© 2008 International Monetary Fund

August 2008
IMF Country Report No. 08/295

Barbados: 2008 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2008 Article IV consultation with Barbados, the following documents have been released and are included in this package:

- The staff report for the 2008 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 16, 2008, with the officials of Barbados on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 8, 2008. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff statement of July 21, 2008, updating information on recent developments.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July 25, 2008 discussion of the staff report that concluded the Article IV consultation.

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

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

Price: $18.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

BARBADOS

Staff Report for the 2008 Article IV Consultation

Prepared by the Staff Representatives for the 2008 Consultation with Barbados

Approved by Ranjit Teja and G. Russell Kincaid

July 8, 2008

- ***Background***. After solid performance in recent years, growth is projected to slow to 2¼ percent in 2008, reflecting spillovers from the economic slowdown in advanced economies. At the same time, sharply higher costs for imported oil and food are projected to push up inflation to 9 percent and widen the current account deficit to 8½ percent of GDP.

- ***Focus of consultation***. The discussions focused on policies to balance the conflicting risks to inflation, growth, and medium-term sustainability. While the government has maintained some policy space by postponing the liberalization of the capital account, its options are constrained by high public debt and the peg to the U.S. dollar. The staff made the following recommendations:

    - ***Fiscal policy*** should focus on creating the space for targeted support to vulnerable groups within this year's reduced deficit target and on identifying measures to lower public debt and support external sustainability over the medium term.

    - ***Monetary policy*** should aim at containing inflation expectations. Thus, further reductions in interest rates should be contingent on signs of a sharper slowdown in demand than is currently anticipated.

    - ***The wage bargaining process***, which is conducted under a tripartite framework, should support fiscal and monetary policies by minimizing second-round effects of the oil and food price shocks on inflation.

    - ***Financial sector policy*** should focus on strengthening banking regulation, oversight of the nonbank sector, and cross-country cooperation among regulators and supervisors. An FSSA, summarizing the findings of an FSAP Update mission, is being issued separately.

- ***Authorities' views***. The authorities agreed with the thrust of these recommendations, but on fiscal policy, preferred to rely on nontax rather than tax measures to raise revenues. They indicated that specific measures would be included in the revised budget to be presented in early July.

- ***Exchange system***. Barbados has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on current account transactions. While the real exchange rate is not far from its estimated equilibrium, domestic policy adjustments will be needed in the medium term to contain external imbalances under its fixed exchange rate system.

- ***Mission***. The team visiting Bridgetown during June 4–16 comprised Christina Daseking (head), Gamal El-Masry, Alejandro Guerson, and Magda Kandil (all WHD). Jonathan Fried (Executive Director) and Marco Espinosa (MCM) participated in the concluding discussions.

Contents Page

Tables

Figures

Boxes

Appendix

I. Background

1. **Barbados' economy benefits from strong institutions and social and political stability**. The country has one of the highest per capita incomes in the region, compares favorably on a wide range of social, political, and competitiveness indicators, and enjoys an investment grade rating. These factors have helped Barbados become a prime location for high-end tourism and offshore financial services. In January 2008, a new government was elected, with the Democratic Labour Party ending the Barbados Labour Party's 14 years in office.

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

	Barbados	Jamaica	Trinidad & Tobago
Economic indicators			
GDP per capita (USD 2007)	13,605	4,172	15,905
S&P sovereign rating (forex long-term debt)	BBB+	B	A-
Moody's sovereign (forex long-term debt)	Baa2	B1	Baa1
Social indicators 1/			
Human Development Index (UNDP, rank)	31	101	59
Health and Primary Education Index (WEF, rank)	9	72	62
Business climate 1/			
Global Competitiveness Index (WEF, rank)	50	78	84
Business Competitive Index (WEF, rank)	41	61	74
Regulatory Quality (WB, percentile)	76.6	58.5	71.2
Political indicators 1/			
Corruption Perception Index (TI, rank)	23	84	79
Political Stability (WB, percentile)	84.1	36.1	41.3
Rule of Law (WB, percentile)	83.3	33.3	48.1

Sources: IMF World Economic Outlook, World Bank Governance Indicators, World Economic Forum Indices, Transparency International, and UNDP.

1/ A low rank or high percentile indicate relative strength.

2. **As a small and open economy, however, Barbados lacks scope for diversification and is vulnerable to external shocks**. The country's trade openness and dependence on tourism and a few other services expose it to geopolitical tensions and cyclical swings. This has been reflected in significant output volatility, including a major crisis in the early 1990s and a recession after 9/11. Moreover, while the 33-year peg to the U.S. dollar enjoys strong support and credibility, vulnerabilities arise from high public debt and a sizeable current account deficit. Indeed, even though the exchange rate is currently close to its estimated equilibrium, and there are no apparent signs of competitiveness problems in the dominant tourism sector, an adjustment of domestic policies will be important over the medium term to contain external imbalances and preserve sustainability (Box 1).

3. **Last year's Article IV consultation focused on reducing these risks against the backdrop of a prospective opening of the capital account**. This step would have constrained further the conduct of monetary policy and placed an even larger burden of stabilization on fiscal policy. Key recommendations were:

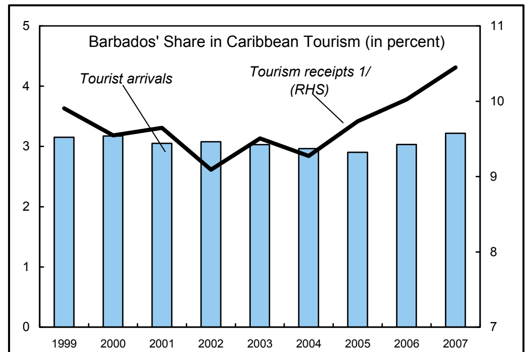
- *fiscal consolidation*, to support the buildup of international reserves and reduce public debt, so as to allow an effective policy response to shocks while safeguarding the sustainability of the peg;

- *adoption of market-based monetary policy instruments*, to manage domestic liquidity in a more volatile environment; and

Box 1. Barbados: Exchange Rate Assessment

Percent deviation from estimated equilibrium rate	
ERER	-1.1-6.4
ES	4.0

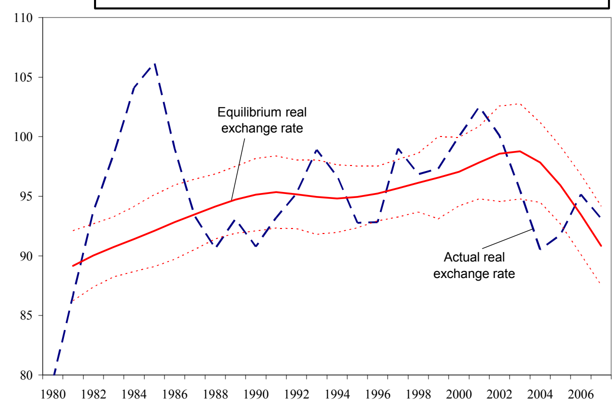
Barbados' exchange rate is currently not far from its estimated equilibrium but domestic policy adjustments will be needed to contain external imbalances over the medium term. This assessment is based on recent tourism performance and two quantitative methodologies—the equilibrium real exchange rate and a modified external sustainability approach. Together they suggest that under current policy plans, the real exchange rate is within a range of -1 to +6 percent around its equilibrium value.



Sources: Caribbean Tourism Organization and country authorities.
1/ The share in receipts is based on a smaller comparator market, including the Bahamas, the Dominican Republic, Jamaica, and the ECCU countries, which together with Barbados account for about half of Caribbean tourist arrivals.

Recent tourism developments suggest broadly adequate competitiveness. The country has maintained its share of Caribbean tourist arrivals, while tourism receipts have actually risen relative to regional competitors, reflecting Barbados' successes at the higher-end market segment.

The equilibrium real exchange rate approach implies a minor overvaluation. This method relies on a panel regression of actual exchange rates on a set of fundamentals, using a sample of tourism-dependent countries (i) in the Caribbean and (ii) across the world (IMF Country Report No. 08/96). For the former, the actual rate falls within the 95-percent confidence band around the equilibrium, with estimated deviations in the range of -1 to +6 percent and a point estimate of +2½ percent (overvaluation). The results for the larger sample of tourism-dependent countries are similar.



The external sustainability approach suggests the need for medium-term policy adjustment. This method focuses on the difference between the underlying current account and the current account that stabilizes a country's net international investment position (NIIP). In Barbados, complete NIIP data are not available, owing to capacity constraints. The authorities collect data on a subset of NIIP, however, which captures most of the country's net foreign debt and currently stands at 10 percent of GDP.[1] Stabilizing this net debt measure, shifts the focus to the current account deficit, minus net FDI inflows, which would have to decline to about ½ percent of GDP to keep the net external debt ratio constant. At the same time, there would be sizeable increases in equity liabilities from net FDI inflows that are not captured by this measure. This stabilizing position compares with a medium-term projection of 2 percent of GDP for the non-FDI financed current account deficit, which assumes a deteriorating external environment but also an improvement in the fiscal position under current policies. The additional current account adjustment of 1½ percentage points of GDP could be achieved by a real depreciation of about 4 percent, using standard trade elasticities scaled by openness. Alternatively, the same adjustment could be achieved by additional fiscal savings of about 3 percentage points of GDP—assuming that about half of the current account impact is offset by lower private savings. Without this additional fiscal adjustment, net external debt would be projected to stabilize at around 40 percent of GDP.

[1] The net foreign debt measure is derived as the sum of external public and private sector debt (non-bank), minus external assets of the National Insurance Scheme, minus NFA of the central bank and the commercial banks.

- *strengthening of financial sector regulation and supervision,* to guard against excessive exposures and spillovers under an open capital account.

4. **The new government faces the additional challenge of responding to a deteriorating external environment**. So far, Barbados has shown resilience to the financial turmoil in advanced markets, and economic performance has remained fairly robust (Box 2 and Figure 1). However, confronted with a weakening global environment; rising imported food prices; and growing fiscal losses from limited pass-through of record high oil prices, the government took a number of important decisions, including:

- a more *sequenced approach to capital account liberalization*, with a postponement of the previous administration's plan to remove controls on regional transactions early this year;

- a joint agreement with CARICOM partners to *eliminate or reduce the common external tariff* on selected food items on a temporary basis; and

- a large *adjustment in controlled prices for fuel products* to stem fiscal losses and reduce the distortion of price signals. This was later followed by a decision to grant limited tax rebates on diesel fuel to sectors hardest hit by the adjustment (e.g., farmers and fishermen).

II. Policy Issues

5. **The discussions focused on the appropriate mix of policies to balance the conflicting risks to inflation, growth, and medium-term sustainability**. At the current juncture, with significant price pressures and great uncertainties about the severity of the global slowdown and its impact on Barbados, the mission and the government broadly agreed on both the economic outlook and the following priorities for a coordinated policy response:

- ***Fiscal policy***. Identify areas for fiscal savings to create space for targeted support of the most vulnerable groups and reduce the high public debt ratio over the medium term.

- M***onetary policy***. Contain inflation expectations by resisting interest-rate reductions at the current juncture and making further cuts contingent on a sharper-than-expected slowdown in aggregate demand.

- ***Wage formation***. Support fiscal and monetary policies by promoting wage moderation within the established tripartite framework to minimize second-round effects of the oil and food price shocks.

- ***Financial sector policy***. Strengthen banking regulation, prudential oversight of the nonbank sector, and effective cross-country cooperation among regulators and supervisors.

Box 2. Barbados: Recent Developments and Short-Term Outlook

Thus far, the global financial turbulence has had little effect on Barbados, but a sustained economic slowdown in advanced economies could translate into weaker tourism receipts and FDI. Inflation was kept low by limited pass-through of high fuel prices. These have been adjusted recently, however, and as elsewhere, the government is under pressure to respond to rising food prices.

- **The financial turmoil in advanced economies has had little impact on Barbados' banks, thus far**. Banks remain liquid and do not appear exposed to the risky mortgage-backed securities or highly leveraged operations that have resulted in large losses at U.S. and European financial institutions.

- **Economic activity has remained fairly robust but is likely to slow in the course of this year**. The economy grew at a solid rate of 3¼ percent in 2007, with tourism performing well throughout the first quarter of 2008, helped by improved competitiveness vis-à-vis Europe and Canada. As a result, the current account deficit declined to 7¼ percent of GDP in 2007, and reserves rose to 4 months of imports. As the global slowdown takes hold of Barbados' main trading partners, however, tourism receipts are expected to weaken. A similar slackening is anticipated in the buoyant housing market for luxury houses, resulting in lower FDI inflows.

