COMMONWEALTH OF THE BAHAMAS

2012/2013
MID-YEAR BUDGET STATEMENT
ON THE SIX MONTHS ENDING 31st DECEMBER 2012

PRUDENT STEWARDSHIP

Presented to the Honourable House of Assembly

by

The Rt. Hon. Perry G. Christie, M.P.
Minister of Finance
on
Monday, 25th February, 2013

INTRODUCTION

I have the honour to present the Mid-Year Budget Statement for the six-month period ending December 31, 2012.

In this Statement, my Government is committing itself to a course of prudent stewardship of the nation's economy and fiscal affairs. It includes no increases in taxes.

I would like to begin by acknowledging the change in leadership that was recently effected at the Ministry of Finance. I want to express my sincere appreciation to Mr. Ehurd Cunningham for his many years of dedicated service to the Government, the last four of which have been as Acting Financial Secretary. I welcome Mr. John Rolle who assumed the responsibility of Financial Secretary on February 1st of this year. Mr. Rolle has extensive experience in the service of The Bahamas within the Central Bank. During the last three years, he served as a Senior Advisor to the Executive Director who represents Canada, the Caribbean and Ireland at the IMF. In that capacity, he gained invaluable exposure to the fiscal challenges confronting the Caribbean region as well as other constituencies within the IMF. He will therefore be well placed to lead the Ministry of Finance as it addresses the important challenges of the future.

In our Charter for Governance and the Speech from the Throne, my Government set out an aggressive plan to transform the Bahamian economy and society for the benefit of all Bahamians. We are firmly committed to the pursuit of the various critical components of that plan by, among other things:

- **relentlessly attacking the crime problem which is vital to creating an environment propitious to strong growth and job creation;**
- **strengthening our key tourism industry;**
- **promoting additional foreign direct investment across the country, and particularly in Grand Bahama and the Family Islands;**
- **exploring avenues for further diversifying our economy, especially in the agricultural area through science and technology to improve our competitiveness in food production. Two initiatives will play a pivotal role in the transformative process, namely an Agriculture and Marine Science Institute on**

North Andros and a 20-year development plan that has been developed for an innovative, science-based and technology-driven Agriculture sector.

We are also committed to

- **further diversifying our financial services sector;**
- **further development and expansion of our yachting and shipping registries;**
- **expanding our investments in education; and**
- **strengthening national training through the establishment of the National Training Agency to establish a competency based training and job placement system that is flexible and responsive to the actual requirements of the workplace.**

We have, since the election, focused our attention on these and the other major areas of our change and growth agenda and we will persist in planning and further developing initiatives that assuredly will get our country to where it should be economically and fiscally going forward. Based on developments to this point, with the virtual completion of the tourism plant in New Providence with Atlantis and Baha Mar, as well as new developments that we are currently examining in Bimini, Grand Bahama, San Salvador, Abaco, Eleuthera and Cat Island, I harbor a great sense of optimism for the future.

The fiscal measures that I will set out in this plan are an integral component of our growth strategy and will ensure that the Government will be soundly placed financially to implement the full complement of initiatives that comprise that strategy. As such, it is desirable that we move to address the fiscal challenges as promptly as possible.

Shortly after the election, in the 2012/13 Budget Communication, I indicated that my Government had inherited a very difficult fiscal situation from its predecessor which, in addition to a large negative imbalance between Recurrent Expenditure and Revenue, also featured significant cost overruns and carryover spending into the current fiscal year. As a result, our room to manoeuvre was severely constrained as we developed the 2012/13 Budget within a very tight timeframe after the May 2012 election.

In light of this situation, I stated our firm commitment to restoring public finances to a healthier and more sustainable position and, to that end, I outlined specific

and significant structural reforms that would be implemented as part of a medium-term fiscal consolidation plan. In particular, I laid out plans to implement a fundamental reform of our tax system and to strengthen our system of tax administration. I will shortly provide a brief update on the status of these various initiatives.

However, economic and fiscal developments in the first half of the 2012/13 fiscal year have been less favourable than had been expected and the Government has had to make operational adjustments to ensure that we deliver on the full fiscal year targets. In the first-half period to December 2012, we noted the following:

- **weaker than expected economic growth; and**
- **consequently lower than expected Recurrent Revenue collections.**

Early in the 2012/13 fiscal year, the Government was also obliged to reduce its level of short-term bank financing, which had accumulated due to the consistent shortfalls in the projected revenues over the last three fiscal years, 2009/10 to 2011/12. The short term financing was provided by the Central Bank, through advances and the purchase of Treasury Bills, and by the Royal Bank of Canada through an increase in the then Government's overdraft facility to $200 million from the normal $100 million.

