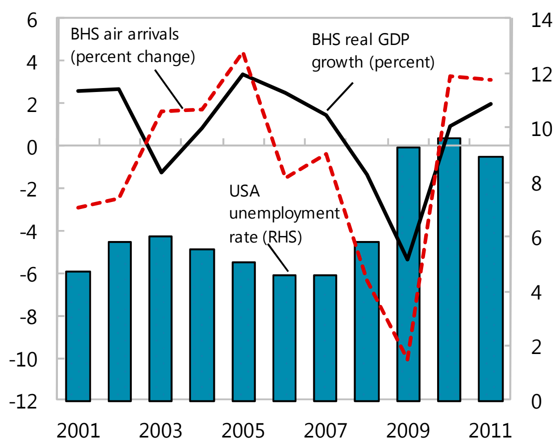
[2] As of end-2007, total public sector debt was about 40 percent of GDP, mostly domestic.

[3] In August, Moody's affirmed The Bahamas' A3 bond rating, but revised the outlook from stable to negative.

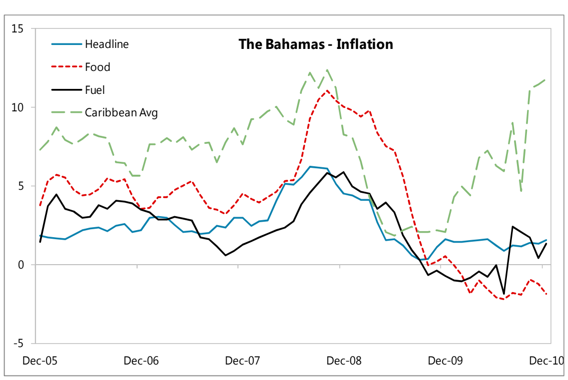
RECENT ECONOMIC DEVELOPMENTS

6. After having been severely impacted by the global financial crisis, the Bahamian economy began a tepid recovery in 2010.

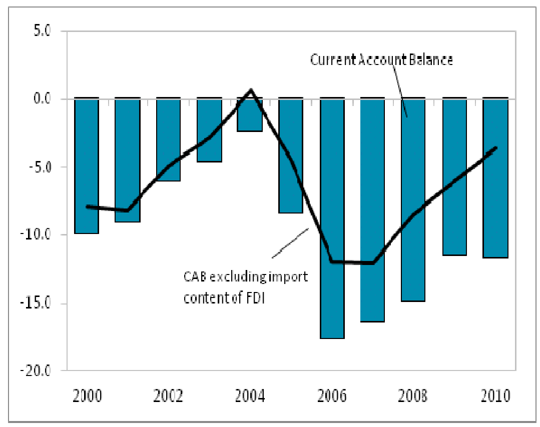
- **Real GDP grew by about one percent.** The rebound was led by the trade, hospitality, transport, and governments services sectors, while the construction and offshore financial services sectors continued to contract.



- **Inflation remained subdued at 1½ percent (y-o-y).** Food prices declined by over 1 percent. In contrast, fuel and transportation prices rose by about 2½ percent, but had a lower impact on inflation than in other Caribbean countries, because of their relatively lower share in the CPI basket.

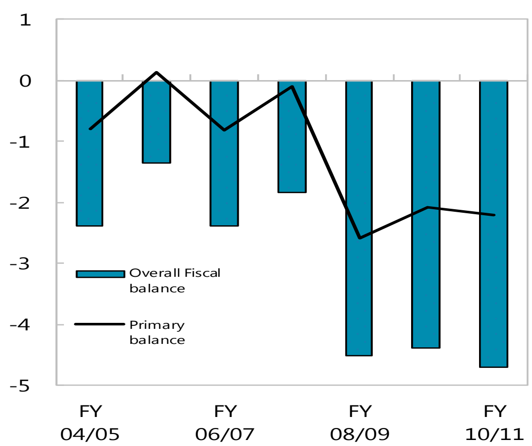


- **The external current account deficit remained broadly stable at 11½ percent of GDP.** Exports rebounded, and growth of non-oil imports remained subdued by weak economic activity. However, rising FDI and other private capital inflows boosted reserves to US$860 million at end-2010 (about 2½ months of next year's imports of goods and services).

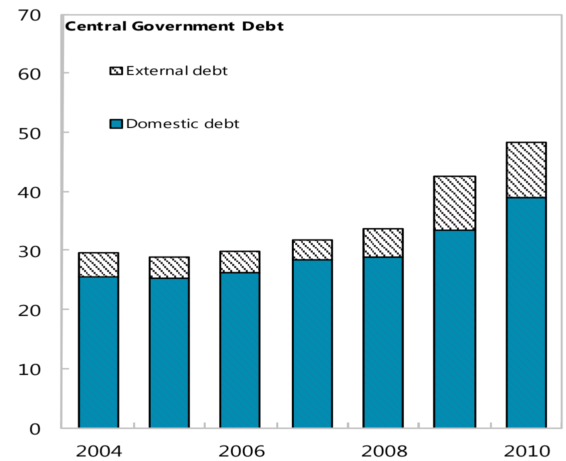


- **Staff estimates that the deficit of the central government deteriorated in FY 2010/11.** Total revenues increased owing to sizeable one-off transactions, related to stamp taxes on the signing of the Baha Mar project (a $3.5 billion resort complex) and the transfer of ownership of the Bahamas Oil Refining Company (1½ percent of GDP). Excluding the large one-off transactions, revenues increased by about ½ percent of GDP. Trade and property taxes continued to underperform. Expenditure increased more than proportionately, including owing to higher spending on goods and services.[4]

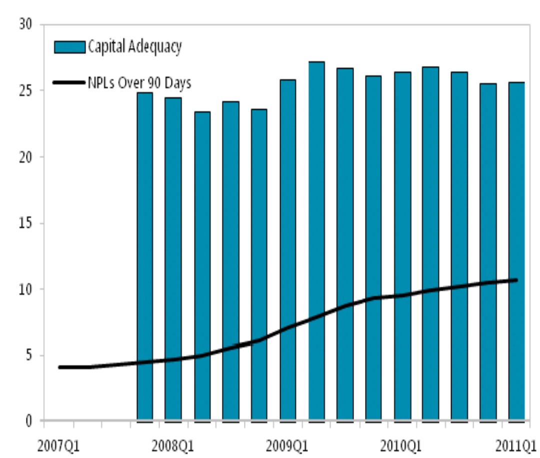
As a result, the central government deficit rose to 4.7 percent of GDP. The sale of 51 percent of the shares of the Bahamas Telecommunications Company (about 2½ percent of GDP) eased financing pressures.



- **Public debt continued to rise.** At end-2010, central government debt was 48 percent of GDP, up from about 34 percent of GDP two years earlier, while total public debt reached almost 62 percent of GDP.[5] Domestic debt accounts for more than 80 percent of public debt. The debt is mostly in variable rate instruments and held mainly by commercial banks, public corporations, and pension funds, which (given capital controls) are mandated to invest primarily in domestic securities.



- **High NPLs are a source of concern.** Banks have maintained high overall capital-adequacy ratios (well above the minimum requirement of 17 percent) (Figure 5). Banks' loan portfolio, however, continued to show signs of weakness, as the severe economic downturn pushed up the non-performing loans-to-total loans ratio over 10 percent – above regional peers. In addition, the level of provisioning to NPLs appears to be below peers.



[4] Expenditure increases included an employment program and pension liabilities assumed by the government following its partial divestment from the telecommunications company.

[5] Total public debt includes all debt from non-financial public corporations (guaranteed and non-guaranteed).

OUTLOOK

The Bahamas: Medium-Term Macroeconomic Framework (Current Policies)—Staff Projections
(In percent of GDP, unless otherwise indicated)

				Staff Projections					
	2008	2009	2010	2011	2012	2013	2014	2015	2016
Real GDP (in percent)	-1.3	-5.4	1.0	2.0	2.5	2.7	2.3	2.5	2.7
Inflation (average, in percent)	4.4	2.1	1.0	2.5	2.0	2.0	2.0	2.0	2.0
Overall fiscal balance 1/	-1.8	-4.5	-4.4	-4.7	-5.0	-4.4	-4.3	-4.3	-4.4
Central government debt 1/	32.6	37.9	45.4	48.6	49.9	51.8	53.4	54.8	55.9
External current account balance	-14.9	-11.4	-11.7	-17.1	-19.1	-20.2	-18.2	-15.2	-13.3
Gross international reserves (in US$ millions) 2/	563	816	860	955	927	975	1,035	1,154	1,284
In months of next year's goods & services imports	1.8	2.6	2.3	2.3	2.1	2.2	2.3	2.5	2.7

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

1/ Central government only. Fiscal year data (to June).
2/ Includes SDR allocation of US$178.9 million in September 2009.

7. **The near-term outlook is for stronger growth, but a weaker fiscal and debt position.**

- **Real GDP is projected to grow at about 2 percent in 2011**, driven by a rebound in tourism and construction activity. Tourist arrivals in general, and cruise ship arrivals in particular, are increasing, with stopover arrivals projected to approach the level of 2008 by year-end, although yielding lower average revenues. In addition to double-digit growth in the cruise sector, there has been a strong rebound in the key market of advance group reservations. Inflation is projected to rise to about 2½ percent, in line with higher global food and fuel prices, while the external current account deficit is expected to widen, driven by higher oil imports and a pick-up in FDI-financed construction. The overall balance of payments, however, is projected to record a surplus of about US$94 million owing to strong FDI and private capital inflows.
- **The fiscal accounts will remain under pressure.** The budget for FY 2011/12 contemplates measures aimed at strengthening revenue performance, including an effort to centralize the collection of taxes (on business, property, stamp, hotel occupancy, and casino). However, the budget increases spending on new government initiatives (e.g., the introduction of e-government), extends tax holidays, and lifts the freeze on public wages that was imposed in last year's budget. Staff estimates that these plans would increase the central government deficit to about 5 percent of GDP by end-June 2012 and raise central government debt to about 50 percent of GDP. Additional risks to the fiscal outlook stem from the continued weak performance of non-financial public corporations—and the need for more transparency in this area—and contingent liabilities from the failed insurance company CLICO.

- **The scope for supportive monetary policy will remain limited.** In June 2011, against a background of subdued price pressures and a stronger reserves position, the central bank lowered the discount rate to 4½ percent (from 5¼ percent). Although this action, the first rate change in six years, was aimed at supporting the incipient recovery its effects on credit demand and activity are likely to be weak.

- **The increase in non-performing loans is expected to abate due to stronger activity.** Stress tests conducted by the authorities suggest resiliency of the banking system.

8. The medium-term outlook is mixed. Output growth is expected to rise to 2½-3 percent in 2012–13, driven by tourism and new FDI projects. Of these projects, the most important is Baha Mar, which is likely to have a significant impact on the economy, particularly during the peak of construction (2012–13).[6] Growth would remain in that range thereafter, with upside potential if key projects under study materialize. Strengthened tourism receipts would help narrow the external current account deficit to about 13 percent of GDP by end-2016, while higher fiscal revenues would help lower the primary deficit. The central government deficits, however, would remain at almost 4½ percent of GDP per year during the period, raising the central government debt-to-GDP ratio to close to 56 percent, and overall public debt to about 69 percent by 2016.

9. The outlook is subject to downside risks. While a faster rebound in tourism activity or the start of large-scale hotel investments would improve the outlook, risks appear at this stage tilted to the downside. A slower-than-expected recovery of output and employment in the United States could dampen the pickup in economic activity and weaken the fiscal and external positions. External accounts are also highly sensitive to increases in the international prices of food and fuel. Given the exposure to the real estate sector, some commercial banks could see excess collateral diminish and vulnerability increase if the recovery stalls. Finally, vulnerability to hurricanes (Hurricane Irene hit The Bahamas in August, although the impact appears to have been relatively small) highlights the potential fiscal costs of natural disasters.

10. Delays in implementing reforms (in particular revenue reforms, to curb the debt) could jeopardize a sustained recovery.

The large borrowing necessary to improve the physical and social infrastructure constitutes a source of vulnerability. A delay in reversing the rising debt trajectory could raise financing costs.

[6] During the construction period, the project operators expect the work force will increase by up to 4,400 persons, and US$750-900 million could be injected into the economy, triggering additional second-round economic activity. Project documents also estimate the complex will attract 400,000 additional stay-over arrivals and generate direct tax revenues of about US$60 million (¾ percent of 2011 GDP) per year.

Box 1. Expanding Tourism Potential in The Bahamas: Challenges and Strategy

The Bahamas is an island archipelago of 700 islands and about 2000 cays, with a total land mass of about 14,000 square km scattered over almost 260,000 square km of territorial waters. Starting at just 80 km off Florida's eastern coast, The Bahamas has leveraged its proximity to the United States and natural beauty in its marketing strategies. With 70 percent of its population of 350,000 people living in New Providence, the scope for expansion of a variety of tourism products to the sparsely populated Family Islands is vast.

