

The Bahamas: 2010 Article IV Consultation—Staff Report; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2010 Article IV consultation with The Bahamas, the following documents have been released and are included in this package:

- The staff report for the 2010 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on September 10, 2010, with the officials of The Bahamas on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on October 12, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its October 27, 2010 discussion of the staff report that concluded the Article IV consultation.

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

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INTERNATIONAL MONETARY FUND

THE BAHAMAS

Staff Report for the 2010 Article IV Consultation

Prepared by the Staff Representatives for the 2010 Consultation
with The Bahamas

Approved by Miguel A. Savastano and James Roaf

October 12, 2010

Executive Summary

- **Context.** A collapse in tourism triggered by the global crisis of 2008–09 led to a sharp contraction in domestic activity, a rise in unemployment, and a narrowing of the external current account deficit. The output contraction deteriorated the fiscal position, and weakened the banking system, but capital and liquidity levels remain high. Weaknesses in nonbank institutions carry contingent fiscal risks, albeit with low risks of contagion to the rest of the financial system.
- **Outlook.** Real GDP is projected to grow modestly in 2010, and moderately over the medium term as tourism recovers. Although higher oil prices are expected to widen the external current account deficit, international reserves are expected to increase in 2010–11 owing to strong capital inflows. The authorities' fiscal strategy aims at reducing the fiscal deficit by more than 2 percent of GDP in the fiscal year through end-June 2011, but the targets seem too ambitious given the underlying measures.
- **Key policy issues.** Discussions focused on the appropriate fiscal consolidation strategy; improving fiscal transparency; the adequate level of international reserves; the regulation and supervision of the financial sector, particularly for nonbank institutions; and reforms to boost economic growth over the medium term.
- **Exchange system.** The Bahamian dollar is pegged to the U.S. dollar at parity. The Bahamas has accepted the obligations of the Article VIII, Sections 2, 3, and 4, and maintains an exchange system that is free of restrictions on payments and transfers for current international transactions. There have been no changes since the previous Article IV Consultation.
- **Mission.** Discussions were held in Nassau during August 30–September 10. The team comprised: G. Leon (head), C. Macario, and P. Liu (all WHD), and met with Prime Minister Hubert Ingraham, Minister of State in Finance Zhivargo Laing, Central Bank Governor Wendy Craig, senior government officials, members of parliament, and private sector representatives. T. Hockin and J. Rolle attended key meetings.

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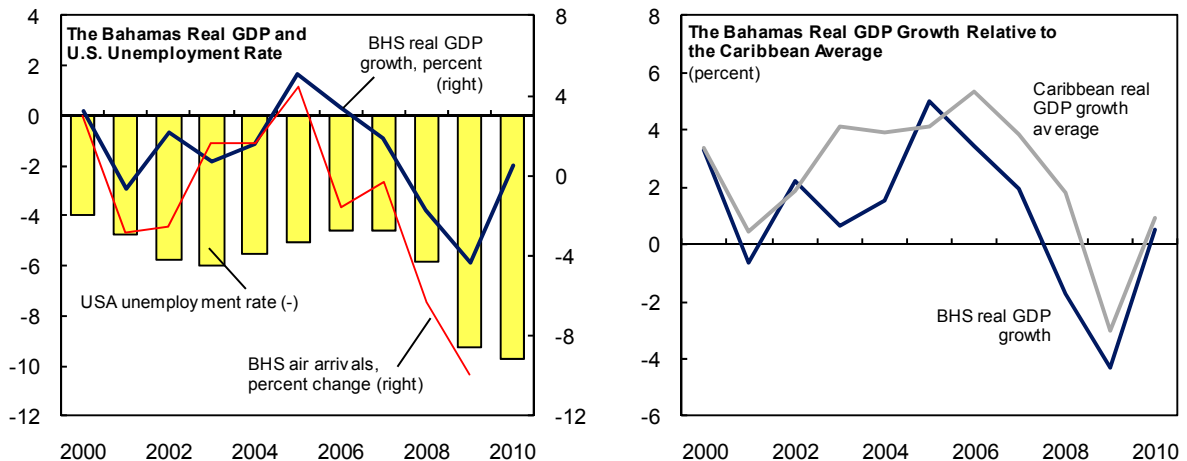
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I. BACKGROUND

1. ***The Bahamas depends heavily on tourism and financial services and has a moderately high level of income per capita.*** The most dynamic activities are located in Nassau, while most of the population resides in New Providence and Grand Bahama. Economic diversification has proved challenging, including due to the high cost of providing adequate infrastructure across the archipelago.
2. ***Although the ruling party has a majority in parliament, the electoral calendar is a factor.*** The Free National Movement (FNM) government has enough votes to pass legislation to enact its legislative agenda, but is concerned about measures that may delay an economic recovery. Elections are scheduled for 2012.
3. ***The key recommendations made during the previous Article IV Consultation remain valid.*** On June 5, 2009, directors commended the Bahamas' strong track record of prudent macroeconomic management, but encouraged the authorities to broaden the domestic tax base, reduce distortions, increase the resilience of revenues to shocks, and specify contingency measures to reign in the growth in public debt.

II. RECENT DEVELOPMENTS

4. ***The global crisis had a profound impact on the Bahamian economy.*** During 2009, tourist arrivals declined by 10 percent and foreign direct investment fell by over 30 percent, leading to a sharp contraction in domestic activity.¹ Real Gross Domestic Product (GDP) declined by 4½ percent and unemployment increased to over 14 percent (from about 9 percent in 2008), with the hotel industry and the construction sector accounting for the bulk of the layoffs. Annual inflation declined to 1.3 percent (from 4½ percent a year earlier), reflecting lower import prices and the contraction in domestic activity.