When we came to office, we also faced some $100 million in carry-over expenditures from the 2011/12 fiscal period. This $100 million expenditure included the following obligations:

- **Unpaid cheques and wire transfers $63.14 million;**
- **52-week Job Programme $23.0 million; and**
- **Teachers/Public Service Union lump sum payments $10.86 million.**

On top of facing these unpaid bills the Government has proceeded to reduce the overdraft facility in keeping with our debt management reform exercise, which was foreshadowed during the debate on the amendment to the Financial Administration and Audit Act which took place in November 2012. The benefit of this reduction of the overdraft facility is that it will substantially reduce our overall cost of financing.

Nevertheless, these bills must be paid. With these adjustments in short-term financing facilities it is necessary to settle these obligations through longer-term borrowing.

In December of 2012, Moody's announced a downgrade in our country's credit rating along with a negative outlook. To underpin its Statement, Moody's cited a significant deterioration of the Government's balance sheet since 2007, which was exacerbated by a low revenue base, and a high and rising debt level. In September 2012, Standard and Poor's downgraded the outlook for our credit rating to negative over similar concerns about our debt dynamics and the strength of our commitment to fiscal reforms.

The latest IMF Article IV staff consultation report that was presented to the Executive Board of the Fund on February 4th of this year, also calls for the implementation of a medium-term framework for broad-based fiscal consolidation to address, in its words, the imperative of a lower debt burden.

I want to stress at this point and in the strongest terms possible, that these are not merely academic matters of little interest to the average Bahamian. As I will explain shortly, the fiscal straits in which the Government finds itself have a direct and significant bearing on both the affairs of Government and the daily lives of our citizens.

As well, we face the prospects of higher rates of interest on any future borrowings at a time when our annual interest expenses already exceed $200 million and consume roughly one out of every seven Revenue dollars. That is money that is simply siphoned away from the valuable programmes and services that the Government could be providing to the public each and every year. Moreover, the additional financing needs of Government that are met in the domestic market divert credit that could otherwise be available to Bahamian businesses and the general public.

Thus, we now stand at a critical juncture that calls for immediate and resolute action. By both addressing the near-term fiscal pressures that we face and pursuing the implementation of a concrete and credible medium-term fiscal consolidation plan, we will return the public finances to a more desirable and sustainable position. Confidence will thereby be restored and strengthened and, in turn, this will underpin stronger economic growth and job opportunities going forward.

In this Mid-Year Budget Statement, I will lay out the specifics of both our short-term and medium-term fiscal action plans.

Let me quickly provide some context on recent economic developments, the outlook for the economy and a synopsis of the fiscal performance during the period of July

to December 2012. I invite you to peruse the analysis provided by the Central Bank of the Bahamas in Annex A for more of these details.

THE ECONOMIC CONTEXT

As for the economic context, the near-term performance of, and prospects for, the world economy have been somewhat more modest than had been expected at the time of the 2012/13 Budget.

More importantly, the U.S. economy is now estimated to have grown by a modest 2.3 per cent in 2012 but it may achieve results slightly below this estimate in 2013.

The Bahamian economy has continued to recover from the global economic and financial crisis. The main drivers are, on the one hand, a modest though ongoing rebound in tourism. On the other hand, the large public and private sector investment projects that are underway are sustaining aggregate demand and also enhancing our tourism productive capacity going forward.

The IMF estimates that the economy grew by 2.5 per cent in real terms in 2012, as was projected in the 2012/13 Budget.

As for economic prospects going forward, the IMF's forecast is that the Bahamian economy will grow by 2.7 per cent in real terms in 2013, as had been presented at the time of the 2012/13 Budget.

Beyond this year, given the emerging developments that I have outlined above, I am confident that the Bahamian economy can achieve significantly stronger growth, with the attendant creation of additional employment opportunities.

Permit me now to address the fiscal situation.

BUDGET PERFORMANCE IN 2012/13

Recurrent Revenue

The evolution of Recurrent Revenues in the first six months of the 2012/13 fiscal year reflected the economic developments during that period. Our intake was not as strong as expected because the growth of the economy in current dollar terms, which is our effective tax base, has not been as robust as anticipated. A tighter rein on expenditures is

therefore necessary to ensure that we deliver on our deficit target of 6.5 percent of GDP, to which we committed ourselves at the start of this fiscal year.

Recurrent Expenditure

On the expenditure side, recurrent spending during the first half of the fiscal year has been broadly in line with the budget, and the Government had executed about 45 percent of its planned expenditure.

Capital Expenditure

Capital Expenditure during the first half of the fiscal year amounted to some 36 per cent of the projected level for the full year presented in the last Budget Communication.

FISCAL PLAN OF ACTION IN 2012/13 AND BEYOND

Fiscal Action in 2012/13

At the mid-year, the Government is making internal adjustments to ensure that we meet the GFS Deficit target of 6.5 per cent of GDP that was presented in the last Budget Communication. Moreover, we are beginning to lay the foundation for more comprehensive reforms to deliver on a medium-term consolidation of public finances. Honourable Members may expect a more detailed elaboration of policy actions to achieve our objectives in the forthcoming 2013/2014 Budget Communication.