Forms of Tourism

The main industries of The Bahamas are tourism, financial services, light manufacturing, and trans-shipment operations, the latter located mainly on Grand Bahama. New Providence accounts for 55–60 percent of the country's tourist activity, and follows the large seaside resorts model (the most prominent of which is the Atlantis Resort). In the Family Islands, the preferred model is small boutique hotels and luxurious private villas, catering to wealthy tourists and second-home owners from the United States and Canada.

Market Diversification

Given the seasonality of the tourism industry, capacity utilization on the islands ranges from near 100 percent during the peak winter season to less than 30 percent during late summer. Promotion campaigns strive to attract tourists during the low season. The authorities, in partnership with large private hotel owners, have embarked on a strategic plan to diversify and increase tourist arrivals from Latin America, especially Brazil and Argentina. As part of this strategy, the authorities have succeeded in attracting daily flights from Panama City, which acts as a hub for a Latin American air carrier. With demand during the winter season in the Southern Hemisphere coinciding with the period of low utilization of hotel capacity in The Bahamas, increasing the arrivals of South American tourists could mitigate the cyclical pattern of tourism revenue.

Developing the Family Islands

The main challenge to developing tourism in the Family Islands of The Bahamas is the high per capita cost of providing basic infrastructure, utilities, and social services, including health facilities. Overcoming these challenges will require creative and cost-effective solutions. In health infrastructure, for example, one solution proposed is the setting up of satellite health units on strategic locations, combined with efficient emergency travel systems. Another challenge is the cost of providing adequate airlift to the remote islands, given the relatively small scale of operations. An envisaged model is for one or two large "magnet" resorts, capable of attracting jet services from target markets, combined with a 'hubbing' concept (possibly using smaller aircraft) to feed tourists to the smaller boutique-hotels in nearby islands. These large resorts can also be focal points for economies of scale in setting up desalination or power generation plants, as well as for encouraging the development of small enclave industries for the provision of ancillary goods and services.

Diversification Efforts

Although labor and utility costs are quite high in The Bahamas, some large outer islands, such as Andros, have large water and land resources ideal for developing agriculture. For such activities to develop, however, it will be important to act rapidly in reducing costs to doing business in The Bahamas.

POLICY DISCUSSIONS

The Bahamas' key policy challenge is to ensure sustainability of public finance and raise real GDP growth on a sustained basis. The authorities noted their commitment to fiscal consolidation, in particular through revenue mobilization. They also viewed improving the business environment and strengthening the soundness of the financial system as important for private-sector-led growth.

A. Consolidation Strategy

11. The authorities reiterated their commitment to strengthen fiscal performance and place the public debt on a sustainable path. Their strategy comprises both revenue and expenditure measures, and an improved debt management.

- **New revenue measures mainly hinge on improvement in the tax administration.** The authorities explained initiatives underway to improve tax administration, including strengthening customs; consolidating the collection of several taxes in one institution; and introducing a new procedure to reduce smuggling of tobacco products. They also noted the introduction of a revamped business license tax.[7]

- **Narrowing the scope of tax expenditures and transfers is another element.** The authorities are introducing time limits and transition arrangements for fiscal incentives provided under the Industries Encouragement Act. In addition, they are seeking to reduce transfers to public corporations, including by encouraging private-public-partnership arrangements.

- **Improving debt management.** The authorities are giving priority to greater coordination of debt management at the Ministry of Finance and the Central Bank.

12. Staff welcomed the authorities' medium-term strategy, but noted this would not be sufficient. In particular, staff welcomed the consolidation of tax collection in one unit, and the plan to stabilize incentives.

13. Staff urged the authorities to adopt more comprehensive policies geared at placing the government debt-to-GDP ratio on a declining path over the medium term. A stronger fiscal effort was needed to create buffers for future shocks, improve physical and social infrastructure, and keep borrowing cost low. Staff also noted that delaying action on fiscal consolidation, particularly with regard to revenue reform, might result in additional external risks and fiscal pressures.

14. Staff suggested giving priority to revenue mobilization. It noted that the most dynamic sectors of the economy generate a small share of revenue, and that their spells of growth did not translate proportionately to higher fiscal revenues. Reforms aimed at broadening the tax base, for example through the adoption of a domestic consumption tax, should therefore be a key priority. Further, staff noted that the time limits currently applied to the Industries Encouragement Act could be extended to the other fiscal incentive regimes.

[7] These initiatives and measures complement those adopted in the previous fiscal year, which included improved tax administration and higher tax rates on vehicles, air departure, and hotel rooms.

15. The authorities agreed that revenue reform was a key priority. They concurred that the current revenue structure is inefficient and inequitable, and noted that they had sought technical assistance from the IDB to reform the tax system. They noted, however, that actions in this area were unlikely under this legislature.

16. Expenditure restraint is also needed. Government expenditure is projected to remain at about 20 percent of GDP over the medium term. The government's wage bill accounts for over 40 percent of revenues, and is projected to rise following the lifting of the wage freeze adopted in FY 2010/11; transfers to public enterprises are high, and interest costs are rising. Staff highlighted the need to gradually return the wage bill, as a share of GDP, to the pre-crisis level, and keep transfers and other current expenditures under control.

17. The financial position of public enterprises must be improved. The financial position of several public enterprises (including Bahamas Air, and the electricity and water and sewerage companies) appears to be weak, and the lack of timely information on the contribution of public enterprises to the overall fiscal stance is a vulnerability that needs to be addressed. Several public enterprises are inefficient and require recurrent government transfers to operate. A strategy to lower the drag of these enterprises on public finances (including through divestments) is urgently needed.

18. Staff also encouraged the authorities to continue improving fiscal transparency. It stressed the need for more timely and accurate accounts for public enterprises, and improving the data on intra-public sector financing, in particular from the national pension fund. While welcoming the authorities' interest in receiving Fund technical assistance on these areas, staff encouraged a focus on:

- Improving revenue forecasting;
- Preparing consolidated accounts for the public sector; and
- Making public all tax incentives (including costs, main terms and conditions, and beneficiaries).

B. Growth Strategy

19. The government's strategy to improve growth performance was discussed. Near-term growth was likely to increase owing to the recovery of tourism and the start-up of large projects.[8] The government strategy comprises:

- ***Growth-enhancing measures.*** These include: (i) measures to increase airlift and expand coverage to the Family Islands, and boost cruise arrivals;[9] (ii) an aggressive program to increase FDI from Canada, the U.S., Latin America, and China; and (iii) fostering the development of small- and medium-size enterprises.
- ***Improving the business environment.*** Measures to reduce red tape and streamline administrative procedures (including by launching the e-government

[8] Large projects include the development of the Baha Mar resort, expansion of existing resorts, and continuing the construction of the airport and road improvements.

[9] A recent agreement with a low-cost U.S. carrier will increase airlift from states along the East coast of the U.S. to Grand Bahama.

system) are being adopted.[10] At the same time, a job-readiness program aims to improve productivity.

- ***Combating crime.*** The authorities are providing greater resources to law enforcement, expanding the courts system, and strengthening the prosecutorial process.

20. Staff welcomed the authorities' broad-based growth strategy. It noted that the emphasis on measures different from fiscal incentives for boosting growth was a positive development, since the country's growth performance over the last decade suggests that the fiscal incentives model had not been effective in promoting sustained growth. Staff also suggested improving economic diversification and employment through innovation in high value-added downstream tourism products. Staff noted the need for investment in public utilities to improve efficiency and provide adequate infrastructure to support the growth strategy.

C. External Stability and Exchange Rate Policy

21. There was agreement that the fixed exchange rate system has served The Bahamas well. The authorities restated their commitment to support the peg and continue building reserves. They explained that their recent decision to lower the policy rate had been taken in the context of adequate reserves (about US$1,075 million or close to three months of imports) and low inflationary pressures.

22. Staff and the authorities agreed that the exchange rate level remains broadly in line with medium-term fundamentals (Figure 3). Estimates from the macrobalance approach suggest that the projected medium-term current account deficit for The Bahamas is close to the estimated current account "norm", while regressions suggest that the current level of the real exchange is broadly in line with fundamentals.[11] These results, however, are subject to potentially severe estimation shortcomings and are sensitive to the assumptions used. In this connection, the authorities noted that the higher FDI expected in the coming years would raise the country's growth and export potential over the medium to long term. Given the uncertainties from a weak global environment, staff noted the importance of investing in basic infrastructure and ensuring the efficient delivery of basic utilities to attract revenue-producing FDI and enhance the country's competitiveness.

D. Financial Sector

23. Capital adequacy ratios are high, but the weak loan portfolio highlights the need for intensified supervision. Stress tests conducted by the authorities suggest that the system could withstand a further deterioration in the banks' loan portfolio without endangering compliance with capital requirements. Capital adequacy ratios (CARs) at end-May 2011 (26 percent, on average), were well above the regulatory threshold, while excess liquidity was about 20 percent.

[10] The Bahamas ranked 77 of 183 countries in the Doing Business 2011 Report, down from 68 in 2010. The decline in ranking reflected lower rankings in all categories with the exception of 'Enforcing Contracts".

[11] Key variables used in the exchange rate equations include the oil balance, the fiscal balance, net foreign assets, and income growth.

Banks' loan portfolios, however, which have been weakened by the slowdown in activity, represent a vulnerability.

24. Reliance on macro-prudential policies also has increased. A CAR trigger of 14 percent on banks has been in place since the onset of the global crisis. In addition, since November 2009, banks have been required to seek central bank approval to distribute dividends. The central bank has continued to require a debt service-to-income limit of 45 percent, and a loan-to-value ratio cap of 85 percent on personal loans—measures that exist since 2004. The establishment of a credit bureau, projected to start operating in early 2013, should help to further mitigate credit risk, by collecting information on individuals' borrowing and bill payment records, thus helping lenders assess credit worthiness.

25. Additional steps to strengthen financial sector supervision are ongoing. The central bank has implemented an enhanced risk-based supervision framework, adopted the use of special focus examinations (e.g., credit risk delinquency management), and is pursuing a number of initiatives.[12] These include (i) the enhanced supervision of all large financial institutions; (ii) bringing credit unions under the purview of the central bank; (iii) drafting legislation to facilitate consolidated supervision across different financial sectors (including securities and insurance); and (iv) participating in regional supervision efforts and coordinating with Canadian regulators.[13]

26. The authorities have also made progress in enhancing the AML/CFT framework. Various guidelines on regulation have been amended to address (i) enhanced customer due diligence requirements; (ii) strengthening internal controls, and compliance and audit procedures; (iii) improved record keeping for high-risk countries; and (iv) establishing conditions for third party introducers. Given that control processes for activity originating in the offshore sector may take place in locations outside the jurisdiction of The Bahamas, the central bank has also focused on ensuring the integrity of local governance and risk oversight arrangements in institutions under its purview.[14]

27. Progress was reported on the resolution of CLICO-Bahamas. Settlement of the failed insurance company is now more likely, following the favorable ruling regarding the Wellington Preserve in Florida. Staff welcomed the positive developments and urged for a prompt resolution that minimizes fiscal contingent liabilities.

[12] The central bank exercises regulatory and supervisory oversight of banks, trust companies, money transmission businesses and private trust companies.

[13] An update assessment of the Bahamian financial system under the Financial Sector Assessment Program is scheduled in 2012.

[14] The Bahamas Compliance Commission, a part of the jurisdiction's anti-money laundering efforts, is a supervisory body for groups of professionals (e.g., lawyers, accountants) that hold funds on behalf of clients. It works closely with the Inspector of Financial and Corporate Service Providers, who regulates persons providing corporate management services.

STAFF APPRAISAL

28. The Bahamas economy has started to recover from the global financial crisis, but unemployment remains high. Real GDP in 2011 is projected at 2 percent, driven by the rebound of tourism and the launch of large investment projects. The medium-term growth outlook has improved, compared to the 2010 Article IV staff report, but downside risks are high. On the domestic front, risks arise from delays in implementing fiscal and economic reforms necessary to reverse the rising trend in debt, build buffers, including for damage from natural disasters, and improve efficiency and competitiveness. These could have adverse effects on private investment and financing costs. On the external front, the main downside risk is a weaker-than-expected recovery in the United States, which would cap the rebound of tourism and delay the large FDI tourism projects.

29. Fiscal consolidation should be the main policy priority. A strong fiscal consolidation strategy is essential to place the public debt-to-GDP ratio on a sustainable path and to build buffers, including reserves, that could be used to mitigate the impact of natural disasters and external shocks. Revenue mobilization can be strengthened through improvements in tax administration and lower tax expenditures. In addition, early implementation of revenue reform (e.g., a consumption tax) is essential, since delays may result in additional risks and pressures. Expenditure restraint, especially on wages and transfers, strengthening the weak financial position of public enterprises, and enhancing fiscal transparency would also underpin the fiscal effort.

