INTERNATIONAL MONETARY FUND

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# THE BAHAMAS

July 2015

## 2015 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

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 2015 Article IV consultation with The Bahamas, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 8, 2015 consideration of the staff report that concluded the Article IV consultation with The Bahamas.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 8, 2015, following discussions that ended on March 20, 2015, with the officials of The Bahamas on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 21, 2015.
- An **Informational Annex** prepared by the IMF staff.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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June 10, 2015

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

**IMF Executive Board Concludes 2015 Article IV Consultation with The Bahamas**

On June 8, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with The Bahamas.[1]

Real GDP expanded by an estimated 1 percent in 2014 on the back of increased tourist arrivals, but growth remains well below pre-global crisis levels. Supported, in part, by rising US economic activity, air arrivals grew by almost 5 percent in 2014 and applied room rates improved by 7 percent. Domestic demand has been weighed down by the weak macroeconomic outlook, high household indebtedness, and high unemployment which stood at 15.7 percent in November 2014. Inflation rose to 2.2 percent in January 2015 (1.2 percent in December 2014), as the imposition of the value added tax (VAT) offset the effects of declining oil prices.

The fiscal deficit in FY2013/14 is estimated to have narrowed to 3.3 percent of GDP from 5.4 percent in FY2012/13. Revenue was lower-than-budgeted, but a substantial reduction in current spending resulted in an overall fiscal deficit below the budget target. The debt GDP ratio is estimated to have reached 61 percent in FY2013/14 from 56 percent in FY2012/13.The external current account continues to record sizable deficits, 22 percent of GDP in 2014, reflecting the large import component of the Baha Mar resort project. International reserves totaled US$839 million at end-March 2015, equivalent to 2.3 months of next year's projected imports of goods and services. Nonperforming loans remain elevated at 16 percent of total loans at end-March 2015, and continues to constrain private sector credit growth. While domestic banks continue deleveraging, the banking sector remains well capitalized and liquid.

Growth is expected to strengthen over 2015–16 with the improvement in US activity and the opening of Baha Mar but significant structural impediments remain. Potential GDP growth is estimated at about 1½ percent over the medium term, insufficient to generate a significant reduction in the high unemployment rate. Absent structural reforms, including in the labor market and the energy sector, significantly higher growth than currently projected will be required to absorb new entrants to the labor force and reduce the unemployment rate to single digits over the medium term. The full opening of Baha Mar and two smaller projects, together

[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.

with the strengthening US economy could represent a major boost to exports in the near-term. Beyond 2016, growth would taper off as US growth decelerates, and the base effects from the opening of Baha Mar fade. Inflation is expected to remain low, but VAT implementation early this year would add an estimated 2½ percentage points to the CPI. Over the medium term, the external current account deficit would return to single digits as construction-related outflows are anticipated to be replaced by a rise in travel services receipt. Risks to the outlook continue to be tilted to the downside, necessitating continued fiscal consolidation, and implementation of structural measures to strengthen competitiveness, raise potential growth and lower unemployment.

**Executive Board Assessment**

Executive Directors noted that the economy is recovering but the outlook remains challenging. Despite the U.S. recovery and the imminent opening of the Baha Mar resort, growth is expected to remain below pre-global crisis levels, and the current account deficit remains elevated. Against this backdrop, Directors called for structural reforms to strengthen competitiveness, raise potential growth, and lower unemployment; and for continued efforts to strengthen the fiscal position.

Directors underscored the importance of finalizing and implementing the National Development Program (NDP) to accelerate medium-to-long-term economic and social development, including through diversification of the economy. Active labor market policies could help foster job creation and, in this context, Directors urged the authorities to build on existing training programs and placement services, while easing restrictions on labor mobility. Over the medium term, enhancing the efficiency of labor market regulations and institutions and greater investment in human capital will be essential to increasing productivity and competitiveness. Directors also stressed the importance of stepping up reforms of the state-owned enterprises, in particular in the energy sector.

Directors commended the authorities for the substantial progress on fiscal consolidation, and successful introduction of the VAT. They called for steadfast implementation of the planned fiscal consolidation in order to rebuild buffers and place public debt on a declining path. In this regard, they stressed the need for continued revenue reforms, including strengthening tax administration. They also recommended rationalization of current expenditures in the context of a medium–term budget framework.

Directors generally agreed that the exchange rate peg has continued to serve The Bahamas well. To support the peg going forward, they stressed the importance of structural reforms to improve competitiveness, noting that this would also avoid placing an excessive burden on fiscal policy.

Directors welcomed continued progress in financial sector reforms, including the planned introduction of a new credit bureau. They noted that the financial sector remains well capitalized and liquid, and agreed that efforts to further strengthen financial sector regulation and supervision should continue. Directors recommended that the authorities adopt policies that will address persistently high non-performing loans to allow the banking system to play a more effective role in supporting growth.

## Table 1. The Bahamas: Selected Social and Economic Indicators

| | | | Est. | Projections | | |
|---|---|---|---|---|---|---|
| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
| (Annual percentage changes, unless otherwise indicated) | | | | | | |
| **Real sector** | | | | | | |
| Real GDP | 0.6 | 2.2 | 0.0 | 1.0 | 1.8 | 2.8 |
| Nominal GDP | -0.3 | 4.4 | 2.4 | 0.9 | 5.0 | 4.1 |
| Consumer price index (annual average) | 3.2 | 2.0 | 0.4 | 1.2 | 2.1 | 1.5 |
| Consumer price index (end of period) | 3.2 | 0.7 | 0.8 | 0.2 | 2.1 | 1.5 |
| Unemployment rate (in percent) | 15.9 | 14.4 | 15.8 | 15.0 | 14.8 | 13.9 |
| Saving rate (percent of GDP) | 12.4 | 10.0 | 9.3 | 6.9 | 8.3 | 10.9 |
| Investment rate (percent of GDP) | 27.5 | 28.3 | 27.0 | 28.8 | 20.8 | 19.2 |
| **Financial sector** | | | | | | |
| Credit to the nonfinancial public sector | 4.0 | 14.9 | 23.6 | 4.0 | 8.0 | 5.6 |
| Credit to the private sector | 1.1 | -0.3 | -1.2 | -2.8 | -0.2 | 0.6 |
| Liabilities to the private sector | 1.9 | -0.1 | 0.2 | 1.2 | 3.4 | 3.6 |
| **External sector** | | | | | | |
| Exports of goods and services | 3.6 | 10.5 | -1.3 | -1.7 | 5.2 | 10.3 |
| *Of which:* Travel receipts (gross) | -1.0 | 7.9 | -1.2 | 1.0 | 11.4 | 12.1 |
| Imports of goods and services | 12.9 | 15.6 | -2.6 | 4.1 | -11.9 | 0.1 |
| (In percent of GDP, unless otherwise indicated) | | | | | | |
| **Central government 1/** | | | | | | |
| Revenue and grants | 18.1 | 17.9 | 16.3 | 17.1 | 18.4 | 18.8 |
| Expenditure | 21.9 | 22.0 | 21.7 | 20.5 | 21.4 | 20.9 |
| Overall balance | -3.8 | -4.3 | -5.4 | -3.3 | -3.0 | -2.1 |
| Primary balance | -1.1 | -2.0 | -3.0 | -0.8 | -0.1 | 0.6 |
| Central government debt | 45.0 | 48.4 | 56.3 | 60.9 | 63.0 | 63.2 |
| **External sector 2/** | | | | | | |
| Current account balance | -15.1 | -18.3 | -17.7 | -21.9 | -12.5 | -8.3 |
| Change in net international reserves | | | | | | |
| (Increase -) | -0.3 | 0.9 | 0.8 | -0.5 | -0.4 | -0.7 |
| External public debt (end of period) | 13.2 | 17.8 | 20.2 | 23.0 | 22.7 | 22.3 |
| **Memorandum items: 2/** | | | | | | |
| Gross international reserves | | | | | | |
| (End of period; millions of U.S. dollars) | 885 | 810 | 742 | 788 | 820 | 886 |
| In months of next year's G&S imports | 2.2 | 2.0 | 1.8 | 2.2 | 2.2 | 2.3 |
| In percent of reserve money | 100 | 90 | 86 | 80 | 81 | 84 |
| GDP (in millions of Bahamian dollars) | 7,890 | 8,234 | 8,432 | 8,511 | 8,939 | 9,305 |

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

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

2/ The data refer to calendar years.

# THE BAHAMAS

## STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

May 21, 2015

**Context.** Economic activity strengthened somewhat in 2014 while the external current account deficit worsened primarily as a result of Baha Mar construction-related imports. The authorities continue to make substantial progress on fiscal consolidation with successful VAT implementation in January 2015 setting the stage for continued improvements in the fiscal position. Lower oil prices helped keep inflation anchored in 2014. Still, notwithstanding the capital flow management (CFM) regime, international reserves remain low.

**Key policy advice:** Despite the U.S. recovery and the imminent opening of the Baha Mar resort, the growth outlook remains well below pre-global crisis levels, and strong and timely measures should be implemented to strengthen competitiveness and raise potential growth. In addition, rebuilding fiscal and external buffers will be essential for sustaining macroeconomic stability:

- ***Reigniting strong and inclusive medium-term growth.*** Structural reforms are needed to address longstanding competiveness issues including labor market impediments to growth. Energy sector reforms could substantially lower energy costs, boost productivity and facilitate economic diversification in the medium term. A diversification strategy should explore the potential for increasing value added in the tourism sector, including through deepening linkages with agriculture.

- ***Rebuilding fiscal and external buffers.*** Notwithstanding the CFM regime, the fixed exchange rate peg constrains monetary policy, leaving fiscal policy as the main instrument for macroeconomic stabilization. Steadfast implementation of the VAT and expenditure rationalization in the context of a medium-term budgetary framework, together with public enterprise reforms, would help rebuild fiscal buffers and support international reserves.

- ***Preserving financial sector stability.*** The pre-crisis credit boom has left the banking system with an overhang of non-performing loans, which will likely continue to generate headwinds for the economy. Despite this, the banking system remains very well capitalized and liquid. Measures should be put in place to resolve the debt overhang while further strengthening the regulatory and supervisory framework.

Approved By
**Charles Enoch (WHD) and Era Dabla-Norris (SPR)**

The Team that visited Nassau during March 9–20, 2015 comprised Messrs. W. Samuel (Head), J. Okwuokei, D. Kanda, and M. Lutz (all WHD). It was assisted at headquarters by F. Strodel, E. Moreno, and E. Kapijimpanga (all WHD). The team reviewed recent economic developments and the outlook and discussed the main policy issues. They met with Prime Minister Christie; Minister of Tourism Wilcombe; Minister of Environment and Housing Dorsett; Minister of State for Finance Halkitis; Central Bank Governor Craigg; Financial Secretary Rolle; other senior government officials and representatives of the opposition; and the banking, tourism and business communities. Mr. Parent, Senior Advisor in the Executive Director's Office, attended some of the policy discussions.

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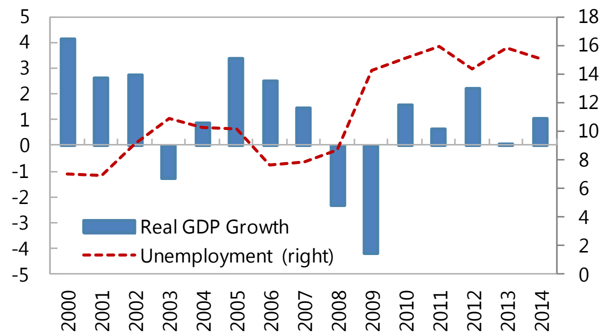
## ANNEXES

# RECENT DEVELOPMENTS, OUTLOOK AND RISKS

## A. Recent Economic Developments

1. **Economic activity is slowly recovering.** Real GDP expanded by an estimated 1 percent in 2014[1] on the back of increased tourist arrivals, but growth remains well below pre-global crisis levels (the level of real GDP also remains below its pre-crisis peak). Supported, in part, by rising U.S. economic activity, air arrivals grew by almost 5 percent in 2014 and applied room rates improved by 7 percent. Domestic demand has been weighed down by the weak macroeconomic outlook, high household indebtedness, and high unemployment which stood at 15.7 percent in November 2014. Inflation rose to 2.2 percent in January 2015 (1.2 percent in December 2014), as the imposition of the value added tax (VAT) offset the effects of declining oil prices.

**Growth and Unemployment**
(in percent)




Source: The Bahamian authorities; and Fund staff estimates.

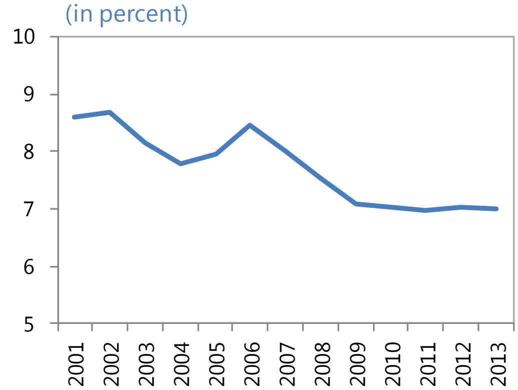
2. **The fiscal deficit in FY 2013/14 (July to June) is estimated to have narrowed to 3.3 percent of GDP (from 5.4 percent).** Revenue was lower-than-budgeted, but a substantial reduction in current spending, including on wages and salaries, and on goods and services resulted in an overall fiscal deficit below budget target. The debt-GDP-ratio is estimated to have reached 61 percent in FY2013/14 from 56 percent in FY2012/13. Key public enterprises including Bahamasair, Bahamas Electricity Corporation (BEC) and the Water and Sewerage Corporation (WSC) continue to be a drag on government finances. In September 2014, Moody's downgraded The Bahamas' rating one notch to Baa2 citing deterioration of the government's balance sheet and subdued economic growth.

3. **The external current account continues to record sizable deficits.** Reflecting the large import components of the Baha Mar resort project, the external current account deficit surged to 22 percent of GDP in 2014. The investment/GDP ratio remains in excess of 25 percent of GDP, and an improved fiscal position has raised the rate of public saving, albeit overwhelmed by an implied reduction in the private saving rate (Figure 4). Foreign financial inflows, including government borrowing, are estimated, however, to have helped cushion reserve losses.

[1] The real and nominal GDP data for 2010–2014 were revised in March 2015, which affected staff's macroeconomic projections and outlook for 2015–2020.

4. **Traditional external competiveness indicators do not unambiguously indicate real effective exchange rate (REER) misalignment**. A simple average of the three methodologies used suggests an improvement in competitiveness, albeit under 10 percent, would be needed to close the external current account balance. On the other hand, The Bahamas' share of Caribbean tourism arrivals has been stable recently with upside prospects from the opening of Baha Mar and other FDI-financed investments (Figure 3, Annex 2).[2] Nonetheless, the mixed picture suggests that enhancing competitiveness including through structural reforms remains a priority.

**Share of Caribbean Tourist Arrivals**
(in percent)

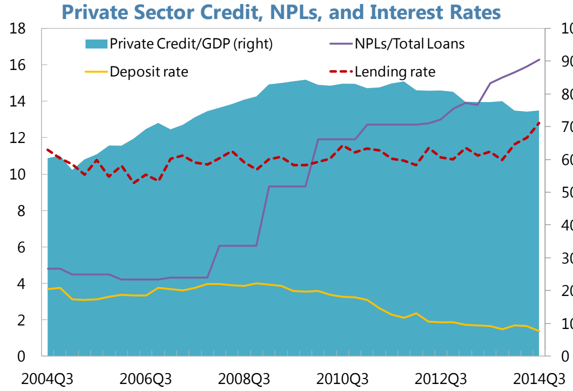



Source: IMF staff estimates.

5. **External reserves remain low.** Reserves totaled US$839 million at end-March 2015, equivalent to 2.3 months of next year's projected imports of goods and services. However, this reflects, in part, a net purchase of US$175 million from the government following an external bond placement early last year (Box 1).

6. **The domestic banking system's deleveraging process continues but the sector remains well capitalized and liquid.** Net domestic assets declined by 2.6 percent through December 2014 with private sector credit falling back to its 2009 level. Nonperforming loans remain elevated, with 16 percent of total loans overdue by 90 or more days in March 2015. In October 2014, the government established a special purpose company to take over non-performing commercial loans (US$100 million, 1.1 percent of GDP) of a weak state-owned bank. The banking system's end–2014 capital adequacy, in excess of 33 percent of risk-weighted assets, remains well above the central bank's 17 percent target. With subdued lending prospects, banks also continue to be liquid (with the liquid/total asset ratio at 23 percent at end–2014).

**Private Sector Credit, NPLs, and Interest Rates**




Sources: Central Bank of Bahamas; and Statistics Office.

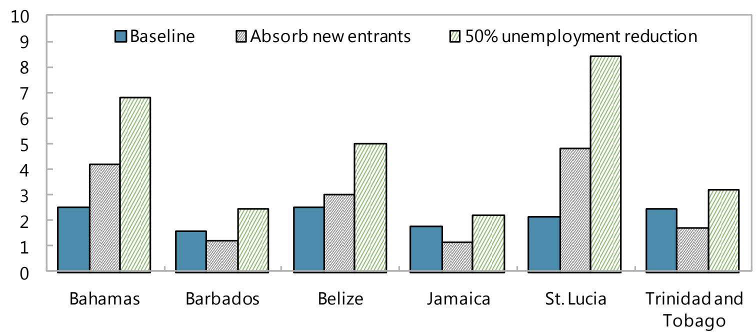
## B. Macroeconomic Outlook and Risks

7. **Growth is expected to strengthen over 2015–16 with the improvement in U.S. activity and the opening of Baha Mar, but significant structural impediments remain**. Staff estimates potential GDP growth at about 1½ percent over the medium term, insufficient to generate a significant reduction in the high unemployment rate. Structural impediments, including in the labor

[2] The new EBA-lite methodology suggests a 38 percent depreciation in the real effective exchange to close the current account gap, although adjusting the current account deficit by the one-off nature of the Baha Mar project as well as "normal" FDI-related imports reduces the estimated overvaluation to 7½ percent.

market and the energy sector, imply that significantly higher growth than currently projected will be required to absorb new entrants to the labor force and reduce the unemployment rate to single digits over the medium term. However, the full opening of Baha Mar and two smaller projects would increase hotel room inventory by about 20 percent, and together with the strengthening U.S. economy could represent a major boost to exports and the near-term growth outlook. Nonetheless, staff growth projections are tempered by the significant risk that Baha Mar would cannibalize arrivals to other Bahamian destinations unless existing structural challenges are addressed. The improvement in activity from lower oil prices is broadly offset by VAT introduction and ongoing private sector deleveraging. U.S. dollar appreciation is expected to have only a marginal impact on activity, given the peg and dominance of the U.S. as a trading partner. Beyond 2016, growth tapers off as U.S. growth decelerates over the medium term, and the base effects from the opening of Baha Mar fade. Inflation is expected to remain low over the medium term, but VAT implementation early this year would add an estimated 2½ percentage points to the CPI. Over the medium term, the external current account deficit returns to single digits as construction-related outflows are anticipated to be replaced by a rise in travel services receipt.

**Real GDP Growth Under Alternative Scenarios, 2013-18**
(average, percent)




8. **Risks continue to be tilted to the downside although with considerable uncertainty (see Table 8).** Spillover risks to The Bahamas stem mainly from the U.S. economy, mostly through the trade and financial channels, but oil price shocks are also important (Annex 3). While the offshore financial system remains substantial, the 2012 FSAP concluded that the domestic financial sector's susceptibility to offshore spillovers is limited (Annex 4). Nonetheless, the eventual normalization of U.S. monetary policy could further strengthen the dollar, worsening the external competitiveness of The Bahamas vis-à-vis non-U.S. dollar pegged competitors. This, together with adverse shocks to the U.S economy, weaker than projected activity in the global economy, and a disappointing Baha Mar performance would dampen economic recovery, make fiscal consolidation challenging, and weigh on the current account and foreign reserves. However, the net effects of these adverse risks on the external balance are uncertain, as the winding down of Baha Mar construction and lower oil prices are expected to reduce imports going forward. VAT implementation setbacks, and a weak fiscal consolidation generally, could undermine the authorities' policy credibility, and heighten risks to long-term debt sustainability and the country's credit rating. The persistently elevated non-performing loan (NPL) ratio poses a tail–risk threat to financial sector stability. Meanwhile, the recent rapprochement in U.S./Cuban relations poses an as yet un-quantified risk to the economic model of many tourism-based Caribbean economies.

# POLICY DISCUSSIONS

*While growth momentum is improving amid U.S. recovery, it remains weak. With relatively low international reserves, policy discussions focused on rebuilding fiscal and external buffers and raising productivity and competitiveness to reignite growth. Specifically, staff's recommendations centered on policies to (i) reignite strong and inclusive medium term growth; (ii) restore fiscal and debt sustainability; (iii) rebuild external buffers; and (iv) preserve financial sector stability.*

## A. Reigniting Strong and Inclusive Medium-Term Growth

9. **Staff noted that The Bahamas faces several challenges in boosting its growth potential**. First, the country must attract sufficient tourist demand to fill the large impending increase in supply. Second, labor market rigidities constrain the potential supply of labor in the medium term. Persistently high unemployment rates suggest the presence of wage rigidities while business surveys cite a lack of skilled labor as an important constraint to growth. Third, there are significant impediments to the growth of small and medium enterprises (SMEs). Fourth, there are more general constraints to investment. The 2015 World Bank Doing Business Indicators ranks The Bahamas 97th out of 189 countries. Moreover, The Bahamas had a Distance to (best practice) Frontier score of 61.37 out of a maximum of 100, indicating much room for improvement. The Bahamas has particularly low rankings in getting credit, protecting investors, and registering property.

10. **Persistently high unemployment underscores the need for policies to promote more inclusive growth (Box 2).** The Bahamas enjoys a relatively high per capita income (third highest in the Western Hemisphere behind the U.S. and Canada), which has helped to maintain high living standards. However, since the onset of the global financial crisis, the unemployment rate has remained in double digits mostly due to depressed domestic demand and exports and may have contributed to the recent rise in crime rates. There is evidence of significant structural unemployment, which suggests the existence of impediments to job creation and proper functioning of the labor market. Evidence points to skills mismatches, which partly reflects deficiencies in the education system and migration of skilled labor. At the same time, according to the private sector, efforts to hire foreign labor to fill skill shortages are occasionally hampered by difficulties in securing work permits. Moreover, the job content of growth appears relatively low and is compounded by low productivity and high real wages.

11. **Inclusive growth policies would also reduce inequality and gender imbalances (Box 2).** Income inequality appears relatively high as indicated by the Gini coefficient estimated at 46 percent in 2011. Although the 2014 World Economic Forum's global gender gap report ranks The Bahamas high in attaining gender balance (35th out of 142 countries), males appear to be lagging in educational attainment, and much more in securing technical and professional jobs. Females, on the other hand, seem to be lagging in political empowerment as indicated by the proportion of women in parliament and cabinet.

12. **Staff concurred with the authorities on the need to finalize and implement the National Development Plan (NDP).** The NDP would assess the country's macroeconomic performance, institutions, and governance and propose strategies to accelerate economic, institutional, and social development over the medium term and long run. The NDP should review The Bahamas' economic diversification strategy with a view to exploring scope for increasing value added, including in the tourism sector through deepening linkages with agriculture. In view of the employment and labor market challenges, staff recommended enhancing active labor market policies to foster job creation and deliver more inclusive growth. In the short term, the focus should be on building upon existing vocational and on-the-job training programs, and job placement services, while seeking to attract skilled Bahamians in the Diaspora and easing restrictions on intra-Caribbean labor mobility. In the long term, improving educational outcomes, better alignment of educational curricula with skills demand, aligning wages to productivity, and enhancing the efficiency of labor market regulations and institutions would be essential to increasing productivity and competitiveness. In addition, greater investment in infrastructure and human capital would be necessary to ensure that growth is broad–based and that the benefits are spread more widely.