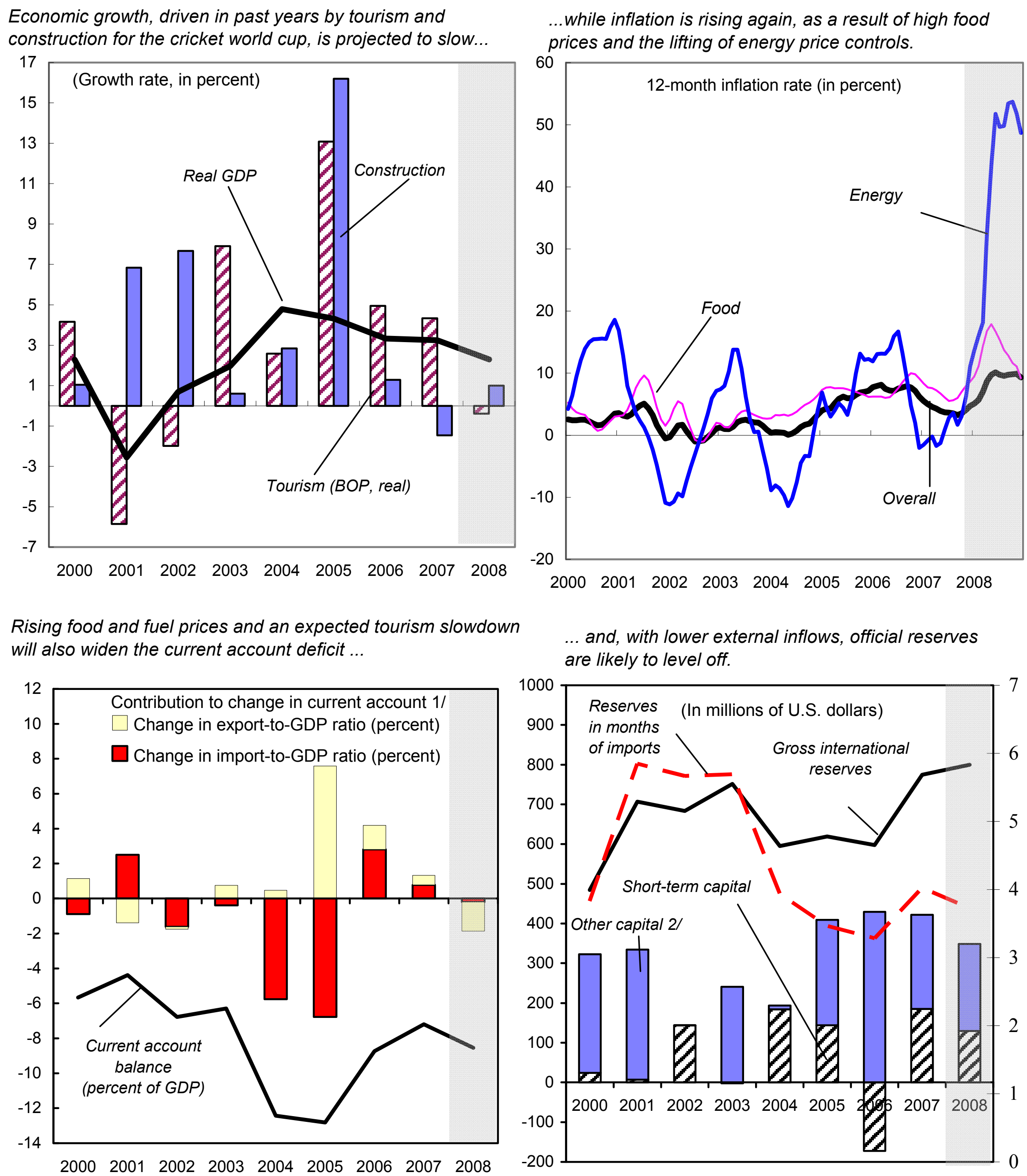
- **Downward-trending annual inflation rates masked pent-up price pressures that have recently been unleashed**. A freeze of retail fuel prices introduced in late 2006 helped reduce consumer inflation from 7½ percent in 2006 to 4 percent in 2007. However, it also resulted in large losses at the state-owned National Oil Company, in the range of 1–1¼ percent of GDP. To prevent further fiscal losses and price distortions, the new government decided in April to raise prices for individual oil products by some 25–75 percent. This adjustment, together with record high food prices, is now pushing up inflation, and world oil prices have risen further since.

Barbados: Main Economic Indicators, 2004-08
(In percent, unless otherwise indicated)

	2004	2005	2006	Prel. 2007	Proj. 2008
Real GDP growth	4.8	4.3	3.3	3.3	2.3
CPI inflation (average)	1.4	6.1	7.3	4.0	9.0
Current account (in percent of GDP)	-12.4	-12.8	-8.7	-7.2	-8.5
GIR (in months of imports)	3.9	3.5	3.3	4.0	3.7

Sources: Central Bank of Barbados; and Fund staff projections.

Figure 1. Barbados: Macroeconomic Developments, 2000-08

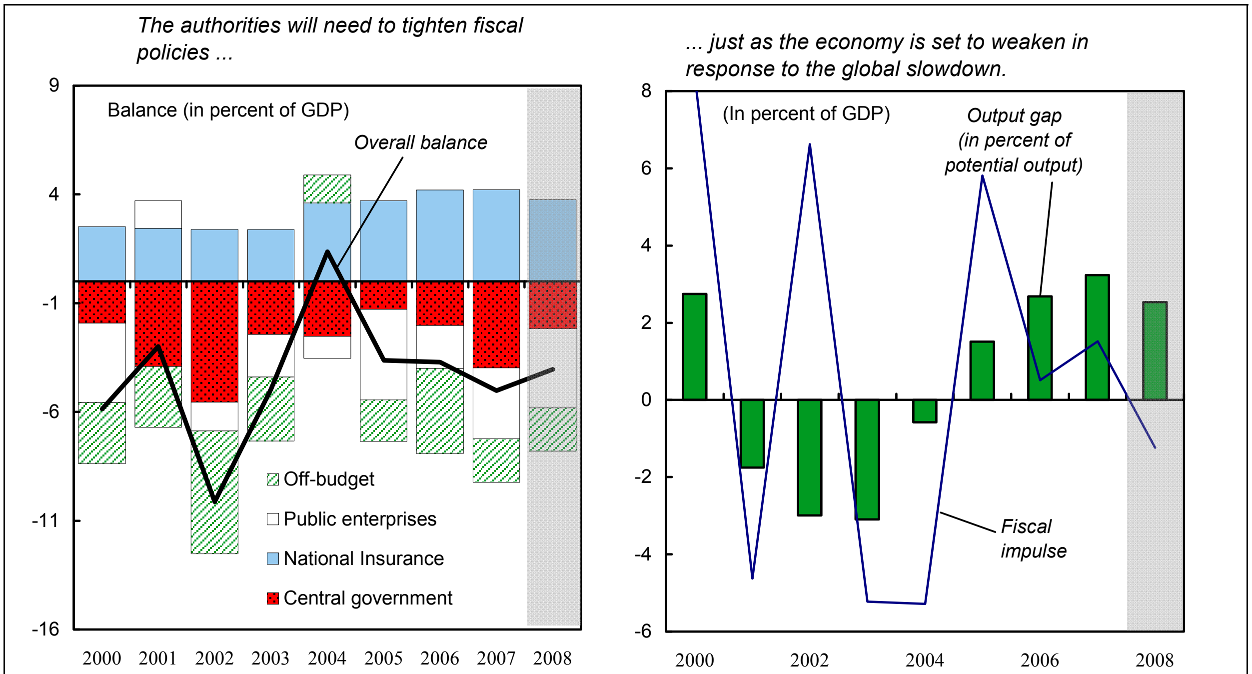


Sources: Central Bank of Barbados; and Fund staff projections.

1/ An increase in the export (import) ratio is shown as a positive (negative) contribution, and vice versa.
2/ Includes errors and omissions.

A. Fiscal Policy: Providing Support While Safeguarding Sustainability

6. **The new government stressed its commitment to fiscal prudence, with a view to balancing the central government accounts over the medium term**. A revised budget for this fiscal year will be presented to Parliament in early July. While specific measures remain to be announced, the authorities indicated that the new budget would stay within their earlier deficit target for the central government of 2¼ percent of GDP. The mission welcomed the implicit adjustment of about 1¾ percentage points of GDP in FY 2008/09, while pointing to the need to offset the combined effect of a likely economic slowdown and targeted support measures in the form of larger social assistance, a higher tax credit threshold, and a price rebate on diesel for selected sectors.

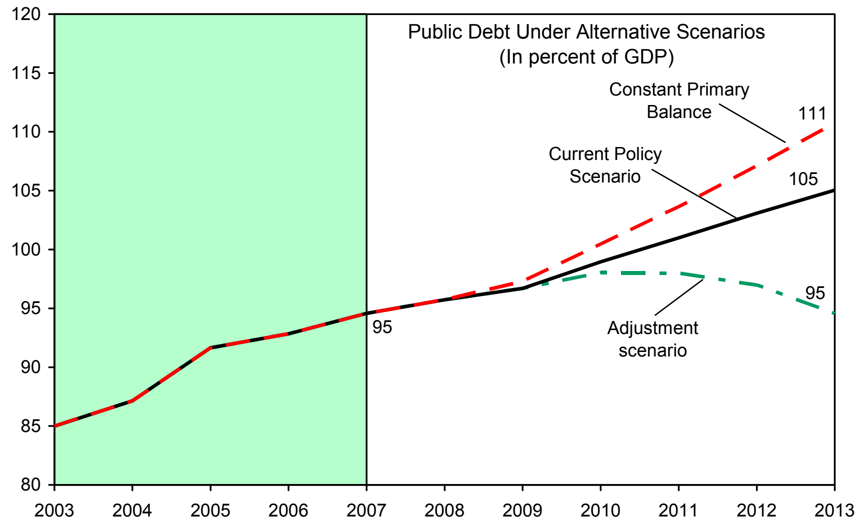


Sources: Central Bank of Barbados and Fund staff estimates and projections.

7. **Notwithstanding these commitments, current policies are unlikely to reverse the rising trend in the overall public debt ratio over the medium term**. Despite strong economic growth during the past three years, total public debt rose to 95 percent of GDP—or a still high 87 percent if earmarked sinking funds are netted out. As much of the recent increase reflected off-budget projects and deficits in public enterprises, the mission welcomed the government's decision to reassess the costs and benefits of earlier-planned projects, such as the multi-purpose sugar factory. Nevertheless, a projected fiscal adjustment of 3½ percentage points of GDP under current policies—1¾ percentage points assumed for 2007/08 and another 1¾ percentage point projected over the medium term, as a result of lower capital spending and

transfers to public enterprises—is unlikely to reverse the rising trend in the debt ratio. (Table 6 and Figure 2). A high probability for the debt ratio to rise and the need for a persistent adjustment in the primary balance are further confirmed by a stochastic analysis of the debt dynamics based on historical patterns (Box 3).

8. **Accordingly, the mission encouraged the authorities to adopt a more ambitious adjustment path, consistent with restoring a public sector surplus in the medium term**. Specifically, it recommended an additional tightening of 4 percentage points of GDP above the 3½ percentage points projected under current policies. This would generate a modest surplus in the public sector balance, bring the debt ratio back to its current level, and imply favorable debt dynamics beyond the medium term. In light of ongoing capital projects and the time needed for new measures to take effect, the additional adjustment would not be expected to begin before 2010. This phasing would also avoid a more pronounced fiscal withdrawal in 2009, when the effect of the global slowdown on the domestic economy is expected to be largest.



Source: Fund staff simulations.

Fiscal Adjustment Under Current and Alternative Policies (in percent of GDP)								
	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	Total Adjustment
			Current Policy Scenario					
NFPS balance,	-5.0	-4.0	-3.0	-2.7	-2.6	-2.6	-2.7	…
Balance, excl. NIS	-9.2	-7.8	-7.3	-7.2	-7.3	-7.3	-7.3	…
Primary balance, excl. NIS	-3.2	-1.3	-0.7	-0.4	-0.2	0.0	0.3	…
Adjustment (change in primary balance)	…	1.9	0.6	0.3	0.2	0.2	0.3	3.4
			Alternative Adjustment Scenario					
NFPS balance,	-5.0	-4.0	-3.0	-1.6	-0.4	0.7	1.9	…
Balance, excl. NIS	-9.2	-7.8	-7.3	-6.1	-5.1	-4.0	-2.7	…
Primary balance, excl. NIS	-3.2	-1.3	-0.7	0.6	1.8	3.0	4.2	…
Adjustment (change in primary balance)	…	1.9	0.6	1.3	1.2	1.2	1.2	7.4
Additional adjustment above Baseline	…	0.0	0.0	1.0	1.0	1.0	1.0	3.9

Source: Fund staff projections.