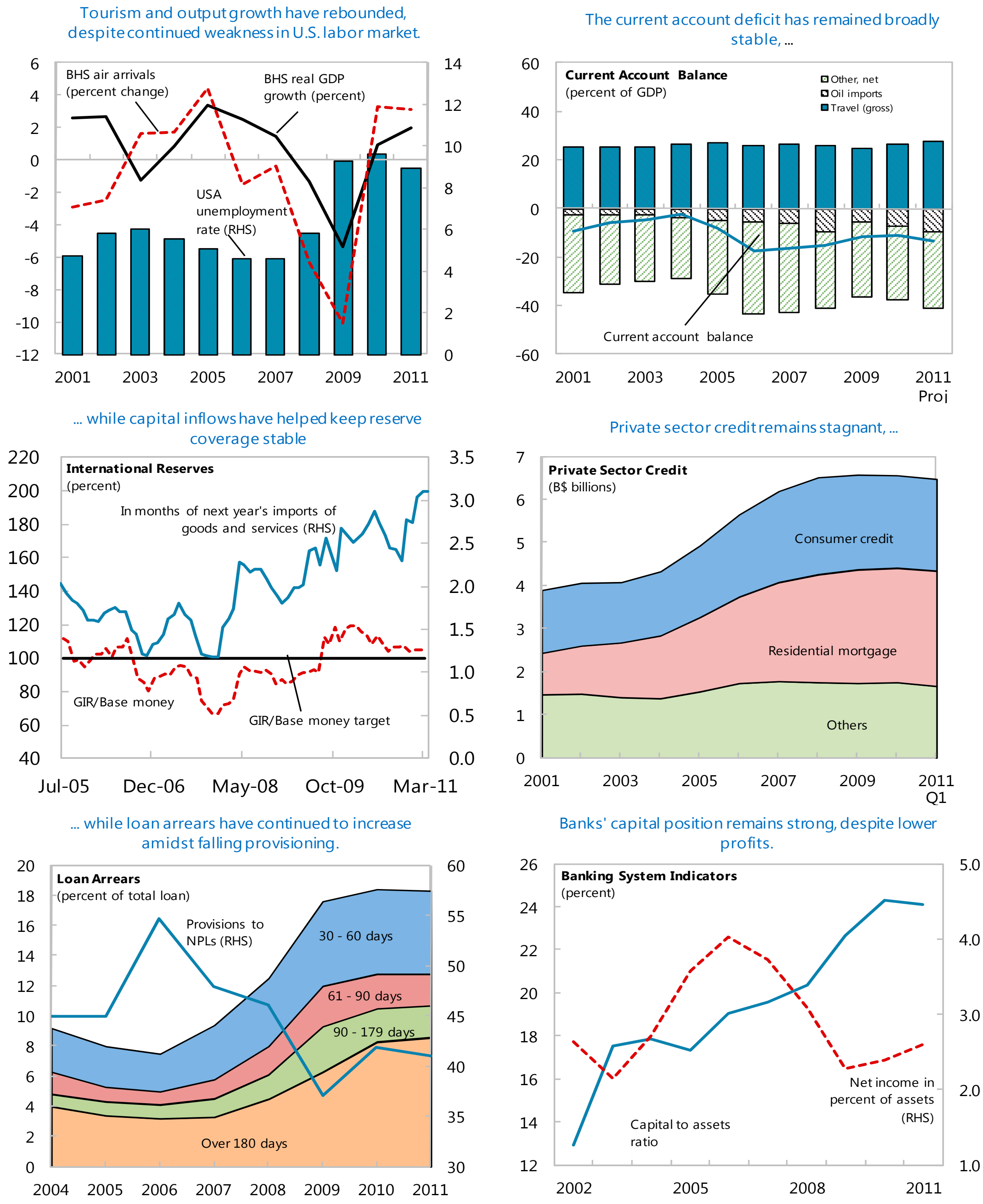
30. The authorities' growth strategy is broadly appropriate. Measures aimed at reducing obstacles to doing business are particularly promising. Staff welcomes the lower reliance on fiscal incentives, which has failed to deliver high growth rates. Further improving basic infrastructure, particularly regarding energy and water provision, and developing high value-added downstream tourism products will be key to achieving higher growth rates.

31. The fixed exchange rate system continues to serve the country well. Staff analysis suggests that the level of the exchange rate remains broadly in line with medium-term fundamentals. The authorities are committed to maintaining the exchange rate peg and strengthening the external position by building reserves over the medium term.

32. Staff welcomes the recent measures to strengthen financial sector supervision, but highlights the importance of maintaining close monitoring of financial developments. Recent measures adopted to further strengthen the financial sector, including the adoption of macro-prudential policies, and steps to facilitate stronger supervision across sectors and at the regional level, should enhance the resilience of the financial system. The planned establishment of a credit bureau and bringing credit unions under the purview of the central bank are also welcome. The high level of non-performing loans, and limited provisioning, however, calls for further intensifying the monitoring of financial institutions.

33. Staff recommends that the next Article IV consultation take place on the standard 12-month cycle.

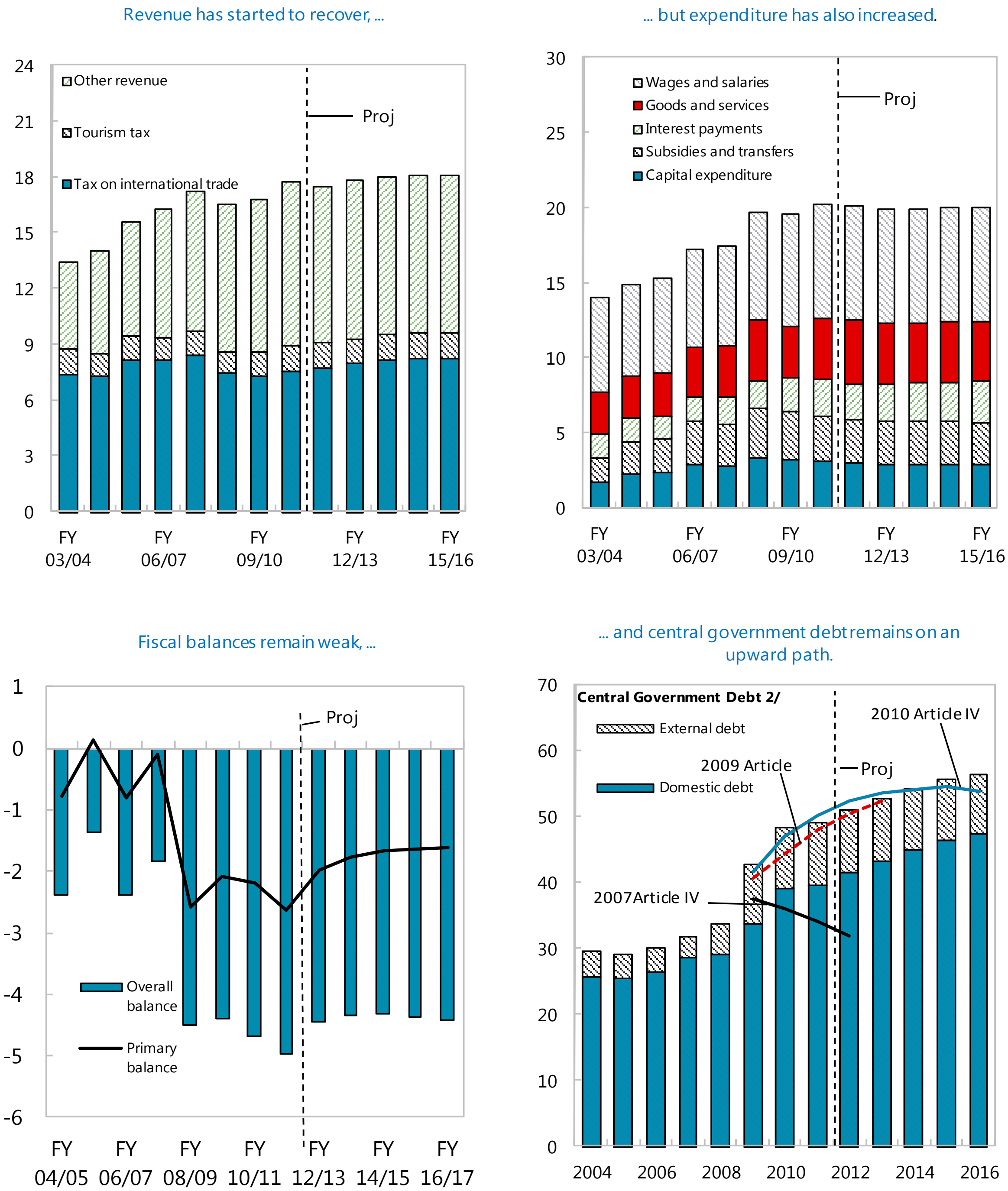
Figure 1. The Bahamas: Recent Developments



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

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

(In percent of GDP)

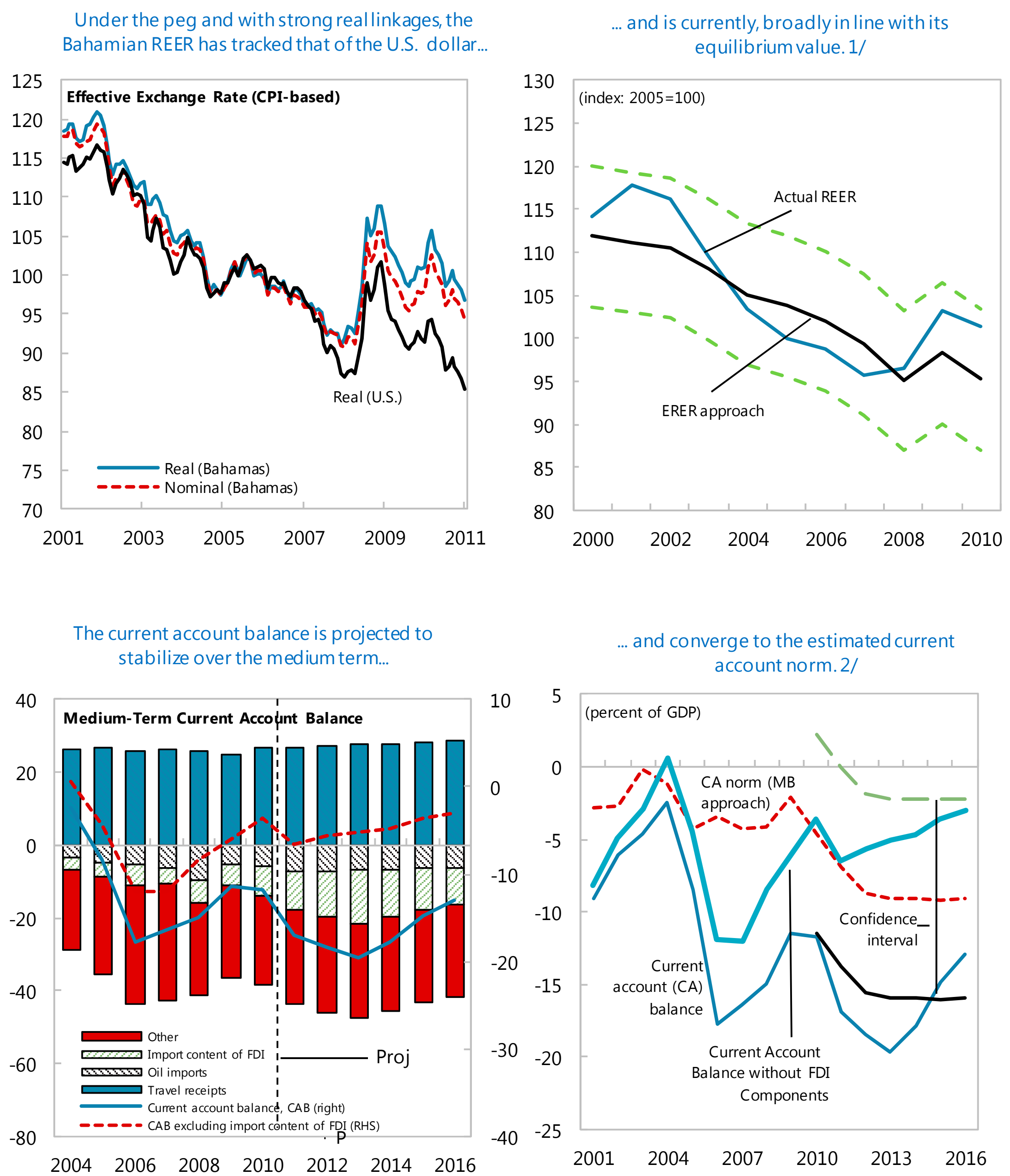


Sources: The Bahamian authorities; and Fund staff estimates.

1/ Central government fiscal year ending June 30.

2/ Calendar year basis.