13. **Affordable and dependable electricity supply is critical to maintaining The Bahamas' image as a high-end tourist destination (Annex 5)**. Improving the efficiency of the electricity company could substantially lower energy costs, boost productivity, and facilitate economic diversification over the medium term. There appears to be significant scope for boosting energy efficiency through more efficient generation, appropriate pricing (balancing cost reduction and investment needs), expanding the use of alternative energy sources, and improved monitoring (including the collection of arrears).

14. **Advancing far reaching reforms at the state-owned enterprises (SOEs) is key to reigniting growth.** The pace of reforms in loss–making public entities, including the BEC, Bahamasair, and WSC, appears to be lagging and could hamper efforts towards alleviating infrastructure bottlenecks and enhancing medium term growth. Staff urged speedy reform of these entities, focusing on lowering operating costs, rationalizing tariffs, increasing capital investment, enhancing the regulatory framework and generally raising the quality and reliability of service. In particular, staff urged the authorities to press ahead with plans to place the electricity company on a commercially–sound basis and to liberalize the regulatory framework.

***Authorities Views:***

- The authorities fully agreed with staff on the need to promote higher and more inclusive growth, observing in particular that there was an urgent need to reduce the very high youth unemployment rates, thus also helping to stem rising crime rates. They noted that growth has not been strong enough to absorb new entrants to the labor force, but are optimistic that Baha Mar opening and other new projects could potentially lower unemployment. They acknowledged that income inequality is high, but it is partly due to highly paid expatriates, especially in the financial sector.

- They regarded the NDP as critical to their efforts to strengthen and diversify the Bahamian economy and have set up the Bahamas Investment Promotion Agency (BIPA) within the Office of the Prime Minister to spearhead efforts to finalize the NDP. The BIPA would be tasked with monitoring all priority projects in a centralized fashion, ensuring timely implementation. Currently, work on the NDP is focusing on diagnostic studies along several dimensions, including educational policy, the business environment, and policies pertaining to the Family Islands. The authorities also indicated that energy sector policies would be integrated with the NDP to ensure consistency. They are building an agriculture school that would train students in commercial farming, among other activities, which would help reduce food imports.

- On energy sector reforms, and in addition to those already announced (Annex V), the authorities indicated that they would be outsourcing the management of the Bahamas Electricity Corporation to a private sector company with a mandate to run the BEC on a fully commercial basis. This would imply rationalization of tariffs and employment policies, and laying the basis for increased investment and the modernization of generation plants. In addition, they were considering options to set up an independent regulator for the electricity sector. Transformation of the BEC should lower energy prices, and enhance the competitiveness of the tourism sector.

## B. Rebuilding Fiscal and External Buffers

15. **The lack of fiscal space and modest external buffers constrain the use of demand-side policies to stimulate growth.** Notwithstanding capital controls, the exchange rate peg constrains monetary policy. Furthermore, the scope for fiscal stimulus to support the recovery is limited by low international reserves and the need to reverse the debt trajectory.

16. **The introduction of the new VAT reaffirmed the authorities' commitment to medium-term fiscal consolidation.** Staff commended the authorities for the introduction of a broad-based VAT on January 1, 2015 with a standard rate of 7.5 percent and very few exemptions. This represents a significant step towards boosting policy credibility, and bolstering market confidence. The implementation of the VAT appears to have been relatively smooth despite some transitional issues that are being resolved. Early indications of its performance are encouraging, and the authorities seem on course to achieving their initial revenue targets. Following the VAT implementation, the authorities should advance other revenue reform measures on which progress had lagged, including modernization of customs and property tax administration, and establishment of a central revenue agency.

**Medium-Term Fiscal Framework 1/**

(in percent of GDP)

| | | | Staff Projections | | | | | |
|---|---|---|---|---|---|---|---|---|
| | FY12/13 | FY13/14 | FY14/15 | FY15/16 | FY16/17 | FY17/18 | FY18/19 | FY19/20 |
| Revenue | 16.3 | 17.1 | 18.4 | 18.8 | 19.6 | 19.9 | 20.1 | 20.2 |
| Of which: VAT | | | 1.5 | 2.5 | 3.0 | 3.0 | 3.0 | 3.0 |
| Expenditure | 21.7 | 20.5 | 21.4 | 20.9 | 20.8 | 20.6 | 20.6 | 20.5 |
| Of which: Net acquisition of nonfinancial as | 2.9 | 2.6 | 2.7 | 2.6 | 2.6 | 2.6 | 2.6 | 2.6 |
| *Memorandum items:* | | | | | | | | |
| Primary balance 2/ | -3.0 | -0.8 | -0.1 | 0.6 | 1.5 | 2.0 | 2.2 | 2.4 |
| Overall fiscal balance | -5.4 | -3.3 | -3.0 | -2.1 | -1.2 | -0.7 | -0.5 | -0.3 |
| Debt-to-GDP ratio | 56.3 | 60.9 | 63.0 | 63.2 | 63.2 | 63.1 | 62.7 | 62.1 |

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

1/ Fiscal year ends June 30th.

2/ Defined as revenue and grants minus total expenditure (excluding interest payments).

17. **Over the medium term, the government proposes to continue its fiscal consolidation efforts.** The fiscal position is projected to improve steadily in the medium term as envisaged during the 2013 Article IV consultation, with the fiscal deficit expected to narrow to about 2 percent of GDP in FY2015/16 reaching 0.3 percent in 2019/20. The primary balance is projected to move into a surplus in 2015/16. In addition to enhancing revenue, the government proposes to rein in current spending while keeping capital spending around 3 percent of GDP.

18. **The central government debt to GDP ratio will remain elevated, but decline slowly over the medium term as the fiscal position strengthens.** Under the baseline scenario of the debt sustainability analysis, central government debt is projected to peak at 63 percent of GDP in FY2014/15, declining marginally thereafter to 62 percent in FY2019/20. Gross financing requirements will decline from 5.7 percent of GDP in FY2014/15 to about 2.0 percent of GDP in FY2019/20. External financing requirement is highlighted as a significant risk to the debt profile, which could be mitigated by the projected strengthening of the external current account in the medium term. The main risks to debt sustainability remain slower than expected growth and weak fiscal efforts (Annex 1).

19. **Staff agreed that the pace of consolidation planned by the authorities was broadly appropriate, notably in view of the relatively weak growth outlook.** Staff urged the authorities to intensify efforts with regard to the implementation of other tax reforms. Steadfast implementation of the planned fiscal consolidation is key to placing debt levels on a declining path. On the expenditure side, staff welcomed ongoing efforts to tighten spending control, and plans to reform public procurement and payroll management. Currently, the fiscal consolidation plan envisages a small saving on expenditures reform. Accelerated rationalization of current expenditure in the context of a medium–term budgetary framework is therefore warranted to help preserve the hard-won benefits of the VAT and help to restore fiscal and debt sustainability. Staff also urged the authorities to press ahead with plans to introduce fiscal responsibility legislation.

20. **SOE reforms would facilitate fiscal consolidation.** Staff noted that key state-owned entities continue to record sizable financial losses as a result of their public service mandates, operational inefficiencies and inadequate enabling regulatory framework. In particular, operating costs are notably high, mainly reflecting aged facilities and generous employment policies, while productivity is low. Moreover, SOE tariffs have not kept pace with the cost of service delivery, necessitating continued budget support. For example, government support to both Bahamasair and WSC is expected to reach US$60 million (0.7 percent of GDP) in FY2014/15. Aggregate SOE debt was 16 percent of GDP in FY2013/14. Reforms of these entities are thus critical to stemming the drag on public finances.

21. **The large band of uncertainty on the growth outlook calls for continued fiscal vigilance.** Staff recommended the identification of contingency measures for meeting fiscal targets, including offsetting measures, should downside risks materialize. Such measures should aim to protect growth enhancing capital spending given the large infrastructure requirements. In addition, with growth remaining tepid, staff underscored that fiscal consolidation is not only needed to achieve fiscal and debt sustainability, but also critical to rebuilding external buffers in the near term,

and to sustaining the peg. Over the longer term, measures would need to be taken in the area of pensions and health insurance to put these on a fiscally sustainable footing, notably in view of population aging.

***Authorities Views:***

- The authorities broadly agreed with staff's assessment of the fiscal position, and reiterated their commitment to medium-term fiscal consolidation. They acknowledged the need to further contain expenditure growth, in the context of a medium term budgetary framework, as recommended by staff, especially in light of future aging–related spending. They noted that the recently introduced VAT had started bearing fruit and highlighted outstanding issues that are being resolved, including transitioning of the current VAT administrative structure to a new, fully–fledged central revenue administration (CRA) along with the other major domestic taxes, such as real property tax, business license, and stamp duties. A new CRA is expected to come on stream by end–2015, starting with the co–location of the VAT and Internal Revenue Departments. They also noted that the ongoing modernization of customs and property tax departments will further enhance revenue collections.

- As for fiscal contingency measures, the authorities indicated that, in the event of revenue underperformance, they could cut current spending, and prioritize capital spending in order to achieve fiscal targets. They acknowledged that the government will continue to support state–owned enterprises, such as the Water and Sewerage Corporation, and Bahamasair, but at manageable levels while making efforts to improve their efficiency. The authorities remain committed to examining options for fiscal responsibility and, based on a soon to be released discussion paper, plan to have a stakeholder consultation on the issue with recommendations to Cabinet later this year.

22. **The exchange rate peg and system of capital controls continue to serve The Bahamas well as an anchor for price and financial stability**. With a long-standing US$1=B$1 peg, the system has helped deliver real and financial sector stability, facilitating The Bahamas' comparatively high and rising living standards. However, this peg could likely also pose tensions, with the eventual normalization of U.S. monetary policy, and should the U.S. dollar appreciate further relative to other major currencies. With foreign exchange reserves expected to remain at modest levels over the medium term, improvements in macroeconomic resilience through diversification, including in the tourism sector, are crucial, in light of The Bahamas' susceptibility to external shocks. Therefore, staff argued that structural reforms to improve competitiveness are even more urgent to avoid placing an excessive burden of adjustment on fiscal policy.

***Authorities Views***:

- The authorities concurred that enhancing competitiveness was crucial for sustainable growth and maintenance of the exchange rate system. They noted recent successes in diversifying the tourism experience in sports, and highlighted progress in enhancing the business environment, in particular, through trade facilitation and online payment of taxes. They recognized that the opening of Cuba to U.S. tourists presented new challenges, but viewed that the Bahamian product would be able to compete effectively. The authorities pointed out that the current level of international reserves remain within target levels (US$800–US$850 million, above 90 percent of base money) and further accretion to reserves would depend largely on improvement in tourism earnings, as growth strengthens, as well as from foreign direct investment. They will take measures, should they become necessary, to protect reserves from falling below their target levels.

## C. Enhancing Financial Sector Stability

23. **Staff concurred with the authorities' view that the current monetary policy stance remained appropriate.** Given the fixed exchange rate, modest reserves, continued slow growth and contained "core"—non-VAT related, non-energy—inflation, neither loosening or tightening would be appropriate in the current circumstances. However, upward adjustments may eventually be required as U.S. policy rates are increased.

24. **Staff noted that the Bahamian credit channel remains impeded by a nagging debt overhang**. Persistently high NPLs, in the context of the CFM regime, have further limited the local transmission of the expansionary U.S. monetary stance (see also Annex 3). Given the private sector's sizable loan burdens, subdued employment prospects, and tightened credit requirements, new loan demand creation remained muted amid overall deleveraging. Staff noted recent efforts of the authorities and some banks to address long-standing NPLs, and discussed the potential advantages of establishing a specialized agency, including a possible successor to the government's Mortgage Relief Plan. Resolving the debt overhang will help preserve financial stability, allow for specialized management to maximize the value of distressed assets and permit banks to focus on their core business of lending, thereby supporting the recovery. Despite facilitating bankruptcy laws, banks remain reluctant for both economic and social reasons to press for accelerated resolution of nonperforming mortgages. Staff noted that excessive time delays and high costs of property registration and inefficiencies in the enforcement of contracts also likely weighed on the resuscitation of bank lending. However, recently introduced rules for civil procedure focused on streamlining court proceedings and promoting less costly dispute resolutions may prove beneficial.

25. **Staff welcomed the planned introduction of a new credit bureau, including its broad scope**. However, staff noted that while more comprehensive information regarding existing debt obligations and repayment histories would eventually facilitate access to credit, it may initially raise additional lender reluctance if the true level of private sector indebtedness exceeded expectations.

26. **The Bahamian financial sector remains well capitalized and liquid, and progress in improving the supervisory framework continues apace.** Staff welcomed the results of recent banking system stress tests, which indicated that the majority of banks remain resilient to the most extreme shocks given their very high capital to risk-weighted assets ratios. The authorities are further strengthening their regulatory and supervisory framework, largely in accord with FSAP recommendations (Box 3). Staff also noted that implementation of the Basel framework was on

track, and that the AML/CFT evaluation was, after some delay, in train. The authorities are encouraged to enhance compliance and effectiveness of the AML/CFT framework in line with the 2012 FATF standard.

***Authorities Views:***

- The authorities agreed that credit growth will remain subdued, given the weakness in consumer demand, elevated unemployment and as banks continue applying tighter credit standards. They noted that banks were more aggressively writing off and provisioning for bad debts, in some cases incurring sizable losses, and foregoing dividends. A resumption of lending was thought to depend on an improvement in employment prospects, particularly as The Baha Mar resort opens. The resort is expected to employ about 5000 people within 6–7 months of its opening. On the credit bureau, they noted that credit exposures may not be unexpectedly high upon its introduction since banks are conducting due diligence and are dealing with the same set of borrowers.

- The authorities explained that the government's previous mortgage relief program required restructuring to enhance its effectiveness. While they noted that banks had already restructured many mortgages, they suggested that a revamped program was still needed and that they intended to re-launch it soon.

### D. Others

27. **Data provision is generally adequate for economic surveillance**, but some gaps remain in both coverage and timeliness, including in national accounts, the consolidated accounts of the public sector, and the economy-wide international investment position (IIP), due to capacity constraints. Staff supports the authorities' efforts to compile and publish quarterly national accounts and IIP statistics. Accordingly, additional resources are needed to address remaining data shortcomings.

28. **Staff supported addressing ongoing and expanded technical assistance (TA) needs**. CARTAC advisors have identified several areas to support the authorities' efforts including: continuing assistance with implementation of VAT; strategic and medium-term budgeting; adopting the 6$^{th}$ edition of the Balance of Payments Manual; and developing estimates of The Bahamas' IIP.

## STAFF APPRAISAL

29. **Economic activity is slowly recovering, but the outlook holds significant uncertainty.** Real GDP growth remains well below pre-global crisis levels as tourism continues to face headwinds from persistent softness in the high-value-added segment and increased competition from low cost regional destinations. Moreover, domestic demand continues to be weighed down by the weak macroeconomic outlook, high household indebtedness, and high unemployment. Even with the opening of Baha Mar, the medium term growth outlook remains weak.

30. **Policies to support strong, inclusive, and sustainable growth are needed.** In this context, it is essential to finalize and implement the NDP, which would propose strategies to accelerate economic, institutional, and social development over the medium term and long run. Enhancing active labor market policies could help foster job creation and deliver more inclusive growth. The authorities should build on existing vocational and on-the-job training programs, and job placement services, while seeking to attract skilled Bahamians in the Diaspora and easing restrictions on intra-Caribbean labor mobility. In the long term, improving educational outcomes, reducing skills mismatch, and enhancing the efficiency of labor market regulations and institutions would be essential to increasing productivity and competitiveness. In addition, greater investment in infrastructure and human capital would be necessary to ensure inclusive growth.

31. **Fiscal consolidation is critical to sustaining macroeconomic stability over the medium term.** The authorities' planned pace of consolidation appears broadly adequate but implementation risks remain. While VAT is off to a good start, progress on other revenue reforms has been slow given limited implementation capacity, and the authorities will need to reinvigorate efforts in those areas. With the debt level projected to remain elevated in the medium term, accelerated rationalization of current expenditure in the context of a medium–term budgetary framework is therefore warranted to help restore fiscal sustainability. Fiscal consolidation is also critical to rebuilding external buffers in the near term, and to sustaining the peg. Over the medium term, policies should be implemented in the area of pensions and health insurance to put these on a fiscally sustainable footing, notably in view of population aging.

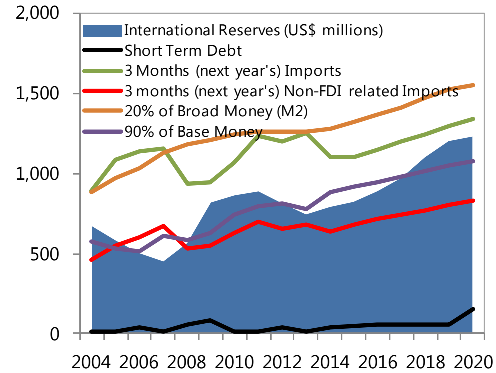
32. **The exchange rate peg and system of capital controls continue to serve The Bahamas well as an anchor for price and financial stability**. However, this peg will likely also face tensions, with the eventual normalization of U.S. monetary policy, and should the U.S. dollar appreciate further relative to other major currencies. In light of the low international reserves, structural reforms to improve competitiveness are therefore urgently needed to avoid placing an excessive burden of adjustment on fiscal policy.

33. **The authorities should consider the merits of an adequately capitalized specialized agency to help resolve debt overhang in the banking system**. More broadly, policies should be adopted that will facilitate addressing persistently high NPLs in order for the banking system to play a more effective role in supporting growth, including encouraging further responsible provisioning and write-down of bad loans and improving the operations of the land registry. Nonetheless, The Bahamian financial sector remains well capitalized and liquid and progress to strengthen financial sector regulation and supervision should continue.

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

## Box 1. Assessment of Reserve Adequacy

**The Bahamas' international reserves remain low.** At end–March 2015, reserves totaled $839 million, up from $742 million at end-2013, equivalent to 2.3 months of next year's imports of goods and services. While current and projected reserves fall short of some standard metrics, these levels are broadly consistent with historical trends, as capital controls and one-off inflows have helped maintain reserve levels. Nonetheless, rebuilding reserve buffers is essential to building resilience to external shocks to which The Bahamas, like other small states, is very susceptible**.**

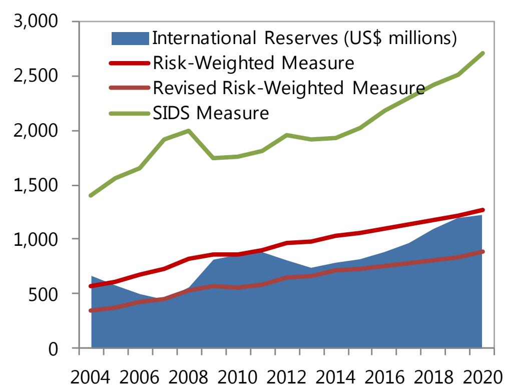



Sources: The Bahamian authorities, and IMF staff estimates.

Reserves have and are projected to easily exceed all short-term official debt, but are expected to fall short of the standard 3-months of imports metric. However, it is currently and is projected to continue meeting this test, after adjusting imports for FDI inflows.

The Bahamas' reserve adequacy outlook is not clear-cut when analyzed under the broad money-based method that is used to capture the risks from currency mismatches and drains arising from possible bank runs. The country's reserve holdings are projected to remain below the broad money norm of 20 percent, but related risks would be relatively limited given the central bank's restrictions on capital flows—all outward capital transfers require exchange control approval, and outflows of resident-owned capital are restricted. Reserves easily meet the Central Bank's statutory 50 percent of total bank liabilities (comprising reserve money, government and other public sector deposits).

The country's reserves holdings are projected to be adequate relative to the recently revised risk-weighted benchmark for economies with capital controls, that is designed to reflect a broader range of sources of risk, such as external liabilities, external demand collapse, and potential capital flight.[1] Reserves are however much below desirable levels when assessed against the more stringent adjusted measure for small island developing states (SIDS)[2] because of their greater vulnerabilities to shocks. This strengthens the case for fiscal consolidation to help build external buffers.




Sources: The Bahamian authorities, and IMF staff estimates.

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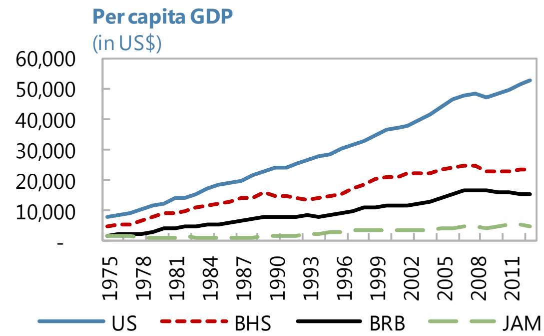
[1] IMF, *Assessing Reserve Adequacy—Specific Proposals* (April 2015). The measure for fixed exchange rate regimes with capital controls is 30 percent of short-term debt at remaining maturity + 20 percent of other portfolio liabilities + 5 percent of broad money + 10 percent of exports.

[2] Nkunde Mwase, *How much should I hold? Reserve Adequacy in Emerging Markets and Small Islands* (WP/12/205). The measure for fixed exchange rate regimes is defined as 95 percent of short-term debt at remaining maturity + 10 percent of broad money + 35 percent of exports.

## Box 2. Where Does The Bahamas Stand in Efforts to Promote Inclusive Growth?

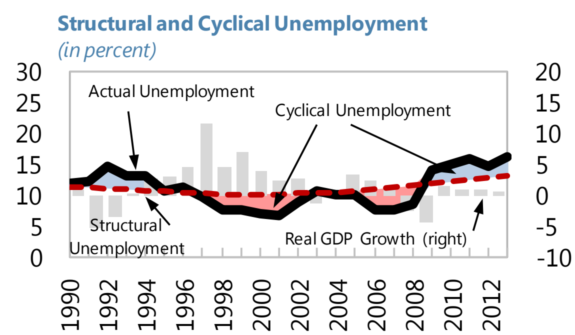
**The Bahamas enjoys a relatively high per capita income, which has helped to maintain high living standards.** Per capita GDP, in nominal terms, grew by almost five–fold from US$5,000 in 1975 to around US$23,000 in 2013 despite sub-par economic performance in recent years. The Bahamas has achieved a high level of social and human development consistent with its income level. However, the high income level masks disparities among the population. The poverty rate stood at 12.8 percent in 2013 up from 9.3 percent in 2001. Although poverty is prevalent in New Providence and Grand Bahama, which together accounts for about three-quarters of the poor and 85 percent of the country's population, income levels in the Family Islands are notably lower.



Sources: IMF World Economic Outlook.

**Evidence points to significant inequality and moderate gender imbalances.** An income-based Gini coefficient is estimated at 46 percent in 2011 indicating that the income share of the top 20 percent of the population was about 16 times the share of the bottom 20 percent. The relatively high income disparity could be partly explained by a significant number of expatriates (12 percent of the employed in 2011 were non–Bahamians), in high paying private sector jobs, particularly in the financial sector. With regard to gender issues, the 2014 World Economic Forum's global gender gap report ranks The Bahamas high in attaining gender balance broadly in several key areas. However, males appear to be lagging in educational attainment, and much more in securing technical and professional jobs. Females, on the other hand, seem to be less politically empowered as measured by the proportion of women in parliament and cabinet.