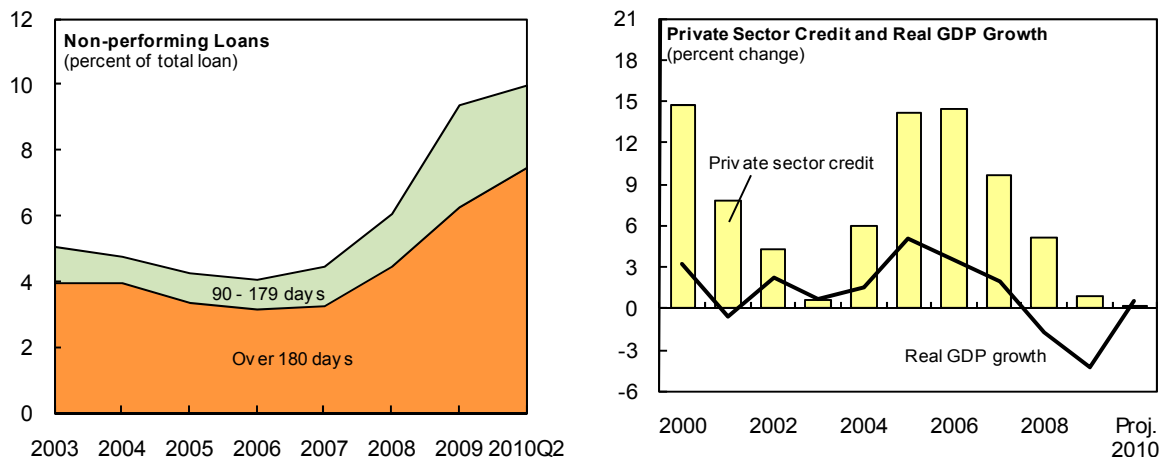
¹ Tourism directly or indirectly accounts for half of economic activity in The Bahamas.

5. ***The balance of payments position improved somewhat, helped by one-off factors.***

Lower import prices contributed to narrow the external current account deficit to about 12½ percent of GDP (16 percent in 2008). External borrowing (US\$300 million) and the one-off Special Drawing Rights (SDR) allocation (US\$179 million) more than covered the current account deficit, and gross international reserves increased to US\$818 million (about 2½ months of imports).

6. ***The downturn deteriorated the fiscal position and weakened the banking system.***

The central government deficit rose by ½-percentage point to 5.3 percent of GDP in the fiscal year ending on June 30. Notwithstanding one-off revenues from a lease transfer, revenues turned out to be 1½-percentage points lower than budgeted. To mitigate the demand shock, the authorities maintained spending broadly in line with the budget, strengthened the social safety net with temporary unemployment programs, and accelerated spending on public investments. Some of these measures were financed off budget through the National Insurance Board (NIB). The sharp fall in activity brought bank credit to a halt—credit to the private sector fell by 0.3 percent (y-o-y) at end-July 2010—and the ratio of non-performing loans (NPLs) rose to over 10 percent at end-June 2010.



7. ***The banking system's position is stabilizing, but risks are elevated.*** Non-performing loans are concentrated largely in mortgages, which account for nearly half of the banks' loan portfolio, though part of the recent increase in NPLs came from commercial loans. Banks' provisioning declined somewhat (to about 37 percent of total NPLs by June 2010), but liquidity remains buoyant and capital adequacy ratios are high for most commercial banks.² Stress tests conducted by the authorities suggest that the banking system has adequate buffers to withstand a further deterioration in banks' loan portfolio, while continuing to comply with capital requirements.³

² As a mitigating factor, the Central Bank estimates that residential-mortgage NPLs are over-collateralized by 20 percent to 120 percent.

³ In November 2009, the Central Bank of The Bahamas increased the minimum capital requirement to 14 percent.

8. ***Rising government debt is a concern.*** At end June 2010, central government debt stood at about 47 percent of GDP, 10 percentage points higher than prior to the crisis. Debt from public enterprises also rose to about 12 percent of GDP, from 10 percent two years earlier. The steep rise in public debt and sluggish revenue outlook has affected the country's sovereign rating. In December 2009, Standard and Poor's lowered its rating for The Bahamas one notch (to BBB+/Stable), and in July 2010 Moody's announced that it was considering a rating downgrade.

III. OUTLOOK AND RISKS

9. ***Near-term growth prospects remain weak.*** Real GDP is projected to grow modestly in 2010, with tourist arrivals benefiting from increased marketing efforts—air arrivals registered a 3 percent increase (y-o-y) in the first half of the year (See Box 1). Inflation is projected to pick up slightly from current low levels, despite weak demand, owing to higher oil prices and planned increases in electricity tariffs. The central government deficit may decline by ½-percentage point of GDP, while central government debt could reach 50 percent of GDP by June 2011. The external current account deficit is projected to widen to about 14 percent of GDP in 2010 and 2011, but one-off capital inflows and (still subdued) Foreign Direct Investment (FDI) are projected to strengthen the international reserves position.

10. ***The medium-term outlook is somewhat more favorable.*** Following five years of below-trend performance, a return to a trend growth rate of about 2½ percent is expected for 2012, if the projected improvement in global conditions materializes. Higher tourism receipts would narrow the external account deficit to about 12 percent of GDP by 2015, but the overall balance of payments could record deficits of about ½ percent of GDP on average, unless capital flows pick up or oil prices decline. The fiscal outlook, however, remains worrisome. Even though staff projects that revenues as a share of GDP will exceed pre-crisis levels by FY 2012/13 and that the primary deficit will be nearly eliminated by FY 2015/16, the ratio of central government debt to GDP is likely to continue rising for the next 4 to 5 years and to approach 55 percent by 2015.