As for Recurrent Expenditure, the Ministry of Finance is using traditional methods at its disposal to contain the expenditures of Government Ministries and Departments over the remainder of the current fiscal year.

As well, the Government expects that, in the normal course of our capacity to execute on public sector investments and some reprioritization, we will moderate the pace of Capital Expenditures below the amounts budgeted.

What is more important though are the structural enhancements we are making to improve revenue performance and tighten expenditure controls over the

medium-term. Beyond the measures set out below, I would signal that the Government will engage, over the coming months leading up to the 2013/14 Budget Communication, in a comprehensive review and assessment of all revenue areas with a view to seeking means of enhancing the Government's revenue collections going forward.

Today, I am announcing select measures to enhance Recurrent Revenue in 2012/13 and beyond.

Measures will be taken to improve the infrastructure of Customs electronic submissions, thereby strengthening revenue controls and reducing Customs personnel costs. The review of Customs fees is part of our overall reassessment to bring fees more in line with the cost of providing Government services. Government fees are an area that we will review more comprehensively in the 2013/2014 Budget Communication.

My Government is now moving to further strengthen real property tax administration. The Government will present in the next Budget Communication a comprehensive programme to reform the real property tax administration, which will include new legislation, software and operating procedures. In the interim, to provide relief to taxpayers, we are announcing a new amnesty programme in respect of real property taxes, also effective on March 1st 2013, that will incentivize increased payments. There are four components to this programme, namely:

- **to encourage self-registration, owners of residential properties above the $250,000 exemption threshold, and owners of commercial properties, who have never received a property tax bill will be encouraged to register their properties with the Chief Valuation Officer by June 30, 2013. For these registrants, the Government will waive all back taxes if any.**

- **to encourage registered property owners with arrears to become current with their tax payments, the government will provide waivers as follows:**
  - **where no more than three years of payment arrears exist, 50 percent of the total owed in both assessment and surcharges, provided payment is made by June 30, 2013;**
  - **where accumulated arrears for more than three years exist, 100 percent of surcharges only, provided payment is made by December 31, 2013.**

- **to reward residential property tax payers who are current with their assessments, the government will rebate 5 percent of the annual real property tax assessment, provided the owners remain current with their payments over the next three years.**
- **To make Real Property Tax more client-focused, we have introduced a process to automatically review all instances of year-on-year variations in residential property tax assessments of more than 15 percent or where the average yearly increase between revaluations exceeds 10 percent.**
- **These efforts are being taken to clean up the real property tax register and modernize the administrative infrastructure so that, going forward, the Government can take a firmer stance in enforcing compliance.**

In order to provide enhanced assistance to small business operators and promote growth and job creation, I am announcing that the rate of Excise Tax on trucks less than 20 tons is being reduced from 85 per cent to its previous level of 65 per cent. That is also expected to generate increased revenue for Government through increased purchases of trucks. I would flag at this point that the Government will, as we develop the next Budget Communication, also thoroughly review the entire structure of Excise Tax rates on all motor vehicles, while bearing in mind the traffic and environmental implications.

These immediate fiscal actions in respect of Recurrent Expenditure, Capital Expenditure and Recurrent Revenue will help us secure the 2012/13 GFS Deficit target that was presented in the last Budget Communication, namely 6.5 per cent of GDP but, more fundamentally set the tone for broader reforms which we will unveil in the near-term.

However, as indicated previously, we have to finance this year some $100 million in carry-over expenditures from 2011/12. The Government will be seeking authorization for additional borrowing in the amount of $100 million in 2012/13.

A Medium-Term Fiscal Consolidation Plan

At this stage, the Government is setting its sights on a medium-term strategy that, barring unforeseen developments, will consolidate the public finances and achieve

significant and sustainable reductions in the Government debt burden over time. For the sake of prudence, the plan will be monitored closely and, on the basis of evolving developments, will be adjusted as necessary as we move forward.

As the key components of our medium-term fiscal plan, I am announcing that action will be pursued in respect of Recurrent Expenditure, Recurrent Revenue and Capital Expenditure in order to both eliminate the primary deficit and get the debt-to-GDP ratio to lower levels. The primary deficit excludes interest charges on the debt and debt repayments and represents the key indicator of debt sustainability.

On the Recurrent Expenditure front, we will implement a steady decline in its ratio to GDP by one half of a percentage (0.5%) of GDP per year, beginning in 2013/14 and on through 2016/17. As such we intend to reduce the ratio of Recurrent Expenditure to GDP from the projected 21.1% over the course of this fiscal year to 19.1% of GDP by 2016/17.

On the Capital side, we believe that a sustainable medium-term target is 3% of GDP, which in today's level translates into annual investments in the area of $250 million. We will move toward that target by restricting Capital Expenditure to 3.5 per cent of GDP in 2013/14.