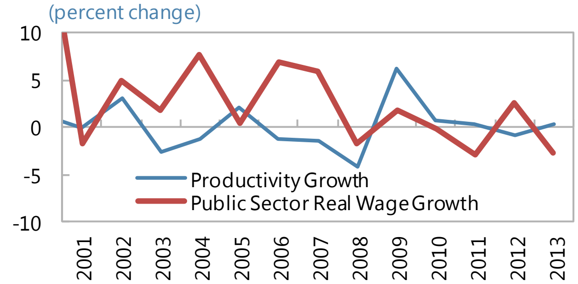
**High unemployment, particularly among the youth is a major concern, and could be fuelling recent increases in crime.** The unemployment rate rose to 14.2 percent in 2009 from 8.7 percent in 2008 following the onset of the global financial crisis. Since then, the unemployment rate has averaged 15 percent with that of the youth (15–24 years) doubling the national rate. Anecdotal evidence suggests that less than a quarter of high school graduates enroll for tertiary education, thus adding to the labor force annually an estimated 4000 youths. Meanwhile, criminal activities are reported to have increased in recent years. The United Nations Office of Drugs and Crimes estimates the homicide rate for The Bahamas at around 30 per 100,000 in 2012, mostly related to gang, or organized crime.



Sources: National Authorities and Fund staff Calculations.

## Box 2. Where Does The Bahamas Stand in Efforts to Promote Inclusive Growth? (concluded)

**Unemployment appears significantly structural, partly reflecting a dysfunctional education system and migration of skilled labor**. Evidence points to a mismatch between types of skills demanded by private sector employers' and skills supplied by the labor force. The education system is reported to produce graduates who are ill-prepared for the labor market due to lack of basic skills and necessary qualifications. Similar to the rest of the Caribbean, migration of skilled labor is high in The Bahamas. According to the private sector, efforts to hire foreign labor to fill skill shortages are occasionally hampered by difficulties in securing work permits partly because of delays in the approval process and weaknesses in the government's mentorship program.



Sources: National Authorities and Fund staff Calculations.

**A relatively low job content of growth is compounded by low productivity and high real wages**. A recent IMF study[3], estimates growth–employment elasticity to average 0.5 percent for The Bahamas. This implies that without structural reforms, higher than currently projected real GDP growth will be needed over the medium term to absorb new entrants to the labor force and to significantly reduce unemployment from its current high level. Moreover, despite a relatively high labor force participation rate, 73 percent in 2014, labor productivity, for the most part, has not kept pace with real wage growth in the last decade.

**A comprehensive set of policies is needed to address these multi-faceted issues**. In the context of a national strategy, such policies should aim to reignite strong medium term growth, remove impediments to job creation, strengthen existing active labor market programs, and combat crime. Government's social safety net programs need to be streamlined, while the educational system should be reformed to better align curricula with skills demand and improve educational outcomes. It will also be critical to align wages to productivity, and enhance the efficiency of labor market and immigration regulations and institutions.

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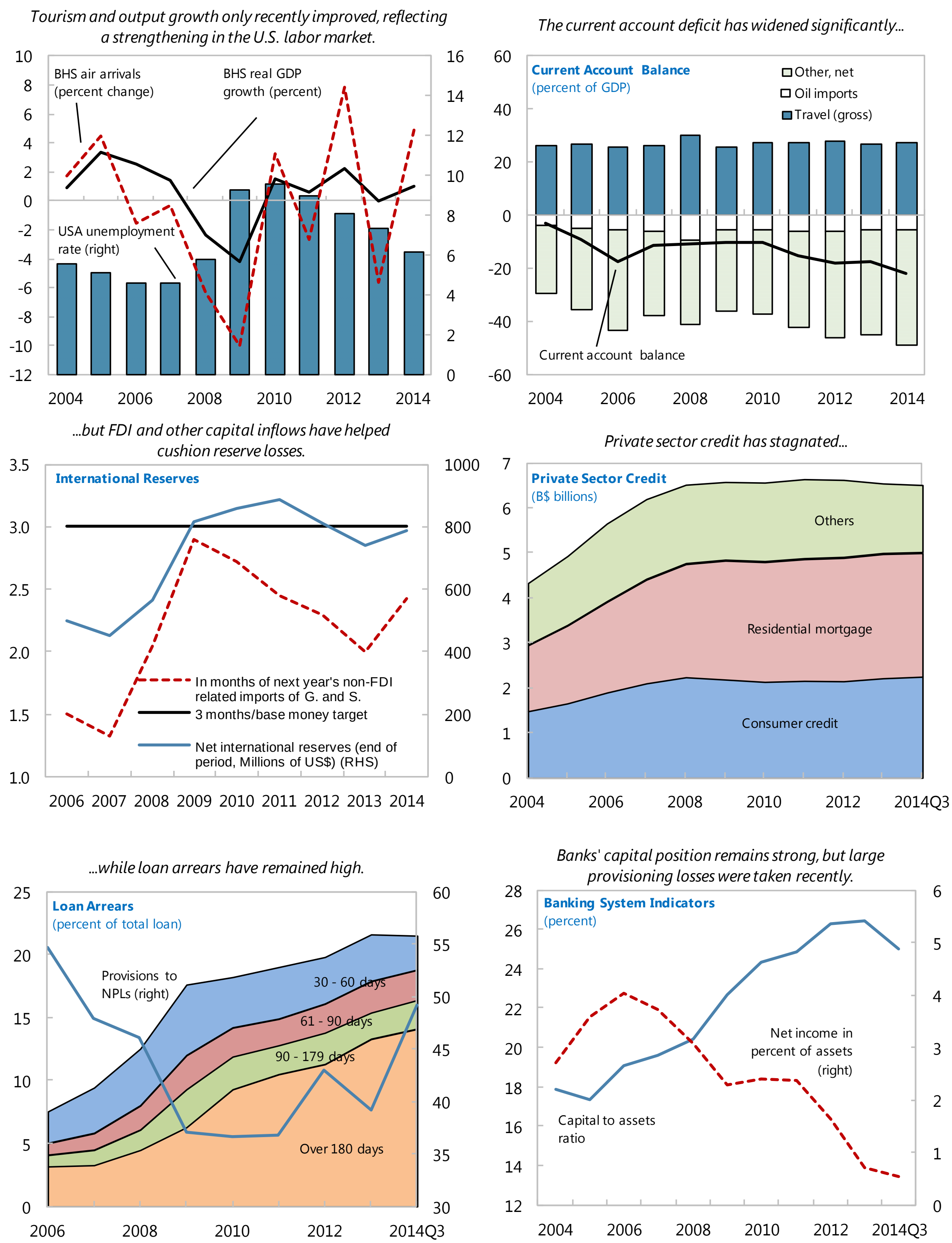
[3]Kandil et. al. (2014) "Labor Market Issues in the Caribbean: Scope to Mobilize Employment Growth", (WP/14/115).

### Box 3. Recent Financial Sector Regulatory and Supervisory Developments

**In July 2012, The Bahamian authorities participated in a Financial Sector Assessment Program.** At that time, the FSAP mission found no short-term threats to financial stability. Moreover, the mission concluded that the oversight of the financial system is independent and strong, particularly with respect to banking supervision. Nonetheless, the authorities continue to further improve the regulatory and supervisory system, including in the following areas:

- Risk-based supervisory framework/crisis management: The Central Bank of the Bahamas (CBB) and other regulatory authorities continue strengthening their frameworks, including with IMF technical assistance (most recently by the Legal Department in March 2015 to discuss the bank resolution, crisis management framework, and in April 2015 by CARTAC to the Securities Commission regarding risk-based supervision). Banking system stress tests for credit quality, liquidity and interest rate sensitivity indicated most recently that, with the exception of one institution (now undergoing restructuring), the banking systems' capital buffers are resilient to extreme shocks;
- Basel II/III: A roadmap for implementing Basel II/III was introduced in 2013, envisaging a 30-month timeline ending in 2015Q4, with live implementation to commence in 2016Q1. Progress has been on schedule, with most foreign-owned institutions already observing Basel III;
- Anti-money laundering/combating the financing of terrorism (AML/CFT): The authorities had committed to undergo an assessment within 18 months of the FSAP. Consistent with the greater flexibility in the timing of assessments relative to FSAPs as agreed in March 2014, this assessment is tentatively scheduled to be undertaken by the Caribbean Financial Action Task Force (CFATF) in November 2015.
- Deposit Insurance: The Deposit Insurance Corporation (DIC), under the supervision of the CBB, is implementing a three-year (2013–16) strategic plan to adopt FSAP recommendations, including improving transparency and disclosure, generating adequate pre-funding (and identify ex ante borrowing resources), and ensuring prompt payout periods;
- Credit unions: Seven credit unions with assets totaling $345.3 million (3.5 percent of the domestic banking systems' assets), are to be brought under the regulatory and supervisory ambit of the CBB. Legislation is before Parliament, but the CBB undertook its first onsite inspection of credit unions during 2014. Upon adoption, credit union deposits will have DIC protection;
- Credit Bureau: The CBB issued in September 2014 a consultation paper containing key provisions of a Draft Credit Reporting Bill and Draft Regulations, followed in November with a Request for Solution, with a kickoff scheduled for December 2017. The proposal aims for a wide coverage of potential creditors, with mandatory reporting by financial institutions, and regulatory required reporting for public utilities, hire/purchase entities, and public registers; and
- Tax Information Exchange Agreements (TIEA)/U.S. Foreign Accounts Tax Compliance Act (FATCA): As regards to the former, The Bahamas was found to be "Largely Compliant" in the Global Forum's Phase 2 Peer Review report (November 2013). Reporting under FATCA is scheduled to begin in September 2015 following the signing of an Intergovernmental Agreement (IGA) with the United States in November 2014.

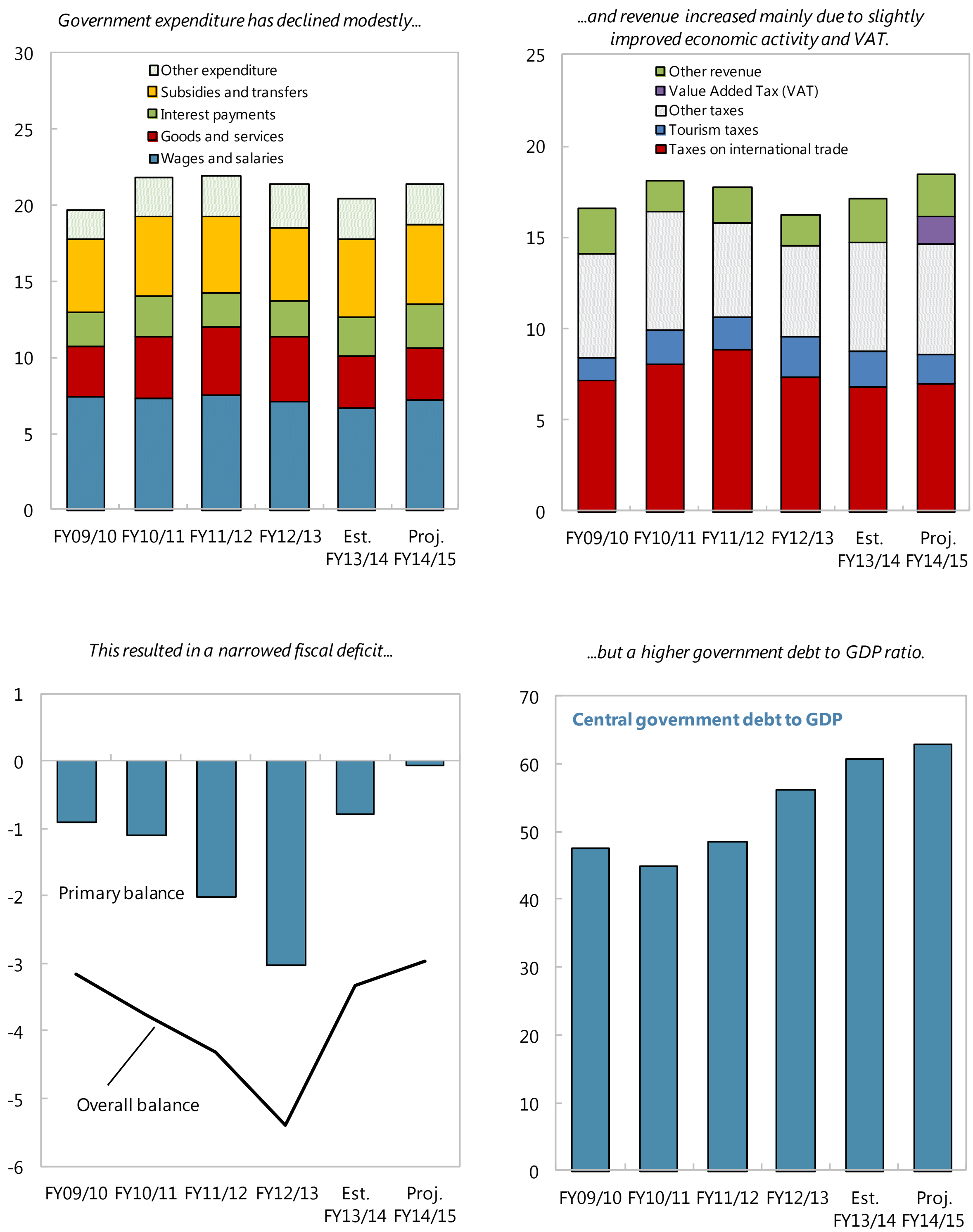
## Figure 1. The Bahamas: Recent Developments




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

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

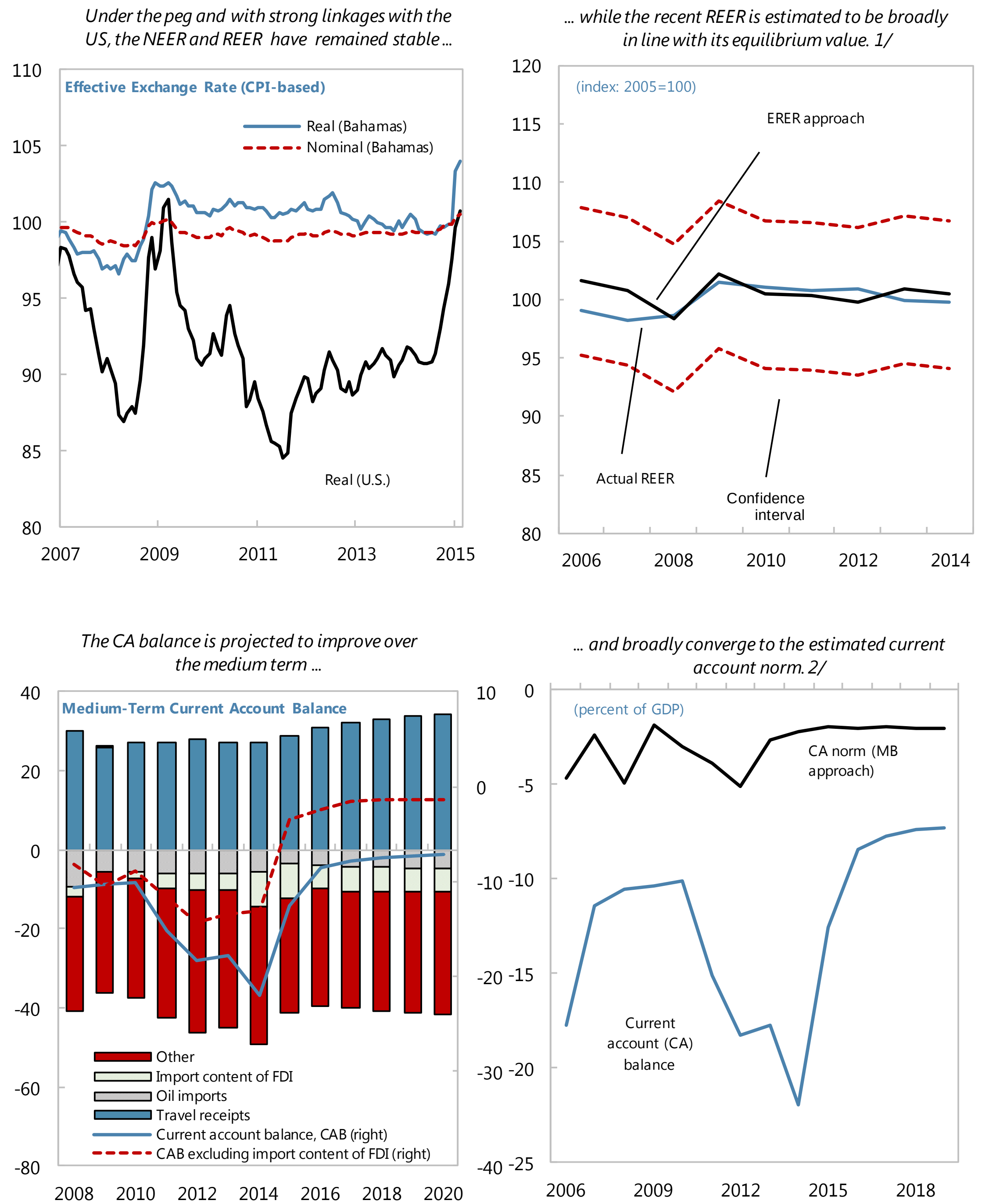
(In percent of GDP)




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

1/ Central government fiscal year ending June 30.

## Figure 3. The Bahamas: Exchange Rate Assessment

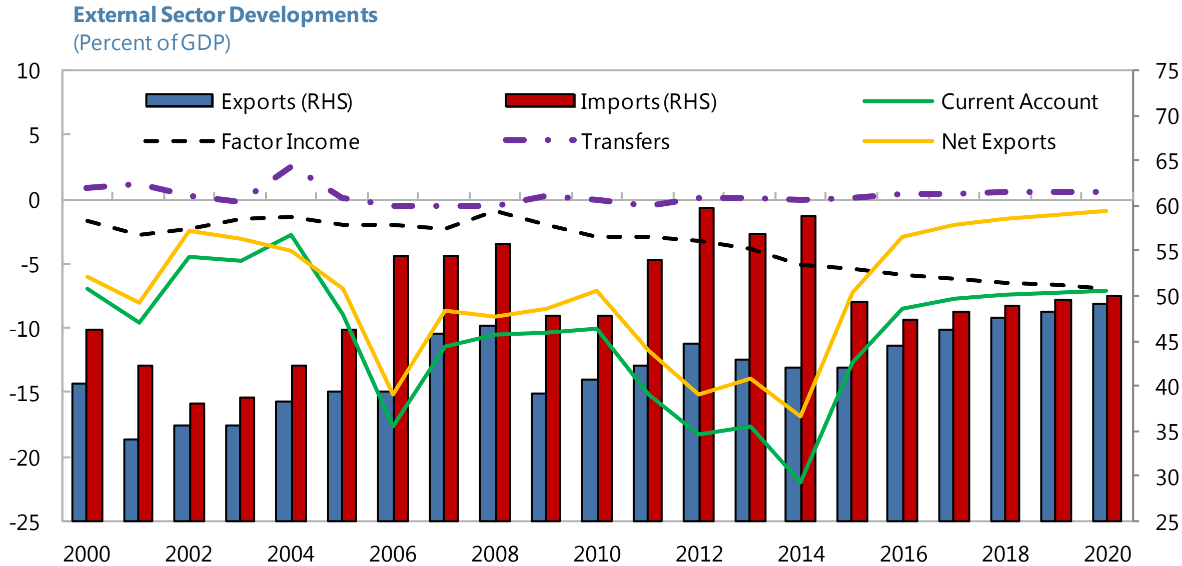


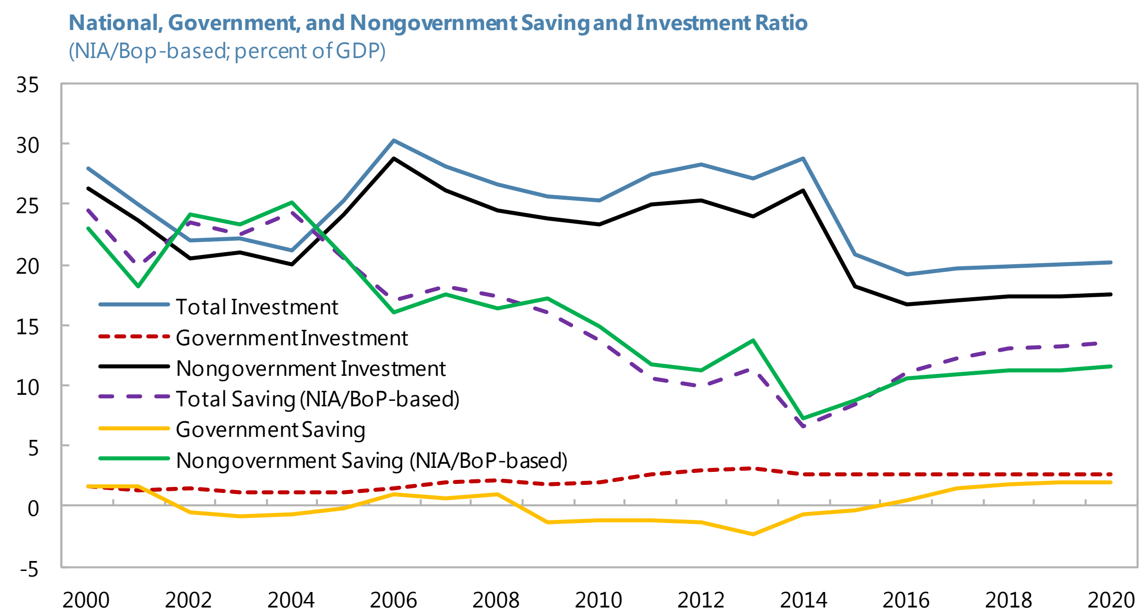

Sources: IMF, Information Notice System; and Fund staff calculations.

1/ The equilibrium value is computed using the equilibrium real exchange rate approach as in Vitek (2010).