Box 3. Barbados: Stochastic Analysis of Fiscal Policy and Public Debt

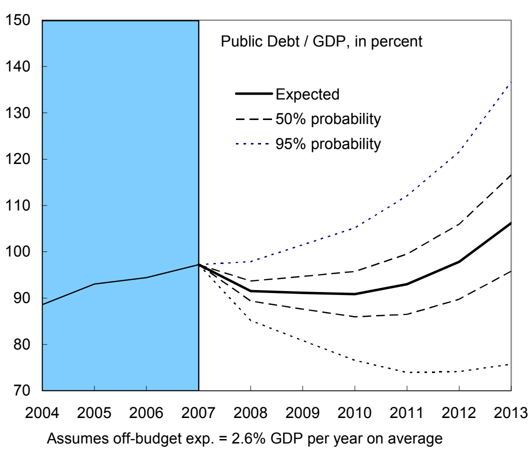
A simulation exercise incorporating the possibility of shocks reveals that, based on the historic experience of the past 27 years, the probability of rising public debt is high in the absence of persistent policy changes. The simulations indicate that a continuation of revenue and expenditure patterns observed in the past would have a 75 percent probability of raising the debt ratio above its 2007 level over the medium term.

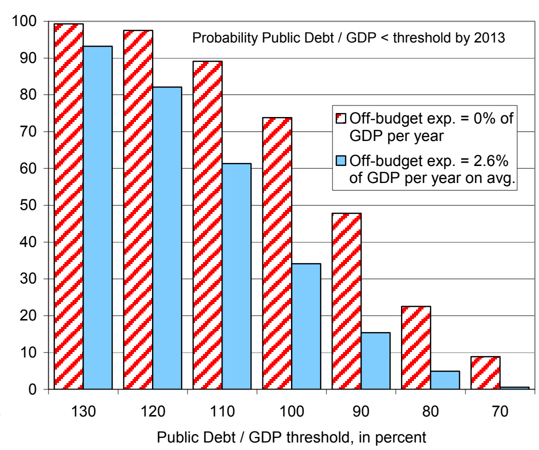
This result is obtained from a VAR model of the Barbadian economy and its fiscal dynamics. The estimated model includes as variables the real growth of the different components of the fiscal balance (tax revenue, primary and off-budget expenditures, and interest payments), real GDP growth, the real exchange rate, and the T-bill rate. It is used to generate a large number of simulated projections of the primary balance by generating shocks to these variables with the same properties (volatility, persistence and co-movement) as actual shocks during the period 1980-2007. The simulated series are then used to determine debt ratios based on the following identity:

$$d_t = \frac{(1+r_t)}{(1+g_t)} d_{t-1} - pb_t + oe_t ,$$

where d is the debt-to-GDP ratio, r is the real interest rate, g is real GDP growth, pb is the simulated primary balance as a share of GDP, and oe is off-budget expenditures as a share of GDP. Recursive substitution provides a large number of debt projections that can be tabulated to obtain probability distributions of debt dynamics for each simulated year (2008-13).

The results indicate that even in the most benign scenarios with positive shocks, the debt ratio is likely to increase. There is a 75 percent probability that the medium-term debt ratio will exceed its current level, assuming off-budget expenditures of 2.6 percent of GDP—which is the average observed during 2000-07. In this case, the model predicts an average debt ratio of 106 percent of GDP by 2013. The elimination of off-budget expenditures alone would reduce the probability of a deterioration in the debt ratio to one-third. Bringing the debt ratio on a firmly declining path, however, is likely to require a sustained change in the primary balance.





Source: IMF staff calculations, based on data provided by the Central Bank of Barbados.

9. **The authorities agreed with the mission on the need to reverse the rising trend in the public debt ratio over the medium term**. They pointed to the measures they had already taken as an indication of their resolve to restore fiscal prudence and alluded to additional measures in the forthcoming budget. Although gross financing needs of about 20 percent of GDP are significant, the mission agreed that rollover risks were mitigated by the high share of domestic liabilities in public debt and the fact that one-third of them are held by the National Insurance Scheme (Tables 3 and 6). Nevertheless, such risks could mount in a more challenging environment, particularly if the debt ratio continued to rise.

10. **The mission therefore urged the authorities to decide promptly on measures to generate the necessary fiscal savings, suggesting a number of options**.

On the expenditure side, the government could achieve savings by:

- *Better prioritizing new government projects*. This is crucial to contain debt creation outside the central government, whereby a consolidated presentation of all quasi-fiscal activities in the budget would provide additional scrutiny.

- *Adjusting prices of utilities and public services* to reduce the budgetary impact of across-the-board subsidies and mitigate costly price distortions. An automatic pass-through mechanism for fuel together with adjustments in regulated prices for other subsidized goods and services, such as natural gas, water, and transportation, could generate medium-term savings of perhaps 1–1½ percent of GDP.

- *Containing the public sector wage bill*. This will be important not only to support the government's adjustment efforts, but also to help mitigate second-round effects on inflation. A reduction by ½ percentage point of GDP would bring the wage bill back to its recent historic minimum of 10½ percent of GDP.

On the revenue side, measures could include:

- *Raising tax rates on offshore activities.* Maximum corporate tax rates for offshore businesses are at 2½ percent, compared with 25 percent for domestic companies, but generate about two-thirds of corporate tax revenues. Raising offshore tax rates by just 1 percentage point would still keep them at attractive levels, while generating additional revenues of up to 2 percent GDP.

- *Lifting the cap on the property tax*. Currently, property taxes are capped at an equivalent of US$30,000 a year. With a maximum tax rate of 0.75 percent, the cap becomes effective for properties valued at or above US$4 million, which is a buoyant market segment, dominated by non-residents. While the initial revenue impact of lifting the cap may not be large—perhaps on the order of ¼ percent of GDP—it would grow with the rate of property appreciation.

- *Reducing tax incentives for foreign investments.* Past estimates put the costs of the various incentive schemes at about 6 percent of GDP. Actions on this front could deliver additional revenue of perhaps 1–2 percent of GDP in the medium term, but would be most effective if coordinated with other countries in the region.

- *Improving tax administration*. Integration of the different domestic tax departments under a Central Revenue Authority, as envisaged by the government, will facilitate strategic policy implementation and should create some savings of perhaps ½–1 percent of GDP from synergies and improved compliance.

- *Adjusting the VAT*. Tax collection could also be strengthened through improvements in the VAT system, for example, by removing exemptions and extensive zero-ratings. Such actions could raise revenues by an estimated ¾–1¾ percentage points of GDP.

11. **The mission stressed that this list of measures, while not exhaustive, provided the government with choices**. Taken together, the measures could generate savings of about 5–9 percentage points of GDP over the medium term—well in excess of the mission's proposed additional adjustment of 4 percentage points. The authorities broadly agreed with the need for, and suggested magnitude of, medium-term fiscal savings. They also viewed subsidies as distortive and were open to further adjustments in controlled prices, as well as a possible lifting of the property tax cap, at a later stage. They were concerned, however, about raising international business taxes or the VAT in the current environment. Instead, the authorities saw room to raise non-tax revenues through fees and charges, with specific proposals to be included in the revised budget.

Possible Fiscal Adjustment Measures
(In perecent of GDP)

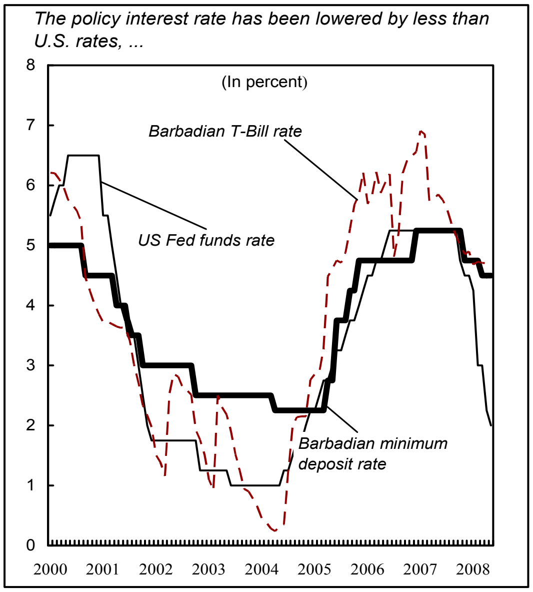
Measures	Time frame for Action 1/	Time frame for Results 1/	Savings
Expenditure measures			
Adjust subsidized prices	ST	ST / MT	1-1½
Contain public wages	ST	ST / MT	½
Revenue measures			
Raise corporate tax rates on offshore companies	ST	MT	1-2
Lift cap on property tax	ST	ST/MT	¼
Reduce tax incentives for foreign direct investments	MT	MT	1-2
Strengthen tax administration	ST / MT	MT	½-1
Adjust VAT	MT	MT	¾-1¾
Total potential fiscal savings			5-9

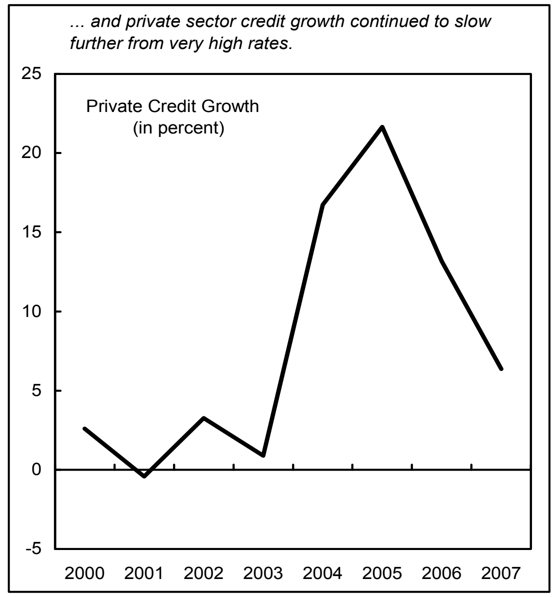
1/ Short term (ST); medium term (MT).
Source: Staff estimates.

B. Monetary Policy: Containing Inflation Expectations

12. **The mission endorsed the Central Bank of Barbados' cautious approach to adjusting its policy rate in response to the easing in the United States**. While historically, Barbados' minimum deposit rate has tracked the U.S. federal funds rate fairly closely, the CBB has lowered interest rates only twice in the past year, by 50 basis points in November 2007 and 25 basis points this March. As a result, the interest differential has risen to 250 basis points in April, or 130 basis points relative to the six-months LIBOR. Lending rates have only been lowered by 35 basis points, while private credit growth has continued to moderate.

Absent a surge in short-term capital inflows—which have been kept at bay by imperfect capital mobility and exchange controls—or signs of a sharper economic slowdown, the mission considered this policy appropriate to contain inflation expectations. While core inflation and wage growth seem to have been contained thus far, the authorities agreed that the outcome of upcoming wage negotiations will be an important factor going forward.

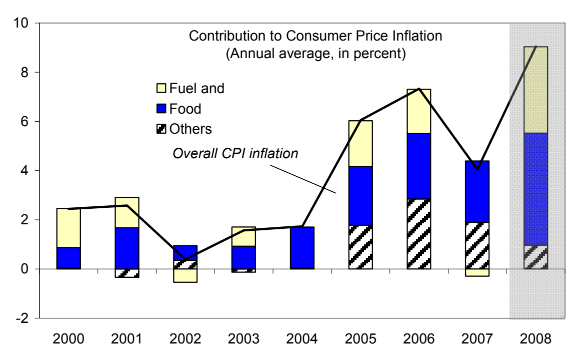




13. **The mission encouraged the authorities to continue preparations for introducing indirect policy instruments**. With the expectation that exchange controls for regional transactions would be removed early this year, the CBB was working on options for shifting from interest rate controls and reserve requirements to market-based policy instruments. Plans were well advanced to activate the discount facility, using repos and reverse repos, and to forecast liquidity. In parallel, the CBB was considering ways to build up a stock of securities for prospective open-market operations. While the mission understood the rationale for delaying the liberalization of the capital account until global markets have calmed, it encouraged the authorities to continue with the necessary preparations for the introduction of indirect policy instruments to be able to move forward as soon as practical.

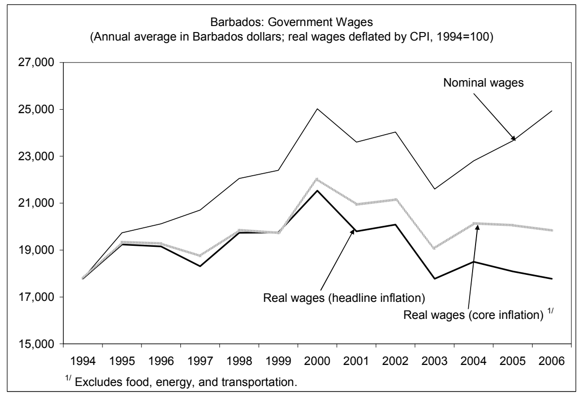
C. Wage Formation: Minimizing Second-Round Effects on Inflation

14. **The outcome of wage negotiations will play a decisive role for the effectiveness of other policies in addressing the current challenges**. With much of the recent rise in food and oil prices believed to be permanent, importing countries will have to adjust to the implied cut in real incomes. The faster this adjustment takes place, the smaller the



subsequent economic and social costs of persistent inflation. This calls for a coordinated policy response where properly targeted and stability-oriented fiscal and monetary policies are complemented by wage agreements that help contain second-round price pressures.