Finally we are targeting structural reforms that would improve the revenue yield over the medium-term by almost 4 percent of GDP, to 21.5% of GDP in 2016/17 from 17.6% in 2012/13.

The successful implementation of this plan over the medium-term is projected to result in:

- **a return to surpluses on Recurrent Account by 2015/16;**
- **primary surpluses by 2014/15; and**
- **a turnaround in the GFS Balance from a deficit to GDP ratio of 6.5% of GDP this year to a small surplus by 2016/17.**

In sum, through these efforts, we expect to be able to arrest the growth in the debt to GDP ratio by 2014/15 and to begin a gradual reduction in the ratio to just over 50% of GDP by 2016/17.

Let me provide a brief overview of the initial policy actions which will allow us to achieve these objectives.

Recurrent Revenue will be significantly and structurally enhanced through a wide range of measures, including:

- **the establishment of a Central Revenue Agency to strengthen the efficiency and effectiveness of revenue collection across a number of major taxes.**
- **As set out in the White Paper on Tax Reform, the Government is implementing a broad tax reform package that includes the introduction of a Value Added Tax (VAT) in July 2014. While that is an ambitious timeframe, I would note that we have had the benefit of detailed studies of the feasibility of a VAT in The Bahamas. The White Paper contains a fully articulated policy framework for VAT. Following the public consultation process, the Government will present a refined proposal, and advance legislation to bring the VAT into effect. Our target is to circulate the draft legislation for VAT by the second quarter of the next fiscal year. With the introduction of VAT, along with the reductions in other taxes set out in the White Paper, we expect a net 2.2 percentage points of GDP improvement in Recurrent Revenue annually.**
- **The Government is committed to wide-ranging reforms of the property tax administrative system that will add 1% of GDP to Recurrent Revenues by 2016/17;**
- **We are undertaking a comprehensive Customs reform and modernization programme, assisted by the IDB that will add revenues equivalent to 0.5% of GDP. The new Customs Management Act will be brought into force by July 1st 2013, providing a modern legislative framework for Customs operations.**
- **We are introducing excise stamps on tobacco products that will sharply enhance compliance and add 0.2% of GDP to revenues. The draft Bill has already been tabled in Parliament. This regime will become operational early in the next Fiscal Year.**

All told, these measures will contribute to boosting the revenue yield of our tax system by almost 4 points of GDP by 2016/17. That will bring our yield somewhat

closer into line with that generally found elsewhere in the Caribbean, though still at the lower end of the range.

On the expenditure side, the overall framework for strengthened public financial management will take place within the scope of the new Financial Administration and Audit Act (FAAA), which will be brought fully into force by July 1st 2013. The Ministry of Finance, in a determined fashion, will enforce expenditure discipline and accountability across all Government Ministries, Department and public corporations.

In this regard, the Government is firmly committed to a fundamental review of its operations as well as its expenditure and revenue control mechanisms, seeking to instill best practices wherever feasible. The Ministry of Finance, in particular, will be restructured and strengthened in order to enhance its capacity to more effectively monitor the operations and expenditures of Government Ministries, Departments and public corporations. We will vigorously strive for higher levels of accountability and transparency. In particular, the Ministry of Finance will undertake urgent and specific actions to deal with electricity consumption, communications costs and the management of Government assets, and motor vehicles specifically, across all areas of Government.

As regards public corporations, the Ministry of Finance will exert more direct and greater oversight of their financial affairs to ensure that they strive for greater levels of efficiency and effectiveness and that they are subject to greater accountability to the Government. This will allow our budgeting process to be more comprehensively informed by the budgets of public corporations, and so that a truly comprehensive approach to fiscal discipline is achieved. As Members would be aware, the Government has already asked subsidy dependent corporations to better align their expenditure plans with the resources that are available from Government.

As well, the planning function of the Ministry of Finance will be strengthened such that new investments and projects are reviewed in an economically and financially sound and effective manner.

Also under the Financial Administration and Audit Act, the government will introduce new Public Sector Procurement Regulations by September 1st 2013, which will impose greater controls and greater efficiency on public spending for goods and services for all public entities including public corporations.

Public sector pension reform is also on our agenda. As part of this exercise, we are reviewing how the administrative and actuarial costs of existing plans sponsored by public sector agencies and corporations can be reduced and managed in a more comprehensive fashion, with minimal impact on existing public sector employees.

Through this medium-term fiscal consolidation plan, we will arrest the rise in the Government debt-to-GDP ratio and put it on a steady downward path. There are additional policy actions to be elaborated, including the establishment of a Council of Economic Advisors which, as I explained, will be unveiled during the 2013/2014 Budget Communication.

CONCLUSION

Mr. Speaker, through this Statement, I have provided a mid-course update on my Government's ongoing careful management of public finances. That stance is solidly anchored in our fundamental fiscal anchors and is designed to return us to more prudent and sustainable levels of Government Debt over time.