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

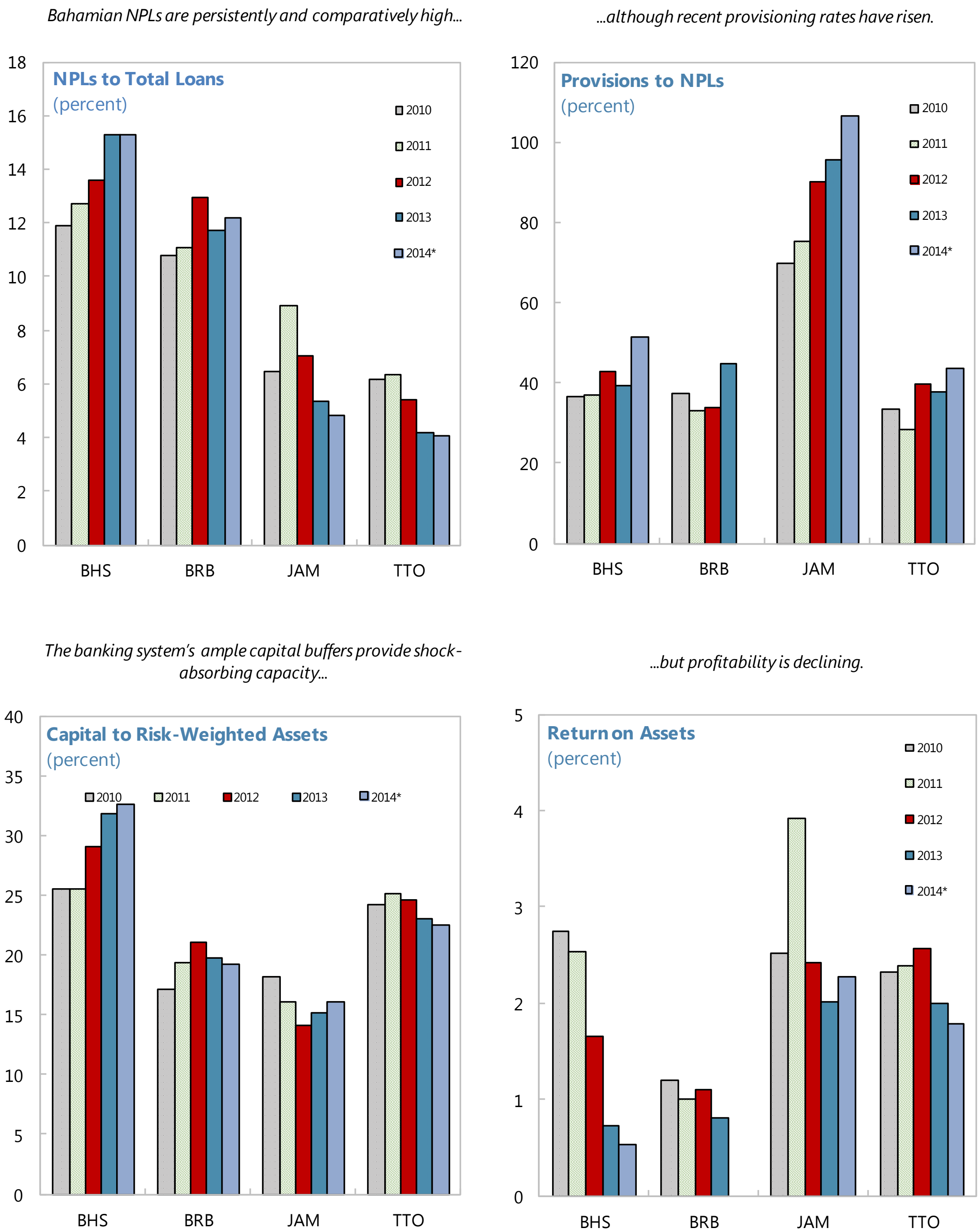
## Figure 4. The Bahamas: External, Saving, and Investment Developments




Source: The Bahamian authorities, and IMF staff estimates and projections.

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



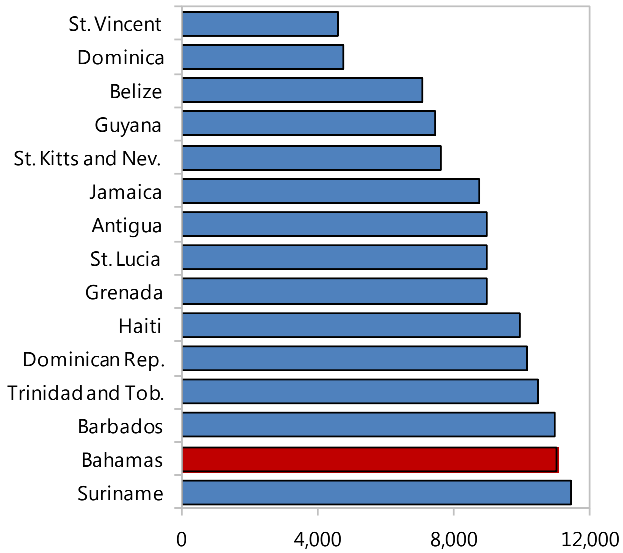

Sources: International Financial Statistics; National authorities; and Fund staff estimates.

1/ Regional comparators include Barbados, Jamaica, and Trinidad and Tobago.
*2014 data for The Bahamas are for Q4, but for other countries are latest available.

## Figure 6. Structural Competiveness Indicators

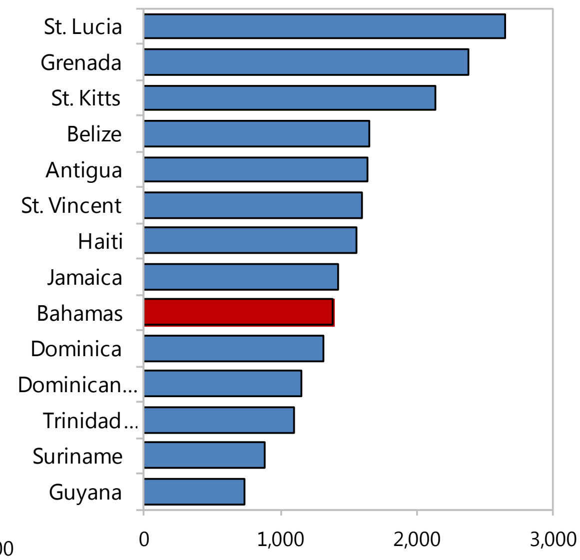
*The Bahamas scores well on airport capacity…*

**Airport Capacity**
(Runway length in feet)



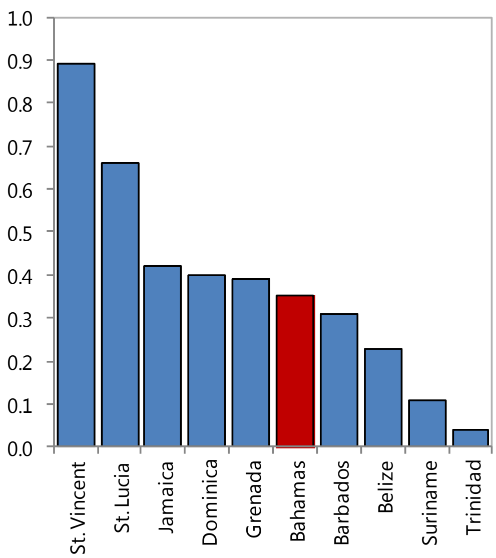

*…and is near the regional average on import costs…*

**Import Costs, 2008-09**
(US$ per 20 foot container)



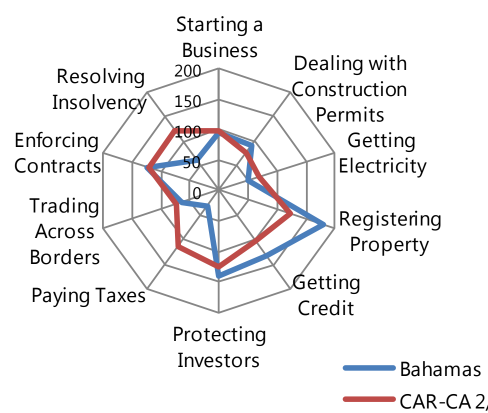

*…as well as electricity tariffs…*

**Electricity Tariffs**
(US dollars per KWH, June 2011)




*…but the regulatory environment needs improvement, in some areas.*

**Doing Business Indicators, 2015 1/**
(rankings out of 185 countries)




1/ The closer the line to the center of the chart, the more conducive the regulatory environment is to starting and operating a local firm.
2/ Simple average of Caribbean and Central American

Sources: World Bank, Doing Business Indicators, Utility Companies, International Energy Agency, and azworldairport.com.

## Table 1. The Bahamas: Selected Social and Economic Indicators

**I. Social Indicators**

| | | | |
|---|---|---|---|
| GDP (US$ millions), 2013 | 8,432 | Poverty rate (percent), 2013 | 12.8 |
| GDP per capita (US$), 2013 | 23,671 | Unemployment rate (percent), Nov. 2014 | 15.7 |
| Population (thousands), 2013 | 356 | Population not using an improved water source (percent), 2012 | 2.0 |
| Life expectancy at birth (years), 2012 | 75.9 | | |
| Adult literacy rate, 15 & up (percent), 2007 | 95.6 | Human development index (rank), 2012 | 49 |

**II. Economic Indicators**

| | 2011 | 2012 | Est. 2013 | 2014 | Projections 2015 | 2016 |
|---|---|---|---|---|---|---|
| (Annual percentage changes, unless otherwise indicated) | | | | | | |
| **Real sector** | | | | | | |
| Real GDP | 0.6 | 2.2 | 0.0 | 1.0 | 1.8 | 2.8 |
| Nominal GDP | -0.3 | 4.4 | 2.4 | 0.9 | 5.0 | 4.1 |
| Consumer price index (annual average) | 3.2 | 2.0 | 0.4 | 1.2 | 2.1 | 1.5 |
| Consumer price index (end of period) | 3.2 | 0.7 | 0.8 | 0.2 | 2.1 | 1.5 |
| Unemployment rate (in percent) | 15.9 | 14.4 | 15.8 | 15.0 | 14.8 | 13.9 |
| Saving rate (percent of GDP) | 12.4 | 10.0 | 9.3 | 6.9 | 8.3 | 10.9 |
| Investment rate (percent of GDP) | 27.5 | 28.3 | 27.0 | 28.8 | 20.8 | 19.2 |
| **Financial sector** | | | | | | |
| Credit to the nonfinancial public sector | 4.0 | 14.9 | 23.6 | 4.0 | 8.0 | 5.6 |
| Credit to the private sector | 1.1 | -0.3 | -1.2 | -2.8 | -0.2 | 0.6 |
| Liabilities to the private sector | 1.9 | -0.1 | 0.2 | 1.2 | 3.4 | 3.6 |
| **External sector** | | | | | | |
| Exports of goods and services | 3.6 | 10.5 | -1.3 | -1.7 | 5.2 | 10.3 |
| *Of which:* Travel receipts (gross) | -1.0 | 7.9 | -1.2 | 1.0 | 11.4 | 12.1 |
| Imports of goods and services | 12.9 | 15.6 | -2.6 | 4.1 | -11.9 | 0.1 |
| (In percent of GDP, unless otherwise indicated) | | | | | | |
| **Central government 1/** | | | | | | |
| Revenue and grants | 18.1 | 17.9 | 16.3 | 17.1 | 18.4 | 18.8 |
| Expenditure | 21.9 | 22.0 | 21.7 | 20.5 | 21.4 | 20.9 |
| Overall balance | -3.8 | -4.3 | -5.4 | -3.3 | -3.0 | -2.1 |
| Primary balance | -1.1 | -2.0 | -3.0 | -0.8 | -0.1 | 0.6 |
| Central government debt | 45.0 | 48.4 | 56.3 | 60.9 | 63.0 | 63.2 |
| **External sector 2/** | | | | | | |
| Current account balance | -15.1 | -18.3 | -17.7 | -21.9 | -12.5 | -8.3 |
| Change in net international reserves (Increase -) | -0.3 | 0.9 | 0.8 | -0.5 | -0.4 | -0.7 |
| External public debt (end of period) | 13.2 | 17.8 | 20.2 | 23.0 | 22.7 | 22.3 |
| **Memorandum items: 2/** | | | | | | |
| Gross international reserves | | | | | | |
| (End of period; millions of U.S. dollars) | 885 | 810 | 742 | 788 | 820 | 886 |
| In months of next year's G&S imports | 2.2 | 2.0 | 1.8 | 2.2 | 2.2 | 2.3 |
| In percent of reserve money | 100 | 90 | 86 | 80 | 81 | 84 |
| GDP (in millions of Bahamian dollars) | 7,890 | 8,234 | 8,432 | 8,511 | 8,939 | 9,305 |

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

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

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

(In millions of Bahamian dollars)

| | | | Prel. | Staff Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | FY11/12 | FY12/13 | FY13/14 | FY14/15 | FY15/16 | FY16/17 | FY17/18 | FY18/19 | FY19/20 |
| **Revenue** | **1,447** | **1,355** | **1,450** | **1,607** | **1,718** | **1,851** | **1,929** | **1,994** | **2,060** |
| Tax revenue | 1,277 | 1,216 | 1,248 | 1,411 | 1,517 | 1,644 | 1,716 | 1,785 | 1,846 |
| Taxes on international trade | 712 | 610 | 575 | 610 | 638 | 669 | 697 | 726 | 756 |
| Tourism taxes | 145 | 186 | 166 | 138 | 131 | 135 | 139 | 143 | 147 |
| Other taxes | 419 | 419 | 507 | 532 | 519 | 556 | 590 | 618 | 635 |
| Value added tax (VAT) | | | | 131 | 228 | 283 | 290 | 298 | 307 |
| Other revenue | 170 | 139 | 202 | 196 | 201 | 208 | 213 | 209 | 215 |
| **Expenditure** | **1,776** | **1,804** | **1,732** | **1,866** | **1,910** | **1,966** | **1,996** | **2,045** | **2,092** |
| Expense | 1,553 | 1,565 | 1,508 | 1,633 | 1,672 | 1,718 | 1,743 | 1,783 | 1,829 |
| Current expenditure | 1,550 | 1,546 | 1,506 | 1,631 | 1,670 | 1,716 | 1,741 | 1,780 | 1,827 |
| Wages and salaries | 608 | 594 | 565 | 628 | 648 | 670 | 678 | 696 | 716 |
| Goods and services | 357 | 354 | 288 | 297 | 301 | 312 | 310 | 318 | 327 |
| Interest payments | 186 | 198 | 215 | 252 | 251 | 259 | 265 | 269 | 272 |
| Subsidies and transfers | 399 | 400 | 438 | 454 | 470 | 476 | 489 | 497 | 511 |
| Capital transfers | 3 | 19 | 2 | 2 | 2 | 2 | 2 | 2 | 2 |
| Net acquisition of nonfinancial assets | 223 | 239 | 224 | 233 | 238 | 248 | 253 | 263 | 263 |
| **Gross Operating Balance** | **-106** | **-210** | **-58** | **-26** | **45** | **133** | **186** | **211** | **232** |
| **Net lending (+) / borrowing (–)** | **-348** | **-450** | **-282** | **-259** | **-192** | **-115** | **-66** | **-51** | **-31** |
| **Net acquisition of financial assets** | **102** | **96** | **79** | **79** | **79** | **79** | **79** | **79** | **79** |
| Domestic | 102 | 96 | 79 | 79 | 79 | 79 | 79 | 79 | 79 |
| Foreign | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Net incurrence of liabilities** | **451** | **546** | **362** | **338** | **272** | **194** | **146** | **131** | **110** |
| Domestic | 370 | 320 | -64 | 252 | 217 | 155 | 117 | 105 | 88 |
| Foreign | 80 | 226 | 426 | 87 | 54 | 39 | 29 | 26 | 22 |

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

1/ Fiscal year ends June 30.

## Table 3. The Bahamas: Operations of the Central Government 1/

(in percent of GDP)

| | FY11/12 | FY12/13 | Prel. FY13/14 | Staff Projections FY14/15 | FY15/16 | FY16/17 | FY17/18 | FY18/19 | FY19/20 |
|---|---|---|---|---|---|---|---|---|---|
| **Revenue** | **17.9** | **16.3** | **17.1** | **18.4** | **18.8** | **19.6** | **19.9** | **20.1** | **20.2** |
| Tax revenue | 15.8 | 14.6 | 14.7 | 16.2 | 16.6 | 17.4 | 17.7 | 18.0 | 18.1 |
| Taxes on international trade | 8.8 | 7.3 | 6.8 | 7.0 | 7.0 | 7.1 | 7.2 | 7.3 | 7.4 |
| Tourism taxes | 1.8 | 2.2 | 2.0 | 1.6 | 1.4 | 1.4 | 1.4 | 1.4 | 1.4 |
| Other taxes | 5.2 | 5.0 | 6.0 | 6.1 | 5.7 | 5.9 | 6.1 | 6.2 | 6.2 |
| Value added tax (VAT) | | | | 1.5 | 2.5 | 3.0 | 3.0 | 3.0 | 3.0 |
| Other revenue | 2.1 | 1.7 | 2.4 | 2.3 | 2.2 | 2.2 | 2.2 | 2.1 | 2.1 |
| **Expenditure** | **22.0** | **21.7** | **20.5** | **21.4** | **20.9** | **20.8** | **20.6** | **20.6** | **20.5** |
| Expense | 19.3 | 18.8 | 17.8 | 18.7 | 18.3 | 18.2 | 18.0 | 17.9 | 17.9 |
| Current expenditure | 19.2 | 18.6 | 17.8 | 18.7 | 18.3 | 18.2 | 18.0 | 17.9 | 17.9 |
| Wages and salaries | 7.5 | 7.1 | 6.7 | 7.2 | 7.1 | 7.1 | 7.0 | 7.0 | 7.0 |
| Goods and services | 4.4 | 4.2 | 3.4 | 3.4 | 3.3 | 3.3 | 3.2 | 3.2 | 3.2 |
| Interest payments | 2.3 | 2.4 | 2.5 | 2.9 | 2.8 | 2.7 | 2.7 | 2.7 | 2.7 |
| Subsidies and transfers | 4.9 | 4.8 | 5.2 | 5.2 | 5.2 | 5.1 | 5.1 | 5.0 | 5.0 |
| Capital transfers | 0.0 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net acquisition of nonfinancial assets | 2.8 | 2.9 | 2.6 | 2.7 | 2.6 | 2.6 | 2.6 | 2.6 | 2.6 |
| **Net lending (+)/borrowing (–)** | -4.3 | -5.4 | -3.3 | -3.0 | -2.1 | -1.2 | -0.7 | -0.5 | -0.3 |
| **Net acquisition of financial assets** | **1.3** | **1.2** | **0.9** | **0.9** | **0.9** | **0.8** | **0.8** | **0.8** | **0.8** |
| Domestic | 1.3 | 1.2 | 0.9 | 0.9 | 0.9 | 0.8 | 0.8 | 0.8 | 0.8 |
| Foreign | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Net incurrence of liabilities** | **5.6** | **6.6** | **4.3** | **3.9** | **3.0** | **2.1** | **1.5** | **1.3** | **1.1** |
| Domestic | 4.6 | 3.8 | -0.8 | 2.9 | 2.4 | 1.6 | 1.2 | 1.1 | 0.9 |
| Foreign | 1.0 | 2.7 | 5.0 | 1.0 | 0.6 | 0.4 | 0.3 | 0.3 | 0.2 |
| ***Memorandum items:*** | | | | | | | | | |
| Primary balance (In millions of B$) | -162 | -252 | -67 | -7 | 59 | 144 | 198 | 217 | 241 |
| In percent of GDP | -2.0 | -3.0 | -0.8 | -0.1 | 0.6 | 1.5 | 2.0 | 2.2 | 2.4 |
| Central government debt (In millions of B$) | 3,906 | 4,689 | 5,158 | 5,496 | 5,768 | 5,962 | 6,108 | 6,239 | 6,349 |
| In percent of GDP | 48.4 | 56.3 | 60.9 | 63.0 | 63.2 | 63.2 | 63.1 | 62.7 | 62.1 |
| Nominal GDP (In millions of B$) | 8,062 | 8,333 | 8,471 | 8,725 | 9,122 | 9,431 | 9,680 | 9,944 | 10,225 |

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

1/ Fiscal year ends June 30.

**Table 4. The Bahamas: Outstanding Stock of Public Debt**

(in percent of GDP) 1/

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|
| **Central government debt** | **33.5** | **42.5** | **47.0** | **48.2** | **53.4** | **58.4** | **62.6** |
| External | 4.7 | 9.0 | 9.2 | 10.1 | 12.7 | 15.1 | 18.0 |
| Domestic | 28.9 | 33.5 | 37.8 | 38.1 | 40.8 | 43.3 | 44.6 |
| *Of which:* in foreign currency | 0.0 | 0.0 | 0.9 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Public corporations' debt** | **10.5** | **11.9** | **13.5** | **14.3** | **16.1** | **15.8** | **16.4** |
| External | 0.7 | 0.8 | 2.4 | 3.1 | 5.1 | 5.1 | 5.0 |
| Domestic | 9.8 | 11.1 | 11.1 | 11.2 | 11.0 | 10.8 | 11.4 |
| *Of which:* in foreign currency | 5.0 | 5.5 | 5.5 | 5.3 | 5.2 | 4.8 | 5.2 |
| **Total public sector** | **44.1** | **54.4** | **60.5** | **62.6** | **69.6** | **74.2** | **79.0** |
| External | 5.4 | 9.8 | 11.6 | 13.2 | 17.8 | 20.2 | 23.0 |
| Domestic | 38.7 | 44.6 | 49.0 | 49.3 | 51.8 | 54.1 | 56.0 |
| *Of which:* in foreign currency | 5.1 | 5.5 | 6.4 | 5.3 | 5.2 | 4.8 | 5.2 |
| **Consolidated public sector 2/** | **35.3** | **45.1** | **51.7** | **53.9** | **60.7** | **66.1** | **70.6** |
| External | 5.4 | 9.8 | 11.6 | 13.2 | 17.8 | 20.2 | 23.0 |
| Domestic 2/ | 30.0 | 35.3 | 40.1 | 40.6 | 42.9 | 45.9 | 47.6 |
| *Of which:* in foreign currency | 5.0 | 5.5 | 5.5 | 5.3 | 5.2 | 4.8 | 5.2 |

Source: Central Bank of The Bahamas.

1/ Calendar year basis.
2/ Excludes central government debt holdings by public corporations.