Figure 3. The Bahamas: Exchange Rate Assessment

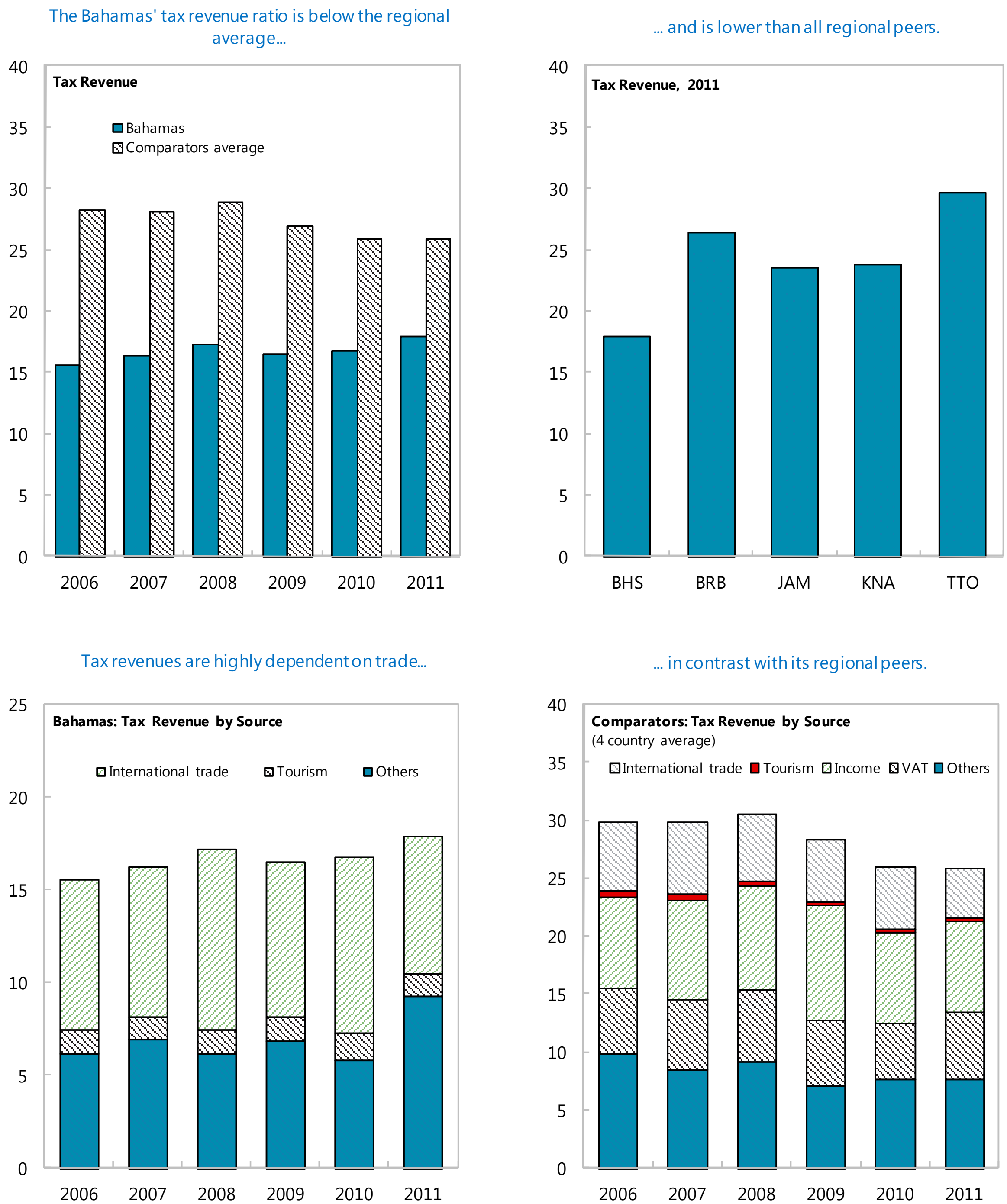


Sources: IMF, Information Notice System; and Fund staff calculations.

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

Figure 4. The Bahamas: Tax Revenue Regional Comparison 1/

(In percent of GDP)

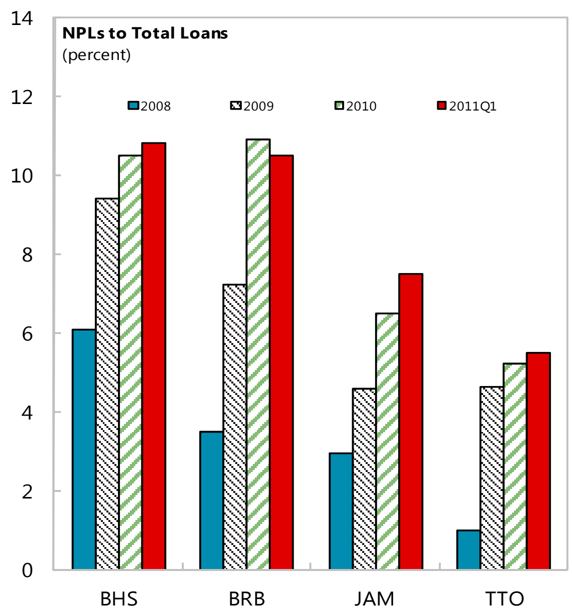


Sources: National authorities; and Fund staff estimates.

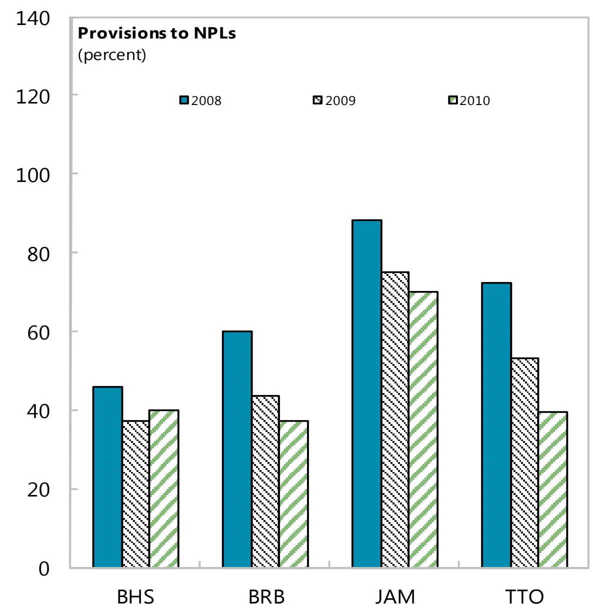
1/ Regional comparators include Barbados, Jamaica, St. Kitts and Nevis, and Trinidad and Tobago.

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

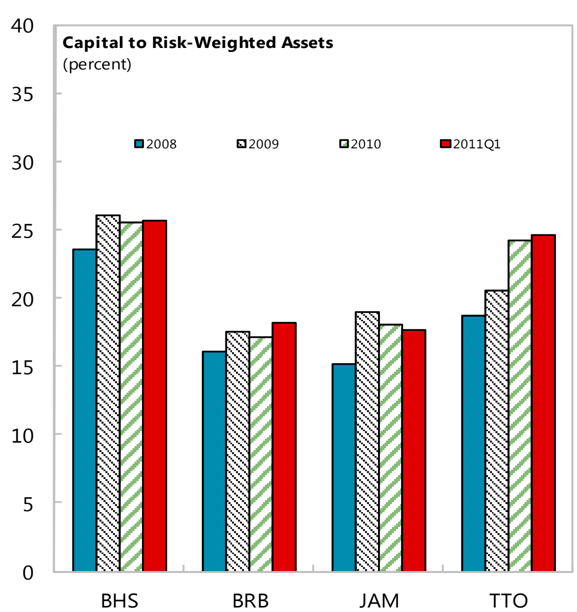
As in other countries, NPLs rose sharply following the recession...



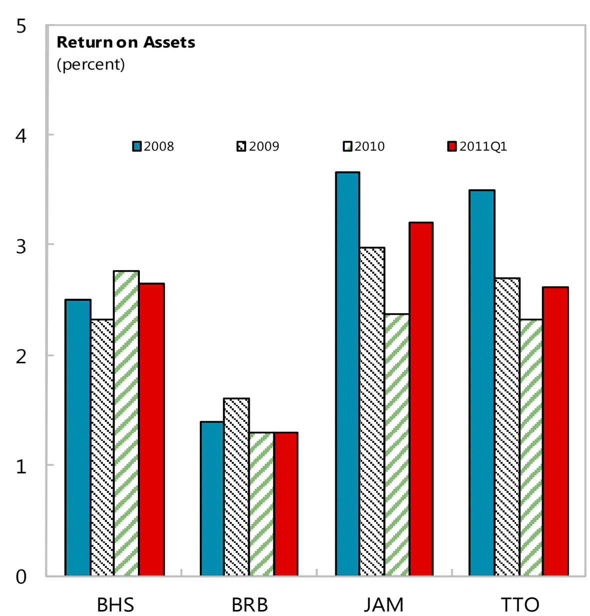
... but provisions are lower than all regional peers.



CARs remain high, as in the rest of the region, partly due to large holdings of government papers...



... while profitability is stable.



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

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

Table 1. The Bahamas: Selected Social and Economic Indicators

I. Social Indicators

GDP (US$ millions), 2010	7,700	Poverty rate (percent), 2004	9.3
GDP per capita (US$), 2010	21,773	Unemployment rate (percent), 2011	13.7
Population (thousands), 2010	353.7	Population not using an improved water source (percent), 2006	3.0
Life expectancy at birth (years), 2010	74.4		
Adult literacy rate, 15 & up (percent), 2007	95.6	Human development index (rank), 2010	43

II. Economic Indicators

					Staff Projections	
	2007	2008	2009	2010	2011	2012
(Annual percentage changes, unless otherwise indicated)						
Real sector 1/						
Real GDP	1.4	-1.3	-5.4	1.0	2.0	2.5
Nominal GDP	4.3	-1.0	-5.3	-1.3	4.8	5.9
Consumer price index (annual average)	2.5	4.4	2.1	1.0	2.5	2.0
Consumer price index (end of period)	2.8	4.5	1.3	1.6	4.0	1.5
Unemployment rate (in percent) 2/	7.9	8.7	14.2	...	13.7	... ..
Financial sector						
Credit to the nonfinancial public sector	11.5	16.1	9.3	39.2	15.3	13.6
Credit to the private sector	9.7	5.1	0.9	-0.4	6.2	6.8
Liabilities to the private sector	9.6	5.1	1.8	2.6	9.1	10.2
External sector						
Exports of goods and services	8.8	2.5	-14.7	4.4	7.3	7.6
Of which: Travel receipts (gross)	6.5	-2.2	-10.0	6.7	4.5	9.0
Imports of goods and services	4.6	1.5	-18.9	1.1	19.7	11.2
(In percent of GDP, unless otherwise indicated, on a calendar year basis) 1/						
Central government						
Revenue and grants	16.0	17.4	17.1	16.3	17.6	17.6
Current expenditure	15.9	16.8	18.2	18.4	19.5	19.4
Capital expenditure and net lending	2.7	2.9	4.0	2.8	3.0	2.9
Primary balance	-1.0	-0.4	-3.1	-2.4	-2.4	-2.3
Overall balance	-2.7	-2.3	-5.2	-4.9	-4.8	-4.7
Central government debt	31.7	33.6	42.5	48.3	48.9	50.9
External sector						
Current account balance	-16.4	-14.9	-11.4	-11.7	-17.1	-19.1
Change in net international reserves (increase -)	0.6	-1.4	-3.2	-0.6	-1.2	0.3
External public debt (end of period)	4.0	5.4	9.8	11.9	11.9	11.8
Memorandum items:						
Gross international reserves						
(end of period; millions of U.S. dollars)	449	563	816	860	955	927
In months of next year's G&S imports	1.2	1.8	2.6	2.3	2.3	2.1
In percent of reserve money	67	87	117	104	106	93
External debt-service ratio 3/	6.6	6.6	25.4	11.5	5.7	8.5
GDP (in millions of Bahamian dollars)	8,319	8,239	7,806	7,700	8,074	8,552

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

1/ Revised national accounts data.
2/ 2009 figure based on October Interim survey.
3/ In percent of exports of goods and services. The increase in 2009 reflects repayment of internal forex loan of US$ 185 million to domestic banks.