15. **The government agreed with the mission on the importance of wage moderation at the current juncture**. It noted that Barbados' tripartite framework of consultation between government, business, and trade unions has been successful in restoring and maintaining competitiveness, particularly after the severe crisis in the early 1990s. At that time, unions agreed to a nominal cut in public sector and a freeze in private sector wages to defend the peg to the U.S. dollar. Real wages also adjusted to the most recent economic shock in 2001. Thus, the government was hopeful that national consultations in mid-June would be successful in generating a consensus on wage moderation in the months ahead to prevent second-round price pressures and future job losses.



D. Financial Sector Policies: Strengthening Regulation and Supervision

16. **An FSAP update mission found a resilient financial system in the face of the global turmoil but also some weaknesses in its regulation and supervision**. The domestic banking system appears currently sound, profitable, and able to weather moderate shocks. It is also well insulated from the offshore sector, and the new deposit insurance scheme is a welcome addition to the safety net. Nevertheless, the mission identified a number of weaknesses in financial sector regulation and supervision that need to be addressed to contain future risks to financial stability. Its key recommendations are summarized in Box 4 and include:

- *Enhancing banking sector regulation.* While noting a number of important upgrades that have been implemented in recent years, the FSAP team recommended additional measures to enhance banking regulation, including in the areas of asset classification, provisioning requirements, and large exposure and related-party transactions.

- *Improving regulation and supervision of the nonbank financial sector,* which with assets of about 65 percent of GDP is nearly half the size of the banking sector. Currently, insurance companies rely largely on self regulation, which exposes the sector to material risks. For credit unions, which are currently under supervision of the Registrar of the Cooperatives, there is a need to step up joint inspections with the CBB. Establishment of a Financial Services Commission, with a clear mandate and structure to supervise the entire nonbank financial sector, should help remove these gaps.

Box 4. Key FSAP Update Recommendations[1]

1. Banking

- Update capital adequacy, classification of assets, and loss provision regulations.
- Issue aggregate-limit regulations for large exposures and related-party transactions to be applied on a consolidated basis, and licensing criteria for holding companies.
- With banks predominantly foreign owned, there is an urgent need to strengthen cross-border consolidated supervision and home/host collaboration, including by conducting simulated "fire drills" to help plan and exercise the response to a crisis.
- Improve the level of public awareness of the features and function of the new deposit insurance scheme.

2. Insurance

- Formalize regulation of the insurance sector.
- Improve the timeliness of supervisory returns, including by imposing fines for late-filing, and redesign processes for onsite inspection, and offsite analytical support.
- Given the sector's ever-growing cross-border activities and ownership dependence, strengthen the collaboration with regional authorities in the supervision of larger international conglomerates.

3. Credit Unions

- Resume joint on-sight examinations by the Central Bank of Barbados and the Registrar of the Cooperatives Department.
- Consider issuing a specialized Credit Union Law.

4. Securities Markets

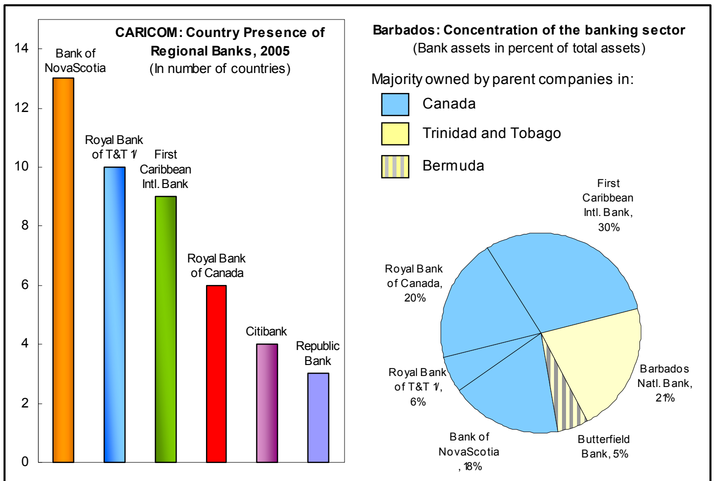
- Provide the Securities Commission with statutory power to make legally binding rules, inspect and access all information of regulated firms, share information and otherwise cooperate with domestic and foreign supervisors.
- Develop and implement a regular inspection program for regulated firms and require them to have adequate internal control- and risk-management policies and procedures.

5. Financial Services Commission

- With progress in the supervision of both the credit union and insurance sectors having come to a halt, and given the importance of bolstering the powers of the Securities Commission, the new government should promptly clarify its plans regarding the mandate and structure of the yet-to-be established Financial Services Commission.

[1] Based on the accompanying Financial System Stability Assessment.

- *Strengthening consolidated supervision and cross-border cooperation.* With the financial system dominated by regional banking groups and conglomerates, supervisors will need to cooperate actively across industries and with their counterparts in other Caribbean countries and in Canada, given the dominance of Canadian financial institutions in the region.



1/ The Royal Bank of Trinidad and Tobago is in the process of being acquired by the Royal Bank of Canada.
Source: Country authorities and Fund staff estimates.

III. Staff Appraisal

17. **The government is faced with the challenge of balancing conflicting risks to inflation, growth, and medium-term sustainability**. While direct spillovers from the financial turmoil have been contained, Barbados is likely to feel the delayed impact of weaker global demand on tourism, with repercussions on the rest of the economy. At the same time, the government is under pressure to respond to rising food and fuel prices, while high public debt is severely constraining its fiscal space. Moreover, whereas Barbados' real exchange rate is currently not far from its estimated equilibrium, domestic policy adjustments will be needed in the medium-term to contain external imbalances under the fixed exchange rate system. Addressing these challenges will require a coordinated response of fiscal, monetary, incomes, and financial sector policies.

18. **Fiscal policy will need to identify savings to finance targeted support to the most vulnerable groups, while containing risks to medium-term sustainability**. The government is planning to gradually eliminate the central government deficit, starting with a tightening of 1¾ percentage points of GDP this year. However, to reverse an otherwise deteriorating trend in the public debt dynamics and reduce external imbalances, the authorities will have to take additional measures that would shift a sizeable overall public sector deficit to a modest surplus by 2013. As savings will take time to build, it will be important to identify and commit to specific revenue and expenditure measures early on.

19. **Monetary policy should continue to focus on containing the risk of entrenching inflation expectations**. The CBB's decision to lower interest rates by only 75 basis points since last fall, has created a sizeable differential with U.S. rates. This comparatively tight stance is appropriate, in the absence of a surge in short-term capital inflows, to contain inflation expectations. Further easing of interest rates may be warranted at a later stage should there be signs of a more severe slowdown in economic activity. In the meantime, the

authorities should advance the preparation for introducing indirect monetary policy instruments to be ready for the shift once global financial markets have calmed.

20. **The outcome of wage negotiations will play an important part in determining the effectiveness of the overall policy response to the current challenges**. To the extent that the price increases are persistent, wage moderation, aimed at minimizing second-round effects of the oil and food price shocks, will be crucial to help the economy adjust in the least harmful way. For this reason, it is important to avoid wage indexation to currently high headline inflation rates.

21. **Risks to external and domestic stability can be further reduced by addressing identified weaknesses in prudential oversight of the financial sector**. The authorities should, therefore, swiftly implement the main recommendations of the FSAP update mission. Besides a number of important provisions to strengthen banking regulation and cross-border cooperation, priority should be given to improving the much weaker prudential oversight of the non-bank sector.

22. **The provision of macroeconomic data is broadly adequate for surveillance.** However, efforts should be made to improve the coverage and timeliness of national accounts, monetary, and balance of payments data, including the net international investment position.

23. **It is recommended to hold the next consultation on the standard 12-month cycle**.

Table 1. Barbados: Selected Economic, Financial, and Social Indicators

I. Social and Demographic Indicators (most recent year)

Population (people in millions)	0.274	Adult literacy rate	99.4
Per capita GDP (in US$)	12,426	Population share below poverty line	13.0
Life expectancy at birth in years	75.4	Gini coefficient	42.0
Rank in UNDP Development Index	31	Unemployment rate	7.4

Main products, services and exports: tourism, financial services, rum, sugar, and chemicals.

II. Economic Indicators

	2004	2005	2006	Prel. 2007	Proj. 2008	2009
	(Annual percentage change)					
National accounts and prices						
Real GDP	4.8	4.3	3.3	3.3	2.3	2.0
Deflator	-0.2	2.3	2.8	3.5	8.7	5.7
Nominal GDP	4.5	6.7	6.2	6.8	11.2	7.8
CPI inflation (average)	1.4	6.1	7.3	4.0	9.0	5.9
CPI inflation (end of period)	4.3	7.3	5.7	4.8	8.6	3.2
Domestic demand (contribution to growth)	7.8	-2.8	-2.7	0.8	1.9	3.5
Foreign demand (contribution to growth)	-3.1	7.1	6.0	2.5	0.4	-1.5
External sector						
Exports of goods and services	5.5	21.8	8.6	7.8	8.3	5.4
Imports of goods and services	14.8	17.9	2.0	5.6	11.5	6.0
Real effective exchange rate (average)	-5.2	1.3	3.8	3.7	...	...
Terms of trade	-3.4	-5.9	-3.8	-0.3	-3.5	0.8
Money and credit (end of period)						
Net domestic assets	43.5	14.1	14.2	9.3	0.2	15.8
Of which: private sector credit	16.7	21.7	13.2	6.4	2.5	7.8
Broad money	17.4	6.9	11.3	13.2	2.8	13.7
Velocity (GDP relative to broad money)	1.2	1.2	1.1	1.1	1.2	1.1
Interest rate on deposits (average in percent per annum)	2.5	4.1	4.7	5.1	4.5	4.5
Interest rate on loans (average in percent per annum)	9.8	10.6	10.7	10.7	10.4	10.4
	(In percent of GDP, unless otherwise indicated)					
Public finances (fiscal year)						
Nonfinancial public sector overall balance	1.4	-3.6	-3.7	-5.0	-4.0	-3.0
Central Government						
Revenue and grants	33.1	35.1	34.2	34.9	35.3	35.1
Expenditure	35.7	36.4	36.3	38.9	37.5	37.3
Interests	4.6	4.8	5.0	4.9	5.2	5.1
Balance	-2.5	-1.3	-2.0	-4.0	-2.2	-2.2
NIS	3.6	3.7	4.2	4.2	3.8	4.3
Public enterprises	-1.0	-4.2	-2.0	-3.3	-3.6	-3.3
Off-budget activities	1.3	-1.9	-3.9	-2.0	-2.0	-1.8
Primary balance	4.5	-0.1	0.0	-1.4	-0.1	0.7
Debt						
Total external debt 1/	39.5	41.3	43.4	39.6	41.2	42.6
Public sector (fiscal year)	87.1	91.6	92.8	94.6	95.7	96.7
External	27.3	28.9	27.6	24.2	26.0	25.6
Domestic	59.8	62.8	65.2	70.4	69.7	71.1
Savings and investment						
Gross domestic investment	23.7	24.8	26.6	26.8	22.1	22.1
Public	7.5	6.9	7.6	7.5	5.6	5.6
Private	16.2	18.0	19.0	19.4	16.5	16.5
National savings	11.2	12.0	17.9	19.6	13.6	13.8
Public	8.9	3.2	3.9	1.0	1.6	2.5
Private	2.4	8.8	14.0	18.7	12.0	11.2
External savings	12.4	12.8	8.7	7.2	8.5	8.3
Balance of payments						
Current account	-12.4	-12.8	-8.7	-7.2	-8.5	-8.3
Capital and financial account	6.9	13.6	8.1	12.4	9.2	7.8
Official capital	-1.8	3.4	1.5	-1.2	1.7	1.5
Private capital 2/	8.6	10.2	6.6	13.6	7.5	6.3
Of which: long-term flows	1.2	1.0	13.7	9.7	4.9	4.0
Overall balance	-5.6	0.8	-0.7	5.2	0.7	-0.5
Memorandum items:						
Exchange rate (domestic currency/U.S. dollar)	2.0	2.0	2.0	2.0	2.0	2.0
Nominal GDP (in millions of Barbados dollars)	5,634	6,010	6,382	6,818	7,582	8,173

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

1/ Includes public sector and nonfinancial private sector debt.
2/ Includes short-term and long-term flows, and errors and omissions.