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

	2007	2008	2009	Staff Projections					
				2010	2011	2012	2013	2014	2015
Real GDP (in percent)	1.9	-1.7	-4.3	0.5	1.5	2.5	2.5	2.5	2.5
Inflation (end of period, in percent)	2.9	4.5	1.3	1.7	1.2	1.7	2.0	2.0	2.0
Overall fiscal balance 1/	-2.5	-2.1	-4.9	-5.3	-4.8	-4.3	-3.7	-3.4	-3.3
Central government debt 1/	34.9	36.8	41.4	46.9	50.1	52.3	53.5	54.1	54.5
External current account balance	-17.8	-15.9	-12.6	-13.9	-13.7	-13.2	-12.9	-12.5	-12.1
Gross international reserves (in US\$ millions) 2/	454.2	562.9	818.4	842.0	972.5	926.2	882.9	854.7	839.1
In months of next year's goods & services imports	1.2	1.8	2.4	2.4	2.6	2.4	2.2	2.0	1.9

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

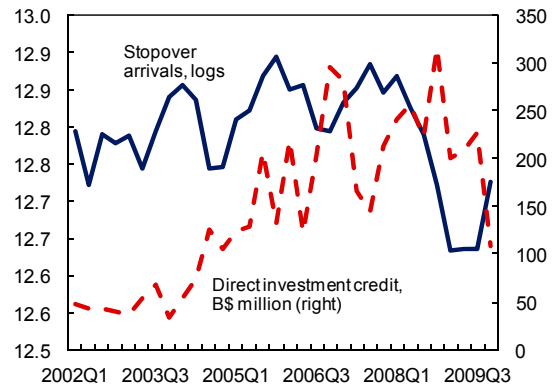
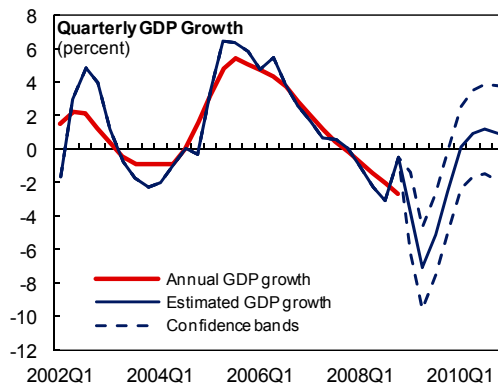
1/ Central government only. Fiscal year data (to June).

2/ Includes SDR allocation of US\$178.9 million in September 2009.

Box 1. Forecasting Economic Activity in The Bahamas

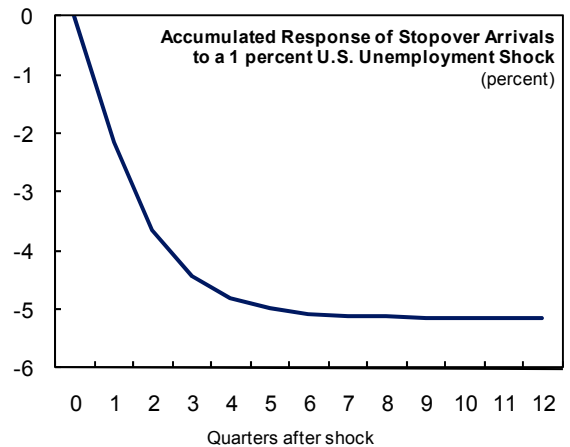
Although the global crisis had a profound impact on the Bahamian economy, the lack of timely quarterly GDP data made it difficult to assess the economic cycle. To overcome this problem, we took advantage of data available on a quarterly basis that are released more frequently, to estimate the quarterly profile of GDP. Results from models estimated with these data show that:¹

- The current recession started in the first quarter of 2008, and the impact of the U.S. downturn was transmitted to The Bahamas primarily through lower tourism arrivals and foreign direct investment.
- The 2009 decline in real GDP was about 4.6 percent;² and significant uncertainty remains about the growth outlook for 2010.



While tourism activity is expected to recover, the outlook depends strongly on U.S. employment

conditions. A Bayesian vector auto-regression model, linking developments in the U.S. with stopover arrivals in The Bahamas, suggests that stopover arrivals will grow by 2 and 5 percent (y-o-y) in 2010 and 2011, conditional on the current projection for growth in the U.S. However, this forecast depends also on U.S. employment conditions. To illustrate, the model shows that a one-percentage point increase in the unemployment rate, would reduce stopover arrivals to The Bahamas by about 4.5 percent over two years. This result suggests that it would be prudent to be prepared for a sustained period of subdued growth, and make contingency plans in case downside risks materialize.



¹ Two empirical models were used: the first is based on a dynamic factor model; and the second is a Bayesian vector autoregressive model using stock prices, U.S. GDP, U.S. unemployment rate, and stopover arrivals. Results of the estimation are available upon request.

² The latest GDP estimate from the Department of Statistics show a contraction of 4.3 percent in 2009.

11. ***There are large downside risks to the medium-term outlook.*** A slower-than-expected recovery of output or employment in the United States or higher than projected energy prices would delay the pickup in activity and weaken further the fiscal and external positions. The large borrowing that would be necessary to improve the inadequate physical and social infrastructure presents additional challenges to expenditure and debt management. Slow progress on structural reforms (including revenues reforms) would also jeopardize a sustained recovery, including through higher borrowing costs. Upside potential to the outlook would stem from a faster-than-expected rebound in tourism activity or the start of large-scale hotel investments.

IV. POLICY DISCUSSIONS

12. ***Against the above backdrop, discussions during the consultation focused on:*** (i) the strategy for fiscal consolidation and increased transparency; (ii) the desirable level of international reserves; (iii) the further strengthening of the financial sector; and (iv) growth-enhancing reforms.

A. Fiscal Policy

13. ***There was agreement that a strong and sustained fiscal effort was necessary to stabilize and then reduce the debt-to-GDP ratio.*** The mission discussed scenarios that showed that lowering the debt-to-GDP ratio to 40 percent by 2015/16 would require a primary surplus of 1.4 percent of GDP, on average, and a cumulative fiscal effort of about 13½ percent of GDP (2.3 percent of GDP per year) over the next 6 years.