## Table 5. The Bahamas: Balance of Payments

| | 2011 | 2012 | Est. 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Staff Projections | | | | | | |
| | (In millions of U.S. dollars) | | | | | | | | | |
| **Current account balance** | **-1,193** | **-1,505** | **-1,494** | **-1,860** | **-1,121** | **-770** | **-708** | **-671** | **-662** | **-646** |
| **Goods (trade balance)** | **-2,132** | **-2,401** | **-2,211** | **-2,421** | **-2,319** | **-2,356** | **-2,454** | **-2,535** | **-2,621** | **-2,708** |
| Domestic exports | 511 | 508 | 574 | 549 | 568 | 588 | 612 | 635 | 659 | 684 |
| Domestic imports | -2,624 | -2,886 | -2,763 | -2,948 | -2,863 | -2,921 | -3,041 | -3,145 | -3,254 | -3,365 |
| Oil | -483 | -496 | -485 | -452 | -285 | -343 | -386 | -421 | -454 | -487 |
| Capital goods | -583 | -688 | -657 | -657 | -647 | -567 | -591 | -607 | -622 | -640 |
| Other domestic imports | -1,558 | -1,702 | -1,621 | -1,838 | -1,931 | -2,010 | -2,064 | -2,117 | -2,178 | -2,239 |
| Other net exports | -19 | -24 | -22 | -22 | -23 | -24 | -24 | -25 | -26 | -27 |
| **Services** | **1,201** | **1,154** | **1,043** | **997** | **1,674** | **2,092** | **2,268** | **2,401** | **2,514** | **2,633** |
| Travel (net) | 1,895 | 2,026 | 2,022 | 2,097 | 2,355 | 2,655 | 2,854 | 3,011 | 3,155 | 3,304 |
| Travel (credit) | 2,142 | 2,311 | 2,285 | 2,308 | 2,572 | 2,882 | 3,090 | 3,257 | 3,409 | 3,568 |
| Travel (debit) | -246 | -286 | -262 | -212 | -217 | -227 | -236 | -245 | -255 | -264 |
| Other services | -694 | -872 | -979 | -1,100 | -681 | -563 | -586 | -610 | -640 | -671 |
| *Of which:* | | | | | | | | | | |
| Construction services (net) | -163 | -266 | -483 | -643 | -189 | -41 | -44 | -46 | -49 | -52 |
| Offshore companies local expenditure (net) | 139 | 176 | 180 | 201 | 208 | 218 | 229 | 240 | 251 | 262 |
| **Income and transfers** | **-262** | **-257** | **-326** | **-436** | **-476** | **-506** | **-522** | **-537** | **-554** | **-570** |
| **Capital and financial account** | **988** | **1,306** | **990** | **1,415** | **1,153** | **836** | **790** | **800** | **763** | **674** |
| Capital transfers | -6 | -7 | -10 | -9 | -9 | -10 | -10 | -10 | -11 | -11 |
| Long-term public sector 1/ | 130 | 411 | 138 | 415 | 52 | 22 | 9 | 3 | -1 | -107 |
| Commercial banks' NFA | -101 | -2 | 62 | -162 | 0 | 0 | 0 | 0 | 0 | 0 |
| Foreign direct investment | 667 | 526 | 382 | 251 | 262 | 276 | 292 | 309 | 326 | 344 |
| Other private capital | 298 | 379 | 417 | 920 | 848 | 548 | 498 | 498 | 448 | 448 |
| **Overall balance** | -205 | -198 | -504 | -445 | 32 | 66 | 82 | 129 | 101 | 28 |
| **Change in net international reserves (increase -)** | **-24** | **75** | **69** | **-46** | **-32** | **-66** | **-82** | **-129** | **-101** | **-28** |
| | (In percent of GDP) | | | | | | | | | |
| **Current account balance** | **-15.1** | **-18.3** | **-17.7** | **-21.9** | **-12.5** | **-8.3** | **-7.4** | **-6.8** | **-6.6** | **-6.2** |
| **Goods (trade balance)** | **-27.0** | **-29.2** | **-26.2** | **-28.4** | **-25.9** | **-25.3** | **-25.7** | **-25.9** | **-26.0** | **-26.1** |
| Domestic exports | 6.5 | 6.2 | 6.8 | 6.4 | 6.3 | 6.3 | 6.4 | 6.5 | 6.5 | 6.6 |
| Domestic imports | -33.3 | -35.0 | -32.8 | -34.6 | -32.0 | -31.4 | -31.8 | -32.1 | -32.3 | -32.5 |
| Oil | -6.1 | -6.0 | -5.8 | -5.3 | -3.2 | -3.7 | -4.0 | -4.3 | -4.5 | -4.7 |
| Capital goods | -7.4 | -8.4 | -7.8 | -7.7 | -7.2 | -6.1 | -6.2 | -6.2 | -6.2 | -6.2 |
| Other domestic imports | -19.8 | -20.7 | -19.2 | -21.6 | -21.6 | -21.6 | -21.6 | -21.6 | -21.6 | -21.6 |
| Other net exports | -0.2 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 |
| **Services** | **15.2** | **14.0** | **12.4** | **11.7** | **18.7** | **22.5** | **23.7** | **24.5** | **24.9** | **25.4** |
| Travel (net) | 24.0 | 24.6 | 24.0 | 24.6 | 26.3 | 28.5 | 29.9 | 30.7 | 31.3 | 31.9 |
| Travel (credit) | 27.1 | 28.1 | 27.1 | 27.1 | 28.8 | 31.0 | 32.3 | 33.2 | 33.8 | 34.4 |
| Travel (debit) | -3.1 | -3.5 | -3.1 | -2.5 | -2.4 | -2.4 | -2.5 | -2.5 | -2.5 | -2.5 |
| Other services | -8.8 | -10.6 | -11.6 | -12.9 | -7.6 | -6.0 | -6.1 | -6.2 | -6.4 | -6.5 |
| **Income and transfers** | **-3.3** | **-3.1** | **-3.9** | **-5.1** | **-5.3** | **-5.4** | **-5.5** | **-5.5** | **-5.5** | **-5.5** |
| **Capital and financial account** | **12.5** | **15.9** | **11.7** | **16.6** | **12.9** | **9.0** | **8.3** | **8.2** | **7.6** | **6.5** |
| Capital transfers | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 |
| Long-term public sector 1/ | 1.6 | 5.0 | 1.6 | 4.9 | 0.6 | 0.2 | 0.1 | 0.0 | 0.0 | -1.0 |
| Commercial banks' NFA | -1.3 | 0.0 | 0.7 | -1.9 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Foreign direct investment | 8.4 | 6.4 | 4.5 | 3.0 | 2.9 | 3.0 | 3.1 | 3.2 | 3.2 | 3.3 |
| Other private capital 2/ | 3.8 | 4.6 | 4.9 | 10.8 | 9.5 | 5.9 | 5.2 | 5.1 | 4.4 | 4.3 |
| **Overall balance** | **-2.6** | **-2.4** | **-6.0** | **-5.2** | **0.4** | **0.7** | **0.9** | **1.3** | **1.0** | **0.3** |
| **Change in net international reserves (increase -)** | **-0.3** | **0.9** | **0.8** | **-0.5** | **-0.4** | **-0.7** | **-0.9** | **-1.3** | **-1.0** | **-0.3** |
| **Memorandum items:** | | | | | | | | | | |
| Gross international reserves (in millions of US dollars) | 885 | 810 | 742 | 788 | 820 | 886 | 967 | 1,096 | 1,197 | 1,226 |
| Nominal GDP (millions of U.S. dollars) | 7,890 | 8,234 | 8,432 | 8,511 | 8,939 | 9,305 | 9,556 | 9,803 | 10,084 | 10,365 |

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

1/ Includes SDR allocation in September 2009.

2/ Includes errors and omissions.

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

| | | | Est. | Staff Projections | |
|---|---|---|---|---|---|
| | 2012 | 2013 | 2014 | 2015 | 2016 |
| (In millions of Bahamian dollars, end of period) | | | | | |
| **Central Bank** | | | | | |
| Gross international reserves | 810 | 742 | 788 | 820 | 886 |
| Net domestic assets | 89 | 123 | 193 | 195 | 165 |
| Credit to nonfinancial public sector (net) | 390 | 488 | 504 | 505 | 475 |
| *Of which:* Central Government | 395 | 490 | 521 | 521 | 521 |
| Other | -301 | -365 | -310 | -310 | -310 |
| Reserve money | 899 | 865 | 981 | 1,015 | 1,051 |
| Currency held by the private sector | 344 | 353 | 375 | 388 | 402 |
| Liabilities with financial institutions | 555 | 512 | 606 | 626 | 649 |
| **Financial system** | | | | | |
| Net foreign assets | 208 | 46 | 286 | 318 | 384 |
| *Of which* : | | | | | |
| Held by commercial banks and OFIs | -602 | -695 | -502 | -502 | -502 |
| Net domestic assets | 6,095 | 6,271 | 6,105 | 6,292 | 6,461 |
| Credit to nonfinancial public sector, net | 1,715 | 2,121 | 2,206 | 2,384 | 2,517 |
| *Of which:* Central Government | 1,592 | 1,943 | 2,021 | 2,199 | 2,332 |
| Credit to private sector | 6,629 | 6,552 | 6,368 | 6,353 | 6,388 |
| Other | -2,249 | -2,402 | -2,469 | -2,445 | -2,445 |
| Liabilities to the private sector (broad money) | 6,304 | 6,317 | 6,390 | 6,609 | 6,844 |
| Money | 1,575 | 1,641 | 1,996 | 2,065 | 2,138 |
| Currency | 217 | 214 | 233 | 241 | 249 |
| Demand deposits | 1,358 | 1,427 | 1,763 | 1,824 | 1,889 |
| Quasi-money | 4,729 | 4,676 | 4,394 | 4,545 | 4,706 |
| (Change in percent of liabilities to the private sector at the beginning of the period) | | | | | |
| Net foreign assets | -1.1 | -2.6 | 3.8 | 0.5 | 1.0 |
| Net domestic assets | 1.0 | 2.8 | -2.6 | 2.9 | 2.6 |
| Credit to nonfinancial public sector | 3.5 | 6.4 | 1.4 | 2.8 | 2.0 |
| Credit to private sector | -0.3 | -1.2 | -2.9 | -0.2 | 0.5 |
| Liabilities to private sector | -0.1 | 0.2 | 1.2 | 3.4 | 3.6 |
| Money | 2.2 | 1.1 | 5.6 | 1.1 | 1.1 |
| Quasi-money | -2.3 | -0.8 | -4.5 | 2.4 | 2.4 |
| (Annual percentage change) | | | | | |
| Net domestic assets | 1.1 | 2.9 | -2.6 | 3.1 | 2.7 |
| Credit to nonfinancial public sector | 14.9 | 23.6 | 4.0 | 8.0 | 5.6 |
| Credit to private sector | -0.3 | -1.2 | -2.8 | -0.2 | 0.6 |
| Liabilities to private sector | -0.1 | 0.2 | 1.2 | 3.4 | 3.6 |
| Money | 9.8 | 4.2 | 21.6 | 3.4 | 3.6 |
| Quasi-money | -3.0 | -1.1 | -6.0 | 3.4 | 3.6 |

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

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

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | Latest Observation 2014 | |
|---|---|---|---|---|---|---|---|---|
| **Financial indicators** | | | | | | | | |
| Broad money (12-month percentage change) | 5.1 | 1.8 | 2.6 | 1.9 | -0.1 | 0.2 | 1.2 | Dec. |
| Private sector credit (12-month percentage change) | 5.1 | 0.9 | -0.4 | 1.1 | -0.3 | -1.2 | -2.8 | Dec. |
| Three-month treasury-bill rate (end of period) | 2.7 | 2.6 | 2.3 | 1.3 | 0.2 | 0.3 | 0.0 | Dec. |
| Domestic public debt (in percent of GDP, end of period) | 38.7 | 44.6 | 49.0 | 49.3 | 51.8 | 54.1 | 56.0 | Dec. |
| **External indicators** | | | | | | | | |
| Exports of goods and services (12-month percentage change) | 0.9 | -20.4 | 4.9 | 3.6 | 10.5 | -1.3 | -1.7 | |
| Imports of goods and services (12-month percentage change) | 1.5 | -18.9 | 1.1 | 12.9 | 15.6 | -2.6 | 4.1 | |
| Current account balance (in percent of GDP) | -10.6 | -10.3 | -10.1 | -15.1 | -18.3 | -17.7 | -21.9 | |
| Capital and financial account balances (in percent of GDP) 2/ | 14.7 | 14.3 | 14.5 | 12.5 | 15.9 | 11.7 | 16.6 | |
| Gross international reserves (end of period, millions of US$) | 563 | 816 | 860 | 885 | 810 | 742 | 788 | Dec. |
| In months of merchandise imports | 2.1 | 3.9 | 4.0 | 3.6 | 2.9 | 2.8 | 2.9 | Dec. |
| In months of next year's imports of goods and services | 1.8 | 2.6 | 2.4 | 2.2 | 2.0 | 1.8 | 2.2 | Dec. |
| In months of next year's non-FDI related G&S imports | 2.0 | 2.9 | 2.7 | 2.4 | 2.3 | 2.0 | 2.4 | Dec. |
| In percent of reserve money | 87.3 | 117.5 | 104.2 | 100.4 | 90.1 | 85.7 | 80.3 | Dec. |
| In percent of broad money | 9.5 | 13.5 | 13.9 | 14.0 | 12.9 | 11.7 | 12.3 | Dec. |
| Commercial banks, net foreign assets (end of period, millions of US$) | -704 | -682 | -708 | -604 | -602 | -695 | -502 | Dec. |
| External public debt (in percent of GDP) | 5.4 | 9.8 | 11.6 | 13.2 | 17.8 | 20.2 | 23.0 | Dec. |
| External debt service (in percent of exports of goods and services) | 2.8 | 20.2 | 7.3 | 4.6 | 5.5 | 8.9 | 3.3 | |
| Central government external debt service (in percent of government revenue) | 3.4 | 20.4 | 4.5 | 8.1 | 4.0 | 4.6 | 4.8 | June |
| REER appreciation (+) (end of period) | 13.0 | -5.6 | 0.2 | 0.4 | -1.0 | -0.6 | 0.2 | Dec. |
| **Banking sector risk indicators 1/** | | | | | | | | |
| Foreign currency deposits, percent of total deposits | 3.5 | 4.0 | 3.7 | 3.3 | 3.5 | 4.4 | 3.7 | Dec. |
| Deposits maturing within 3 months, percent of total deposits | 19.7 | 21.5 | 20.9 | 25.2 | 22.4 | 22.2 | 21.8 | Dec. |
| Capital to risk-weighted assets ratio, percent | 23.5 | 26.1 | 25.5 | 25.5 | 26.1 | 31.7 | 32.7 | Q4 |
| Nonperforming loans to total loans ratio, percent | 6.1 | 9.3 | 11.9 | 12.7 | 13.8 | 15.3 | 15.3 | Q4 |
| Provisions to nonperforming loans ratio, percent | 46.0 | 37.1 | 36.6 | 36.8 | 43.0 | 39.2 | 51.6 | Q4 |
| Pre-tax net revenue, percent of net worth | 14.8 | 10.2 | 9.7 | 9.5 | 5.8 | 5.4 | 0.5 | Q4 |
| Administrative expenses, percent of total assets | 3.3 | 2.9 | 3.1 | 3.2 | 3.3 | 3.8 | 3.8 | Q4 |
| Liquid assets to deposits ratio, percent | 25.1 | 30.0 | 36.1 | 38.3 | 41.0 | 45.5 | 49.7 | Dec. |
| Average interest rate spread, percent | 7.0 | 6.8 | 7.6 | 8.3 | 8.9 | 9.9 | 10.9 | Q4 |

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

1/ Includes errors and omissions.

## Table 8. The Bahamas: Risk Assessment Matrix[1]

| Main Threats | Likelihood of Realization of the Threat | Expected Impact if Threat Materialized | Policy Response |
|---|---|---|---|
| 1. Protracted period of slower growth in advanced economies | **High**<br>Lower-than-anticipated potential growth and persistently low inflation from a failure to fully address crisis legacies, leading to secular stagnation and lower commodity prices. | Weaker recoveries in advanced countries, especially the U.S. which accounts for 80 percent of tourism arrivals to The Bahamas will undermine growth, weaken public finances, and put pressures on the BOP and international reserves. | Diversify growth drivers over the medium term, including building a broader tourist base.<br>Continued fiscal consolidation.<br>Strengthen competitiveness. |
| 2. Protracted period of slower growth in emerging economies | **High**<br>Maturing of the cycle, misallocation of investment, and incomplete structural reforms leading to prolonged slower growth. | A further slowdown of emerging economies would lower medium term growth prospects, particularly as tourism strategy is beginning to be oriented towards growing market share in EMs. | Diversify growth drivers over the medium term, including building a broader tourist base.<br>Strengthen competitiveness.<br>Continued fiscal consolidation. |
| 3. Side-effects from global financial conditions (Persistent dollar strengthening) | **Medium**<br>Improving U.S. economic prospects versus the rest of the world leads to a further dollar surge, boosting non-U.S. trade but creating balance sheet strains for dollar debtors | Relative to low cost destinations and countries whose currencies are not pegged one-to-one to the dollar, a further dollar strengthening would lower tourism arrivals from the U.S., widen the current account deficit and lower reserves. | Diversify growth drivers and sources over the medium term, including building a broader tourist base<br>Strengthen competitiveness. |
| 4. Geopolitical fragmentation that erodes the globalization process and fosters inefficiency. | **Medium**<br>Sustained tensions in Russia/Ukraine depress business confidence and heighten risk aversion, amid disturbance in global financial, trade and commodity markets. Heightened risk of fragmentation in the Middle East, leading to a sharp rise in oil prices, with negative spillovers to the global economy | Spikes in global oil prices will feed into higher inflation, weaken external current account balance, raise travel costs and possibly lower tourist arrivals. | Cautiously use targeted subsidies to protect low-income earners and vulnerable groups.<br>Monetary policy should accommodate the direct impact of commodity price shocks while counteracting potential second-round effects. |

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities.

## Table 8. The Bahamas: Risk Assessment Matrix (concluded)

| | | | |
|---|---|---|---|
| 5. Further delayed opening, or disappointing performance of Baha Mar | **Low**<br>The foreign investors seem knowledgeable in tourism business and a thorough feasibility study was done prior to project commencement. Staff remains conservative about the upside boost on economic activity | The uptick in growth currently projected for 2015–16 would not materialize with adverse implication for government revenues. | Coordinate with the foreign investor to address any shortcomings that would lead to further delays.<br>Continued fiscal consolidation and prompt implementation of<br>the National Development Plan to boost investor confidence and attract FDI. |
| 6. Setback in the implementation of VAT/Delay in fiscal consolidation | **Medium**<br>As with the implementation of a new tax system, the authorities and tax payers are expected to encounter some teething problems from the recently implemented VAT. | VAT implementation setback could lead to revenue underperformance.<br><br>Further delays in fiscal consolidation would undermine the credibility of government, and could pose risks to long-term debt sustainability and the country's investment-grade credit rating. | Speedily address implementation setbacks and transitional issues.<br>Any slippages should be met with offsetting measures in order to meet budget targets. |
| 7. Credit risk in the banking sector | **Low**<br>The non-performing loan (NPL) ratio remains high. There is some degree of uncertainty on the value of underlying collateral for nonperforming mortgages | The banking system's capital buffers provide shock-absorbing capacity. However, NPLs that remain on the balance sheet for prolonged periods could gradually result in higher provisioning and charge-offs, dragging down banks' future profitability. | Further strengthen financial sector supervision and oversight.<br>Quick resolution of the debt overhang in the banking system. |
| 8. Bond market stress from a reassessment in sovereign risk | **Low**<br>Protracted failure to agree on a credible medium term plan for fiscal sustainability in the United States could lead to a sustained loss of confidence. Such developments could undermine the recovery of private domestic demand and severe global market repercussions. | Weak recovery of private demand in the U.S. will affect tourism arrivals in The Bahamas, which in turns would undermine its growth prospects, weaken public finances, and put pressures on the BOP and international reserves. | Diversify growth drivers and sources over the medium term, including building a broader tourist base.<br>Strengthen competitiveness.<br>Continued fiscal consolidation. |

# Annex I. Debt Sustainability Analysis

*The public debt[1] to GDP ratio will remain elevated, but sustainable in the medium term as the fiscal position strengthens. Under the baseline scenario, public debt is projected to peak at 63 percent of GDP in FY 2014/15, declining marginally thereafter to 62 percent in FY 2019/20. Financing conditions would also improve as gross financing requirements gradually decline from 5.7 percent of GDP in FY 2014/15 to about 2.0 percent of GDP in 2019/20. External financing requirement is highlighted as a significant risk to the debt profile, which could be mitigated by the projected strengthening of the current account in the medium term. The main risks to debt sustainability remain slower than expected growth and weak fiscal efforts.*

**Public debt is estimated to have reached 60.9 percent of GDP in FY 2013/14 compared with 56.3 percent in FY 2012/13, reflecting weak fiscal stance and lackluster growth performance.** Under the baseline scenario, public debt is expected to peak at 62.8 percent of GDP in FY 2014/15 and thereafter fall slightly to 62.1 percent of GDP in 2019/20, as the fiscal position gradually strengthens with the authorities' ongoing fiscal consolidation program. A slight reduction in real interest rates will also help stabilize the debt level. Financing conditions would improve as gross financing requirements will gradually decline from 5.7 percent of GDP in FY 2015/16 to about 1.9 percent of GDP in 2019/20. The liquidity in the domestic banking system and a captive investor base limits rollover risks.

**Overall, the heat map reveals moderate or low risks to debt sustainability.** Compared with the benchmark for emerging markets, however, the external financing requirement is highlighted as a significant risk to the debt profile. As a share of total public debt, foreign currency denominated debt rose by 7.6 percentage points to 30 percent in 2013/14. The practice of borrowing to build reserves should be discouraged given that it increases the country's external debt service burden and leaves government's balance sheet more vulnerable to external shocks. The composition of public debt remains very favorable—a large proportion of the debt is held in local currency and only about 13 percent is short term. The projected strengthening of the current account in the medium term is expected to reduce the need for large external financing.

**With respect to real GDP assumptions in the baseline, there appears to be no systematic bias in recent years (2011–2013) as staff projections were close to the outcomes, although in the past, there was a tendency towards optimism.** With median forecast errors of -1.04 percent of GDP and -1.19 percent of GDP respectively, the projections for primary balance appear to have been relatively optimistic, while those of inflation tended to be persimistic during 2006–14. Reflecting the low debt level in the past, historical primary balance is probably not an appropriate comparator. Indeed, staff's projected primary balance over the medium term is broadly consistent with the authorities' planned fiscal adjustment.

[1] The coverage is the central government debt only. The operations of public corporations are not compiled into a consolidated set of public sector accounts.

**Macro-fiscal stress tests indicate a moderate sensitivity of public debt to a variety of shocks, with the greatest sensitivity being to real GDP growth shocks, buttressing staff's recommendation for policy measures to boost growth potential in the medium term.** However, the gross financial requirements are especially sensitive to the real interest rate. Among the various shocks analyzed, sensitivity to real exchange rate shocks remains the lowest. A combined macro-fiscal shock would raise debt to 74 percent of GDP, and gross financing requirements to 4.4 percent of GDP in FY 2019/20.

**Additional results from two alternative scenarios using constant primary balance and historical average of real GDP growth indicate a sharp further rise of public debt to 80 percent of GDP over the medium term with gross financing requirements also rising to 6 percent of GDP.** This reinforces the need for a steadfast implementation of fiscal consolidation program to achieve a more sustainable debt path.

**Estimated at 23 percent of GDP in 2013/14, external public debt, (central government and public corporations) remains relatively low and is projected to stabilize at 22 percent in the medium term.** Bound test results suggest that the external public debt profile is moderately sensitive to shocks to the non-interest current account and the real exchange rate.