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

			Staff Projections					
	FY08/09	FY09/10	FY10/11	FY11/12	FY12/13	FY13/14	FY14/15	FY15/16
Revenue and grants	**1,324**	**1,303**	**1,400**	**1,453**	**1,560**	**1,651**	**1,737**	**1,823**
Tax revenue	1,130	1,109	1,282	1,343	1,444	1,529	1,609	1,689
Taxes on international trade	595	566	595	644	697	748	792	831
Tourism taxes	96	96	106	113	119	123	128	134
Miscellaneous taxes	412	387	530	532	572	600	628	659
Other	27	60	50	53	56	59	61	64
Nontax revenue	194	193	118	110	116	122	128	134
Total expenditure	**1,686**	**1,642**	**1,770**	**1,866**	**1,950**	**2,049**	**2,151**	**2,262**
Current expenditure	**1,423**	**1,396**	**1,531**	**1,624**	**1,696**	**1,785**	**1,877**	**1,977**
Wages and salaries	573	580	599	632	666	698	730	766
Goods and services	322	265	317	357	351	367	384	403
Interest payments	154	178	197	194	215	234	253	274
Subsidies and transfers	373	373	418	441	465	487	509	534
Current balance	**-99**	**-93**	**-131**	**-171**	**-135**	**-134**	**-140**	**-154**
Capital expenditure	**263**	**246**	**239**	**242**	**254**	**264**	**274**	**286**
Capital formation	140	157	200	204	215	225	235	247
Capital transfers and net lending	123	89	39	39	39	39	39	39
Overall balance	**-361**	**-340**	**-370**	**-413**	**-389**	**-397**	**-414**	**-440**
Financing	**361**	**340**	**370**	**413**	**389**	**397**	**414**	**440**
Foreign financing	50	286	33	41	36	31	30	29
Domestic financing 2/	313	54	337	373	353	366	384	410
Memorandum items:								
Primary balance	-207	-161	-173	-219	-175	-164	-160	-166
Central government debt	3,044	3,520	3,834	4,151	4,538	4,900	5,265	5,631

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

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

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

			Staff Projections					
	FY08/09	FY09/10	FY10/11	FY11/12	FY12/13	FY13/14	FY14/15	FY15/16
Revenue and grants	**16.5**	**16.8**	**17.8**	**17.5**	**17.8**	**18.0**	**18.1**	**18.1**
Tax revenue	14.1	14.3	16.3	16.1	16.5	16.7	16.8	16.8
Taxes on international trade	7.4	7.3	7.6	7.8	8.0	8.2	8.3	8.3
Tourism taxes	1.2	1.2	1.3	1.4	1.4	1.3	1.3	1.3
Miscellaneous taxes	5.1	5.0	6.7	6.4	6.5	6.5	6.5	6.5
Other	0.3	0.8	0.6	0.6	0.6	0.6	0.6	0.6
Nontax revenue	2.4	2.5	1.5	1.3	1.3	1.3	1.3	1.3
Total expenditure	**21.0**	**21.2**	**22.4**	**22.5**	**22.2**	**22.3**	**22.4**	**22.5**
Current expenditure	**17.7**	**18.0**	**19.4**	**19.5**	**19.3**	**19.4**	**19.5**	**19.6**
Wages and salaries	7.1	7.5	7.6	7.6	7.6	7.6	7.6	7.6
Goods and services	4.0	3.4	4.0	4.3	4.0	4.0	4.0	4.0
Interest payments	1.9	2.3	2.5	2.3	2.4	2.5	2.6	2.7
Subsidies and transfers	4.7	4.8	5.3	5.3	5.3	5.3	5.3	5.3
Current balance	**-1.2**	**-1.2**	**-1.7**	**-2.1**	**-1.5**	**-1.5**	**-1.5**	**-1.5**
Capital expenditure	**3.3**	**3.2**	**3.0**	**2.9**	**2.9**	**2.9**	**2.9**	**2.8**
Capital formation	1.7	2.0	2.5	2.5	2.5	2.5	2.5	2.5
Capital transfers and net lending	1.5	1.2	0.5	0.5	0.4	0.4	0.4	0.4
Overall balance	**-4.5**	**-4.4**	**-4.7**	**-5.0**	**-4.4**	**-4.3**	**-4.3**	**-4.4**
Financing	**4.5**	**4.4**	**4.7**	**5.0**	**4.4**	**4.3**	**4.3**	**4.4**
Foreign financing	0.6	3.7	0.4	0.5	0.4	0.3	0.3	0.3
Domestic financing 2/	3.9	0.7	4.3	4.5	4.0	4.0	4.0	4.1
Memorandum items:								
Primary balance	-2.6	-2.1	-2.2	-2.6	-2.0	-1.8	-1.7	-1.6
Central government debt	37.9	45.4	48.6	49.9	51.8	53.4	54.8	55.9
Nominal GDP (in B$ millions)	8,022	7,753	7,887	8,313	8,764	9,179	9,605	10,074

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

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

Table 4. The Bahamas: Public Debt

(In percent of GDP)

	2005	2006	2007	2008	2009	2010
Central government debt	**29.0**	**29.9**	**31.7**	**33.6**	**42.5**	**48.3**
External	3.7	3.6	3.3	4.7	9.0	9.5
Domestic	25.2	26.3	28.4	28.9	33.5	38.9
Of which: in foreign currency	0.0	0.1	0.3	0.0	0.0	0.9
Public corporations' debt 1/	**7.8**	**9.0**	**8.7**	**10.5**	**11.7**	**13.5**
External	0.7	0.6	0.8	0.7	0.8	2.4
Domestic	7.2	8.4	8.0	9.8	10.9	11.0
Of which: in foreign currency	2.8	3.7	3.5	5.0	5.4	5.5
Total public sector 1/	**36.8**	**38.9**	**40.4**	**44.1**	**54.3**	**61.8**
External	4.4	4.2	4.0	5.4	9.8	11.9
Domestic	32.4	34.7	36.4	38.7	44.5	49.9
Of which: in foreign currency	2.8	3.8	3.8	5.1	5.4	6.4
Consolidated public sector 1/ 2/	**26.9**	**29.3**	**31.7**	**35.4**	**45.0**	**52.7**
External	4.4	4.2	4.0	5.4	9.8	11.9
Domestic 2/	22.5	25.1	27.6	30.0	35.2	40.8
Of which: in foreign currency	2.8	3.7	3.5	5.0	5.4	5.5

Source: Central Bank of The Bahamas.

1/ Government-guaranteed debt only.
2/ Excludes holdings by public corporations.

Table 5. The Bahamas: Balance of Payments

	2008	2009	2010	2011	2012	2013	2014	2015	2016
				Staff Projections					
	(In millions of U.S. dollars)								
Current account balance	**-1,229**	**-894**	**-900**	**-1,383**	**-1,637**	**-1,816**	**-1,706**	**-1,497**	**-1,370**
Goods (trade balance)	**-2,243**	**-1,825**	**-1,888**	**-2,284**	**-2,613**	**-2,852**	**-2,832**	**-2,782**	**-2,780**
Domestic exports	560	466	459	477	495	515	536	559	582
Domestic imports	-2,798	-2,278	-2,332	-2,745	-3,091	-3,349	-3,350	-3,321	-3,341
Oil	-771	-423	-453	-614	-658	-672	-658	-672	-687
Capital goods	-646	-513	-747	-939	-1,171	-1,352	-1,287	-1,177	-1,098
Other domestic imports	-1,381	-1,342	-1,132	-1,192	-1,263	-1,325	-1,405	-1,472	-1,555
Other net exports	-6	-13	-15	-16	-17	-18	-19	-20	-21
Services	**1,131**	**1,070**	**1,225**	**1,103**	**1,178**	**1,236**	**1,317**	**1,464**	**1,605**
Travel (net)	1,840	1,689	1,831	1,914	2,098	2,227	2,340	2,504	2,680
Travel (credit)	2,144	1,929	2,059	2,152	2,346	2,486	2,610	2,787	2,976
Travel (debit)	-305	-240	-228	-238	-249	-260	-270	-282	-296
Other services	-708	-619	-607	-811	-919	-991	-1,022	-1,040	-1,075
Of which:									
Construction services (net)	-34	-21	-16	-171	-222	-262	-249	-226	-211
Offshore companies local expenditure (net)	234	182	158	167	175	183	191	201	210
Income and transfers	**-117**	**-139**	**-237**	**-202**	**-202**	**-200**	**-191**	**-180**	**-195**
Capital and financial account	**1,212**	**1,115**	**1,120**	**1,477**	**1,610**	**1,864**	**1,766**	**1,616**	**1,499**
Capital transfers	-8	-7	-4	-4	-4	-4	-4	-5	-5
Long-term public sector 1/	106	504	148	49	44	34	32	33	31
Commercial banks' NFA	36	-22	24	0	0	0	0	0	0
Foreign direct investment	860	664	861	1,341	1,479	1,744	1,658	1,508	1,403
Portfolio investment & other private capital	218	-24	90	90	90	90	80	80	70
Other private capital	218	-24	90	90	90	90	80	80	70
Net errors and omissions	**130**	**32**	**-175**	**0**	**0**	**0**	**0**	**0**	**0**
Overall balance	**113**	**253**	**45**	**94**	**-27**	**48**	**60**	**119**	**130**
Change in net international reserves (increase -)	**-113**	**-253**	**-45**	**-94**	**27**	**-48**	**-60**	**-119**	**-130**
	(In percent of GDP)								
Current account balance	**-14.9**	**-11.4**	**-11.7**	**-17.1**	**-19.1**	**-20.2**	**-18.2**	**-15.2**	**-13.3**
Goods (trade balance)	**-27.2**	**-23.4**	**-24.5**	**-28.3**	**-30.6**	**-31.8**	**-30.2**	**-28.3**	**-26.9**
Domestic exports	6.8	6.0	6.0	5.9	5.8	5.7	5.7	5.7	5.6
Domestic imports	-34.0	-29.2	-30.3	-34.0	-36.1	-37.3	-35.7	-33.8	-32.4
Oil	-9.4	-5.4	-5.9	-7.6	-7.7	-7.5	-7.0	-6.8	-6.7
Capital goods	-7.8	-6.6	-9.7	-11.6	-13.7	-15.1	-13.7	-12.0	-10.6
Other domestic imports	-16.8	-17.2	-14.7	-14.8	-14.8	-14.8	-15.0	-15.0	-15.1
Other net exports	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Services	**13.7**	**13.7**	**15.9**	**13.7**	**13.8**	**13.8**	**14.0**	**14.9**	**15.6**
Travel (net)	22.3	21.6	23.8	23.7	24.5	24.8	24.9	25.5	26.0
Travel (credit)	26.0	24.7	26.7	26.7	27.4	27.7	27.8	28.4	28.8
Travel (debit)	-3.7	-3.1	-3.0	-3.0	-2.9	-2.9	-2.9	-2.9	-2.9
Other services	-8.6	-7.9	-7.9	-10.0	-10.7	-11.0	-10.9	-10.6	-10.4
Income and transfers	**-1.4**	**-1.8**	**-3.1**	**-2.5**	**-2.4**	**-2.2**	**-2.0**	**-1.8**	**-1.9**
Capital and financial account	**14.7**	**14.3**	**14.5**	**18.3**	**18.8**	**20.8**	**18.8**	**16.4**	**14.5**
Capital transfers	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long-term public sector 1/	1.3	6.5	1.9	0.6	0.5	0.4	0.3	0.3	0.3
Commercial banks' NFA	0.4	-0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment	10.4	8.5	11.2	16.6	17.3	19.4	17.7	15.3	13.6
Portfolio investment & other private capital	2.6	-0.3	1.2	1.1	1.1	1.0	0.9	0.8	0.7
Other private capital	2.6	-0.3	1.2	1.1	1.1	1.0	0.9	0.8	0.7
Net errors and omissions	**1.6**	**0.4**	**-2.3**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**1.4**	**3.2**	**0.6**	**1.2**	**-0.3**	**0.5**	**0.6**	**1.2**	**1.3**
Change in net international reserves (increase -)	**-1.4**	**-3.2**	**-0.6**	**-1.2**	**0.3**	**-0.5**	**-0.6**	**-1.2**	**-1.3**
Memorandum items:									
Gross international reserves (in millions of US dollars)	563	816	860	955	927	975	1,035	1,154	1,284
Nominal GDP (millions of U.S. dollars)	8,239	7,806	7,700	8,074	8,552	8,976	9,381	9,829	10,319

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

1/ Includes SDR allocation in September 2009.

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

	2008	2009	2010	Staff Projections 2011	2012
(In millions of Bahamian dollars, end of period)					
Central Bank					
Gross international reserves	563	816	860	954	926
Net domestic assets	82	-121	-35	-53	67
Credit to nonfinancial public sector (net)	202	179	255	237	357
Of which: Central Government	201	183	260	299	339
Other	-120	-300	-290	-290	-290
Reserve money	645	695	826	901	993
Currency held by the private sector	206	208	195	212	234
Liabilities with financial institutions	439	487	631	688	759
Financial system					
Net foreign assets	-141	134	152	246	217
Of which :					
Held by commercial banks and OFIs	-704	-682	-708	-708	-708
Net domestic assets	6,065	5,898	6,039	6,507	7,225
Credit to nonfinancial public sector, net	1,006	1,100	1,531	1,766	2,007
Of which: Central Government	924	1,024	1,414	1,649	1,889
Credit to private sector	6,537	6,596	6,573	6,982	7,458
Other	-1,478	-1,797	-2,065	-2,241	-2,241
Liabilities to the private sector (broad money)	5,924	6,032	6,191	6,753	7,442
Money	1,275	1,284	1,335	1,456	1,605
Currency	206	208	195	212	234
Demand deposits	1,069	1,076	1,141	1,244	1,371
Quasi-money	4,650	4,749	4,856	5,297	5,837
(Change in percent of liabilities to the private sector at the beginning of the period)					
Net foreign assets	1.3	4.6	0.3	1.5	-0.4
Net domestic assets	3.8	-2.8	2.3	7.6	10.6
Credit to nonfinancial public sector	2.5	1.6	7.2	3.8	3.6
Credit to private sector	5.6	1.0	-0.4	6.6	7.1
Liabilities to private sector	5.1	1.8	2.6	9.1	10.2
Money	-0.5	0.2	0.9	2.0	2.2
Quasi-money	5.5	1.7	1.8	7.1	8.0
(Annual percentage change)					
Net domestic assets	3.7	-2.7	2.4	7.8	11.0
Credit to nonfinancial public sector	16.1	9.3	39.2	15.3	13.6
Credit to private sector	5.1	0.9	-0.4	6.2	6.8
Liabilities to private sector	5.1	1.8	2.6	9.1	10.2
Money	-2.0	0.7	4.0	9.1	10.2
Quasi-money	7.2	2.1	2.3	9.1	10.2