14. ***The authorities considered that the measures adopted in the FY 2010/11 budget would result in significant fiscal consolidation.*** Improvements in tax administration and collection and the new tax measures were expected to increase government revenues by 2 percent of GDP.⁴ They noted that these measures would be supplemented by strict expenditure control, including on wages, lower transfers to public enterprises, and a reform of fiscal incentives.⁵

15. ***Staff recommended identifying contingency measures to support the authorities' strategy.*** It noted that the authorities' scenario was somewhat optimistic about the yield of the recent measures. The authorities indicated a commitment to take additional measures if projected revenue shortfalls were to endanger the fiscal targets.

⁴ The budget for FY 2010/11 contains increases in the following taxes: (i) excise taxes on vehicles, with the exception of hybrids; (ii) air and sea departure taxes, and taxes on hotel rooms; (iii) domestic beer; (iv) stamp tax on realty transactions; (v) stamp tax on bank transactions and annual fees payable by retail banks. In addition, tax incentives under the Industries Encouragement Act (IEA) will be limited to 5 years from the date of approval (there were no limits previously).

⁵ The budget envelope for the current year contemplates reigning in spending through the following measures: cuts of 2.6 percent of the budget for ministries and agencies; cuts in the overall pay for the prime minister, cabinet members, and members of parliament; and a hiring freeze.

16. ***It was agreed that a comprehensive tax reform was necessary for a sustained fiscal consolidation.*** The authorities view the ongoing tax administration reforms as a means to improve revenue yield, but have also been laying the foundations for the adoption of a Value Added Tax (VAT) sometime in the future. Staff noted that cross-country evidence suggests that a successful implementation of a VAT could yield additional revenues of about 2–3 percent of GDP, an amount similar to the additional fiscal effort needed for significantly reducing the debt-to-GDP ratio. To ensure the success of the reforms, staff highlighted the need for early preparations, such as the roll out of public campaigns, to gain social support.

17. ***The mission highlighted the need to improve fiscal transparency, especially on public enterprises.*** The authorities noted that they plan to reduce transfers to public corporations to gradually improve their financial position and are considering privatization and public-private-partnerships as possible options for their reform strategy. While welcoming these steps, staff urged the authorities to monitor carefully and prepare consolidated accounts for the overall non-financial public sector, including by incorporating off-budget operations in the central government budget.

The Bahamas: Operations of Public Corporations
(In percent of GDP)

	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Total revenue 1/	12.2	12.9	12.9	14.5	12.3	...
Of which: Central government transfers 1/	0.4	0.5	0.6	0.4	0.3	...
Total expenditure 1/	12.1	12.9	12.7	15.0	12.5	...
Overall balance 1/	0.1	0.0	0.2	-0.5	-0.3	...
Debt 2/	9.6	10.4	10.3	10.6	12.4	12.5

Sources: Ministry of Finance; and the Central Bank of The Bahamas.

1/ Preliminary information. Includes Airport Authority, Bahamasair, Bahamas Development Bank, Bahamas Electricity Corp., Broadcasting Corp., Bahamas Telecommunication Corp., and Water and Sewerage Corp. Data for 2008/09 do not include Broadcasting Corp.

2/ Includes all in footnote 1 except Broadcasting Corp. plus Bahamas Mortgage Corp., Bridge Authority, College of the Bahamas, Educational Guarantee Fund, Education Loan Authority, Hotel Corp., Nassau Airport Development Company, and The Clifton Heritage Authority.

18. ***The authorities are taking gradual steps towards adopting a medium-term fiscal framework.*** To anchor the debt-reduction strategy, the Ministry of Finance (MoF) will start including two-year ahead fiscal projections in their draft budget. The authorities also plan to rationalize tax incentives and transfers, incorporate them into the budget, and disclose full details. The mission argued that these initiatives would help strengthen fiscal transparency, but stressed the need for adopting a more detailed medium-term macroeconomic and budget framework to anchor expectations and inform the policy debate.

B. Monetary and Exchange Rate Policy

19. ***Monetary policy remained supportive of the exchange rate peg.*** Despite the decline in output and inflation, the central bank maintained its policy rate at 5½ percent throughout 2009 to support the credibility of the exchange rate peg, maintain stability of the financial system, and strengthen international reserves. Staff agreed with the authorities' view that the fixed exchange rate continues to provide an adequate nominal anchor for the peg.

20. *Updated estimates from CGER-type equilibrium exchange rate methodologies suggest that the Bahamian dollar is broadly in line with fundamentals (Figure 3).*⁶ The real exchange rate appreciated in 2008 owing to the sharp increase in oil prices, but has fallen recently with lower oil prices and domestic inflation. Estimates from the macrobalance approach suggest that the projected medium-term current account deficit for The Bahamas is close to the estimated current account “norm”, while single equations regressions of the equilibrium real exchange rate and PPP analyses suggest that the current level of the real exchange is broadly in line with fundamentals. These results, however, are subject to well-known estimation shortcomings and are sensitive to the assumptions used.

21. *The authorities regard their current reserve level as adequate.* They indicated that they are currently targeting a minimum reserve coverage ratio of about 80 percent of base money, considerably higher than the 50 percent coverage stipulated in the law. Staff acknowledged that The Bahamas coped relatively well in the past with rather low reserve coverage ratios, but noted that an even larger reserve cushion would help mitigate the impact of large negative shocks, provide some room for a counter-cyclical response, and enhance the credibility of the peg. The authorities concurred on the rationale for a higher level of reserves, and indicated that they would like to explore alternative measures of reserve-adequacy suitable for The Bahamas. They requested staff input in this task.⁷