Table 2. Barbados: NonFinancial Public Sector Operations 1/

(In percent of GDP, unless otherwise indicated)

		Prel.	Proj.					
	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
Public sector								
Current revenue	41.1	41.0	40.5	40.7	40.7	40.7	40.6	40.6
Current expenditure	37.6	41.6	39.8	39.4	39.3	39.4	39.5	39.5
Interest to the private sector	4.9	4.9	5.4	5.4	5.6	5.8	5.9	6.1
External	1.9	1.5	2.3	1.9	1.9	1.9	1.9	1.9
Domestic	3.0	3.3	3.1	3.5	3.7	3.9	4.0	4.2
Capital revenue	2.9	2.9	3.0	3.2	3.3	3.6	3.7	3.6
Of which : interest from the private sector	1.2	1.3	1.5	1.6	1.7	1.9	2.0	1.8
Capital expenditure	6.3	5.3	5.7	5.7	5.7	5.7	5.7	5.7
Balance	**0.2**	**-3.0**	**-2.1**	**-1.2**	**-1.0**	**-0.8**	**-0.8**	**-1.0**
Off-budget activity balance	**-3.9**	**-2.0**	**-2.0**	**-1.8**	**-1.8**	**-1.8**	**-1.8**	**-1.8**
Off-budget investment	-3.3	0.1	-0.5	-1.0	-1.0	-1.0	-1.0	-1.0
PPPs	-1.2	-2.3	-1.6	-0.8	-0.9	-0.9	-0.9	-0.9
Funds	0.6	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Overall balance	**-3.7**	**-5.0**	**-4.0**	**-3.0**	**-2.7**	**-2.6**	**-2.6**	**-2.7**
Of which : **primary balance**	**0.0**	**-1.4**	**-0.1**	**0.7**	**1.1**	**1.3**	**1.3**	**1.5**
Central government								
Current revenue	34.2	34.9	35.3	35.1	35.2	35.2	35.2	35.2
Current expenditure	32.3	35.6	34.5	34.2	34.3	34.4	34.3	34.3
Of which : interest payments	5.0	4.9	5.2	5.1	5.2	5.3	5.3	5.4
External	1.7	1.4	2.0	1.6	1.6	1.5	1.5	1.5
Domestic	3.4	3.5	3.2	3.5	3.6	3.8	3.8	4.0
Capital revenue and grants	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Capital expenditure and net lending	4.0	3.4	3.0	3.0	3.0	3.0	3.0	3.0
Balance	**-2.0**	**-4.0**	**-2.2**	**-2.2**	**-2.1**	**-2.2**	**-2.1**	**-2.2**
National Insurance				2.1	2.4	2.4	2.4	2.4
Current revenue	7.1	7.6	6.5	6.6	6.5	6.5	6.4	6.4
Current expenditure	5.3	6.0	5.4	5.2	5.1	5.1	5.2	5.2
Capital revenue	2.3	2.5	2.6	2.9	3.0	3.3	3.4	3.3
Of which: interest revenues from central government	1.1	1.2	1.1	1.2	1.3	1.4	1.4	1.5
Capital expenditure	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Balance	**4.2**	**4.2**	**3.8**	**4.3**	**4.5**	**4.7**	**4.7**	**4.5**
Public enterprises balance 1/	**-2.0**	**-3.3**	**-3.6**	**-3.3**	**-3.3**	**-3.3**	**-3.3**	**-3.3**
Total financing	**3.7**	**5.0**	**4.0**	**3.0**	**2.7**	**2.6**	**2.6**	**2.7**
Foreign financing	**1.0**	**0.9**	**2.0**	**1.3**	**1.2**	**1.3**	**1.2**	**1.2**
Central government	1.3	1.2	1.2	0.6	0.6	0.6	0.6	0.6
Disbursements	2.3	0.5	1.4	1.0	3.0	0.7	0.7	0.6
Amortization	-2.2	-1.6	-1.4	-1.0	-3.0	-0.7	-0.7	-0.6
Privatization receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Public enterprises	-0.3	-0.3	0.8	0.7	0.7	0.6	0.6	0.6
Domestic financing	**2.7**	**4.1**	**2.1**	**1.7**	**1.5**	**1.3**	**1.4**	**1.6**
Central government	5.2	4.9	3.0	3.4	3.4	3.4	3.4	3.5
Public enterprises	2.3	3.6	2.9	2.6	2.7	2.7	2.7	2.8
National Insurance Scheme (NIS)	-4.2	-4.2	-3.8	-4.3	-4.5	-4.7	-4.7	-4.5
Funds	-0.6	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Memorandum item:								
Nominal fiscal year GDP (In Barbados dollars, mln)	6,491	7,009	7,730	8,284	8,740	9,240	9,750	10,296

Sources: Ministry of Finance; and Fund staff estimates.

1/ Fiscal year (April–March). Ratios expressed relative to fiscal-year GDP.

Table 3. Barbados: Public Sector Debt 1/

	2006/07	Prel. 2007/08	Proj. 2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
	(In millions of Barbados dollars)							
Public sector	**6,025**	**6,628**	**7,400**	**8,011**	**8,649**	**9,331**	**10,052**	**10,816**
External	1,793	1,695	2,011	2,122	2,230	2,350	2,469	2,589
Domestic	4,233	4,934	5,389	5,888	6,419	6,981	7,582	8,227
Central government	**5,069**	**5,444**	**5,933**	**6,267**	**6,613**	**6,985**	**7,380**	**7,799**
External 2/	**1,586**	**1,509**	**1,765**	**1,816**	**1,864**	**1,924**	**1,983**	**2,043**
Domestic	**3,484**	**3,935**	**4,168**	**4,451**	**4,749**	**5,061**	**5,397**	**5,757**
Short Term	635	844	750	804	848	896	946	999
Long term	2,849	3,091	3,418	3,647	3,901	4,165	4,451	4,758
Government guaranteed	**956**	**1,185**	**1,467**	**1,744**	**2,036**	**2,346**	**2,672**	**3,016**
External 2/	207	186	246	306	366	426	486	546
Domestic	749	999	1,220	1,438	1,670	1,919	2,185	2,470
	(In percent of GDP)							
Public sector	**92.8**	**94.6**	**95.7**	**96.7**	**99.0**	**101.0**	**103.1**	**105.0**
External	27.6	24.2	26.0	25.6	25.5	25.4	25.3	25.1
Domestic	65.2	70.4	69.7	71.1	73.4	75.5	77.8	79.9
Central government	**78.1**	**77.7**	**76.7**	**75.6**	**75.7**	**75.6**	**75.7**	**75.7**
External 2/	**24.4**	**21.5**	**22.8**	**21.9**	**21.3**	**20.8**	**20.3**	**19.8**
Domestic	**53.7**	**56.1**	**53.9**	**53.7**	**54.3**	**54.8**	**55.3**	**55.9**
Short Term	9.8	9.7	9.7	9.7	9.7	9.7	9.7	9.7
Long term	43.9	46.4	44.2	44.0	44.6	45.1	45.6	46.2
Government guaranteed	**14.7**	**16.9**	**19.0**	**21.1**	**23.3**	**25.4**	**27.4**	**29.3**
External 2/	3.2	2.7	3.2	3.7	4.2	4.6	5.0	5.3
Domestic	11.5	14.2	15.8	17.4	19.1	20.8	22.4	24.0
Memorandum items:								
NIS financial assets	37.6	39.1	39.3	41.0	43.6	46.1	48.5	46.0
NIS holdings of central government debt	18.0	19.3	19.1	19.6	20.2	20.8	21.4	22.0
Public sector debt less NIS assets	55.2	55.5	56.4	55.7	55.4	54.9	54.5	59.1
Public sector debt less NIS holdings	74.8	75.2	76.6	77.1	78.7	80.2	81.7	83.1
Assets held in earmarked sinking funds	7.6	7.8	7.9	8.0	8.2	8.4	8.6	8.7
Public debt, excl. sinking funds	85.2	86.7	87.8	88.7	90.7	92.6	94.5	96.3

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

1/ Fiscal year (April–March). Ratios expressed relative to fiscal-year GDP.

Table 4. Barbados: Balance of Payments
(In millions of U.S. dollars)

		Prel.	Proj.					
	2006	2007	2008	2009	2010	2011	2012	2013
Current account	**-279**	**-245**	**-324**	**-339**	**-345**	**-347**	**-347**	**-331**
Exports	1,994	2,149	2,326	2,451	2,588	2,740	2,895	3,060
Imports	2,187	2,310	2,575	2,730	2,874	3,025	3,179	3,327
Exports of goods	465	485	506	530	561	596	634	674
Of which: re-exports	195	210	221	232	248	265	285	305
Imports of goods	1,468	1,536	1,739	1,835	1,934	2,036	2,140	2,235
Services (net)	810	891	984	1,025	1,088	1,155	1,222	1,293
Credit	1,529	1,664	1,820	1,921	2,027	2,144	2,261	2,385
Of which: travel (credit)	967	1,044	1,130	1,177	1,244	1,315	1,386	1,462
Debit	719	774	836	895	939	989	1,039	1,093
Investment income (net)	-171	-191	-180	-161	-167	-175	-183	-191
Credit	96	104	102	110	116	123	130	137
Debit	266	295	283	272	283	298	313	328
Of which: interest on public debt	52	50	71	69	68	70	73	75
Current transfers (net)	85	107	106	102	108	114	120	127
Credit	142	164	163	180	190	201	212	223
Debit	56	57	57	78	82	87	91	96
Capital and financial account	**251**	**374**	**349**	**320**	**359**	**361**	**366**	**358**
Long-term	486	290	252	224	248	263	276	288
Public sector	48	-41	66	61	54	58	60	60
Private sector	437	332	186	163	194	205	216	228
Of which: FDI flows	437	332	186	163	194	205	216	228
Short-term	-172	185	130	126	141	127	120	100
Public sector	0	0	0	0	0	0	0	0
Private sector	-172	185	130	126	141	127	120	100
Change in commercial banks assets	-63	-101	-32	-30	-30	-30	-30	-30
Errors and omissions	**7**	**48**	**0**	**0**	**0**	**0**	**0**	**0**
Overall balance (deficit -)	**-21**	**177**	**25**	**-19**	**14**	**14**	**19**	**27**
Reserve movements (- increase)	**21.3**	**-176.8**	**-25.2**	**18.8**	**-14.5**	**-14.3**	**-18.8**	**-26.7**
Memorandum items:								
Current account (percent of GDP)	-8.7	-7.2	-8.5	-8.3	-8.0	-7.6	-7.2	-6.5
Current account after FDI (percent of GDP) 2/	5.0	2.5	-3.6	-4.3	-3.5	-3.1	-2.7	-2.0
Exports of G&S (annual growth rate)	8.6	7.8	8.3	5.4	5.6	5.9	5.7	5.7
Imports of G&S (annual growth rate)	2.0	5.6	11.5	6.0	5.3	5.3	5.1	4.7
Gross international reserves (in US $ million)	598	775	800	781	795	810	829	855
In months of imports	3.3	4.0	3.7	3.4	3.3	3.2	3.1	3.1
In percent of short-term liabilities 1/	53.5	59.6	56.4	48.6	46.9	45.0	43.2	42.4
In percent of short-term liabilities, excluding banks	117.6	112.4	98.9	78.2	73.1	68.0	63.3	60.7

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

1/ Includes maturing public sector short-term external debt, banks' short-term foreign liabilities, and an estimate of nonbank short-term foreign liabilities based on capital account inflows since 2003.

2/ A positive number indicates net FDI inflows in excess of the current account deficit.

Table 5. Barbados: Selected Vulnerability Indicators

(In percent of GDP, unless otherwise indicated)

	2004	2005	2006	Prel. 2007	Proj. 2008	2009
Real sector indicators						
Travel receipts	27.5	29.8	30.3	30.6	29.8	28.8
Fiscal indicators 1/						
Public sector debt	87.1	91.6	92.8	94.6	95.7	96.7
External	27.3	28.9	27.6	24.2	26.0	25.6
Domestic	59.8	62.8	65.2	70.4	69.7	71.1
Public sector external debt service	3.7	2.1	3.7	3.2	3.3	2.8
Public sector external debt service, in percent of revenues	8.4	4.6	8.5	7.3	7.7	6.4
Interest	4.3	0.6	3.7	3.3	4.3	3.9
Amortization	4.1	4.0	4.8	4.0	3.4	2.5
External indicators						
Gross international reserves (in millions of US dollars)	595.2	619.2	597.9	774.6	799.8	781.0
In months of imports	3.9	3.5	3.3	4.0	3.7	3.4
In percent of short-term liabilities 2/	103.6	68.0	53.5	59.6	56.4	48.6
In percent of short-term liabilities, excl. banks	271.4	170.9	117.6	112.4	98.9	78.2
In percent of narrow money	61.5	61.6	52.8	62.0	64.6	49.3
External debt 3/	39.5	41.3	43.4	39.6	41.2	42.6
External interest payments, in percent of exports 4/	10.0	9.3	9.6	9.7	8.8	9.0
External amortization payments on public debt, in percent of exports	3.4	2.9	3.4	2.8	2.4	1.9

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

1/ On a fiscal-year basis, including central government, public enterprises, and National Insurance Scheme.
2/ Includes maturing public sector short-term external debt, banks' short-term foreign liabilities, and an estimate of nonbank short-term foreign liabilities based on capital account inflows since 2003.
3/ Includes public sector and nonbank private debt.
4/ Includes interest payments on public and private external debt.