## Figure A1.1. The Bahamas: Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(in percent of GDP unless otherwise indicated)

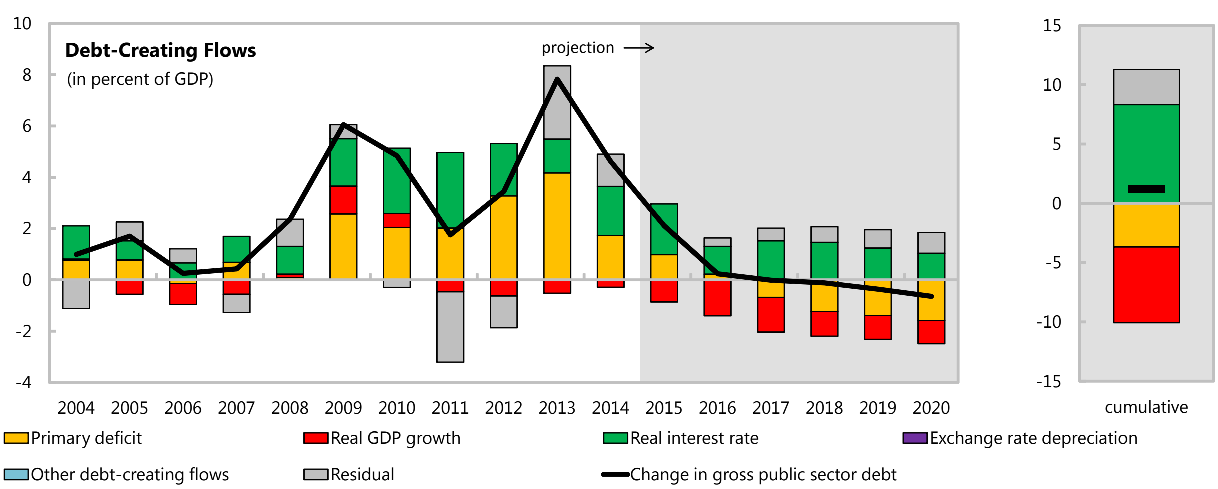
### Debt, Economic and Market Indicators [1/]

| | Actual | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2004-2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
| Nominal gross public debt | 36.0 | 56.3 | 60.9 | 63.0 | 63.2 | 63.2 | 63.1 | 62.7 | 62.1 |
| Public gross financing needs | 4.9 | 8.3 | 6.8 | 5.7 | 4.3 | 3.1 | 2.6 | 2.4 | 1.9 |
| Real GDP growth (in percent) | 0.5 | 1.1 | 0.5 | 1.4 | 2.3 | 2.2 | 1.6 | 1.5 | 1.5 |
| Inflation (GDP deflator, in percent) | 1.2 | 2.2 | 1.1 | 1.5 | 2.2 | 1.2 | 1.0 | 1.2 | 1.3 |
| Nominal GDP growth (in percent) | 1.7 | 3.4 | 1.7 | 3.0 | 4.6 | 3.4 | 2.6 | 2.7 | 2.8 |
| Effective interest rate (in percent) [3/] | 5.8 | 5.1 | 4.6 | 4.9 | 4.0 | 3.7 | 3.4 | 3.2 | 3.0 |

| As of September 05, 2014 | | |
|---|---|---|
| Sovereign Spreads | | |
| Spread (bp) 2/ | | n.a. |
| CDS (bp) | | n.a. |
| Ratings | Foreign | Local |
| Moody's | Baa2 | Baa2 |
| S&Ps | BBB | BBB |
| Fitch | n.a. | n.a. |

### Contribution to Changes in Public Debt

| | Actual | | | Projections | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2004-2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | cumulative | debt-stabilizing primary balance [8/] |
| Change in gross public sector debt | 2.4 | 7.8 | 4.6 | 2.1 | 0.2 | 0.0 | -0.1 | -0.4 | -0.6 | 1.2 | |
| Identified debt-creating flows | 2.8 | 5.0 | 3.4 | 2.1 | -0.1 | -0.5 | -0.7 | -1.1 | -1.5 | -1.7 | 0.1 |
| Primary deficit | 1.3 | 4.2 | 1.7 | 1.0 | 0.2 | -0.7 | -1.2 | -1.4 | -1.6 | -3.7 | |
| Primary (noninterest) revenue and grants | 16.2 | 16.3 | 17.1 | 18.4 | 18.8 | 19.6 | 19.9 | 20.1 | 20.2 | 117.0 | |
| Primary (noninterest) expenditure | 17.5 | 20.4 | 18.9 | 19.4 | 19.1 | 18.9 | 18.7 | 18.7 | 18.6 | 113.3 | |
| Automatic debt dynamics [4/] | 1.4 | 0.8 | 1.6 | 1.1 | -0.3 | 0.2 | 0.5 | 0.3 | 0.1 | 1.9 | |
| Interest rate/growth differential [5/] | 1.4 | 0.8 | 1.6 | 1.1 | -0.3 | 0.2 | 0.5 | 0.3 | 0.1 | 1.9 | |
| Of which: real interest rate | 1.6 | 1.3 | 1.9 | 2.0 | 1.1 | 1.5 | 1.5 | 1.2 | 1.0 | 8.3 | |
| Of which: real GDP growth | -0.1 | -0.5 | -0.3 | -0.8 | -1.4 | -1.3 | -1.0 | -0.9 | -0.9 | -6.4 | |
| Exchange rate depreciation [6/] | 0.0 | 0.0 | 0.0 | … | … | … | … | … | … | … | |
| Other identified debt-creating flows | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Privatization receipts (negative) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Contingent liabilities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Other debt-creating flows (specify) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Residual, including asset changes [7/] | -0.4 | 2.9 | 1.3 | 0.0 | 0.3 | 0.5 | 0.6 | 0.7 | 0.8 | 2.9 | |




Source: Fund Staff Calculations.

1/ Public sector is defined as central government.

2/ Bond Spread over U.S. Bonds.

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

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

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

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

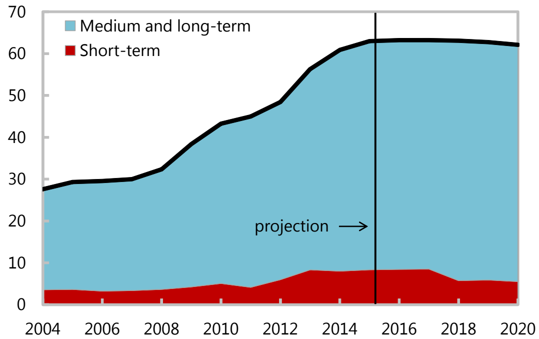
7/ For projections, this line includes exchange rate changes during the projection period.

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

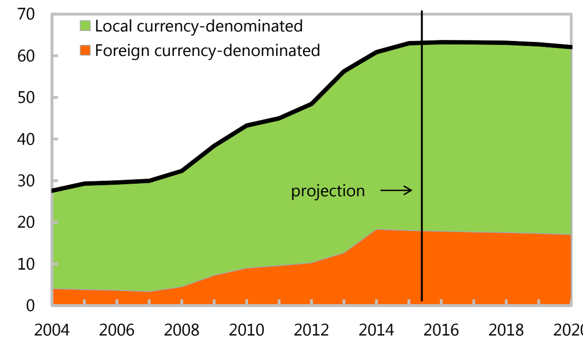
## Figure A1.2. The Bahamas: Public DSA - Composition of Public Debt and Alternative Scenarios

### Composition of Public Debt

**By Maturity**
(in percent of GDP)



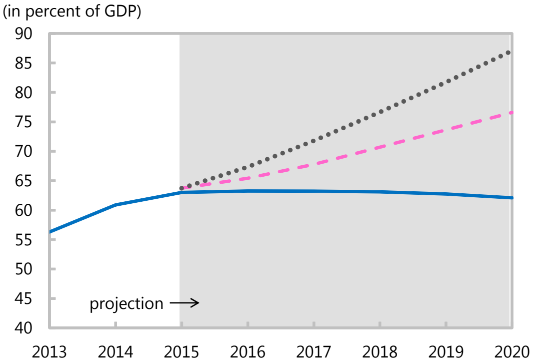

**By Currency**
(in percent of GDP)



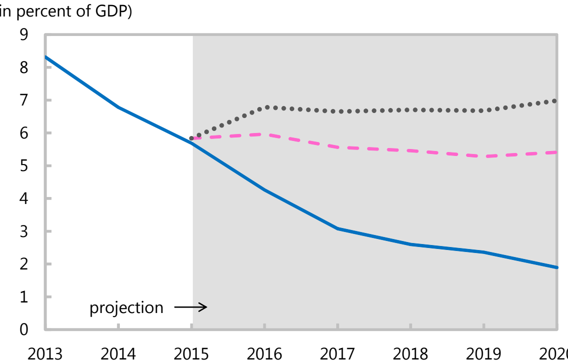

### Alternative Scenarios

Baseline    Historical    Constant Primary Balance

**Gross Nominal Public Debt**
(in percent of GDP)




**Public Gross Financing Needs**
(in percent of GDP)



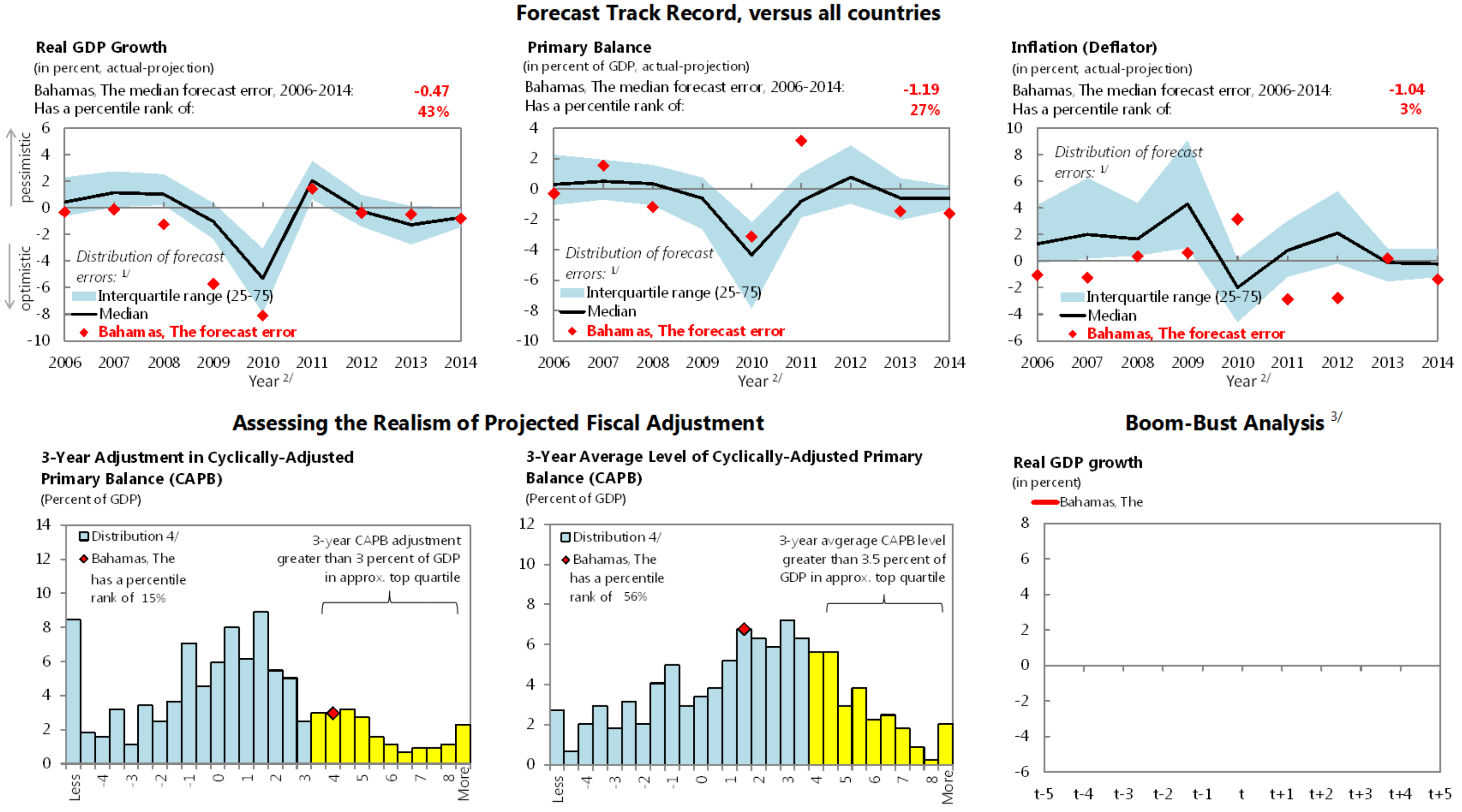

### Underlying Assumptions
(in percent)

| **Baseline Scenario** | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|
| Real GDP growth | 1.4 | 2.3 | 2.2 | 1.6 | 1.5 | 1.5 |
| Inflation | 1.5 | 2.2 | 1.2 | 1.0 | 1.2 | 1.3 |
| Primary Balance | -1.0 | -0.2 | 0.7 | 1.2 | 1.4 | 1.6 |
| Effective interest rate | 4.9 | 4.0 | 3.7 | 3.4 | 3.2 | 3.0 |
| **Constant Primary Balance Scenario** | | | | | | |
| Real GDP growth | 1.4 | 2.3 | 2.2 | 1.6 | 1.5 | 1.5 |
| Inflation | 1.5 | 2.2 | 1.2 | 1.0 | 1.2 | 1.3 |
| Primary Balance | -1.0 | -1.0 | -1.0 | -1.0 | -1.0 | -1.0 |
| Effective interest rate | 4.9 | 4.6 | 4.6 | 4.5 | 4.5 | 4.5 |

| **Historical Scenario** | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|
| Real GDP growth | 1.4 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 |
| Inflation | 1.5 | 2.2 | 1.2 | 1.0 | 1.2 | 1.3 |
| Primary Balance | -1.0 | -1.7 | -1.7 | -1.7 | -1.7 | -1.7 |
| Effective interest rate | 4.9 | 4.6 | 4.8 | 4.9 | 5.1 | 5.2 |

Source: Fund Staff calculations.

**Figure A1.3. The Bahamas: Public DSA – Realism of Baseline Assumptions**




Source : IMF Staff.

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

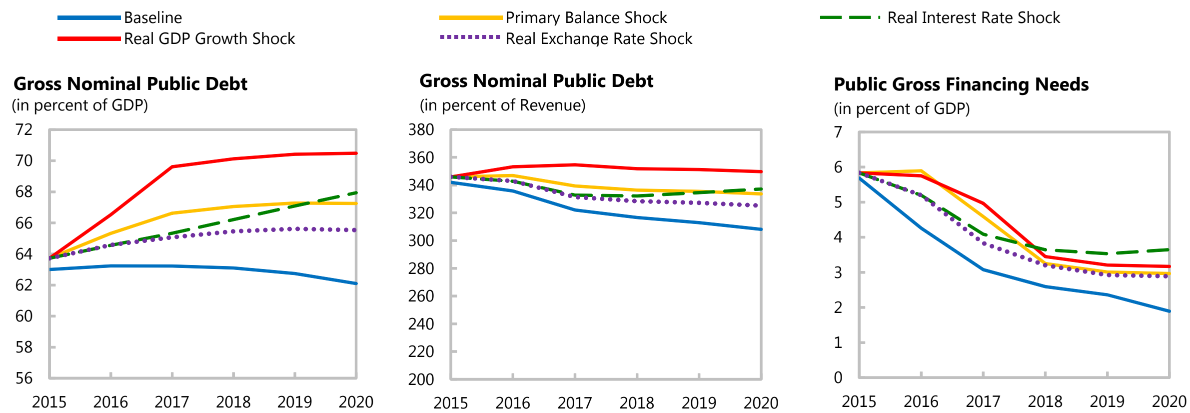
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Bahamas, The.

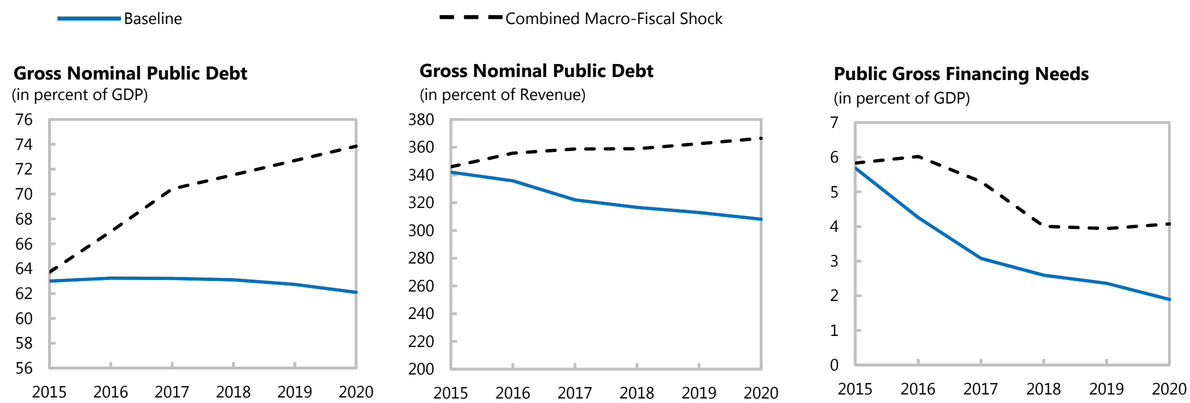
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

## Figure A1.4. The Bahamas: Public DSA - Stress Tests

### Macro-Fiscal Stress Tests




### Additional Stress Tests




### Underlying Assumptions

(in percent)

| **Primary Balance Shock** | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|
| Real GDP growth | 1.4 | 2.3 | 2.2 | 1.6 | 1.5 | 1.5 |
| Inflation | 1.5 | 2.2 | 1.2 | 1.0 | 1.2 | 1.3 |
| Primary balance | -1.0 | -0.9 | 0.0 | 1.2 | 1.4 | 1.6 |
| Effective interest rate | 4.9 | 4.6 | 4.6 | 4.6 | 4.6 | 4.6 |
| **Real Interest Rate Shock** | | | | | | |
| Real GDP growth | 1.4 | 2.3 | 2.2 | 1.6 | 1.5 | 1.5 |
| Inflation | 1.5 | 2.2 | 1.2 | 1.0 | 1.2 | 1.3 |
| Primary balance | -1.0 | -0.2 | 0.7 | 1.2 | 1.4 | 1.6 |
| Effective interest rate | 4.9 | 4.6 | 5.0 | 5.2 | 5.5 | 5.8 |
| **Combined Shock** | | | | | | |
| Real GDP growth | 1.4 | 0.5 | 0.4 | 1.6 | 1.5 | 1.5 |
| Inflation | 1.5 | 1.7 | 0.7 | 1.0 | 1.2 | 1.3 |
| Primary balance | -1.0 | -0.9 | -0.2 | 1.2 | 1.4 | 1.6 |
| Effective interest rate | 4.9 | 4.6 | 5.0 | 5.3 | 5.6 | 5.9 |

| **Real GDP Growth Shock** | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|
| Real GDP growth | 1.4 | 0.5 | 0.4 | 1.6 | 1.5 | 1.5 |
| Inflation | 1.5 | 1.7 | 0.7 | 1.0 | 1.2 | 1.3 |
| Primary balance | -1.0 | -0.7 | -0.2 | 1.2 | 1.4 | 1.6 |
| Effective interest rate | 4.9 | 4.6 | 4.6 | 4.6 | 4.6 | 4.6 |
| **Real Exchange Rate Shock** | | | | | | |
| Real GDP growth | 1.4 | 2.3 | 2.2 | 1.6 | 1.5 | 1.5 |
| Inflation | 1.5 | 2.4 | 1.2 | 1.0 | 1.2 | 1.3 |
| Primary balance | -1.0 | -0.2 | 0.7 | 1.2 | 1.4 | 1.6 |
| Effective interest rate | 4.9 | 4.6 | 4.6 | 4.6 | 4.6 | 4.5 |

Source: Fund staff calculations.

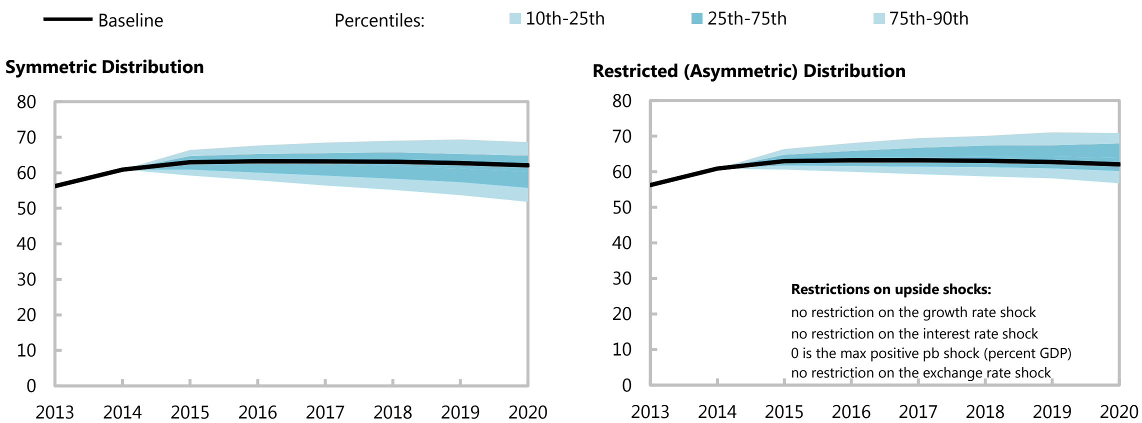
## Figure A1.5. The Bahamas: Public DSA Risk Assessment

### Heat Map

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

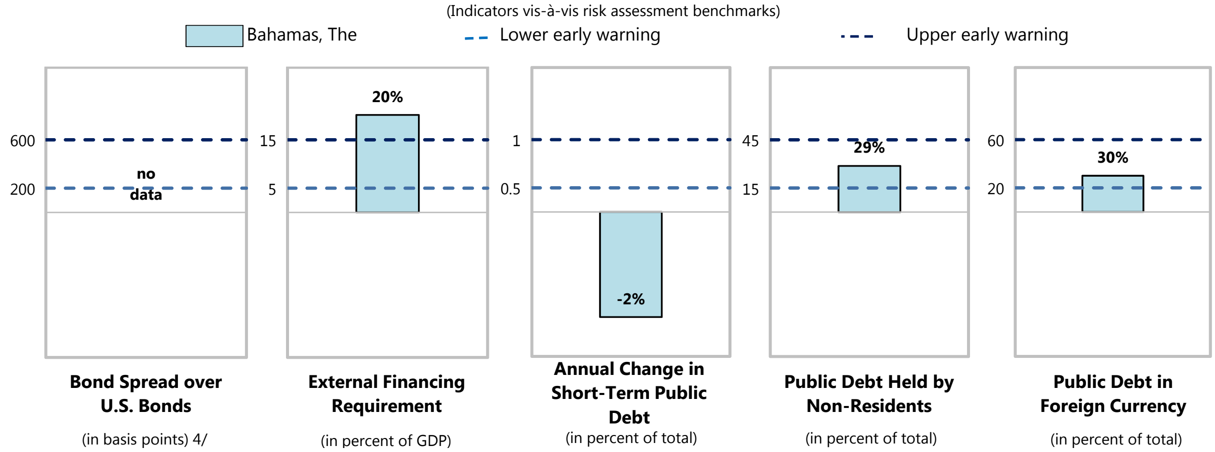
### Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)




### Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)




Source: Fund staff calculations.