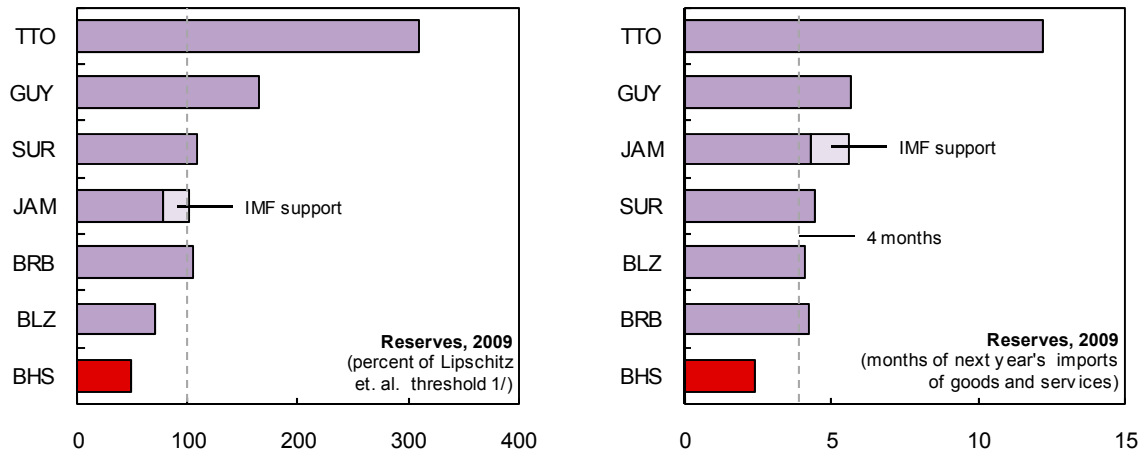
The Bahamas: Gross International Reserves

	Average				Staff Projections					
	2002-06	2007	2008	2009	2010	2011	2012	2013	2014	2015
Gross international reserves										
In millions of U.S. dollars (end of period)	521	454	563	818	842	972	926	883	855	839
In months of next year's goods & services imports	1.8	1.2	1.8	2.4	2.4	2.6	2.4	2.2	2.0	1.9
In percent of base money	94.7	67.5	87.3	117.8	117.2	129.9	117.5	105.8	96.8	89.8
In percent of broad money	11.7	8.1	9.5	13.6	13.5	15.0	13.5	12.2	11.1	10.3
In percent of foreign debt service	875	912	1,164	301	1,465	1,662	1,477	1,362	1,334	1,330

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

⁶ Key variables used in the exchange rate equations include the oil balance, the fiscal balance, net foreign assets, and income growth.

⁷ As one possible approach to consider, staff suggested the reserve adequacy threshold proposed by Lipschitz, L., M. Messmacher, and A. Mourmouras in “Much higher than you thought?” *mimeo*, April 2006.



1/ The Lipschitz et. al. threshold is based on the full coverage of foreign debt service, plus 10 percent of broad money, plus 20 percent of next year's imports of goods and services (Lipschitz and others (2006)). Foreign debt service is for the central government, except for Guyana, which also includes public enterprises; and Belize, which also includes publicly-guaranteed debt.

22. ***A market-based auction mechanism for the issuance and pricing of government securities is being developed.*** At present, government bonds are issued by allotment at a fixed price, based on the prime rate (see Box 2). The central bank is exploring options for a more transparent market-based mechanism that will better reflect domestic money market conditions and improve the allocation of resources. The new auction-based system is expected to be in place in 2011.

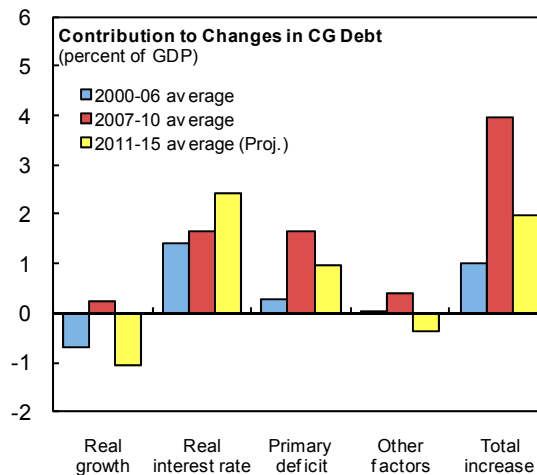
C. Financial Sector

23. ***It was agreed that the deterioration in the banks' loan portfolio warrants close monitoring.*** Results from stress tests conducted by the authorities suggest that the banking system could withstand a further deterioration in loan portfolios. However, since the degree of vulnerability could vary across banks, staff stressed the need to intensify on-site inspections and monitoring, and review the prompt corrective action framework. In particular, staff suggested in-depth monitoring of entities showing rapid and concentrated loan growth in recent years.

24. ***The authorities restated their commitment to further strengthening the banking system.*** They noted that the banking supervision department of the central bank is strengthening staff capability, increasing the frequency of reporting, and accelerating on-site inspections. In addition, they are carrying out stress tests on a regular basis, and plan on improving their analysis of interest, liquidity, and credit risks. To strengthen the safety net and crisis management capacity, the authorities are reviewing the legal framework to assess their ability to respond effectively to a crisis, and are participating in a regional effort on contingency planning for financial crises. They are also reinforcing collaboration with other supervisors, particularly Canadian regulators.

Box 2. Domestic Government Debt: Moving Towards a Market-Based Auction Mechanism

Government securities in The Bahamas are currently issued at a predetermined rate (related to the prime rate set by the central bank). Notwithstanding the shortcomings of issuing securities at a predetermined rate, the Bahamas' debt management system has performed satisfactorily: most of the debt has long maturities; there are no central bank securities that compete with government debt; and the securities enjoy investment grade rating.¹ However, the interest on government debt is quite high and plays an increasingly important role in the debt dynamics (see chart).



Adoption of a more transparent, market-based system for the issuance and pricing of government securities would improve the current situation. It would allow rates to better reflect money market conditions, promote the development of domestic financial markets, and could potentially lower interest payments. Moreover, the development of a yield curve could be helpful in the formulation of monetary policy and the pricing of private sector debt securities. Moving to an auction-based system requires choosing the type of auction mechanism and strengthening the coordination between fiscal and monetary policy.