Table 6. Barbados: Public Sector Debt Sustainability Framework, 2003–13
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing primary balance 9/
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	
1 **Baseline: Public sector debt 1/**	85.0	87.1	91.6	92.8	94.6	**95.7**	**96.7**	**99.0**	**101.0**	**103.1**	**105.0**	**2.1**
Of which : foreign-currency denominated	27.2	27.3	28.9	27.6	24.2	26.0	25.6	25.5	25.4	25.3	25.1	
2 Change in public sector debt	-2.9	2.2	4.5	1.2	1.7	1.2	1.0	2.3	2.0	2.1	2.0	
3 Identified debt-creating flows (4+7+12)	-2.4	-1.9	2.0	2.4	2.4	-1.0	0.9	2.2	1.9	2.0	1.8	
4 Primary deficit	1.7	-3.0	1.6	1.8	3.2	1.3	0.7	0.4	0.2	0.0	-0.3	
5 Revenue and grants	47.1	47.1	48.6	50.6	50.8	51.7	51.7	51.8	51.8	51.8	51.8	
6 Primary (noninterest) expenditure	48.8	44.1	50.2	52.4	53.9	53.0	52.4	52.2	52.0	51.8	51.6	
7 Automatic debt dynamics 2/	-0.6	1.1	0.4	0.6	-0.8	-2.3	0.2	1.8	1.8	2.0	2.1	
8 Contribution from interest rate/growth differential 3/	-0.6	1.1	0.4	0.6	-0.8	-2.3	0.2	1.8	1.8	2.0	2.1	
9 *Of which:* contribution from real interest rate	1.6	4.9	3.7	3.4	1.8	-0.4	2.1	4.3	4.7	4.9	5.0	
10 *Of which:* contribution from real GDP growth	-2.2	-3.8	-3.3	-2.9	-2.6	-1.9	-1.9	-2.5	-2.9	-2.9	-2.9	
11 Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	
12 Other identified debt-creating flows	-3.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
13 Privatization receipts (negative)	-3.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2-3) 5/	-0.5	4.0	2.5	-1.2	-0.6	2.2	0.1	0.1	0.1	0.1	0.1	
Public sector debt-to-revenue ratio 1/	180.4	185.0	188.4	183.6	186.2	185.3	187.1	190.9	194.8	198.8	202.6	
Gross financing need 6/	18.6	14.3	20.1	19.4	19.9	20.2	17.4	19.4	17.2	17.2	17.1	
in billions of U.S. dollars	0.5	0.4	0.6	0.6	0.7	0.8	0.7	0.8	0.8	0.8	0.9	
Scenario with key variables at their historical averages 7/						**95.7**	**98.8**	**102.1**	**105.6**	**109.1**	**112.8**	**3.0**
Scenario with no policy change (constant primary balance) in 2008-2013						**95.7**	**97.3**	**100.5**	**103.6**	**107.1**	**110.7**	**2.3**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	2.6	4.7	4.1	3.3	3.0	2.2	2.1	2.8	3.1	3.0	3.0	
Average nominal interest rate on public debt (in percent) 8/	7.0	6.5	7.0	7.0	7.1	7.6	7.4	7.5	7.6	7.6	7.8	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	2.0	6.1	4.6	4.1	2.2	-0.3	2.5	4.8	5.1	5.2	5.2	
Nominal appreciation (increase in U.S. dollar value of local currency, in percent)	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	4.9	0.4	2.4	2.9	4.8	7.9	4.9	2.7	2.5	2.5	2.5	
Growth of real primary spending (deflated by GDP deflator, in percent)	-6.6	-5.3	18.6	7.8	6.0	0.4	1.0	2.4	2.8	2.6	2.5	
Primary deficit	1.7	-3.0	1.6	1.8	3.2	1.3	0.7	0.4	0.2	0.0	-0.3	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

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

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

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

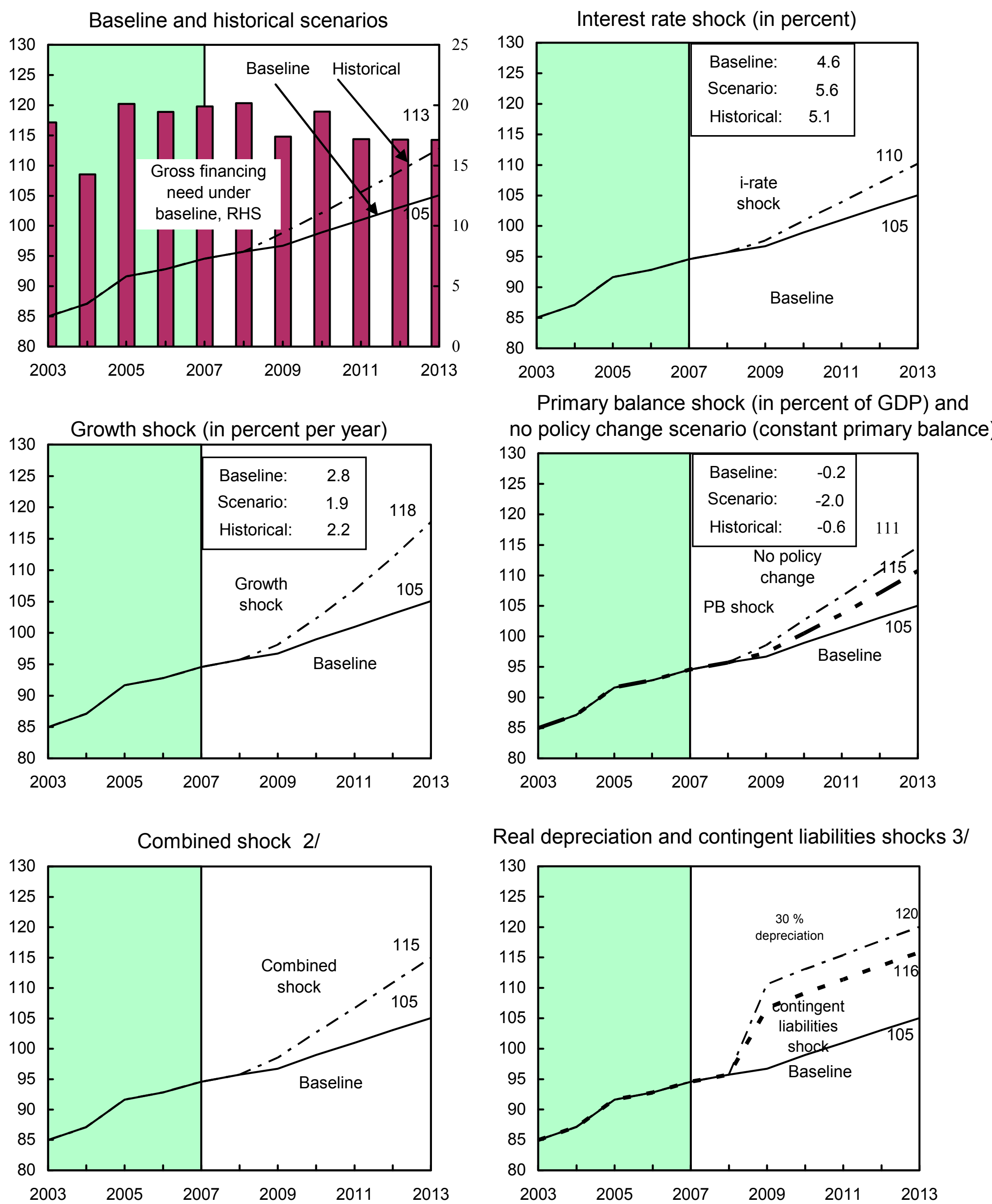
5/ For projections, this line includes exchange rate changes.

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.

Figure 2. Barbados: Public Debt Sustainability, Bound Tests 1/
(Public debt in percent of GDP)



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

Table 7. Barbados: External Debt Sustainability Framework, 2003–13
(In percent of GDP, unless otherwise indicated)

		Actual					Projections						Debt-stabilizing non-interest
		2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	current account 6/
1	**Baseline: External debt**	43.9	39.5	41.3	43.4	39.6	**41.2**	**42.6**	**44.3**	**45.3**	**46.0**	**46.1**	**-2.2**
2	Change in external debt	-1.4	-4.3	1.8	2.1	-3.8	1.6	1.4	1.7	1.0	0.7	0.1	
3	Identified external debt-creating flows (4+8+9)	-3.1	9.3	9.3	-7.4	-5.3	2.8	3.5	2.5	1.8	1.4	0.7	
4	Current account deficit, excluding interest payments	2.0	9.7	9.7	4.4	2.9	3.8	3.6	3.3	2.9	2.5	1.8	
5	Deficit in balance of goods and services	5.8	11.1	10.2	6.1	4.7	6.6	6.8	6.6	6.3	5.9	5.3	
6	Exports	53.0	53.5	61.1	62.5	63.0	61.4	60.0	60.1	60.1	60.2	60.3	
7	Imports	58.8	64.6	71.3	68.5	67.7	67.9	66.8	66.7	66.4	66.1	65.5	
8	Net nondebt creating capital inflows (negative)	-5.7	-1.2	-1.0	-13.7	-9.7	-4.9	-4.0	-4.5	-4.5	-4.5	-4.5	
9	Automatic debt dynamics 1/	0.6	0.8	0.6	1.9	1.5	4.0	3.9	3.6	3.4	3.5	3.4	
10	Contribution from nominal interest rate	4.2	2.7	3.1	4.3	4.3	4.8	4.7	4.7	4.7	4.7	4.7	
11	Contribution from real GDP growth	-0.8	-2.0	-1.6	-1.3	-1.3	-0.8	-0.8	-1.1	-1.3	-1.3	-1.3	
12	Contribution from price and exchange rate changes 2/	-2.9	0.1	-0.9	-1.1	-1.5	...	...	...	...	...	...	
13	Residual, incl. change in gross foreign assets (2-3) 3/	1.7	-13.7	-7.5	9.5	1.5	-1.2	-2.1	-0.8	-0.8	-0.7	-0.6	
	External debt-to-exports ratio (in percent)	82.7	73.9	67.6	69.5	62.9	67.2	71.1	73.7	75.3	76.4	76.6	
	Gross external financing need (in billions of US dollars) 4/	0.2	0.4	0.4	0.3	0.3	0.4	0.4	0.5	0.4	0.4	0.4	
	in percent of GDP	8.1	14.2	14.2	10.2	8.9	10.0	9.4	10.6	8.9	7.9	7.2	
	Scenario with key variables at their historical averages 5/						**41.2**	**42.4**	**44.0**	**45.6**	**47.3**	**49.4**	**-1.9**
	Key Macroeconomic Assumptions Underlying Baseline												
	Real GDP growth (in percent)	2.0	4.8	4.3	3.3	3.3	2.3	2.0	2.6	3.2	3.0	3.0	
	GDP deflator in U.S. dollars (change in percent)	6.8	-0.2	2.3	2.8	3.5	8.7	5.7	2.7	2.5	2.4	2.5	
	Nominal external interest rate (in percent)	10.2	6.5	8.3	11.0	10.6	13.4	12.2	11.6	11.3	11.1	10.8	
	Growth of exports (U.S. dollar terms, in percent)	10.4	5.5	21.8	8.6	7.8	8.3	5.4	5.6	5.9	5.7	5.7	
	Growth of imports (U.S. dollar terms, in percent)	9.5	14.8	17.9	2.0	5.6	11.5	6.0	5.3	5.3	5.1	4.7	
	Current account balance, excluding interest payments	-2.0	-9.7	-9.7	-4.4	-2.9	-3.8	-3.6	-3.3	-2.9	-2.5	-1.8	
	Net non-debt creating capital inflows	5.7	1.2	1.0	13.7	9.7	4.9	4.0	4.5	4.5	4.5	4.5	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in U.S. dollar terms, g = real GDP γροωτη ρατε, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