As I signaled in my address to the Bahamas Business Outlook Conference last month, there are clear indications that the economy has turned the corner and that, despite the risks that are present, we can look forward to better days ahead. To reiterate, because of the new developments that the Government is now considering, I remain optimistic that a period of renewed growth and job creation is ahead of us.

I draw the attention of Honourable Members to the Table on public finances in Annex B to the Statement.

I have the Honour to present the Mid-Year Budget Statement.

25th February, 2013

ANNEX A

ECONOMIC BACKGROUND

ECONOMIC BACKGROUND[1]

INTRODUCTION

Indications are that the ongoing recovery in the domestic economy was sustained during 2012, underpinned by continued gains in tourism sector output, alongside increased foreign investment-led construction activity. The International Monetary Fund estimates that Real GDP grew by 2.5%[2] during the year, following expansions of 0.2% and 1.6% in 2010 and 2011, respectively.

The following sections highlight the main international economic developments in 2012, followed by an analysis of domestic conditions and a forecast of the economy in 2013.

INTERNATIONAL ECONOMIC OUTLOOK

The global economy sustained its modest growth in 2012, supported by robust expansions in emerging markets and more muted gains in the United States economy; however, with most of Europe mired in recession, the IMF lowering its forecast for growth worldwide to 3.2%[3] in 2012 from 3.9% a year earlier.

Faced with a relatively weak recovery, most major central banks either maintained or increased the level of monetary accommodation in their economies. Several central banks, including the Federal Reserve, the Bank of England and the Bank of Japan, increased the size of their asset purchase programmes during the year in an effort to keep lending rates low, and stimulate economic activity. The Bank of China also attempted to achieve the same outcome by reducing its reserve requirement by 50 basis points and cutting its benchmark deposit and lending rates to 3.0% and 6.0%, respectively.

The fiscal crisis in the euro zone prompted the most significant policy response by the European Central Bank (ECB), as the Bank supplied approximately €530.0 million to banks and cut interest rates by 25 basis points during the first half of the year, and in September, it announced a series of measures to support members whose fiscal deficits and debts had deteriorated to unsustainable levels, termed the "*Outright Monetary Transactions*" programme.

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[1] This Annex is base on material provided by the Central Bank of The Bahamas.
[2] See: International Monetary Fund (IMF) *"World Economic Outlook"* October 2012.
[3] See: International Monetary Fund (IMF) *"World Economic Outlook Update"* January 2013.

Despite experiencing a 0.1% contraction in the fourth quarter, indications are that the United States economy firmed by 2.3% in 2012, extending the growth of 1.8% noted a year earlier. Underpinning this outturn was a rebound in residential housing, a moderation in import growth and a smaller decline in state & local government spending. With economic conditions improving modestly, approximately 2.4 million jobs were created during the year, resulting in the unemployment rate decreasing by 0.7 of a percentage point to 7.8%. Occasioned mainly by a contraction in energy costs and lower accretions to food prices, annual inflation softened to 1.7% in 2012 from the 3.0% advance in the prior year.

With regards to the other major economies, real GDP in the United Kingdom is expected to remain relatively unchanged in 2012, as an increase in output in the third quarter, due to the hosting of the Olympics, was negated by declines in other quarters. Expectations are that the euro area's economy contracted during the year, owing to ongoing weakness in several southern states. In contrast, China's economy rose by an estimated 7.8% over the year, buoyed by the Government's stimulus measures.

Movements in commodity prices were mixed in 2012, as the average price of crude oil fell marginally by 0.3% to $111.38 per barrel, vis-à-vis a 39.1% surge in the prior year. With regard to precious metals, the average cost of gold moved higher by 6.5% to $1,676.24 per troy ounce, a slowdown from 2011's 27.1% gain, while silver prices declined by 11.8% to $31.38 per troy ounce, a turnaround from the 39.1% expansion in the prior period.

DOMESTIC ECONOMIC DEVELOPMENTS

Domestic economic activity was supported by an expansion in the tourism sector, as the ongoing recovery in the main source markets, combined with several private/public sector incentive programmes, led to further gains in the high value-added group segment. Similarly, the growth in construction sector output reflected mainly foreign investment-related project activity—particularly the Baha Mar development—and to a lesser extent, Government's ongoing infrastructural works programmes. Despite the improvement in two of the main sectors, the absence of a more board-based recovery resulted in employment conditions remaining challenging, while inflation rose slightly, due to a modest uptick in international food and fuel prices.

Developments in the monetary sector were dominated by Government's financing requirements and weak private sector credit conditions, which led to modest growth in banking sector liquidity. In contrast, increased demand for foreign currency to facilitate current payments and fuel imports, along with muted net inflows from the real sector, resulted in a modest contraction in external reserves over the year.