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

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

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

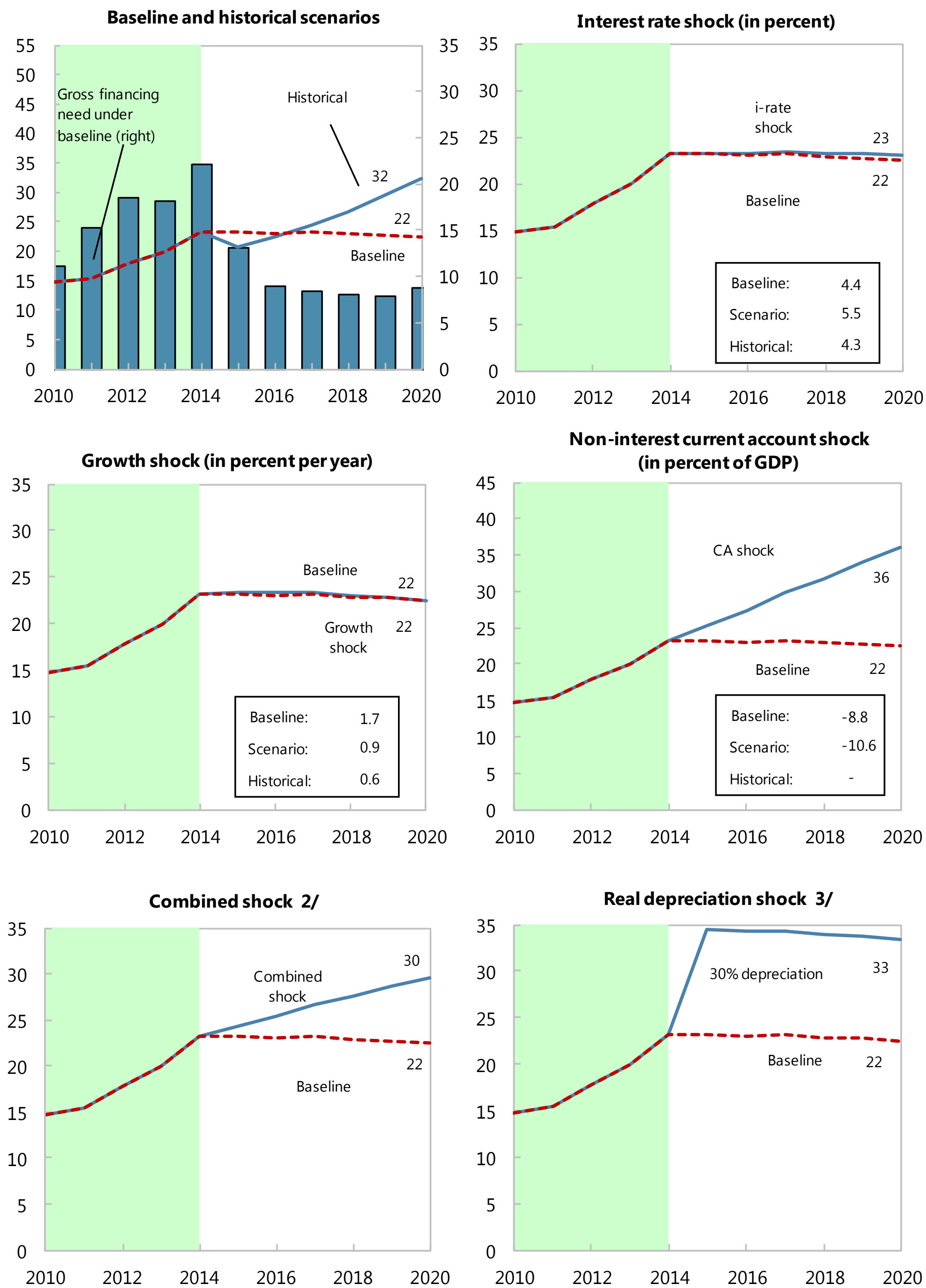
Lower and upper risk-assessment benchmarks are:

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

4/ An average over the last 3 months, 07-Jun-14 through 05-Sep-14.

## Figure A1.6. The Bahamas: External Debt Sustainability: Bound Tests 1/

(External debt, in percent of GDP)




Sources: International Monetary Fund, Country desk data, and Fund staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2010.

**Table A1.1 The Bahamas: External Debt Sustainability Framework, 2010-2020**
(In percent of GDP, unless otherwise indicated)

| | Actual | | | | | | | Projections | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2010 | 2011 | 2012 | 2013 | 2014 | | | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | Debt-stabilizing non-interest current account 6/ |
| **Baseline: External debt** | **14.7** | **15.4** | **17.8** | **19.9** | **23.2** | | | **23.2** | **23.1** | **23.1** | **22.8** | **22.7** | **22.5** | **-2.9** |
| Change in external debt | 0.3 | 0.7 | 2.4 | 2.1 | 3.3 | | | -0.1 | -0.1 | 0.1 | -0.3 | -0.1 | -0.2 | |
| Identified external debt-creating flows (4+8+9) | -1.1 | 6.7 | 11.2 | 12.8 | 18.8 | | | 9.3 | 4.9 | 4.4 | 3.9 | 3.7 | 3.5 | |
| Current account deficit, excluding interest payments | 9.4 | 14.5 | 17.4 | 16.9 | 21.0 | | | 11.4 | 7.3 | 6.6 | 6.3 | 6.2 | 6.1 | |
| Deficit in balance of goods and services | 7.1 | 11.8 | 15.1 | 13.9 | 16.9 | | | 7.3 | 2.9 | 2.0 | 1.5 | 1.2 | 0.8 | |
| Exports | 40.6 | 42.2 | 44.6 | 43.0 | 42.0 | | | 42.0 | 44.5 | 46.3 | 47.5 | 48.3 | 49.2 | |
| Imports | 47.7 | 54.0 | 59.8 | 56.9 | 58.8 | | | 49.3 | 47.4 | 48.3 | 48.9 | 49.5 | 50.0 | |
| Net non-debt creating capital inflows (negative) | -11.0 | -8.4 | -6.4 | -4.5 | -3.0 | | | -2.9 | -3.0 | -3.1 | -3.2 | -3.2 | -3.3 | |
| Automatic debt dynamics 1/ | 0.5 | 0.6 | 0.2 | 0.4 | 0.8 | | | 0.8 | 0.6 | 0.8 | 0.8 | 0.7 | 0.7 | |
| Contribution from nominal interest rate | 0.6 | 0.6 | 0.8 | 0.8 | 1.0 | | | 1.2 | 1.2 | 1.2 | 1.1 | 1.1 | 1.0 | |
| Contribution from real GDP growth | -0.2 | -0.1 | -0.3 | 0.0 | -0.2 | | | -0.4 | -0.6 | -0.4 | -0.3 | -0.3 | -0.3 | |
| Contribution from price and exchange rate changes 2/ | 0.1 | 0.1 | -0.3 | -0.4 | 0.0 | | | ... | ... | ... | ... | ... | ... | |
| Residual, incl. change in gross foreign assets (2-3) 3/ | 1.4 | -6.0 | -8.8 | -10.7 | -15.5 | | | -9.3 | -5.0 | -4.3 | -4.2 | -3.9 | -3.7 | |
| External debt-to-exports ratio (in percent) | 36.3 | 36.6 | 39.9 | 46.3 | 55.4 | | | 55.2 | 51.8 | 50.0 | 48.1 | 47.0 | 45.8 | |
| **Gross external financing need (in billions of US dollars) 4/** | **0.9** | **1.2** | **1.5** | **1.5** | **1.9** | | | **1.2** | **0.8** | **0.8** | **0.8** | **0.8** | **0.9** | |
| in percent of GDP | 11.1 | 15.3 | 18.5 | 18.2 | 22.2 | | | 13.1 | 9.0 | 8.3 | 8.0 | 7.9 | 8.7 | |
| **Scenario with key variables at their historical averages 5/** | | | | | | 10-Year Historical Average | 10-Year Standard Deviation | **20.8** | **22.3** | **24.5** | **26.8** | **29.5** | **32.4** | **-7.0** |
| **Key Macroeconomic Assumptions Underlying Baseline** | | | | | | | | | | | | | | |
| Real GDP growth (in percent) | 1.5 | 0.6 | 2.2 | 0.0 | 1.0 | 0.6 | 2.3 | 1.8 | 2.8 | 1.6 | 1.5 | 1.5 | 1.5 | |
| GDP deflator in US dollars (change in percent) | -0.4 | -0.9 | 2.1 | 2.4 | -0.1 | 1.2 | 1.9 | 3.1 | 1.3 | 1.1 | 1.0 | 1.4 | 1.3 | |
| Nominal external interest rate (in percent) | 4.4 | 4.0 | 5.6 | 4.9 | 5.0 | 4.3 | 0.7 | 5.6 | 5.4 | 5.1 | 4.9 | 4.8 | 4.7 | |
| Growth of exports (US dollar terms, in percent) | 4.9 | 3.6 | 10.5 | -1.3 | -1.5 | 3.3 | 10.9 | 5.1 | 10.3 | 6.7 | 5.3 | 4.7 | 4.6 | |
| Growth of imports (US dollar terms, in percent) | 1.1 | 12.9 | 15.6 | -2.6 | 4.4 | 5.9 | 12.0 | -12.0 | 0.2 | 4.6 | 3.9 | 4.0 | 3.9 | |
| Current account balance, excluding interest payments | -9.4 | -14.5 | -17.4 | -16.9 | -21.0 | -13.7 | 4.3 | -11.4 | -7.3 | -6.6 | -6.3 | -6.2 | -6.1 | |
| Net non-debt creating capital inflows | 11.0 | 8.4 | 6.4 | 4.5 | 3.0 | 7.7 | 2.5 | 2.9 | 3.0 | 3.1 | 3.2 | 3.2 | 3.3 | |

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate.
e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).
3/ For projection, line includes the impact of price and exchange rate changes.
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

# Annex II. External Current Account Prospects and External Competitiveness

**Standard external competitiveness indicators present a mixed picture, but suggest that there may be emerging concerns.** The results of CGER methodologies are somewhat contradictory, with the ERER approach suggesting the exchange rate to be slightly (2.1 percent) undervalued, while the macroeconomic balance approach suggests that a 16½ percent improvement in the external competitiveness would be required to align the 6¼ percent of GDP current account deficit projected for 2020 with the 2 percent "norm" (Figure 3).[1] Another estimate is available from the External Balance Assessment (EBA) "lite," although it must be noted that this methodology is acknowledged to be of possibly limited applicability in "special cases," including for tourism-based economies and financial centers. A straightforward application of the analysis for the 2015 projected current account deficit (12½ percent of GDP) suggests a 38 percent improvement in external competitiveness would be needed to obtain the 2¾ percent of GDP deficit "norm." However, the combined one-off effects of continued Baha Mar-related construction expenses, as well as the less-than-full-year effect for its tourism earnings potential (estimated to account for about a combined 5¾ percent of GDP), as well as the assumed import component from standard non-debt creating foreign direct investment capital flows (some 2¼ percent of GDP) would reduce the "underlying" current account deficit to about 4½ percent of GDP. This suggests that an improvement in external competitiveness of about 7½ percent would be necessary to result in the current account "norm." Thus, these three methods suggest on balance that an improvement in external competitiveness may be necessary to achieve external sustainability, especially were petroleum prices to increase beyond present WEO forecasts, but the scale of uncertainty regarding the degree of misalignment is considerable.

**Forecasts of future external balances are especially uncertain, notably given the lumpiness of investment.** The sheer magnitude of the Baha Mar project (some 40 percent of 2012 GDP), its sizable increase in tourism capacity (by 2,200 rooms—about 16 percent of current capacity) and potential employment equivalent to 2½ percent of the labor force), and recent delays in its opening complicates forecasts of The Bahamas' external accounts. Additional uncertainties also arise from prospective changes in petroleum prices (to which the Bahamian economy is particularly sensitive, given their almost total reliance on imported energy), and potential increased competition following the U.S./Cuban rapprochement, although these also cloud external prospects throughout the Caribbean. Nonetheless, this suggests taking as broad an approach as possible in viewing external prospects, keeping in mind the unusual degree of uncertainty at present.

**Recognizing that the current account imbalance is the external counterpart to the difference between national investments and saving flows provides another approach to understanding**

[1] The absence of official net international investment position data precludes the use of third, external sustainability (ES), CGER approach

**recent developments.** As seen in Figure 4, the investment/GDP ratio has remained relatively stable since the turn of the century at about 26 percent of GDP. But this masks marked changes in its composition with two notable periods of greater activity, one in the mid 2000s with a sizable expansion of the Atlantis resort along with an emerging boom in residential construction, and in the last few years, the result of Baha Mar (and despite a collapse in other domestic, including residential, construction). National saving appears to have exhibited a trend decline this century, which is somewhat more difficult to explain. The relatively low and generally declining saving rate in Caribbean economies has been documented elsewhere, the reasons for which appear to result from a combination of factors, including a persistently weak post-boom economy, a prolonged worsened terms of trade (the result of higher petroleum prices), and possibly by lower returns to saving.[2]

**Going forward, projecting the external balance as the difference between projections of saving and investment flows highlights its inherent uncertainty, but also focuses on the need for policies that support growth and bolster domestic saving.** Recent revisions to the national accounts, which resulted in much lower real and nominal growth rates in the past few years (and upward revisions in the size of the current account deficit), have tempered growth expectations going forward and, ceteris paribus, worsened external sustainability dynamics. Looking forward, without a decisive implementation of a national development plan that improves the economy's growth prospects, staff foresee a strong possibility of a slow-growth scenario, with the domestic debt overhang and labor market mismatches continuing to dampen employment prospects, thereby retarding income growth and restraining increases in saving rates. Meanwhile, weak demand and breakdown of the credit channel reduces domestic investment prospects and potential output growth rate.

**In light of the mixed picture provided by standard Fund assessments of external competitiveness, and from the uncertain outlook based on recent saving/investment trends, the staff continues to rely on basic indicators of external performance, which provide a somewhat less subdued picture.** The Bahamas is perceived to be a comparatively desirable tourist destination, targeting more affluent clientele. Its relatively expensive reputation has recently been documented in a "Week at the Beach" index.[3] And while the share of Caribbean tourism arrivals has recently stabilized at a lower level than recorded in the early 2000s, reflecting growth in a number of lower-cost destinations, The Bahamas share of Caribbean tourism receipts (and its share of Bahamian GDP) have remained more robust, and the opening of Baha Mar is anticipated to boost

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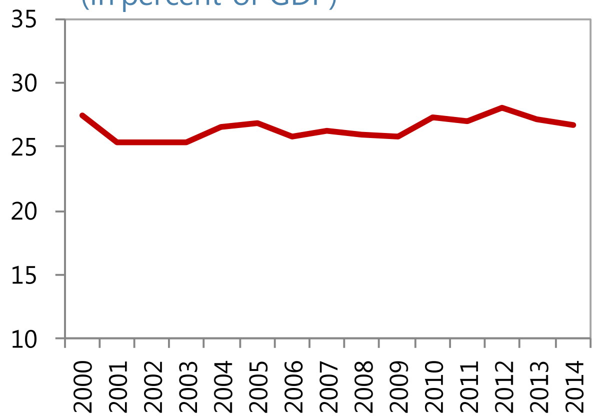
[2] See Grigoli et al (forthcoming), "Saving in Latin America and the Caribbean: Performance and Policies." The authors found that the saving rate for small Caribbean economies is influenced by real income growth, and displays a strong degree of serial correlation, suggesting that persistently slow economic growth depresses saving as agents anticipate the weakness to be temporary. The authors also found that lower returns to saving (observed in the Bahamian context as continued high banking system NPLs have widened the lending/deposit rate spread) depressed Caribbean saving rates, but that the coefficient estimate was not significant. The decline in the Bahamian saving rate last year may also have reflected a one-off increase in consumption in anticipation of the VAT's introduction in 2015.

[3] See Laframboise, et al (2014), "Revisiting Tourism Flows to the Caribbean: What is Driving Arrivals?" IMF Working Paper, WP/14/229.

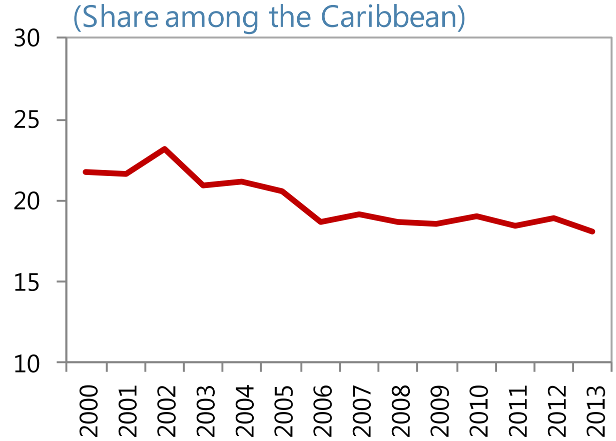
these shares going forward. Furthermore, relative to its comparators, The Bahamas' REER has been stable reflecting its close economic ties with the U.S. Moreover, the magnitude of foreign direct investment continues to be substantial, averaging over 6 percent of GDP over the last five years, and which is thought to be understated as it fails to include re-invested earnings. Thus, while not discounting the challenges facing The Bahamas in continuing to provide a comparatively attractive tourist experience (including with the likely emergence of Cuban competition), both vacationers and investors continue finding it an attractive location. Nonetheless, in light of the limited external buffers, efforts to further improve external competitiveness would be prudent.

**The Bahamas: Tourism Receipts**
(in percent of GDP)



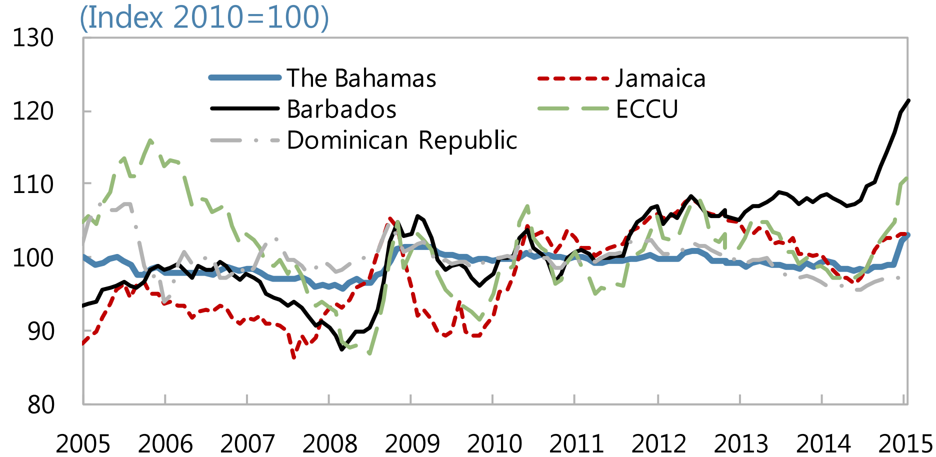

Source: IMF staff estimates.

**The Bahamas: Tourism Receipts**
(Share among the Caribbean)




Source: IMF staff estimates.

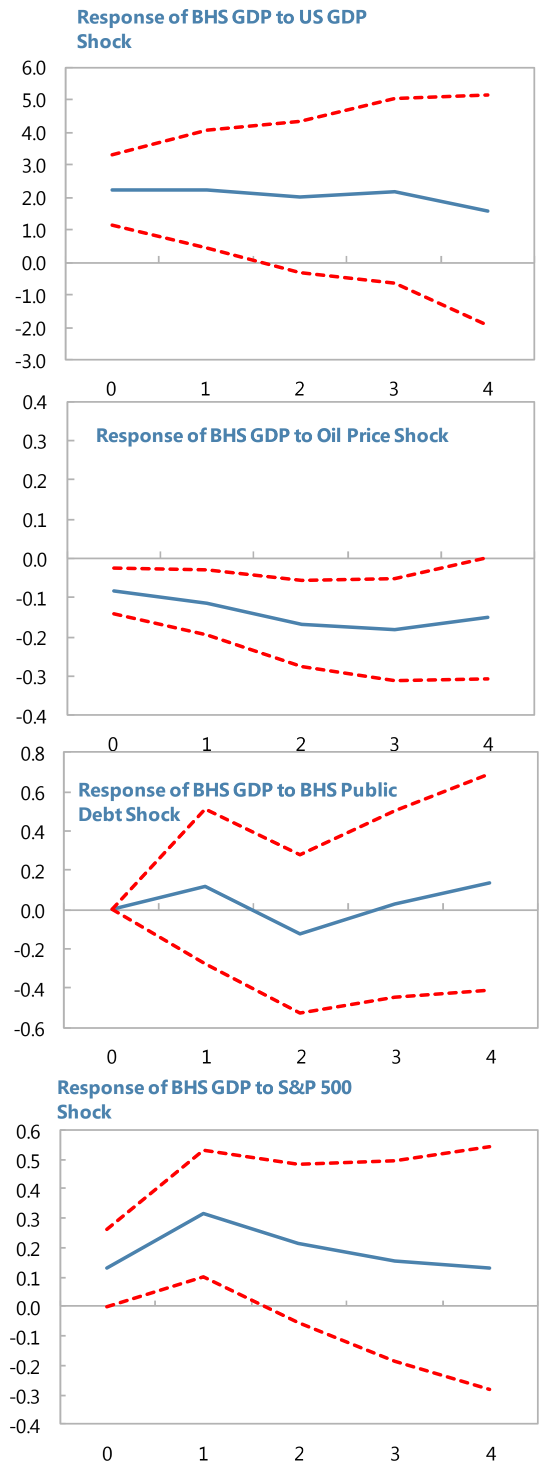
**The Bahamas: REER of Tourism-dependent peers**
(Index 2010=100)




Sources: INS; and Fund staff calculations.

# Annex III. Spillovers to The Bahamas

As a small very open economy, The Bahamas is vulnerable to external shocks. Staff estimated the response of the Bahamian economy to typical shocks using a 5-variable VAR, including U.S. GDP, S&P 500 stock price index, oil prices, Bahamas GDP and Bahamas public debt, using annual data for 1990-2014:



Source: Fund Staff Estimates

- A shock to the U.S. economy that raises U.S. GDP by one percent contemporaneously increases Bahamian GDP by 2¼ percentage points. Moreover, the positive effect on the Bahamian economy persists for one additional year before dissipating.
- The VAR indicates a surprisingly strong and persistent response of Bahamian GDP to oil price shocks. A one percent shock to oil prices causes Bahamian GDP to contemporaneously decline by 0.08 percentage points, and with the effect strengthening somewhat for three years following the shock.
- Shocks to Bahamian public debt do not have a significant effect on Bahamian GDP. This result is however likely to be influenced by the relatively low level of Bahamian debt.
- A one percent shock to the S&P 500 index contemporaneously increases Bahamian GDP by 0.13 percentage points. Moreover, the effect intensifies in the year after the shock, rising to 0.3 percentage points before dissipating in subsequent years.
- Staff also investigated the impact of shocks to U.S. interest rates by incorporating either U.S. 10 year Treasury bond yields or U.S. 6-month LIBOR into the VAR. In both cases, shocks to either 10-year bond yields or the LIBOR did not have significant effects on the Bahamian economy, and the magnitude of the Bahamian GDP response was close to zero.
- A decomposition of variance indicates that shocks to U.S. GDP and oil prices explain a large fraction of the fluctuations in Bahamian

GDP. Indeed, at a 5-year horizon, both explain over 30 percent of the variation in Bahamian GDP, dominating the influence of shocks to the S&P 500 index and the others.

**Decomposition of Variance for The Bahamas Real GDP**

| Horizon (Years) | US GDP | S&P 500 | Oil Prices | Bahamas GDP | Bahamas Central Govt Debt |
|---|---|---|---|---|---|
| 1 | 27.8 | 4.7 | 7.9 | 59.6 | 0.0 |
| 2 | 30.4 | 16.7 | 12.1 | 40.6 | 0.2 |
| 3 | 31.0 | 16.9 | 21.2 | 30.6 | 0.3 |
| 4 | 32.1 | 15.0 | 27.8 | 24.8 | 0.2 |
| 5 | 32.0 | 14.4 | 31.4 | 22.0 | 0.3 |

Source: Fund Staff Estimates

# Annex IV. The Bahamian Financial Sector: Structure, Trends, and Prospects

**The Bahamian financial system is sizable with both domestic and offshore activities.** In addition to a relatively sophisticated domestic financial system (with private sector credit totaling almost 80 percent of GDP), The Bahamas historically has a significant offshore sector. All told, while employing only about 3 percent of the labor force (of which less than 1 percent in the offshore subsector), financial intermediation services narrowly defined account for more than 10 percent of GDP (with additional spillover activities for affiliated real estate and business services, as well as for tourism). The financial sector also, through various taxes and fees, contributes markedly to government revenue. Although these total only about 1–2 percent of GDP in recent years, they account for some 6–10 percent of total government revenues.