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

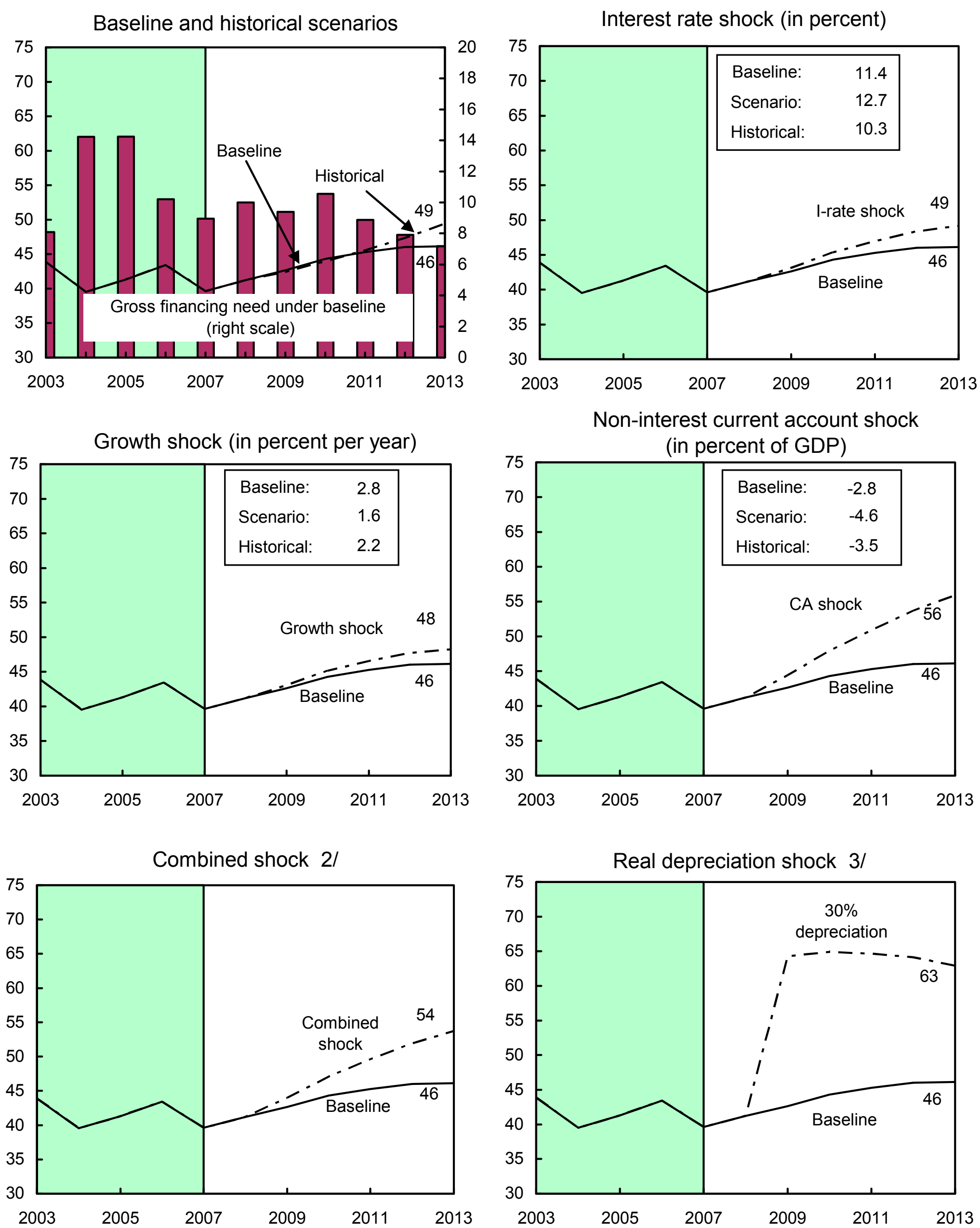
3/ For projection, line includes the impact of price and exchange rate changes.

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 3. Barbados: External Debt Sustainability, Bound Tests 1/
(External debt in percent of GDP)



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

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

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

3/ One-time real depreciation of 30 percent occurs in 2009.

APPENDIX I. BACKGROUND AND SUMMARY OF APPENDICES

Discussion. The 2008 Article IV consultation discussions were held in Barbados during June 4-6, 2008. The staff team comprised C. Daseking (head), G. El-Masry, A. Guerson, and M. Kandil (all WHD). Jonathan Fried (Executive Director for Barbados) and Marco Espinosa (mission chief for the FSAP Update mission, MCM) participated in the wrap-up meeting. The mission met with Senator Hon. Darcy Boyce, Minister of State for Finance and Energy; Dr. Marion Williams, Governor of the Central Bank of Barbados; government officials; and representatives of the private sector, labor unions, and the opposition.

Exchange Rate Arrangements. Barbados accepted the obligations of Article VIII, Sections 2, 3, and 4 on November 3, 1993, and there are no restrictions on the making of payments and transfers for current international transactions. The Barbados dollar has been pegged to the U.S. dollar since mid-1975 at BDS$2.00 = US$1.00.

Fund Relations.

- **Financial assistance**. Barbados has no outstanding purchases and loans with the Fund. The last financial arrangement was a Stand-by Arrangement for the period 02/07/1992 to 05/31/1993 totaling SDR 23.9 million, of which SDR 14.7 million was drawn.

- **Recent technical assistance**:
    - In January 2008, a mission from the Statistics Department visited Barbados on monetary and financial statistics.
    - In March 2008, a mission from the Fiscal Affairs Department visited Barbados and provided assistance in the administration of indirect taxes and customs.
    - CARTAC is currently assisting the Barbados Statistics Services on rebasing, and improving the coverage of, national accounts.

Relations with the World Bank Group. The World Bank just recently concluded an HIV/AIDS awareness and prevention project. A successor project, totaling US$35 million, which is expected to be approved in the second half of 2008 would support the implementation of the 2008–2013 Barbados National HIV/AIDS Strategic Plan.

Relations with the Inter-American Development Bank (IDB). The IDB's Country Strategy with Barbados for the period 2005–08 is focused on public sector reforms and improving competitiveness. The IDB's current Barbados portfolio totals US$129 million, comprising US$3.3 million in technical assistance grants and US$125.9 million in investment loans.

Relations with the Caribbean Development Bank (CDB). Since 1970 the CDB has provided Barbados with loans and grants totaling US$276 million in support of the productive sectors, economic infrastructure, health and education. In 2006, a technical assistance loan of US$3.5 million was approved.

INTERNATIONAL MONETARY FUND

BARBADOS

Staff Report for the 2008 Article IV Consultation—Informational Annex

Prepared by the Western Hemisphere Department

July 8, 2008

Contents Page

Appendices

APPENDIX I. BARBADOS—FUND RELATIONS

As of May 31, 2008

I. **Membership Status**: Joined 12/29/1970; Article VIII

II. **General Resources Account**:	SDR million	Percent Quota
Quota	67.50	100.00
Fund holdings of currency	61.92	91.73
Reserve position in Fund	5.58	8.27

III. **SDR Department**:	SDR million	Percent of Allocation
Net cumulative allocation	8.04	100.00
Holdings	0.12	1.52

IV. **Outstanding Purchases and Loans**: None

V. **Financial Arrangements**:

Type	Approval date	Expiration date	Amount approved (SDR million)	Amount drawn (SDR million)
Stand-by	02/07/1992	05/31/1993	23.89	14.67
Stand-by	10/01/1982	05/31/1984	31.88	31.88

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

	Forthcoming				
	2008	2009	2010	2011	2012
Principal					
Charges/Interest	0.16	0.24	0.24	0.24	0.24
Total	0.16	0.24	0.24	0.24	0.24

VII. **Exchange Rate Arrangements**:

The Barbados dollar has been pegged to the U.S. dollar since mid-1975 at BDS$2.00 = US$1.00. On May 31, 2008, the official buying and selling rates for the U.S. dollar were BDS$1.98 and BDS$2.04, respectively, per US$1.

There are no restrictions on the making of payments and transfers for current international transactions subject to approval under Article VIII. There are exchange controls on some invisibles, but bona fide transactions are approved. All capital outflows and certain capital inflows require approval. The authorities accepted the obligations of Article VIII, Sections 2, 3, and 4 on November 3, 1993.

VIII. **Last Article IV Consultation**

The streamlined 2007 Article IV consultation discussion was concluded by the Executive Board on September 10, 2007; and the Staff Report was issued as IMF Country Report No. 07/315. Barbados is on the standard 12-month consultation cycle.

IX. **Technical Assistance (2004-08)**:

Department	**Dates**	**Purpose**
CARTAC	Ongoing	Rebasing national accounts
FAD	March 2008	Administration of indirect taxes and customs
CARTAC	January 2008	Revenue collection enforcement
STA	January 2008	Monetary and financial statistics
STA	December 2006	Monetary and financial statistics
STA	September 2005	Multi-sector statistics advisor.
CARTAC	March 2004	Regional BOP methodology course.
FAD	September 2004	Tax policy.
CARTAC	January 2004	Development of supply and use tables.

X. **Resident Representative**:

The resident representatives post was closed in January 1995.

APPENDIX II. BARBADOS—RELATIONS WITH THE WORLD BANK
(As of end-May 2008)

1. The World Bank just recently concluded an HIV/AIDS awareness and prevention project. A successor program would support the implementation of the 2008–2013 Barbados National HIV/AIDS Strategic Plan, specifically to promote: (i) adoption of safe behaviors, in particular amongst the most vulnerable groups; (ii) access to prevention, treatment and social care, in particular for the most vulnerable groups; (iii) capacity of organizational and institutional structures that govern the NAP; and (iv) use of quality data for problem identification, strategy definition and measuring results. The estimated amount is US$35 million and is expected to become effective in the second half of 2008.

Summary of World Bank Loans, Credits, and Grants
(In millions of U.S. dollars)

	IBRD	IDA Credits	IDA Grants	Total
Original principal	118.4	0.0	0.0	118.4
Cancellations	16.8	0.0	0.0	16.8
Disbursed	101.5	0.0	0.0	101.5
Undisbursed	0.0	0.0	0.0	0.0
Repaid	85,9	0.0	0.0	85,9
Due	14.3	0.0	0.0	14.3
Exchange adjustment	0.0	0.0	0.0	0.0
Borrower obligation	14.3	0.0	0.0	14.3

APPENDIX III. BARBADOS—RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK
(As of end-May 2008)

Loan approvals by the Inter-American Development Bank (IDB) to Barbados have averaged around US$9 million annually since the IDB was formed in 1959. Disbursements have averaged around US$7 million. Net flows have entered into negative territory in recent years, owing to a slow-down in project implementation.

(US$ million)	2000	2001	2002	2003	2004	2005	2006	2007
Loan approvals	0.0	8.7	17.0	0.0	0.0	4.4	0	5
Loan disbursements	10.4	24.2	15.8	16.0	7.9	4.4	2.2	2.8
Net cash flow	**-6.9**	**8.2**	**0.5**	**-3.2**	**-13.3**	**-14.8**	**-19.4**	**-19.4**
Debt outstanding	**127.0**	**143.9**	**151.6**	**156.6**	**150.7**	**150.1**	**140.6**	**133.0**

The IDB's Country Strategy with Barbados for the period 2005–08 is focused upon the areas of public sector reform and competitiveness. The IDB's current portfolio in the country totals US$129 million, consisting of US$3.3 million in technical assistance grants and US$125.9 million in investment loan operations.

Name	Approval Date	Amount in US$	
		Approved	Disbursed
Education Sector Enhancement Program	1998	60,034,063	34,871,896
Administration of Justice	2001	8,750,000	823,096
Coastal Infrastructure Program	2002	17,000,000	3,548,731
Modernization of Customs, Excise and VAT	2005	4,400,000	236,516
Housing and Neighbourhood Upgrading Programme (Project Prep. Facility)	2006	688,000	68,000
Modernization of the Barbados National Standards System	December 2007	5,000,000	0
Housing and Neighbourhood Upgrading Program - Phase I	January 2008	30,000,000	0
Total		125,872,063	39,548,239

Three new investment loan projects are scheduled for approval before the end of 2008, for a total value of US$28.1 million.

Lending Program 2008 (Public Sector)	**Amount (in US$ millions)**
Modernization of National Procurement System	4.1
Agricultural Health and Food Safety	9.0
Competitiveness Program	10.0
Modernization of the Statistical Service	5.0
Total 2008	28.1

APPENDIX IV. BARBADOS—RELATIONS WITH THE CARIBBEAN DEVELOPMENT BANK
(As at end-May 2008)

The Caribbean Development Bank (CDB) approved US$276.0 million in loans, contingent loans, equity, and grants to Barbados between 1970 and May 2008. This represents 9.3 percent of total approvals to CDB's borrowing member countries.

Of the total funds approved US$78.7 million or 28.5 percent were allocated to the productive sectors which comprise agriculture, manufacturing, tourism, and mining. Within the productive sectors, US$45.5 million, or 16.5 percent of the total, was allocated to the manufacturing sector, while tourism accounted for US$28.9 million, or 10.5 percent.

Economic infrastructure accounted for US$143.8 million or 52.1 percent of approved funds. Of these funds, US$88.1 million (31.9 percent) were allocated to the transportation, US$50.2 million (18.2 percent) to the education, and US$3.2 million (1.2 percent) to the health sectors.

Approximately US$13.5 million in new loans (multisector) was approved in 2003 while no new loans were approved in 2004 and 2005. In 2006, a technical assistance loan of US$3.5 million was approved. No new loan was approved from January 2007 to May 2008.

CDB Loans and Grants Approved to Barbados
1970−May 2008

Sector	US$ million	Percent
Productive sector	**78.7**	**28.5**
Agriculture	4.2	1.5
Manufacturing	45.5	16.5
Tourism	12.0	10.5
Mining	0.1	0.0
Economic infrastructure	**143.8**	**52.1**
Power and energy	0.1	0.0
Water	0.8	0.3
Transportation	88.1	31.9
Housing	1.4	0.5
Education	50.2	18.2
Health	3.2	1.2
Multisector	**53.5**	**19.4**
Total	**276.0**	**100.0**

Source: Caribbean Development Bank.