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

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

	2006	2007	2008	2009	2010
Financial indicators					
Broad money (12-month percentage change)	6.5	9.6	5.1	1.8	2.6
Private sector credit (12-month percentage change)	14.4	9.7	5.1	0.9	-0.4
Three-month treasury-bill rate (end of period)	3.0	3.0	2.7	2.8	2.8
Domestic public debt (in percent of GDP, end of period)	34.7	36.4	38.7	44.5	49.9
External indicators					
Exports of goods and services (12-month percentage change)	3.2	8.8	2.5	-14.7	4.4
Imports of goods and services (12-month percentage change)	21.6	4.6	1.5	-18.9	1.1
Current account balance (in percent of GDP)	-17.7	-16.4	-14.9	-11.4	-11.7
Capital account balance (in percent of GDP) 1/	16.0	12.8	14.7	14.3	14.5
Gross international reserves (end of period, millions of US$)	500	449	563	816	860
In months of merchandise imports	2.2	1.8	2.1	3.9	4.0
In months of next year's imports of goods and services	1.3	1.2	1.8	2.6	2.3
In percent of reserve money	87.7	66.8	87.3	117.5	104.2
In percent of broad money	9.7	8.0	9.5	13.5	13.9
Commercial banks, net foreign assets (end of period, millions of US$)	-754	-704	-704	-682	-708
External public debt (in percent of GDP)	4.2	4.0	5.4	9.8	11.9
External debt service (in percent of exports of goods and services)	5.7	6.6	6.6	25.4	11.5
Central government external debt service (in percent of government revenue)	1.9	3.7	3.4	20.4	8.9
REER appreciation (+) (end of period) 3/	-5.0	-3.9	13.0	-5.6	1.5
Banking sector risk indicators					
Foreign currency deposits, percent of total deposits	2.6	3.7	3.5	4.0	3.7
Deposits maturing within 3 months, percent of total deposits	21.4	20.7	19.7	21.5	20.9
Capital to risk-weighted assets ratio, percent	24.8	24.9	23.5	26.1	25.5
Nonperforming loans to total loans ratio, percent	4.2	4.3	6.1	9.4	10.5
Provisions to total loans ratio, percent	54.7	47.9	46.0	37.1	41.9
Pre-tax net revenue, percent of net worth	20.4	18.6	14.8	10.2	9.7
Administrative expenses, percent of total assets	3.3	3.1	3.3	3.2	3.4
Liquid assets to deposits ratio, percent	17.2	23.3	25.1	30.0	36.1
Average interest rate spread, percent	6.6	6.9	7.0	6.8	7.6

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

1/ Includes errors and omissions.
2/ Information Notice System.

Table 8. The Bahamas: Central Government Debt Sustainability Framework, 2006-2016

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	**Debt-stabilizing primary balance 9/**
1 **Baseline: Public sector debt 1/**	**29.9**	**31.7**	**33.6**	**42.5**	**48.3**	**48.9**	**50.9**	**52.6**	**54.1**	**55.5**	**56.3**	**0.1**
w/o foreign-currency denominated	3.7	3.6	4.7	9.0	10.4	9.5	9.5	9.4	9.3	9.2	9.0	
2 Change in public sector debt	1.0	1.8	1.9	9.0	5.8	0.6	2.0	1.7	1.5	1.4	0.8	
3 Identified debt-creating flows (4+7+12)	0.3	1.4	2.6	7.0	5.5	0.0	2.0	2.0	2.1	1.9	1.8	
4 Primary deficit	-0.3	1.0	0.4	3.1	2.4	2.4	2.3	1.9	1.7	1.7	1.6	
5 Revenue and grants	16.2	16.0	17.4	17.1	16.3	17.7	17.6	17.9	18.1	18.1	18.1	
6 Primary (noninterest) expenditure	15.9	17.0	17.9	20.1	18.7	20.1	19.9	19.8	19.8	19.8	19.7	
7 Automatic debt dynamics 2/	0.5	0.4	2.1	3.9	3.1	0.2	-0.3	0.1	0.3	0.2	0.1	
8 Contribution from interest rate/growth differential 3/	0.5	0.4	2.1	3.9	3.1	0.2	-0.3	0.1	0.3	0.2	0.1	
9 Of which contribution from real interest rate	1.2	0.8	1.7	2.0	3.5	1.1	0.8	1.4	1.5	1.5	1.6	
10 Of which contribution from real GDP growth	-0.7	-0.4	0.4	1.9	-0.4	-0.9	-1.2	-1.3	-1.2	-1.3	-1.4	
11 Contribution from exchange rate depreciation 4/	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	-2.6	0.0	0.0	0.0	0.0	0.0	
13 Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	-2.6	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) 5/	0.7	0.3	-0.7	1.9	0.3	0.6	0.0	-0.3	-0.5	-0.5	-0.9	
Public sector debt-to-revenue ratio 1/	184.7	198.0	192.7	249.3	297.1	276.8	288.9	294.1	299.7	306.4	311.2	
Gross financing need 6/	**2.5**	**3.8**	**3.3**	**9.3**	**6.2**	**7.5**	**5.2**	**5.1**	**5.3**	**5.3**	**5.8**	
in millions of U.S. dollars	199.8	316.0	274.5	722.1	480.2	602.1	441.1	462.1	500.4	521.6	594.0	
Scenario with key variables at their historical averages 7/						**48.9**	**51.8**	**54.4**	**56.9**	**59.5**	**61.7**	**2.3**
Scenario with no policy change (constant primary balance) in 2011-2016						**48.9**	**51.0**	**53.3**	**55.5**	**57.6**	**59.3**	**0.1**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	2.5	1.4	-1.3	-5.4	1.0	2.0	2.5	2.7	2.3	2.5	2.7	
Average nominal interest rate on public debt (in percent) 8/	5.2	5.7	5.7	5.9	5.8	5.3	5.2	5.1	5.2	5.2	5.2	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	4.4	2.9	5.3	5.8	8.0	2.5	1.8	3.0	3.0	3.0	3.0	
Nominal appreciation (increase in US dollar value of local currency, in percent)	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	0.8	2.8	0.4	0.1	-2.3	2.8	3.3	2.2	2.1	2.2	2.2	
Growth of real primary spending (deflated by GDP deflator, in percent)	8.6	8.4	3.5	6.7	-6.5	9.8	1.6	1.9	2.4	2.4	2.5	
Primary deficit	-0.3	1.0	0.4	3.1	2.4	2.4	2.3	1.9	1.7	1.7	1.6	

1/ Gross debt of the central government.

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

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

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

5/ For projections, this line includes exchange rate changes.

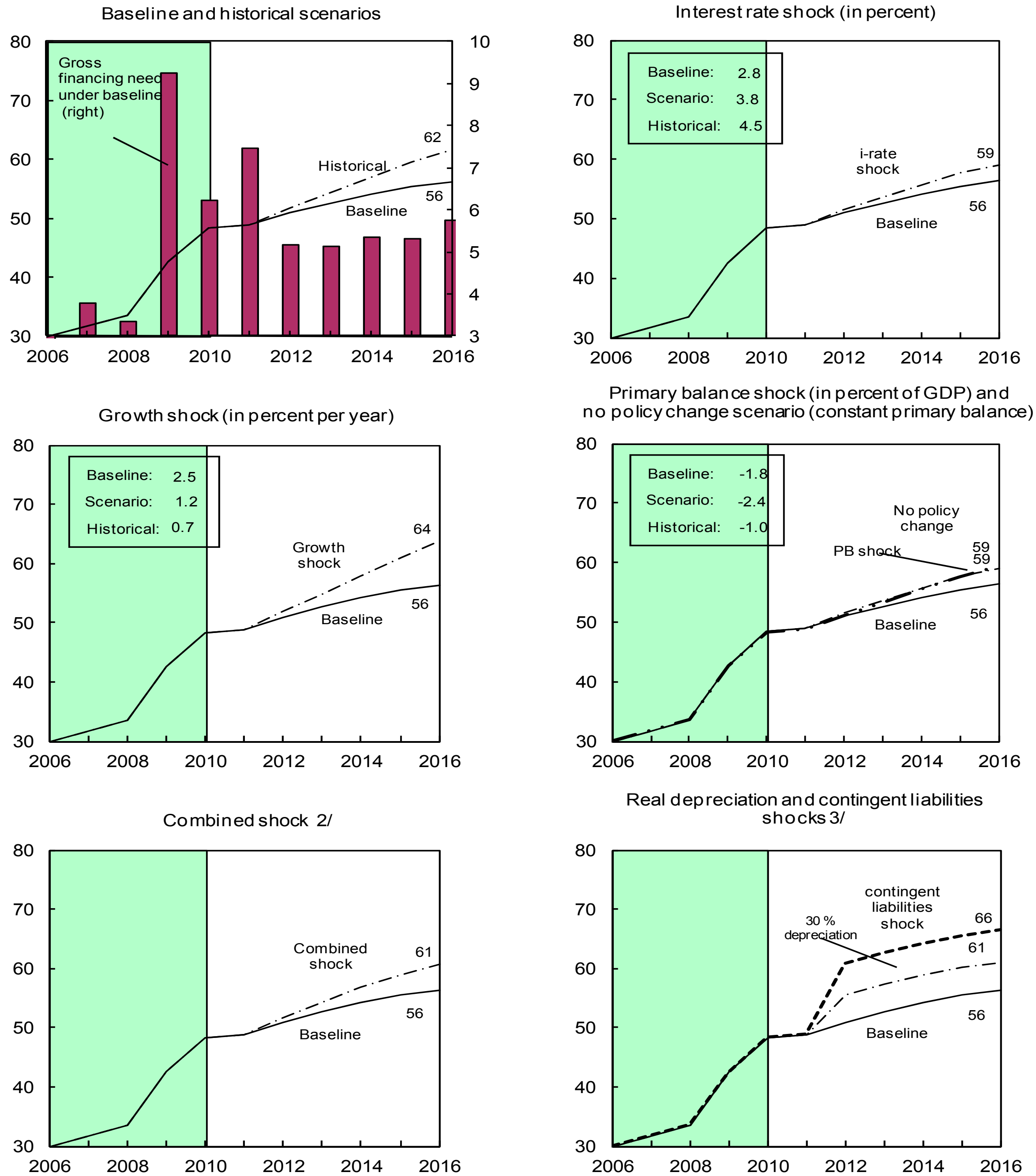
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

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

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

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

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



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

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 9. The Bahamas: External Debt Sustainability Framework, 2006-2016

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2006	2007	2008	2009	2010			2011	2012	2013	2014	2015	2016	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	**7.4**	**6.8**	**9.7**	**14.4**	**15.0**			**14.8**	**13.1**	**13.8**	**14.4**	**14.9**	**15.4**	**-14.3**
Change in external debt	0.8	-0.5	2.8	4.7	0.6			-0.2	-1.7	0.7	0.6	0.5	0.5	
Identified external debt-creating flows (4+8+9)	8.6	7.1	4.5	3.5	0.7			0.2	1.5	0.5	0.2	-0.5	-0.7	
Current account deficit, excluding interest payments	17.5	16.1	14.7	11.3	11.5			17.0	19.1	20.1	18.1	15.2	13.3	
Deficit in balance of goods and services	15.1	13.6	13.5	9.7	8.6			14.6	16.8	18.0	16.1	13.4	11.4	
Exports	39.3	40.9	42.4	38.1	40.4			41.3	42.0	42.0	41.8	42.2	42.5	
Imports	54.4	54.5	55.9	47.8	49.0			55.9	58.7	60.0	58.0	55.6	53.9	
Net non-debt creating capital inflows (negative)	-8.9	-9.0	-10.4	-8.5	-11.2			-16.6	-17.3	-19.4	-17.7	-15.3	-13.6	
Automatic debt dynamics 1/	0.0	-0.1	0.3	0.7	0.4			-0.2	-0.3	-0.2	-0.3	-0.3	-0.4	
Contribution from nominal interest rate	0.2	0.2	0.2	0.2	0.2			0.1	0.1	0.1	0.0	0.0	0.0	
Contribution from real GDP growth	-0.2	-0.1	0.1	0.5	-0.1			-0.3	-0.3	-0.3	-0.3	-0.3	-0.4	
Contribution from price and exchange rate changes 2/	0.0	-0.2	0.0	0.0	0.3			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-7.8	-7.6	-1.7	1.3	-0.1			-0.4	-3.2	0.2	0.4	1.0	1.2	
External debt-to-exports ratio (in percent)	18.7	16.7	22.8	37.8	37.1			35.8	31.2	32.7	34.4	35.3	36.2	
Gross external financing need (in billions of US dollars) 4/	**1.4**	**1.4**	**1.2**	**1.0**	**1.0**			**1.4**	**1.6**	**1.8**	**1.7**	**1.5**	**1.4**	
in percent of GDP	17.8	16.8	15.1	12.2	12.7			17.2	19.2	20.4	18.3	15.4	13.4	
Scenario with key variables at their historical averages 5/						10-Year Historical Average	10-Year Standard Deviation	**14.8**	**15.2**	**18.9**	**23.0**	**27.7**	**32.7**	**-6.8**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	2.5	1.4	-1.3	-5.4	1.0	0.7	2.7	2.0	2.5	2.7	2.3	2.5	2.7	
GDP deflator in US dollars (change in percent)	0.8	2.8	0.4	0.1	-2.3	1.4	2.1	2.8	3.3	2.2	2.1	2.2	2.2	
Nominal external interest rate (in percent)	3.0	3.5	3.0	1.8	1.4	2.4	0.8	0.6	0.5	0.8	0.3	0.2	0.1	
Growth of exports (US dollar terms, in percent)	3.2	8.8	2.5	-14.7	4.4	3.0	8.0	7.3	7.6	5.1	4.1	5.7	5.8	
Growth of imports (US dollar terms, in percent)	21.6	4.6	1.5	-18.9	1.1	3.2	11.9	19.7	11.2	7.2	1.0	0.5	1.8	
Current account balance, excluding interest payments	-17.5	-16.1	-14.7	-11.3	-11.5	-10.1	5.0	-17.0	-19.1	-20.1	-18.1	-15.2	-13.3	
Net non-debt creating capital inflows	8.9	9.0	10.4	8.5	11.2	7.0	3.3	16.6	17.3	19.4	17.7	15.3	13.6	