With regards to the fiscal sector, the National Debt expanded during the year, due mainly to increase long-term financing for the deficit in the form of Government securities and an external bond.

External sector trends featured continued growth in the capital and financial account surplus over the nine months of the year, buoyed by net inflows related to foreign investment activity; however, amid increased imports and higher outflows for construction services, the current account deficit deteriorated.

TOURISM

Indications are that the unfolding recovery in tourism output was sustained in 2012, as total visitor arrivals firmed over the January to November period by 6.3% to 5.3 million, extending the 4.6% gain recorded during the same period of the prior year. Underlying this outturn was an 8.0% advance in the high value-added air component, a reversal from a 3.0% reduction in the comparative 2011 period. Similarly, the larger sea segment advanced by 5.8%; although lower than the 7.1% expansion noted a year earlier.

Disaggregated by port of entry, arrivals to New Providence rose by 10.0%, compared to a marginal 0.9% increase a year ago, led by a 10.2% rise in sea traffic and a 9.6% rebound in air arrivals. Similarly, in Grand Bahama, total visitors grew by 1.9%, a slowdown from the 4.4% advance in 2011, as the increase in the dominant sea segment tapered to 1.2%, while air passengers strengthened by 7.3%. Similarly, gains in Family Island visitors were reduced to 2.1% from 11.7% a year-earlier, as the rise in both air and sea arrivals moderated to 0.7% and 2.3%, respectively.

For the year, preliminary information from a sample of New Providence and Paradise Island hotels revealed that total room revenue advanced by 4.0%, as the occupancy rate firmed by 4.3 percentage points to 68.3%; however, amid increased competition from other destinations, the average daily room rate (ADR) declined by 3.0% to $229.24.

CONSTRUCTION

Construction sector output continued to be driven by ongoing foreign investment projects in the tourism sector, such as Baha Mar and Albany in New Providence, and several smaller developments on the Family Islands, while the public sector's capital works programmes also provided some impetus to the sector. In contrast, domestic private sector activity was subdued, as borrowers remained challenged in meeting their existing mortgage obligations.

Reflecting the weakness in the domestic sector, total mortgage disbursements for new construction and repairs fell by 22.8% to $82.4 million over the nine months to September, as the main residential component contracted by 23.3% to $78.7 million and the smaller commercial segment fell by 12.5% to $3.7 million.

Similarly, mortgage commitments for new construction and repairs to existing structures—a more forward looking indicator of activity—fell by 15.2% to $75.5 million in value and by 42.7% in number to 402. The residential component, which constituted the majority (97.8%), declined by 14.9% to $73.8 million, while commercial commitments contracted by 24.5% to $1.6 million.

During the review period, total mortgages outstanding rose by a modest 1.3% to $3,275.2 million by end-September, with the residential segment—which accounted for 93.7% of the aggregate—increasing by 1.0% and the commercial component by 4.5%.

In terms of interest rates, the cost of commercial loans firmed by 0.3 of a percentage point year-on-year to 8.7%, while the average residential rate steadied at 8.2%.

INFLATION

Domestic inflation—as measured by the change in the Retail Price Index—increased marginally over the twelve months to August 2012 to 2.63% from 2.55% a year earlier. This outturn reflected notable price gains for transport (3.87%)—which are directly affected by fuel prices—and furniture & household operation (3.54%). More muted cost increases were recorded for housing, water, gas, electricity & other fuels—the most heavily weighted component of the index—by 3.23%, food & beverage, by 3.17%, education, by 2.51% and restaurant & hotels, by 2.42%. The majority of the other categories registered average price increases of under 2.0%, with the exception of communication costs, which decreased marginally by 0.18%.

Further, reflecting the upward trajectory in international oil prices, average domestic energy costs increased in 2012, as the average retail price for both gasoline and diesel advanced by 5.5% to $5.46 per gallon and by 6.2% to $5.20 per gallon, respectively. Similarly, the Bahamas Electricity Corporation's average fuel charge rose by 15.3% to 26.68¢ per kilowatt hour (kWh).

FOREIGN INVESTMENT AND THE BALANCE OF PAYMENTS

Provisional balance of payments data for the nine months of 2012 showed a deterioration in the current account deficit by approximately $268.7 million (36.1%) to $1,012.7 million. This outturn reflected a widening in the merchandise trade deficit by an estimated $228.0 million (15.0%) to $1,751.1 million, extending the 9.9% ($136.7 million) increase in the same period of 2011, as the growth in foreign investment activity contributed to the firming in non-oil merchandise imports, by $198.3 million (17.4%) to $1,336.4 million. Similarly, comparatively higher import volumes led to an increase in fuel imports to $737.3 million from $612.9 million in 2011. In addition, the services account surplus deteriorated by $61.7 million (6.3%) to $914.5 million, attributed to an $89.9 million (83.8%) gain in net outflows for construction services, which overshadowed the $58.8 million (3.9%) expansion in net travel receipts. Further, net outflows for transportation services advanced to $203.7 million from $136.0 million in the prior period.