**While the offshore financial system assets are large, the domestic financial sector's susceptibility to offshore spillovers is thought to be limited.** The recent 2013 FSAP concluded that the domestic commercial banking sector is well insulated from the offshore sector, and mainly conducts traditional banking activities. The mission found that connections between the domestic banks and offshore banks are minimal (confined to intra-group activities). Only ½ percent of domestic banking sectors assets and liabilities are with offshore counterparties. Thus, while the potential for offshore sector spillovers to the domestic financial sectors appear limited, they nonetheless remain for the labor market (to a limited extent) and for government revenues.

**The Bahamas: Selected Financial Sector Statistics, 2010-13**

| | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|
| Financial intermediation (share of GDP) | 11.4 | 11.4 | 12.5 | 12.0 |
| Employment (percent of total employment) 1/ | | | | |
| Domestic | 2.4 | 2.4 | 2.3 | 2.3 |
| Offshore | 0.7 | 0.7 | 0.7 | 0.6 |
| Government revenue from the financial sector | | | | |
| Percent of GDP | 1.3 | 1.8 | 1.0 | 1.1 |
| Percent of central government revenues | 7.9 | 10.1 | 5.8 | 6.8 |
| Assets (share of GDP) | | | | |
| Domestic banks | 118 | 115 | 117 | 116 |
| Offshore banks | ... | 6,478 | 3,737 | 2,938 |
| Licensed Mutal Funds | 1,742 | 1,056 | 1,365 | 1,519 |

Sources: Central Bank of The Bahamas; National Statistical Agency

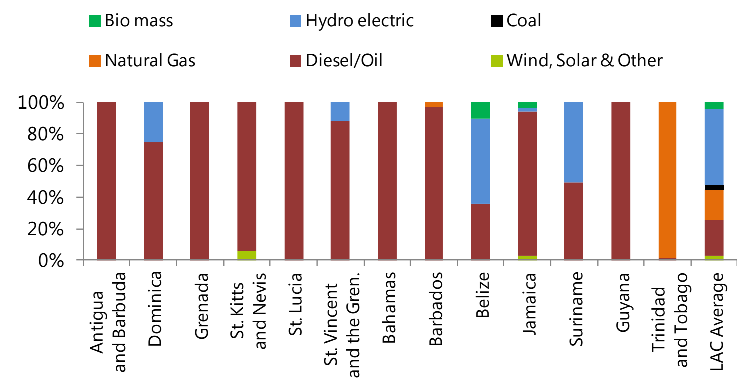
1/ Total employment for 2010 is average of 2009 and 2011. Figures for 2012-13 are averages of within-year survey data.

**In addition to changes in the external regulatory environment, the continued vibrancy of financial sector will depend, in part, on the availability of a highly trained domestic employment pool.** Changes in the international regulatory environment, as well as more firm- or country-specific influences, have resulted in a marked decline in offshore sector assets. These have declined from a 67 times domestic GDP in 2011 to less than one-half that amount in 2013 (and further to 22 times GDP in September 2014). Nonetheless, its employment and GDP shares have yet to be appreciably affected. Going forward, however, the Bahamian financial sector's continued health will depend on a number of factors. The domestic banking system's health will need to deal effectively with the legacy costs of previous over-lending. The external sector's health will be influenced to a great degree by changes in the international regulatory environment. But its future vibrancy will also depend on maintaining and improving the Bahamian business climate more generally and in expanding its pool of well-trained domestic financial sector employment prospects, which requires active engagement with the domestic educational system.

# Annex V. Energy in The Bahamas: Setting, Policies, and Prospects

**The Bahamian economy is extremely reliant on petroleum-based energy, in part a reflection of its geographic peculiarities, leaving it vulnerable to volatile price developments.** The Bahamas has a population of 367,000 (2013) inhabiting 30 of the nation's 700 islands and some 2000 cays, although about three quarters of the population reside in the capital of Nassau (New Providence Island), and in Freeport (Grand Bahama Island), the second largest city. While electrification of the archipelago is nearly universal, The Bahamas' entire economy, as with a number of other Caribbean economies, is almost entirely dependent on imported petroleum products, including for electrical generation as well as for transportation. As a result, the nation's domestic oil import bill is substantial, totaling almost US$500 million in recent years, equivalent to 5–6 percent of GDP. However, with the recent oil price collapse, the oil import bill is projected to be almost halved in 2015, saving a projected 2½ percent of GDP.

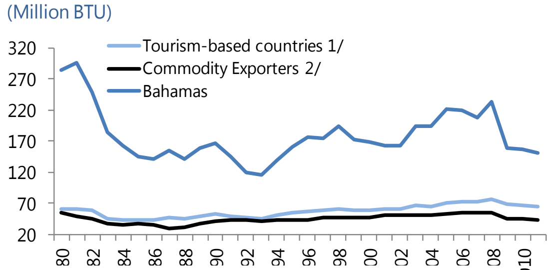
**Installed Generation Capacity in Caribbean Countries**
(In Percent of Total capacity)




Source: World Bank, IDB and IMF staff calculations

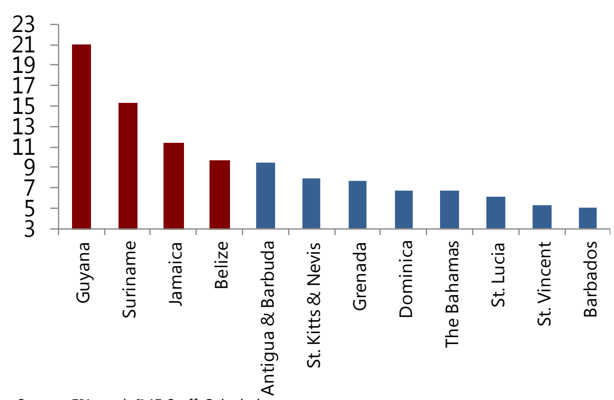
**The Bahamian economy's per capita energy consumption is easily the highest in the Caribbean, but this is mitigated once allowance is made for its high per capita income.** The Bahamas' energy consumption averaged 185 million BTU per capita over 2000–11, is almost three

**Energy Consumption per Capita**
(Million BTU)




1/ includes OECS countries, Barbados and the Bahamas
2/Includes Jamaica, Belize, Guyana, and Suriname; excludes T&T

**Energy Consumption Per Unit of GDP, 2011**
(Thousand BTU per 1 US$ of GDP, 2005 prices)

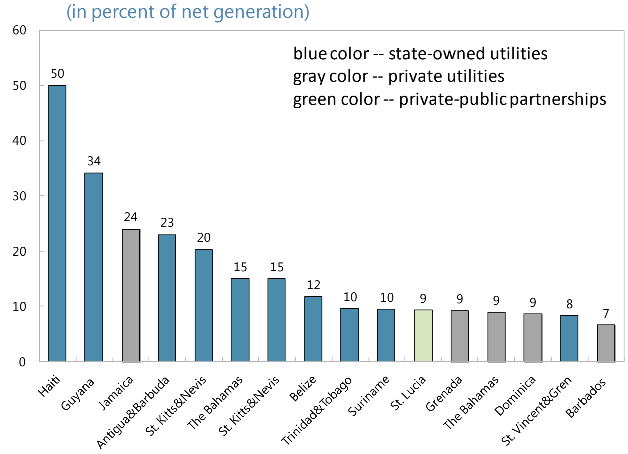



Source: EIA; and IMF Staff Calculations

times the average of tourism-based Caribbean economies, and over 350 percent of the average for commodity exporting Caribbean economies (excluding energy-based Trinidad and Tobago). However, this reflects the economy's high average standard of living, as well as the relatively upscale nature of its tourism product. In fact, energy consumption in The Bahamas per unit of GDP is at about the average for tourism-based Caribbean economies, and well below the average of commodity-based economies.

**As in other Caribbean economies, the structure of nation's electricity sector is inefficient, worsening the overall economy's and the tourism industry's competitiveness.** This is due in part to technical reasons and the country has been slow to recognize the potential from renewable energy sources. Virtually all of the electricity is supplied by two utilities, the state-owned Bahamas Electricity Company (BEC), which provides about 80 percent of total production (servicing Nassau and the rest of New Providence, as well as the Family Islands except Grand Bahama), with the remainder provided by the Grand Bahama Power Company, a Canadian/Japanese venture. Per capita electricity consumption is high, even by Caribbean standards, at 5,700 kWh per capita/year.[1] Unfortunately, the almost complete reliance on fossil fuels in electricity generation, together with the archipelagic nature of the country, results in substantial transmission and distribution losses, albeit on par with other Caribbean economies. This is reflected in high electricity prices, although again similar to those in many other Caribbean Island economies, but substantially above rates in North American economies. As a result, electricity accounts for a substantial component of total expenses in the tourism industry, and therefore has a significant bearing on the sector's external competitiveness.[2]

**Power Utility Companies Energy Losses**
(in percent of net generation)




**The Bahamian authorities recognize the importance of addressing these shortcomings, and have recently taken actions that should lower production costs, boost energy efficiency, and reduce the reliance on imported petroleum.** The authorities adopted The Bahamas National Energy Policy: 2013–2033 in 2014, which set four general goals: improving energy efficiency (including through conservation); modernizing the energy infrastructure; become a world leader in developing and implementing sustainable energy solutions; and having a dynamic and appropriate governance, institutional, legal and regulatory framework, with civic participation. In addition, recognizing the ample potential for renewable energy, the government has proposed to raise the

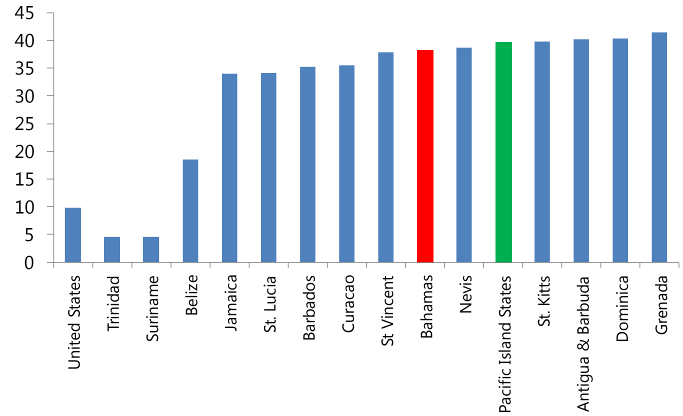
[1] Inter-American Development Bank, "Energy Matrix Country Briefings," (2013).

[2] Respondents to the 2014 KPMG Caribbean Hotel Benchmarking Survey reported that utility expenses were 6.5 percent of total revenue, substantially more than the 3.7 percent average of the STR's U.S. survey. While The Bahamas competes with other Caribbean economies in providing tourism services, the authorities notes that it also views family resorts in central Florida and gaming properties in Las Vegas to be major competitors as well.

contribution from this source to 30 percent by 2030.[3] To this end, it amended in March 2015 the Energy Act to allow for renewable energy self generation (NESG), which allows for individuals to attach to and sell back excess electricity generation to the national grid. The Bahamas has also joined the Carbon War Room's "10 Island Challenge," in which is obliges itself to advance 20 MW of solar utility-scale farms on several islands in the national archipelago.

**Domestic Electricity Tariffs, 2012**

(In US ¢/kWh)




Sources: CARILEC and country authorities.

**The authorities have also recently selected a private company to manage the BEC and are considering altering the energy sector's regulatory framework**. While details of the management contract are still to be finalized, the state will retain 100 percent ownership of the BEC, and intends to employ a business model similar to that used in operation of the capital's airport authority. It is anticipated that the operating company, whose compensation would be largely based on achieving service level targets relating to improved fuel efficiency, reductions in costs, and enhanced reliability, would be able to reduce electricity production costs by some one-third (to about $0.30 per KwH). In addition, the BEC's liabilities would be taken over, financed by a "rate reduction" bond, which would also fund new investments in more efficient electrical generators. The authorities are also considering establishing an independent electricity regulatory authority, (possibly the Utilities Regulation and Competition Authority, the current telecoms regulator), which would oversee the transformation of the BEC's effective monopoly generator/distributor position, toward one allowing for multiple (including private sector) generators.

[3] The IADB's Energy Matrix states that the technical potential for renewable energy exceeds current energy demand by a factor of 50, although its economic potential, given current technologies, is presumably much less.

INTERNATIONAL MONETARY FUND

# THE BAHAMAS

May 21, 2015

## STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX


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


## CONTENTS

# FUND RELATIONS

(As of March 31, 2015)

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

**General Resources Account:**

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

**SDR Department:**

| | SDR Millions | Percent of Quota |
|---|---|---|
| Net cumulative allocation | 124.41 | 100.00 |
| Holdings | 54.15 | 43.53 |

**Outstanding Purchases and Loans:** None

**Latest Financial Arrangements:** None

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

| | | | Forthcoming | | |
|---|---|---|---|---|---|
| | **2015** | **2016** | **2017** | **2018** | **2019** |
| Principal | | | | | |
| Charges/ Interest | 0.03 | 0.04 | 0.04 | 0.04 | 0.04 |
| **Total** | **0.03** | **0.04** | **0.04** | **0.04** | **0.04** |

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

**Assessment of Data Adequacy for Surveillance:**
Data provision is broadly adequate for surveillance. In particular, all critical macroeconomic data, including comprehensive central government finance statistics, are regularly published in the Central Bank of the Bahamas' "*Monthly Economic and Financial Developments*" and *"Quarterly Statistical Digest"*. However, the authorities have yet to develop the institutional capacity for the compilation of international investment position (IIP) statistics and general government accounts data. Also, The Bahamas has still not started compiling balance of payments statistics consistent with the *Balance of Payments Manual 6.* The authorities have expressed interest in technical assistance in the latter two areas, and Fund is ready to provide assistance upon their formal request.

**Last Article IV Consultation:**
The Bahamas is on a 12-month consultation cycle. The last Article IV consultation was concluded by the Executive Board on January 17, 2014 on a lapse-of-time basis (IMF Country Report No. 14/75).

**Technical Assistance**

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

| | | |
|---|---|---|
| CARTAC | August 2014 | Balance of Payment and International Investment Position |
| FAD | September/October 2014 | Revenue Administration |
| FAD | October 2014 | Preparation To Launch a Value Added Tax |
| CARTAC | November 2014 | Quarterly National Accounts |
| CARTAC | December 2014 | Price Statistics |
| CARTAC | December 2014 | Risk-Based Supervision of the Securities Market |
| LEG | March 2015 | Strengthening The Legal Framework for Bank Resolution and Crisis Management |

**Resident Representative:** None

# FINANCIAL RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

**Country Strategy with The Bahamas 2013-2017**

Given the negative impact of the international economic crisis on economic growth, productivity and social cohesion in The Bahamas, the strategic intent of the current CS is to support Government of The Bahamas (GoBH) efforts to ensure macroeconomic sustainability, social stability and employment; and to increase resilience to the negative impacts of natural disasters and climate change. The Bank is supporting: (i) the implementation of fiscal and debt sustainability reforms in public sector finances and management; (ii) assisting with fostering social cohesion, with an emphasis on preventing crime and violence and strengthening the criminal justice system; (iii) assisting with modernizing the electricity subsector and diversify the energy matrix; (iv) facilitating diversification of both the economy and its trading partners by enhancing areas of comparative advantage and removing constraints to private sector activity; and (v) building resilience to natural disasters through improved coastal zone management, incorporating disaster risk reduction and climate change adaptation measures in development planning, control and monitoring. The Bank support focuses on the following priority areas: (1) Public Finances and Management; (2) Citizen Security and Justice; (3) Energy; (4) Private Sector Development; and (5) Coastal Risk Management and Climate Change Adaptation. Interventions in these areas will contribute to stemming the erosion of per capita incomes by protecting public investment space and promoting growth. Efforts are being made to generate non-sovereign guaranteed (NSG) lending that is closely aligned to the development and diversification of the private sector, as well as direct financing in alternative energy and energy efficiency. This is taking place in addition to seeking opportunistic interventions in sectors where IDB participation provides financial and non-financial additionality.

**Other areas for future dialogue:** In addition to the priority areas identified above, the Bank is supporting diagnostic and analytical activities in the following dialogue areas: (a) Education: The provision of quality education services: (i) via strengthening capacity at the secondary education level to improve transition from school to work, including potential areas for PPPs, and (ii) for special needs children and youth throughout all levels of the educational system also with an emphasis on the transition from school to work; (b) Food Security: The country depends almost entirely on imports for food. An analysis will be undertaken of the options for increasing the production and consumption of local food; (c) Transport: An analysis of (i) the potential impacts and opportunities that the completion of the Panama Canal will have for The Bahamas, (ii) how inter-island mobility could be made more efficient across the 28 inhabited islands; (iii) enhancing trade links with the rest of the Caribbean and Latin America; and (d) Informal Immigration: There are significant pockets of poverty that are often associated with the phenomenon of informal immigration. The profiles and needs of such areas will be assessed.

**Active Loans as of April 30, 2015**

(In millions of U.S. dollars)

| Project | Name | Approval Date | Approved | Disbursed | Available |
|---|---|---|---|---|---|
| BH-L1027 | Air Transport Reform Program (PBL) | Dec 14, 2011 | 47.5 | 15 | 32.5 |
| BH-L1027 | Air Transport Reform Program (TC Loan) | Dec 14, 2011 | 2.5 | 2.0 | 0.51 |
| BH-L1028 | WSC Support Program—New Providence Water Supply and Sanitation Systems Upgrade | Nov 16, 2011 | 81.0 | 46 | 34 |
| BH-L1016 | Trade Sector Support Program | Jul 18, 2012 | 16.5 | 4 | 12.3 |
| BH-L1029 | New Providence Transport Program Supplementary Financing II | Sep 04, 2012 | 65.0 | 59 | 6 |
| BH-L1030 | Social Safety Net Reform Program | Jul 18, 2012 | 7.5 | 0.86 | 6.6 |
| BH-L1035 | Performance Monitoring and Public Financial Management Reform | Nov 19, 2014 | 33 | 0 | 33 |
| **Total Loans 7** | | | **253** | **126.86** | **124.91** |

**Net Flow of IADB Convertible Currencies**

(In millions of U.S. dollars)

| Net Flow of IADB Convertible Currencies (US$ million) | | | | | | | |
|---|---|---|---|---|---|---|---|
| | **2009** | **2010** | **2011** | **2012** | **2013** | **2014** | **2015 (P)** |
| a. Loan Disbursements | 24.6 | 32.8 | 57 | 61.9 | 49.4 | 30.4 | 24.2 |
| *...PBL disbursements* | 0 | 0 | 15 | 0 | 0 | 0 | |
| b. Repayments principal | 7.9 | 8.6 | 9.4 | 11.7 | 14.1 | 14.2 | 16.8 |
| **c. Net Loan Flow (a–b)** | **16.7** | **24.2** | **47.6** | **50.2** | **35.3** | **16.2** | **7.4** |
| d. Subscriptions & Contributions | 0.7 | 0.3 | 0.3 | 0.9 | 1 | 0.8 | 0.8 |
| e. Interests & Charges | 5.1 | 5.6 | 5.7 | 6.4 | 6.8 | 6.8 | 6.5 |
| **f. Net Cash Flow (c–d–e)** | **10.9** | **18.3** | **41.6** | **42.9** | **27.5** | **8.7** | **0.1** |
| **(p) Projected.** | | | | | | | |

# STATISTICAL ISSUES

**Statistical data are broadly adequate for surveillance purposes, but some weaknesses remain in both coverage and timeliness, partly reflecting capacity constraints.** The central bank produces annual, quarterly, and monthly reports on macroeconomic developments, and monetary and fiscal data, and is the main source of economic information. The operations of public corporations are not compiled into a consolidated set of public sector accounts, although their debt is included in the public debt data. Thus, a presentation of the general government accounts, including revenue, expenditure, and overall balance is not available.

In March 2015, the Department of Statistics (DoS) updated the CPI methodology with technical assistance from CARTAC. Using the results of the 2013 Household Expenditure Survey, it revised the CPI weights to 2013 from 2006 and changed the base period to November 2014 from February 2010. The coverage was expanded to include new local and foreign items reflecting current expenditures by households. New sample outlets were also introduced to reflect those that are frequently visited by Households.

The DoS continues to develop the Export-Import Price Indices (XMPIs) to meet international standards. CARTAC missions have assisted in compiling the XMPIs, including Tourism Services Price Index (TSPI) on quarterly basis. New XMPIs for goods and major services have been developed, while procedures for systematic re-sampling and re-weighting were modified in order to keep the market basket representative of what is being measured. The DoS is also receiving technical assistance from CARTAC to produce quarterly GDP estimates. A July 2014 mission assessed the quarterly volume estimates and noted that further work is needed for a few industries. It assisted in identifying suitable indicators for deriving quarterly current price estimates using the production approach.

The Bahamas does not prepare data covering the economy-wide external debt position, nor an international investment position (IIP), although they have stated their intention to do so. In August 2014, a CARTAC mission advised the authorities on the requirements for transitioning to Balance of Payments Manual 6 (BMP6) and disseminating statistics on the IIP. The mission noted that most of the conversion from BPM5 to BPM6 is straightforward and some of the data required, such as reserve assets and public sector debt, are already available. However, the authorities will need to collect new data on the nonbank private sector. The authorities are considering publishing BPM6 statistics in June 2015 and IIP statistics in September 2015.

The Inter-American Development Bank (IDB), with the technical support of the United States Census Bureau (USCB), has promoted the development of a methodology called "Tool for Assessing Statistical Capacity" (TASC). This is a self-assessment instrument, the general purpose of which is measuring and evaluating the statistical capacity of a country's National Statistical System (NSS), and more specifically, the operational capacity of its National Statistical Office (NSO), to produce and disseminate basic statistics drawn from censuses, surveys and administrative records. There was a mission to The Bahamas to meet with the Department of Statistics and other agencies that produce statistics to apply the TASC in late November, 2013. As part of the statistical component of the IDB's Public Financial Management reform program (PFM) with the government, the TASC assessment will be applied again to assess how things have evolved since 2013. This assessment is likely to be conducted in a few years once several of the key project activities under the PFM have been undertaken.

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

## The Bahamas: Table of Common Indicators Required for Surveillance
(As of April 30, 2015)

| | Date of Latest Observation (mm/yy) | Date Received | Frequency of Data[7] | Frequency of Reporting[7] | Frequency of Publication[7] |
|---|---|---|---|---|---|
| Exchange Rates | Fixed | | | | |
| International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1] | 3/15 | 04/15 | M | M | M |
| Reserve/Base Money | 2/15 | 04/15 | M | M | M |
| Broad Money | 2/15 | 04/15 | M | M | M |
| Central Bank Balance Sheet | 2/15 | 04/15 | M | M | M |
| Consolidated Balance Sheet of the Banking System | 12/14 | 04/15 | M | M | Q |
| Interest Rates[2] | 3/15 | 04/15 | M | M | M |
| Consumer Price Index | 01/15 | 03/15 | M | M | M |
| Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4] | NA | NA | NA | NA | NA |
| Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government | 12/14 | 02/15 | Q | Q | Q |
| Stocks of Central Government and Central Government-Guaranteed Debt[5] | 12/14 | 02/15 | Q | Q | Q |
| External Current Account Balance | 12/14 | 4/15 | Q | Q | Q |
| Exports and Imports of Goods and Services | 12/14 | 4/15 | Q | Q | Q |
| GDP/GNP | 2014 | 03/15 | A | A | A |
| Gross External Debt | 12/14 | 02/15 | Q | Q | Q |
| International Investment Position[6] | NA | NA | NA | NA | NA |

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

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

[3] Foreign, domestic bank, and domestic nonbank financing.

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

[5] Including currency and maturity composition.

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

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