Uniform price auctions versus discriminatory price auctions. Choosing an auction mechanism that promotes price discovery is important for maximizing revenue and improving market efficiency. Discriminatory price auctions—in which each bidder quotes a price and securities are allotted at different prices—have ambiguous effects on revenue, since they could potentially maximize revenue for the government but, at the same time, create incentives for bidders to lower their bidding price. Uniform price auctions—which allot securities at the cutoff price—eliminate this risk, and always increase revenues; however, in shallow markets it is necessary to take measures to reduce the risk of collusion.²

Coordination between fiscal and monetary policy. A market-determined interest rate on government securities in a fixed exchange rate economy requires strong coordination between the fiscal and monetary authorities. In particular, the policy rate or discount rate set by the central bank should continue to be an effective reference for the yield of government securities and to protect the viability of the peg.

¹ The central bank does not issue its own paper, and is responsible for issuing treasury bills and bonds on behalf of the government. It can hold government securities up to 20 percent of the bank's own demand liabilities.

² Shah, Jobst, Valderrama-Ferrando and Guerra, *Public Debt Markets in Central America, Panama and the Dominican Republic*, Working Paper 147, IMF, 2007; M.S. Mohanty, *Improving liquidity in government bond markets: what can be done?*, BIS Papers 11, June 2002.

25. ***Financial regulatory frameworks, particularly for nonbank financial institutions, are being strengthened.*** Measures being considered include: (i) establishing new legislation to strengthen the supervisory and regulatory framework for insurance, including by placing it under the purview of an independent board; (ii) providing the superintendent of insurance the authority to carry out on-site examinations, issue sanctions and fines, and intervene insurance companies; (iii) improving the securities legislation; (iv) merging the insurance and securities regulatory agencies; (v) moving forward with plans to bring credit unions under the purview of the central bank; and (vi) signing Tax-Information Exchange Agreements (TIEAs), effecting legal, administrative, and regulatory requirements ahead of the Peer Review scheduled for late 2010.⁸

26. ***Efforts to wind down CLICO-Bahamas continue.*** The authorities indicated that difficulties in liquidating CLICO's assets were hindering the resolution and noted that it may be necessary to issue government guarantees to facilitate the sale of the traditional and non-traditional policies. Staff stressed that the resolution strategy had to minimize fiscal costs.

D. Enhancing Medium-Term Growth

27. ***There was agreement that a return to sustained growth was a priority and would contribute to fiscal sustainability.*** The authorities noted that the 2010/11 budget contained measures aimed at unleashing private-sector-led growth including: (i) improving the ease of doing business; (ii) upgrading support for small and medium-sized enterprises, including by proposing the Small and Medium Enterprise Development Act; (iii) consolidating the management of all fiscal incentives in one single institution (under the purview of the MoF) and applying non-discretionary rules uniformly; and (iv) implementing plans for strengthening infrastructure, including through private-public partnerships. The authorities also plan to improve the availability of low-cost and reliable energy, strengthen vocational skills, and apply immigration policy flexibly to better match the needs of industry. Staff supported the authorities' efforts and indicated that these measures could make a significant contribution to enhancing medium-term growth.

E. Other Issues

28. ***The mission emphasized that timely and quality data are essential for effective policymaking and adequate surveillance.*** Staff discussed the strengthening of macroeconomic and financial statistics, in particular government finance statistics and national accounts, to enhance economic surveillance and policy formulation. It reiterated that the Fund stands ready to provide technical assistance in these areas.

⁸ 18 TIEAs were signed before the OECD deadline of end-March 2010, taking the total to 21 TIEAs since 2002 and placing The Bahamas on the OECD "white list."

V. STAFF APPRAISAL

29. ***The Bahamian economy is showing signs of recovery from the global crisis, but rapidly placing public debt on a sustainable path remains the key challenge.*** Staff welcomes the authorities' commitment to maintain prudent macroeconomic policies, including fiscal measures to limit the growth of public debt and monetary policy geared to supporting the exchange rate peg. The consolidation strategy aimed at curtailing the fiscal deficit through revenue and spending measures initiated by the authorities is welcome, but bolder measures may be necessary to reduce the risks of a continued deterioration of the fiscal position. Notwithstanding the large uncertainties and risks, staff is confident that a resolute adherence to fiscal consolidation and an enabling investment climate can provide the foundation for sustained economic growth.