The capital and financial account surplus expanded by an estimated $34.8 million to $863.1 million, reflecting a more than two-fold rise in other 'miscellaneous' investments to $547.4 million. Underpinning this outturn was an increase in net public sector capital inflows—which benefitted from the issuance of secured notes by a public entity—and a rise in domestic banks' net inflows. In contrast, net direct investment inflows declined sharply by $263.5 million to $349.6 million, as net equity investments contracted by $214.8 million, after a $133.3 million surge a year earlier, related to Government's sale of its controlling interest in the Bahamas Telecommunications Company Ltd. (BTC).

MONETARY & CREDIT DEVELOPMENTS

Monetary developments featured a modest build-up in banking system liquidity, relative to 2011, owing mainly to Government's borrowing activities and anemic private sector credit demand. In particular, excess reserves grew by $15.2 million to $450.0 million, following a $45.4 million accumulation last year. Similarly, excess liquid assets rose by $74.3 million to $971.5 million, after an $83.6 million advance in the prior period.

Bahamian dollar credit firmed by $132.2 million during the year, although slowing from the $222.4 million advance noted in 2011. Underlying this outcome, private sector credit contracted by $39.7 million, vis-à-vis a $114.3 million expansion a year earlier, as both consumer credit and commercial lending decreased by $25.8 million and $30.3 million, respectively, outstripping the $16.5 million increase in mortgages. Conversely, buoyed by two issues of Bahamas Government Registered Stock totaling $300.0 million, net credit to the Government firmed by $155.9 million, following a $118.8 million build-up a year earlier. Similarly, claims on the public corporations rose by $15.4 million, a reversal from a $10.5 million decrease in the previous year.

Domestic foreign currency credit expanded by $26.2 million in 2012, in contrast to a $92.0 million falloff a year ago, as private sector credit moved higher by $41.7 million, vis-à-vis a $40.6 million decrease in the prior period. Net credit to the Government edged up by $0.5 million, a reversal from 2011 when the repayment of a short-term loan led to a $68.3 million decline in outstanding claims. In contrast, credit to the rest of the public sector contracted by $15.9 million, compared to a $17.0 million expansion in 2011.

Despite the receipt of proceeds from Government's $180 million external bond issue in December, external reserves declined by $79.9 million to $812.1 million, a reversal from 2011, when inflows from the divestment of Government's controlling interest in the BTC, supported a modest $30.9 million expansion. The contraction in external balances was due mainly to subdued inflows from real sector activity—particularly in the first half of the year—alongside increased foreign currency demand for current payments, banks' profit repatriations and fuel purchases.

With regards to interest rates, the weighted average interest rate spread widened by 51 basis points to 8.9 percentage points, as the 10 basis point softening in the loan rate to 10.88%, was outweighed by the 61 basis points contraction in the corresponding deposit rate to 2.02%.

CREDIT QUALITY

Reflecting subdued economic activity and elevated unemployment levels, banks' credit quality indicators deteriorated in 2012, albeit at a slower pace that the previous year. Aggregate private sector delinquencies grew by $42.4 million (3.5%) to $1,250.5 million, after a $69.1 million (6.1%) increase in 2011, as the ratio of arrears to total private sector loans firmed by 0.8 of a percentage point to 20.0%. As the average age of loan delinquencies continued to increase, non-performing loans—arrears in excess of 90 days and on which banks are no longer accruing interest—expanded by $51.5 million (6.3%) to $867.6 million, resulting in the accompanying ratio advancing by 88 basis points 13.9%. In contrast, short term arrears (31-90 days overdue), declined by $9.1 million (2.3%) to $382.9 million and corresponded with a 12 basis point softening in the relevant ratio to 6.1%.

The growth in delinquencies reflected mainly an increase in the mortgage component by $49.4 million (7.6%) to $699.5 million, as the non-performing segment firmed by $47.3 million (10.5%) and 31-90 day arrears advanced by a more modest $2.1 million (1.1%). In addition, consumer loan delinquencies grew by $8.9 million (3.3%) to $280.2 million, as the $12.2 million (7.3%) growth in non-performing loans overshadowed a $3.4 million (3.2%) reduction in the short-term segment. In a modest offset, commercial arrears fell by $15.9 million (5.5%) to $270.8 million, due to broad-based declines in both the non-accrual and 31-90 day components by $8.1 million (4.0%) and $7.8 million (8.9%), respectively.

Given the modest deterioration in banks credit quality indicators in 2012, institutions raised their total provisions for loan losses by $73.0 million (24.3%) to $373.5 million, resulting in the corresponding ratios of total provisions to arrears and non-performing loans firming by 5.0 and 6.2 percentage points to 29.9% and 43.1%, respectively.