APPENDIX V. BARBADOS—STATISTICAL ISSUES

1. While data provision has some shortcomings, it is broadly adequate for surveillance purposes. Barbados participates in the General Data Dissemination System, with metadata and the authorities' plans for improving the statistical base posted on the Fund's Dissemination Standards Bulletin Board.

Real Sector

2. The Barbados Statistical Services compiles national accounts statistics according to the 1968 SNA manual. A lack of current, reliable source data on nonsugar agriculture, private construction, and nontourism service activities affects production-based GDP estimates. To address some of the weaknesses in this area the authorities initiated a census of economic activity in June 2005. The census covered tourism, financial businesses, and transport and communications. Expenditure-based GDP estimates are derived from selected surveys; the household survey yields a reliable estimate of aggregate consumption, but the external trade and investment surveys suffer from certain weaknesses. Constant price GDP estimates, compiled by the central bank, have an outdated 1974 base year; the authorities are currently updating the base year to 2000 in order to facilitate comparison within the Caribbean Community area. Because of these deficiencies, it is likely that GDP is underestimated by as much as 25-50 percent. The authorities, with the assistance of CARTAC, are currently working on revising the national accounts statistics.

3. Despite recent initiatives to update the consumer price index and the index of industrial production, potential misalignments in real estate prices are not addressed due to the absence of a systematic index of property prices. The consumer price index uses an expenditure basket for 1998–99 for its July 2001=100 series introduced in January 2002. The index of industrial production is based on the sectoral weights from 1982; the authorities are currently working towards rebasing the series to 1994.

Government finance statistics

4. Fairly comprehensive and up-to-date above-the-line data are available for the general government, but there is a lag in the reporting of transfers. As a result of the incomplete coverage of off-budget transactions, a discrepancy exists between the overall balance and financing data. Public enterprise data are not systematically and promptly reported to the Ministry of Finance and Economic Affairs. Financial sector data on public sector net domestic borrowing usually cannot be fully reconciled with above-the-line fiscal data, partly because of limited availability of nonbank financial sector information. The authorities introduced accrual accounting of public finance in April 2007.

5. There has been a pause in the reporting of annual and subannual fiscal data for dissemination in the Fund's publications. Consolidated annual general government data were reported through 2004 for publication in the *Government Finance Statistics Yearbook*, and subannual budgetary central government data were reported through December 2006 for *IFS*.

Monetary and financial statistics

6. Important weaknesses remain with respect to the overall quality, coverage, and timeliness of the monetary and financial statistics. The 2007 and 2008 STA missions found that the quality of monetary and financial statistics was compromised by various methodological problems, misclassifications, and the inconsistent application of residency criterion. The missions recommended correcting a number of misclassifications of accounting data, assisted the Central Bank of Barbados (CBB) in compiling the standardized report forms (SRFs), and established a framework for an Integrated Monetary Database (IMD). The January 2008 follow-up mission compiled a comprehensive depository corporations survey, which included all depository corporations except money-market mutual funds (MMMFs), for which data were unavailable. The mission finalized the SRF-based returns for reporting data for all deposit-taking financial institutions to the CBB. The CBB has recently started compiling monetary statistics based on the SFRs, which include comprehensive detailed depository corporations' data. They were submitted to STA in March 2008.

External sector statistics

7. Lags in the compilation of merchandise trade data, in particular, information on the activities of the offshore sector, limit the timeliness of the external current account balance estimates. Estimates of the components of the external financial account need to be improved, including data on the net international investment position. Quarterly balance of payments estimates are no longer provided for publication in the IFS. Flows affecting net foreign assets should be recorded above the line and accounted for in foreign reserve movements.

BARBADOS: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

As of June 27, 2008

	Date of latest observation	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]	3/31/08	4/29/08	M	M	W
Reserve/Base Money	3/31/08	5/04/08	M	M	M
Broad Money	2/28/08	5/04/08	M	M	M
Central Bank Balance Sheet	3/31/08	5/04/08	M	M	M
Consolidated Balance Sheet of the Banking System	2/28/08	5/04/08	M	M	M
Interest Rates[2]	3/31/08	6/19/08	M	M	M
Consumer Price Index	03/08	6/04/08	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	3/31/08	6/05//08	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	03/31/08	6/05/08	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	03/31/08	6/05/08	Q	Q	Q
External Current Account Balance	12/07	5/12/08	A	A	Q
Exports and Imports of Goods and Services	12/07	5/12/08	A	A	M
GDP/GNP	2007	6/05/08	A	A	Q
Gross External Debt	12/31/07	4/15/08	A	A	M
International Investment Position[6]					

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] 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 a vis nonresidents.
[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).

Statement by the Staff Representative on Barbados
July 25, 2008

1. This statement updates the Board on developments in Barbados since the issuance of the staff report (7/8/2008), including the main policy initiatives announced in the Prime Minister's budget presentation on July 7, which do not change the thrust of the staff appraisal.

2. **Recent data are consistent with the staff's projections for 2008**. The latest national accounts estimates confirm the staff's projections of a significant slowdown in economic activity in 2008. Following a buoyant first quarter, preliminary data for the second quarter suggest a marked weakening in growth, led in particular by the construction and tourism sectors. Accordingly, the authorities now expect the economy as a whole to grow by 2–2½ percent during 2008, consistent with staff projections of 2.3 percent. The authorities also expect an acceleration in inflation to about 8 percent (compared with 9 percent projected by staff).

3. **The revised budget proposals are also broadly consistent with the fiscal stance for FY 2008/09, as presented in the staff report**. The new proposals include increases in taxes on alcohol, tobacco, and gambling, and a wide range of nontax revenues, such as fees on vehicles, professional services, and mobile telephones. These measures are estimated by the authorities to provide additional revenue of about 1.3 percent of GDP on an annual basis. The government proposes to use this fiscal space to finance additional expenditures and tax rebates to targeted groups, estimated to cost 1.1 percent of GDP. These expenditures include: raising the old-age pensions and welfare payments to low-income recipients; providing free bus transportation for school children; zero-rating of VAT for building materials for low-income housing; and supporting agriculture, energy conservation, and alternative energy production. Incorporating these measures into the revised projections for the central government balance implies a deficit of 2 percent of GDP in FY 2008/09, slightly lower than the deficit projected in the staff report of 2.2 percent of GDP.

4. **The government has also decided to adopt an automatic adjustments for fuel prices**. Effective August 2008, prices on petroleum products and natural gas will be regularly adjusted on the basis of a predetermined formula, and without any political involvement. Accordingly, fuel prices are expected to be increased in August, and such regular adjustments are likely to prevent a deterioration in the overall public sector balance that would have otherwise occurred as a result of losses by the National Oil Company.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 08/111
FOR IMMEDIATE RELEASE
August 27, 2008

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

IMF Executive Board Concludes 2008 Article IV Consultation with Barbados

On July 25, 2008, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Barbados.[1]

Background

Barbados' economy benefits from strong institutions and social and political stability. The country has one of the highest per capita incomes in the region, compares favorably on a wide range of social, political, and competitiveness indicators, and enjoys an investment grade rating. These factors have helped Barbados become a prime location for high-end tourism and offshore financial services. As a small and open economy, however, Barbados lacks scope for diversification and is vulnerable to external shocks. The country's trade openness and dependence on tourism and a few other services expose it to geopolitical tensions and cyclical swings. Moreover, while the 33-year peg to the U.S. dollar enjoys strong support and credibility, vulnerabilities arise from high public debt and a sizeable current account deficit.

Barbados has weathered the global financial turmoil well, thus far, but a deteriorating external environment is posing significant challenges to the new government, elected in January. Fairly solid growth in 2007 continued through the first quarter of 2008, driven by strong tourism activity and helped by improved competitiveness vis-à-vis Europe and Canada. However, as the global slowdown is increasingly taking hold of Barbados' main trading partners, economic growth is

[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.

expected to decline by 1 percentage point to 2¼ percent in 2008. Inflation, which was kept low by price controls, is projected to accelerate this year. The spike reflects record high import prices, particularly for oil and food, in conjunction with the recent adjustment in controlled fuel prices, which had been kept unchanged since late-2006. As a result, inflation is projected to rise to 9 percent this year from 4 percent in 2007. At the same time, the rising import bill and the slowdown in tourism will widen the current account deficit to a projected 8½ percent of GDP from 7 percent in 2007.

Executive Board Assessment

Executive Directors noted that Barbados has benefited from strong institutions and social and political stability. Directors observed that the Barbadian authorities are faced with a significant challenge of balancing conflicting risks to inflation, growth, and medium-term sustainability. While direct spillovers from the financial turmoil have been contained, Directors cautioned that weaker global demand could affect the Barbadian economy primarily through its important tourism sector, at a time when inflation has been pushed up by rising food and fuel prices. With the exchange rate pegged to the U.S. dollar and fiscal space constrained by high public debt, Directors stressed the importance of addressing these challenges through a coordinated policy response.

Directors saw the main task for fiscal policy in identifying savings to finance targeted support to the most vulnerable groups, while containing risks to medium-term sustainability. They welcomed the recently revised budget, which combines a reduction in the central government deficit with well-identified revenue measures to finance additional social and other priority spending. Directors encouraged the government to make additional efforts to generate a modest overall public sector surplus over the medium term, to reverse unfavorable debt dynamics and put public debt on a firmly declining trajectory. As fiscal savings could take time to materialize, Directors advised the authorities to identify specific revenue and expenditure measures early on. They welcomed the recent adoption of an automatic fuel price adjustment mechanism as an important step in this direction.

Directors saw the main role for monetary policy in containing the risk of entrenching inflation expectations, and deemed the current policy stance as appropriately tight. However, a reduction in interest rates may become necessary should a more severe slowdown in economic activity be accompanied by easing of inflationary pressures. Directors also encouraged the authorities to advance preparations for introducing indirect monetary policy instruments, to be ready for their implementation once global financial markets have calmed.

Directors viewed the outcome of wage negotiations as critical in determining the effectiveness of the overall policy response to the current challenges. Wage moderation was needed to minimize second-round effects of the oil and food price shocks and thereby help the economy adjust in the least harmful way. Directors warned specifically about the risks of wage indexation to currently high headline inflation rates.

Directors agreed that the 33-year peg of the exchange rate to the U.S. dollar enjoys strong support and credibility and has served the economy well. The real effective exchange rate is currently not far from its estimated equilibrium, and there are no apparent signs of competitiveness problems in the dominant tourism sector. Directors stressed, however, that adjustments in domestic policies will be important in the medium term to contain external imbalances.

Directors welcomed the Financial Sector Assessment Program (FSAP) update finding that the financial system remains resilient in the face of the global turmoil. To ensure that Barbados' financial sector continues to thrive, they encouraged the authorities to address the identified weaknesses in its prudential oversight and to implement the key recommendations of the FSAP update mission. In addition to a number of important provisions to strengthen banking regulation and cross-border cooperation, Directors recommended that priority be given to removing the gaps in the supervision of the nonbank sector.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2008 Article IV Consultation with Barbados is also available.

Barbados: Selected Economic Indicators

	2004	2005	2006	Prel. 2007	Proj. 2008	2009
	(Annual percentage change)					
Output and prices						
Real GDP	4.8	4.3	3.3	3.3	2.3	2.0
Nominal GDP	4.5	6.7	6.2	6.8	11.2	7.8
Consumer prices	1.4	6.1	7.3	4.0	9.0	5.9
Money and credit						
Net domestic assets	43.5	14.1	14.2	9.3	0.2	15.8
Of which: private sector credit	16.7	21.7	13.2	6.4	2.5	7.8
Broad money	17.4	6.9	11.3	13.2	2.8	13.7
	(In percent of GDP, unless otherwise indicated)					
Public sector operations 1/						
Overall balance	1.4	-3.6	-3.7	-5.0	-4.0	-3.0
Central government balance	-2.5	-1.3	-2.0	-4.0	-2.2	-2.2
Off-budget activities	1.3	-1.9	-3.9	-2.0	-2.0	-1.8
National Insurance Scheme balance	3.6	3.7	4.2	4.2	3.8	4.3
Public enterprises balance	-1.0	-4.2	-2.0	-3.3	-3.6	-3.3
Primary balance	4.5	-0.1	0.0	-1.4	-0.1	0.7
Public sector debt 2/	87.1	91.6	92.8	94.6	95.7	96.7
External sector						
External current account balance	-12.4	-12.8	-8.7	-7.2	-8.5	-8.3
External debt 3/	27.3	28.9	27.6	24.2	26.0	25.6
Gross international reserves (in millions of U.S. dollars)	595	619	598	775	800	781
Memorandum item:						
Nominal GDP (in millions of Barbados dollars)	5,634	6,010	6,382	6,818	7,582	8,173

Sources: Barbadian authorities; and IMF staff estimates and projections.
1/ Fiscal year (April–March).
2/ Includes central government and government guaranteed debt.
3/ Includes public sector and nonfinancial private sector debt; end of fiscal year.