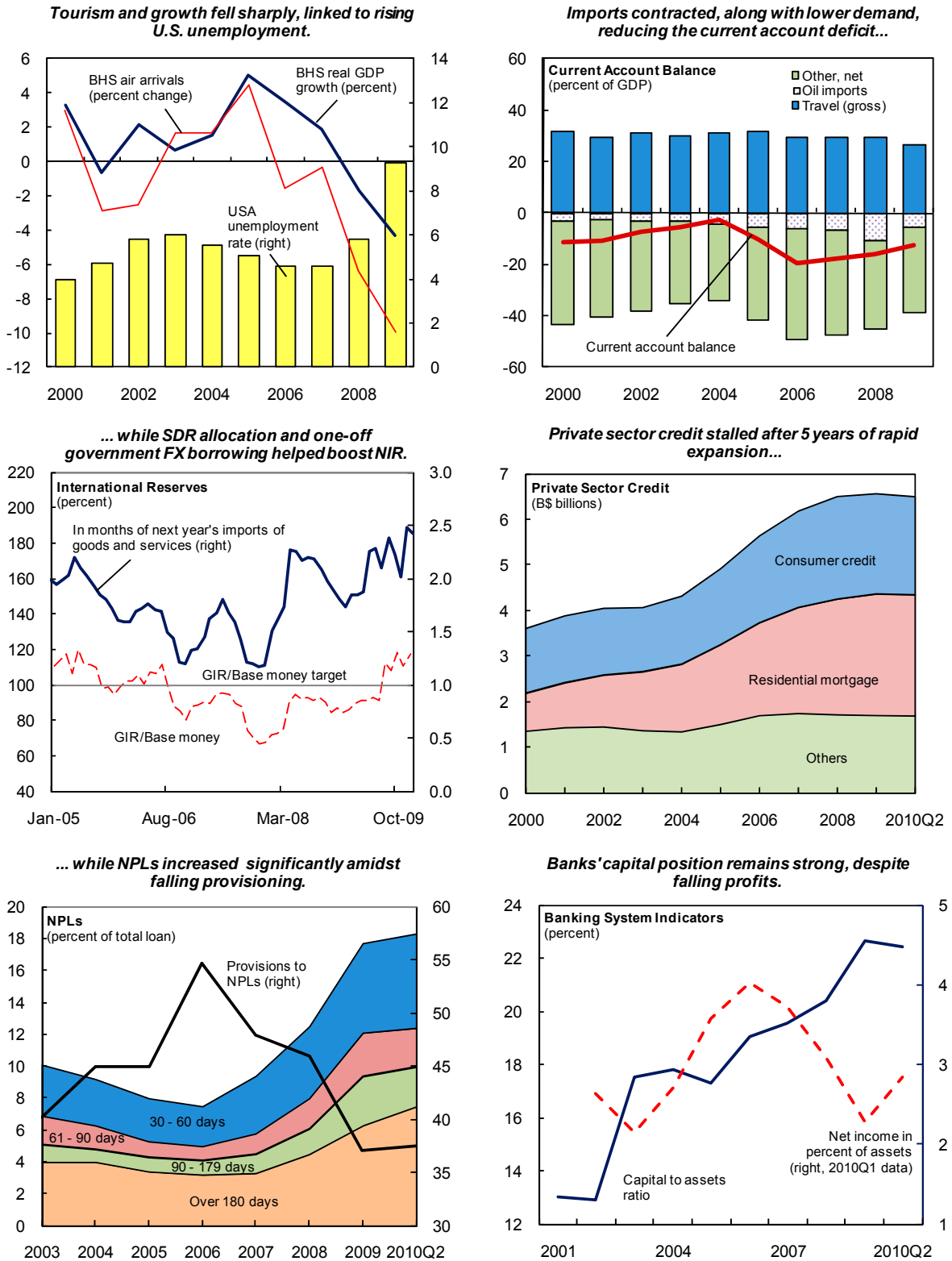
30. ***Greater transparency should underpin the authorities' medium-term fiscal strategy.*** Staff encourages the authorities to extend their budget framework to the medium term and prepare consolidated accounts for the non-financial public sector (including public enterprises and off-budget operations). Disclosure of the terms, conditions, beneficiaries, and fiscal cost of the complex system of tax incentives would help improve transparency and accountability.

31. ***A higher international reserve coverage would help reduce vulnerabilities.*** Although The Bahamas managed well the latest crisis with a relatively low level of reserves, the uncertain global environment and the downside risks to growth in advanced economies put a premium on the cushion the economy has to mitigate adverse shocks. The longstanding peg has served the country well and the current level of the exchange rate is broadly in line with long-term fundamentals.

32. ***Measures underway to strengthen the financial system are welcome, but vulnerabilities remain.*** The measures to enhance banking and insurance supervision, the plans to bring credit unions under the purview of the central bank, and the securities legislation ahead of the peer review are positive developments. However, further strengthening of the nonbank regulatory framework and supervision is needed to mitigate vulnerabilities and contingent liabilities. While acknowledging the difficulties faced to liquidate CLICO, staff urged the authorities to press for a prompt resolution that minimizes contingent fiscal liabilities.

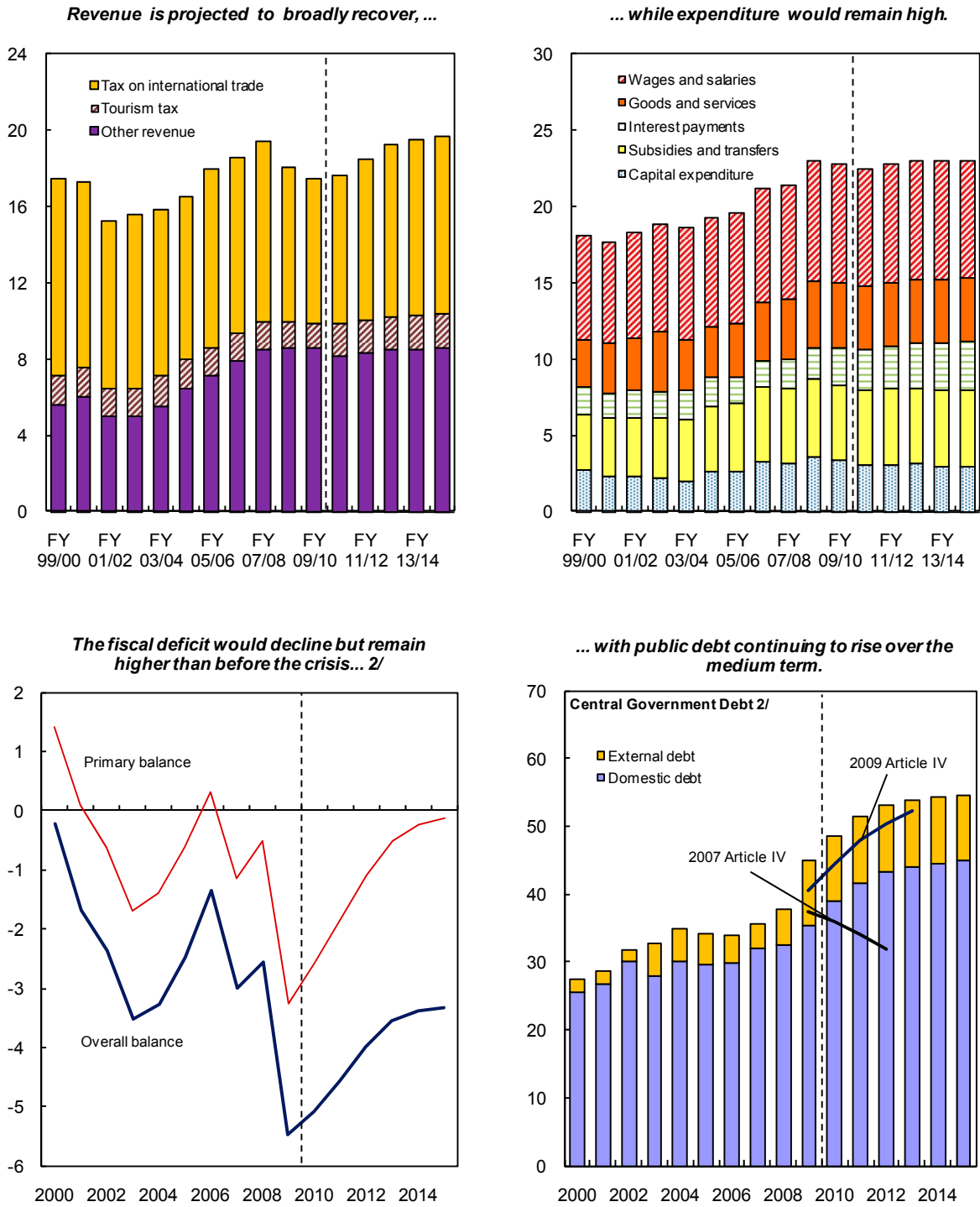
33. ***Next consultation.*** The staff proposes that the next Article IV Consultation take place within the 12-month cycle.