NATIONAL DEBT

During the nine-month period, the Direct Charge on Government advanced by an estimated $368.1 million (9.7%) to $4,172.8 million at end-September 2012, relative to a $6.3 million (0.2%) decline to $3,714.1 million in the corresponding period a year earlier. Bahamian dollar claims, which constituted the bulk (80.1%) of the total, rose by 11.2%, while total foreign currency debt firmed by 4.0%.

Similarly, Government's contingent liabilities rose by $38.2 million (6.9%) to stand at approximately $558.9 million, vis-à-vis a $7.9 million (1.4%) contraction to $556.7 million in

2011. This outturn reflected mainly a rise in the guaranteed debt of the Bahamas Electricity Corporation and the Bahamas Mortgage Corporation.

As a result of these developments, the National Debt rose by an estimated $406.3 million (9.3%) to $4,761.6 million at end-September 2012, vis-à-vis a $14.2 million (0.3%) expansion a year earlier.

ECONOMIC OUTLOOK FOR 2013

Improvements in domestic economic activity are projected to be sustained in 2013, benefitting from continued global growth—particularly in the United States market—which should spur further gains in the high value-added group segment of the tourist market, while ongoing large-scale foreign investment developments, and to a lesser extent public sector programmes, should sustain the growth in construction sector activity. However, until the recovery broadens to absorb the excess capacity in the economy, unemployment levels are expected to remain elevated. Inflation is forecasted to stay at relatively low levels, although domestic energy prices will continue to be affected by the volatility in the international oil markets.

In terms of the monetary sector, expectations are that bank liquidity will remain at elevated levels over the near-term, reflecting the weakness in consumer demand and continued growth in holdings of Government debt. Further, the outlook for external reserves will continue to depend on the strength of foreign currency inflows from real sector activities and the level of demand by the public for funds to facilitate current payments and fuel purchases.

ANNEX B

FISCAL TABLE

MINISTRY OF FINANCE

MEDIUM-TERM FISCAL CONSOLIDATION PLAN

B$ millions

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13 Budget	2012/3 July - Dec. 2012	2012/13 Projected Outturn	2013/14 Projection	2014/15 Projection	2015/16 Projection	2016/17 Projection
1. Recurrent Expenditure	1415	1421	1499	1529	1642	1632	1821	814	1720	1755	1789	1825	1860
2. Recurrent Revenue	1354	1445	1331	1292	1452	1432	1550	633	1430	1580	1740	1952	2090
3. Recurrent Balance (2. minus 1.)	-61	24	-168	-237	-190	-200	-271	-181	-290	-175	-49	127	230
4. Capital Expenditure	235	231	262	251	263	395	400	142	363	300	270	280	295
5. Capital Revenue	7	10	0	0	210	87	0	0	0	0	0	0	0
6. Capital Balance (5. minus 4.)	-228	-221	-262	-251	-53	-308	-400	-142	-363	-300	-270	-280	-295
7. Total Deficit (3. plus 6.)	-289	-197	-430	-488	-243	-508	-671	-323	-653	-475	-319	-153	-65
8. Debt Redemption	106	62	67	89	77	63	121	55	121	84	102	152	145
9. GFS Deficit (7. minus 8.)	-183	-135	-363	-399	-166	-445	-550	-268	-532	-391	-217	-1	80
10.GDP (Current Prices)	8143	8283	7982	7744	7779	7914	8454	N/A	8179	8500	8883	9295	9726
11.GFS Deficit as % of GDP	-2.2	-1.6	-4.5	-5.2	-2.1	-5.6	-6.5	N/A	-6.5	-4.6	-2.4	0.0	0.8
Memo Items:-													
Growth Rate (current prices)	3.9	1.7	-3.6	-3.0	0.5	1.7			3.3	3.9	4.5	4.6	4.6
Government Debt (end June)	2441	2679	3085	3401	3553	3906	4456		4438	4829	5046	5047	4967
Government Debt (% of GDP)	30.0	32.3	38.6	43.9	45.7	49.4	52.7		54.3	56.8	56.8	54.3	51.1
Recurrent Expend. (% of GDP)	17.4	17.2	18.8	19.7	21.1	20.6	21.5		21.0	20.6	20.1	19.6	19.1
Recurrent Revenue (% of GDP)	16.6	17.4	16.7	16.7	18.7	18.1	18.3		17.5	18.6	19.6	21.0	21.5
Capital Expenditure (% GDP)	2.9	2.8	3.3	3.2	3.4	5.0	4.7		4.4	3.5	3.0	3.0	3.0
Primary Balance ($)	-56	8	-209	-220	45	-261	-343		-325	-152	33	249	326
Primary Balance (% of GDP)	-0.7	0.1	-2.6	-2.8	0.6	-3.3	-4.1	-	-4.0	-1.8	0.4	2.7	3.4

* GDP estimates through 2011 are from the Department of Statistics; thereafter from the IMF World Economic Outlook