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

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

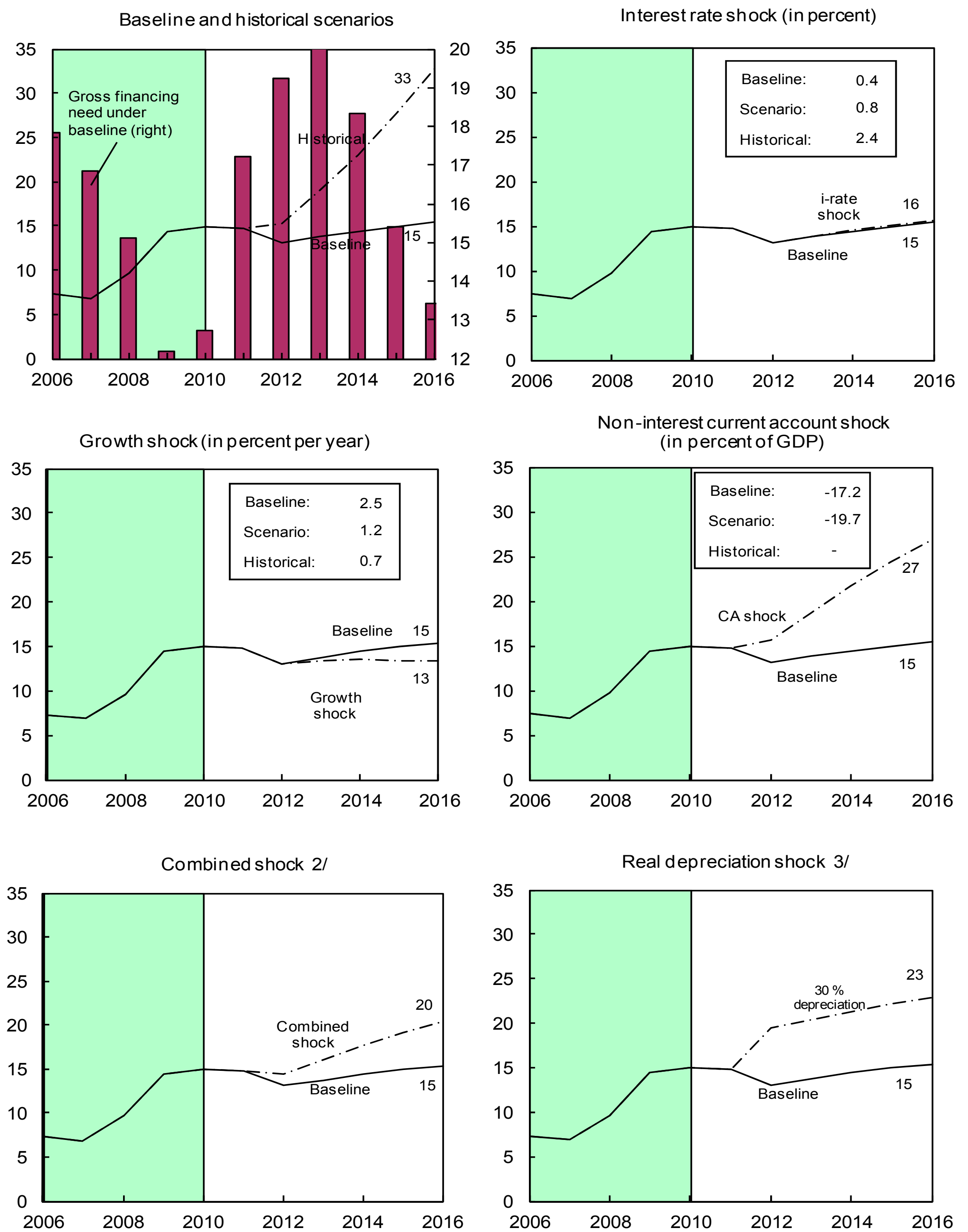
3/ For projection, line includes the impact of price and exchange rate changes.

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

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

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

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



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

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

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

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

INTERNATIONAL MONETARY FUND

THE BAHAMAS

October 20, 2011

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

The Western Hemisphere Department
(In Consultation with Other Departments)

CONTENTS

ANNEX I. THE BAHAMAS—FUND RELATIONS

(As of September 30,2011)

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

General Resources Account

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

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	124.41	100.00
Holdings	114.13	91.73

Outstanding Purchases and Loans

None

Latest Financial Arrangements

None

Projected Payments to Fund

(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2011	**2012**	**2013**	**2014**	**2015**
Principal					
Charges /Interest	0.01	0.03	0.03	0.03	0.03
Total	**0.01**	**0.03**	**0.03**	**0.03**	**0.03**

Exchange Rate Arrangement

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

Last Article IV Consultation:

The Bahamas is on a 12-month consultation cycle. The last Article IV consultation was concluded on October 27, 2010.

Technical Assistance:

Department	Dates	Purpose
STA	2008/2009	Consumer Price Index
MCM/CARTAC	August 2009	Banking supervision
FAD	September 2009	Revenue administration
MCM/CARTAC	December 2009	Credit Union supervision
STA	January 2010	Consumer Price Index
STA	January 2010	Export/Import Price Index
CARTAC	March 2010	Macroeconomic forecasting
STA	May 2010	Consumer Price Index
CARTAC	January 2011	CPI Revision
CARTAC	April 2011	Revenue Mod./Forecasting
CARTAC	May 2011	PFM Reform Action Plan

Resident Representative:

None

ANNEX II. THE BAHAMAS—FINANCIAL RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

Active Loans as of September 1, 2011

(In U.S. dollar millions)

Purpose	Approval Date	Amount	Amount Disbursed
Transforming Education and Training	11/30/2005	13.4	5.9
Supplementary Financing for the New Providence Transport Program	5/22/2008	100.0	65.0
Total		**113.4**	**70.9**

Source: Inter-American Development Bank.

Net Flow of IDB Convertible Currencies

(In U.S. dollar millions)

	2008	2009	2010	Proj. 2011
Loan Approval	100.0	0.0	0.0	121.0
Loan Disbursements	16.2	24.6	32.8	55.2
Repayments (principal)	6.1	7.9	8.6	9.4
Net Loan Flow	**10.1**	**16.7**	**24.2**	**46.1**
Interest and Charges	4.9	5.8	5.6	5.8
Net Cash Flow	**5.2**	**10.9**	**18.6**	**40.3**

Source: Inter-American Development Bank.

Recent Country Strategy

In March of 2010, the Inter-American Development Bank (IDB) approved the new Country Strategy with The Bahamas 2010–2014. Priority areas were determined based on the ongoing strategic dialogue between the Government and the IDB, extensive diagnostic work, and the lessons learned from the implementation of past strategies. Of the four sectors identified—energy, water and sanitation, transport, and small and medium enterprises development—heavy emphasis is placed on infrastructure development given the projected medium-term needs of approximately US$1 billion. The IDB will complement its focus on infrastructure with a program of technical support geared towards enhancement of the country's adaptive capacity and resilience to the effects of climate change. IDB efforts aimed at enhancing competitiveness of smaller-sized local enterprises (which make up a majority of the local private sector) are urgent given the country's plans to increase participation in international trade agreements during the strategy period. Although not included as a priority sector, it is expected that tourism-related projects will re-emerge, thereby creating additional opportunities for the Non-Sovereign-Guaranteed (NSG) loans window.

Based on discussions between the Government of The Bahamas and the IDB, there will be a Country Strategy Update in 2012 to include at least two additional priority sectors: public finances, and the protection and improvement of social services.

ANNEX III. THE BAHAMAS—STATISTICAL ISSUES

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

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

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

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

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

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

The Bahamas: Table of Common Indicators Required for Surveillance

(As of September 28, 2011)

	Date of Latest Observation (dd/mm/yy)	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	Fixed				
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	31/08/11	09/11	M	M	M
Reserve/Base Money	30/06/11	09/11	M	M	M
Broad Money	30/06/11	09/11	M	M	M
Central Bank Balance Sheet	30/06/11	09/11	M	M	M
Consolidated Balance Sheet of the Banking System	30/06/11	09/11	M	M	Q
Interest Rates[2]	30/06/11	09/11	M	M	M
Consumer Price Index	05/11	09/11	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	NA	NA	NA	NA	NA
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	31/03/11	07/11	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	30/06/11	09/11	Q	Q	Q
External Current Account Balance	03/11	09/11	Q	Q	Q
Exports and Imports of Goods and Services	03/11	09/11	Q	Q	Q
GDP/GNP	2010	07/11	A	A	A
Gross External Debt	30/06/11	09/11	Q	Q	Q
International Investment Position[6]	NA	NA	NA	NA	NA

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

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

3 Foreign, domestic bank, and domestic nonbank financing.

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

5 Including currency and maturity composition.

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

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

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 11/135
FOR IMMEDIATE RELEASE
November 4, 2011

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

IMF Executive Board Concludes 2011 Article IV Consultation with The Bahamas

On November 2, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with The Bahamas.[1]

Background

The Bahamian economy began a tepid recovery in 2010, following a sharp recession in 2008 and 2009 in the wake of the global financial crisis. Real Gross Domestic Product (GDP) grew by about 1 percent. The rebound was driven by the trade, hospitality, transport, and government services sectors, while the construction and offshore financial services sectors continued to contract. Inflation remained subdued at 1.5 percent, despite higher fuel and transportation prices, reflecting their relatively low share in the Consumer Price Index (CPI) basket. The external current account deficit remained broadly stable at 11.5 percent of GDP. Exports rebounded, and growth of non-oil imports remained subdued in line with economic activity. At the same time, rising foreign direct investment and other private capital inflows boosted international reserves to US$860 million at end-2010 (about 2.5 months of next year's imports of goods and services).

Staff estimates that the deficit of the central government deteriorated in Fiscal Year 2010/11 (July to June). Total revenues increased, owing to large one-off transactions, but expenditure—especially current spending—increased more than proportionately. As a result, the central government deficit rose to 4.7 percent of GDP (from 4.4 percent in 2010). The sale of 51 percent of the shares of the Bahamas Telecommunications Company (about 2.5 percent of GDP) eased financing pressures. The ratio of government debt to GDP continued rising and exceeded 48 percent of GDP by mid-2011. The bulk of the debt is held domestically by commercial banks, public corporations, and pension funds.

Financial soundness indicators remained strong. Banks have maintained high overall capital-adequacy ratios (well above the minimum requirement) and prudent levels of provisioning. Banks' loan portfolio, however, continued to show signs of weakness, as the severe economic downturn pushed up the ratio of non-performing loans to total loans above 10 percent.

---

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

The outlook is for stronger growth, but weaker fiscal and debt positions. Real GDP growth is expected to hover around 2.5-3 percent per year, but the central government deficit is projected to remain at about 4.5 percent of GDP over the medium term under current policies. Increased economic activity and ongoing improvements to the regulatory and supervisory frameworks are expected to contain financial sector risks. The risks to the outlook, however, are tilted to the downside, given the uncertainties about the pace of the global recovery and world commodity prices.

Executive Board Assessment

Executive Directors welcomed the gradual recovery of The Bahamas economy, but noted that unemployment remains high. While large investment projects will support growth, downside risks arise from a slower-than-expected U.S. recovery, elevated international food and fuel prices, and the vulnerability to natural disasters. Directors called for steadfast implementation of reforms to place public debt on a sustainable path, build fiscal buffers, and enhance medium-term growth prospects.

Directors underscored that the key policy challenge is to ensure sustainable public finances. They encouraged the authorities to strengthen revenue mobilization by improving tax administration and reducing tax expenditures. Directors noted that revenue reforms, such as a broad-based consumption tax, would improve debt dynamics. They also advised the authorities to exercise expenditure restraint, strengthen the financial position of public enterprises, and enhance fiscal transparency.

Directors viewed the authorities' growth strategy as broadly appropriate. They agreed that measures to enhance the business environment, improve infrastructure, and develop high value-added downstream tourism products are key to achieving higher growth.

Directors agreed that the fixed exchange rate regime serves the country well. They noted the staff's assessment that the level of the exchange rate remains broadly in line with medium-term fundamentals. Directors called for close monitoring of the current account position. They welcomed the authorities' commitment to strengthen the country's external position by continuing to build up foreign exchange reserves.

Directors commended the authorities' measures to strengthen financial sector supervision, including the adoption of macro-prudential policies and steps to enhance supervision across sectors and at the regional level. They also welcomed the strengthening of the Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) framework. Directors looked forward to timely implementation of plans to establish a credit bureau and bring credit unions under the supervisory oversight of the central bank. Noting the high level of non-performing loans and limited provisioning, Directors called on the authorities to further intensify the monitoring of financial institutions. They supported the authorities' request for a Financial Sector Assessment Program (FSAP).

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

The Bahamas: Selected Economic Indicators

	2008	2009	Prel. 2010	Proj. 2011
(Annual percentage changes, unless otherwise indicated)				
Real sector 1/				
Real GDP	-1.3	-5.4	1.0	2.0
Nominal GDP	-1.0	-5.3	-1.3	4.8
Consumer price index (annual average)	4.4	2.1	1.0	2.5
Consumer price index (end of period)	4.5	1.3	1.6	4.0
Unemployment rate (in percent) 2/	8.7	14.2	…	13.7
Financial sector				
Credit to the nonfinancial public sector	16.1	9.3	39.2	15.3
Credit to the private sector	5.1	0.9	-0.4	6.2
Liabilities to the private sector	5.1	1.8	2.6	9.1
External sector				
Exports of goods and services	2.5	-14.7	4.4	7.3
Of which: Travel receipts (gross)	-2.2	-10.0	6.7	4.5
Imports of goods and services	1.5	-18.9	1.1	19.7
(In percent of GDP, unless otherwise indicated, on a calendar year basis)				
Central government (on fiscal year basis) 3/				
Revenue and grants	16.5	16.8	17.8	17.5
Current expenditure	17.7	18.0	19.4	19.5
Capital expenditure and net lending	3.3	3.2	3.0	2.9
Primary balance	-2.6	-2.1	-2.2	-2.6
Overall balance	-4.5	-4.4	-4.7	-5.0
Central government debt	37.9	45.4	48.6	49.9
External sector				
Current account balance	-14.9	-11.4	-11.7	-17.1
Change in net international reserves				
(increase -)	-1.4	-3.2	-0.6	-1.2
External public debt (end of period)	5.4	9.8	11.9	11.9
Memorandum items:				
Gross international reserves				
(end of period; millions of U.S. dollars)	563	816	860	955
In months of next year's G&S imports	1.8	2.6	2.3	2.3
In percent of reserve money	87	117	104	106
External debt-service ratio 4/	6.6	25.4	11.5	5.7
GDP (in millions of Bahamian dollars)	8,239	7,806	7,700	8,074

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

1/ Revised national accounts data.

2/ 2009 figure based on May survey.

3/ Data for FY 2008/09 through FY 2011/12.

4/ In percent of exports of goods and services. The increase in 2009 reflects repayment of an internal foreign exchange loan of US$185 million to domestic banks.

Statement by Thomas Hockin, Executive Director for The Bahamas and John Andrew Rolle, Advisor November 2, 2011

Our Bahamian authorities continue to value the policy dialogue with the Fund. They are especially grateful for the outreach by staff in the lesser developed regions of the archipelago (the family Islands), as successive missions broadened their appreciation for the high-cost infrastructural development challenges facing The Bahamas.

The staff assessment rightly outlines the medium-term challenges facing the authorities, namely to safeguard fiscal sustainability and financial sector stability, while cultivating a more accommodating growth environment. The report outlines a credible menu of policy options, which are mostly in tune with initiatives already in train or envisioned by the authorities. The major point of departure is on the timing of, and the resolve to undertake more deep-seated taxation reform. Ongoing public financial management reforms will nevertheless position the government to take such steps in the medium term.

The Economic Environment

As staff notes, the Bahamian economy continues to be impacted by the weak global environment. The recovery, which began mildly in 2010, strengthened during 2011. Soft growth in tourism has been buttressed by a steady strengthening in FDI flows primarily into the tourism plant, and by significant public infrastructure investments that are expected to support more robust private-sector driven expansion over the medium term. Recent contribution from financial services, another important pillar of the economy, has been slightly negative, given the weak external climate and the very conservative domestic credit environment. The economy also faces headwinds from high external fuel prices.

FDI activity is expected to be strong through 2013, both underpinning and financing the bulk of the projected widening in the current account deficit. Conditions should support a gradual reduction in unemployment, with inflation staying in line with trends in the major trading partners. At a lag, growth is also expected to produce a steady improvement in asset quality within the banking system.

However, fiscal strains are expected to persist longer, despite a continued commitment to discipline, as the taxable base of economic activities will only increase more notably once large scale tourism developments transition into operations mode. That said, neither the lifting of the wage freeze nor the pending resolution of CLICO poses significant spending pressures. The resumption of promotions and payment of salary increments will add less than 0.1 percent of GDP to expenditures. Meanwhile, potential contingent liabilities from the CLICO resolution are already capped at less than 0.4 percent of GDP.

Fiscal Policies

The medium-term fiscal objective is still squarely focused on rebuilding the buffers used up during the recession. The authorities are careful not to set specific targets or timelines for reducing the debt ratio in the near term that could undermine the flexibility of fiscal operations, given an external environment that is still uncertain. However, eventual return to a Government sector debt-to-GDP ratio of 40 percent is desirable, and a combination of sustained economic growth and primary surpluses will be needed to achieve this. Improved revenue yields have to contribute substantially to consolidation, albeit within an environment of further enhanced tax administration. Such reforms will prepare The Bahamas for more fundamental structural changes in the tax system over the medium term, once a political decision is taken in this direction. However, either the realization of heightened downside global risk or delayed savings from revenue and expenditure reforms could exacerbate near-term fiscal strains. If this were to occur, the authorities are prepared to take additional measures to contain recurrent spending and postpone low priority investments.

Revenue enhancements are targeting broad base reforms to strengthen both compliance and enforcement. The e-government portal, just launched in July this year, is also increasing the scope for efficient interaction with tax payers. As to initiatives to improve customs collection, the largest single revenue component, the revised 2011 Customs Management Act lays the foundation for modernization that will position the organization at the centre of any deep rooted reform to the tax system. Key non-customs revenue collections will be managed through the new Tax Administration Division (TAD) within the Ministry of Finance, which will employ more risk-based and non-discretionary frameworks to strengthen collections. The government plans to have the TAD evolve into a more autonomous body over the medium to longer term, in keeping with best international practices. In the meantime, one important undertaking is to achieve significantly strengthened real property tax compliance. Similarly, the officials are cognizant of the need to further streamline tax concessions and will explore how best to achieve this, guided by IMF and IDB TA, albeit at a pace that does not undermine the country's relative appeal to FDI.

The authorities concur on the importance of improving the efficiency and transparency of the operations of state-owned enterprises (SOEs). This is essential both to manage contingent risks that could undermine budgetary consolidation efforts, and to lower the cost of inputs for private businesses. In this vein, direct subsidies to loss making enterprises have been capped at reduced levels in both of the last two budgets. In the case of potable water supply, public private partnerships have become central to more efficient production in the context of a multi-year fundamental reform of the Water and Sewerage

Corporation to make it financially viable. For energy, the government is supporting heightened exploitation of competitive renewable sources (wind, solar and geothermal) that would also reduce external exposure to oil price fluctuations. It should be emphasized that current operations of SOEs are already fully monitored and subject to independent external audits. Under the new amended Financial Administration and Audit Act, every public sector entity must prepare an annual report with audited financial statements for tabling in Parliament. Nevertheless, instituting more frequent and consolidated monitoring would further strengthen the public financial management framework, especially for the non-financial enterprises. With this mind, a push is also underway to encourage more frequent reporting, using the 2001 GFS compilation methodology.

Strengthening the debt management framework is also a fiscal priority. The authorities have therefore established a Debt Management Committee, comprised of representatives of the central bank, the Ministry Finance, and the Public Treasury to propose strategic policies for the debt and to comprehensively monitor debt operations. The establishment of the committee, with dedicated technical resources, represents a more pragmatic startup, relative to the immediate alternative of a fully functioning debt management unit—although this is the medium-term goal. Both the Fund and IDB will provide TA to strengthen the functioning of the committee.

Monetary and Financial Sector Policies

On monetary policy, the key objective is still to ensure that domestic credit trends are sustainable, given the fixed exchange rate and the extremely open current account of the balance of payments. In view of the very narrow economic base and very limited room for expenditure substitution between imports and domestic alternatives, policies may at times be implemented in a procyclical fashion. This explains the June 2011 decision by the central bank (CBOB) to reduce the discount rate by 75 basis points, as a signaling device to permit more broad base private sector participation in the recovery. Even with this more relaxed posture, credit expansion is not projected to pick up considerably in the near term given both supply and demand side weaknesses. That said, the central bank also continues to rely on macro-prudential measures to manage credit expansion, and will maintain these suitably tuned to manage a recovery in asset quality within the banking system. The CBOB will also ensure that credit trends support a favorable evolution of the external reserves over the medium term. In this regard, efforts will continue to develop appropriate and more formal targets for the reserves.

Meanwhile, progress continues in strengthening The Bahamas' financial sector regulatory infrastructure, with the dual objectives of enhancing the stability of the domestic sector while boosting the competiveness of international operations, which are an important contributor to growth and employment. The authorities have requested an FSAP for 2012, which will provide a further basis for improvements to the policy and regulatory framework.

Preparations are ongoing to consolidate the supervision of non-bank financial institutions. The central bank is on track to assume oversight for credit unions in the coming months, while supervision of other non-bank activities, including insurance and securities operations, will soon be merged into a second regulator. In the meantime, capacity is being further strengthened in insurance supervision. With the supporting regulations now in place, the revamped 2010 legislation came into force in September 2011, imposing more rigorous capital and solvency requirements on operations as well as mandating enhanced standards for corporate governance. Concurrently for the securities industry, the revised 2011 legislation strengthens provisions for international supervisory cooperation and provides stronger enforcement powers for the Securities Commission.

In the banking sector, the CBOB is enhancing both the capacity and frameworks to monitor credit quality and capital buffers. Under the evolving risk-based framework, a systemic risk surveillance committee has been established in the CBOB for heightened monitoring of systemically important institutions. The quality and depth of information provided to the supervisor on credit exposures has also become more fine-tuned and comparable across institutions. Commercial banks are now subjected to more rigorous and frequent stress testing, while the heightened vigilance has ensured that average provisioning rates have recovered since 2009. This has improved the standing of Bahamian banks relative to regional comparisons on provisioning rates (see trends in Figure 5 of the staff report), and it is supported by a more favorable capital position that continued to strengthen during the recession period. In the meantime, the pending establishment of a domestic credit bureau within the next 18 months will significantly enhance risk management practices and improve the pricing of private credit.

Growth Strategies

Official policies in The Bahamas are broadly focused on boosting the medium-term growth potential while developing a more resilient and diversified economic base that exploits the range of opportunities presented by an archipelagic geography. The objective is to improve the business climate and stimulate increases in both domestic and FDI financed activities. The modernization of the service delivery platform for government services, intensive investments in public infrastructure and education, and continued emphasis on boosting labor force productivity are critical planks in this strategy. A number of other targeted initiatives are also in train. In April 2011, the government successfully privatized a majority of the ownership in the state-owned telecommunications company, which is expected to lead to significant efficiencies in a vital input to exports such as tourism and financial services. A framework also continues to be developed, with the IDB’s assistance, to provide enhanced and more targeted support for SMEs, placing more emphasis on entrepreneurial and business management skills as opposed to providing subsidized financing. On a transitional basis, the government has also committed resources in the current fiscal year for an extensive on the jobs skills enhancement project in the private sector to prepare unemployed persons for accelerated absorption into the workforce as the economy recovers. Direct financing resources were also provided to support startup micro-enterprises. Together, these transitional programs will cost about 0.3% of GDP.

Conclusion

To conclude, our Bahamian authorities will remain alert to the changing external environment and will maintain appropriately tailored and disciplined fiscal policies, as more lasting reforms to public financial management are pursued. They are confident that their efforts will strengthen the base for more fundamental reforms to enhance fiscal sustainability. In the meantime, they will sustain the broad policy thrust on diversifying and strengthening the economy’s growth potential. Initiatives to bolster the stability of the financial sector will also be upheld. In these regards, our authorities are grateful for the ongoing TA from the Fund and other IFIs as well as for the constructive policy dialogue.