Figure 1. The Bahamas: Recent Developments



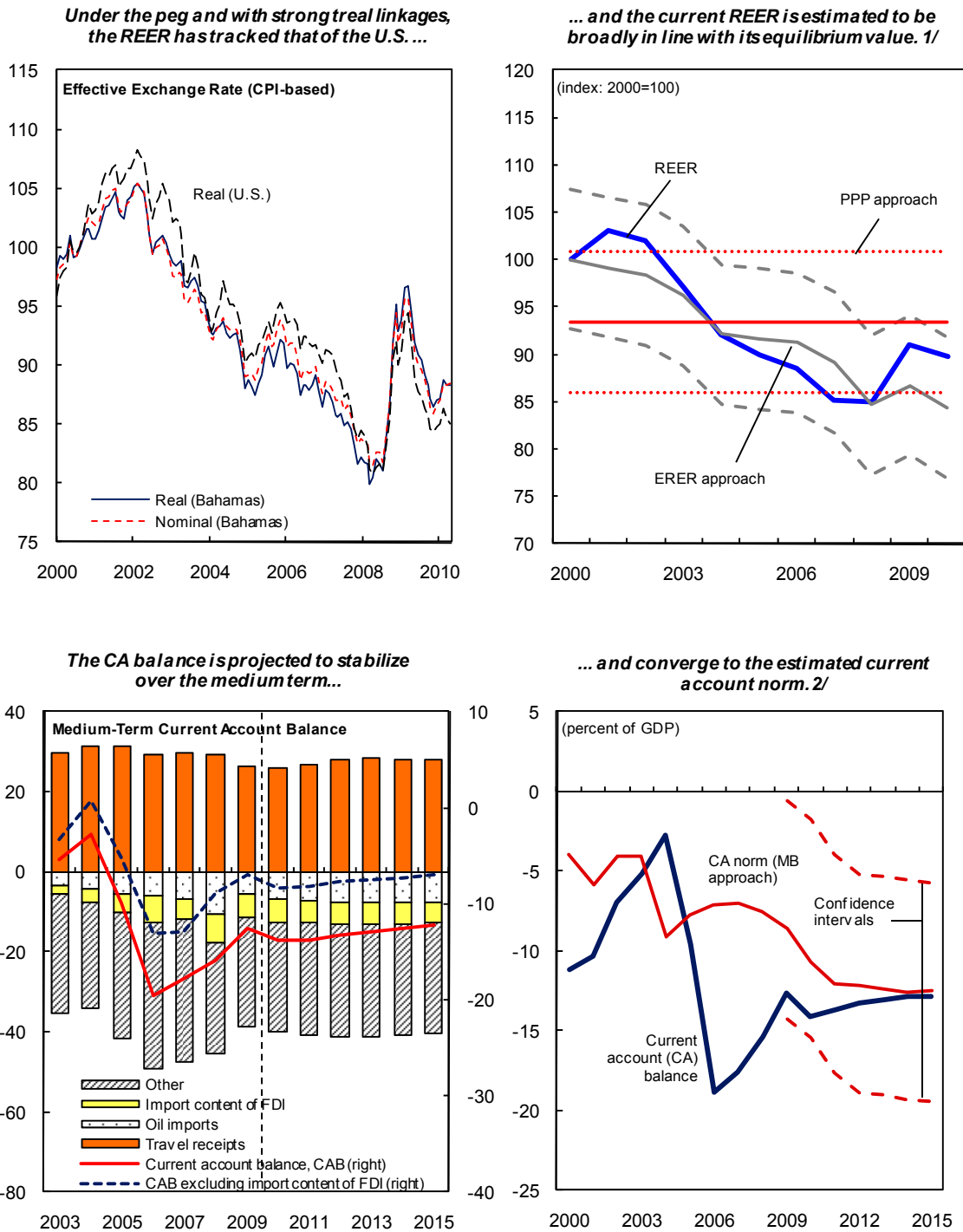
Sources: Bahamian authorities; WEO; and Fund staff estimates and projections.

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



Sources: The Bahamian authorities; and Fund staff estimates.
1/ Fiscal year ending June 30.
2/ Calendar year basis.

Figure 3. The Bahamas: Exchange Rate Assessment

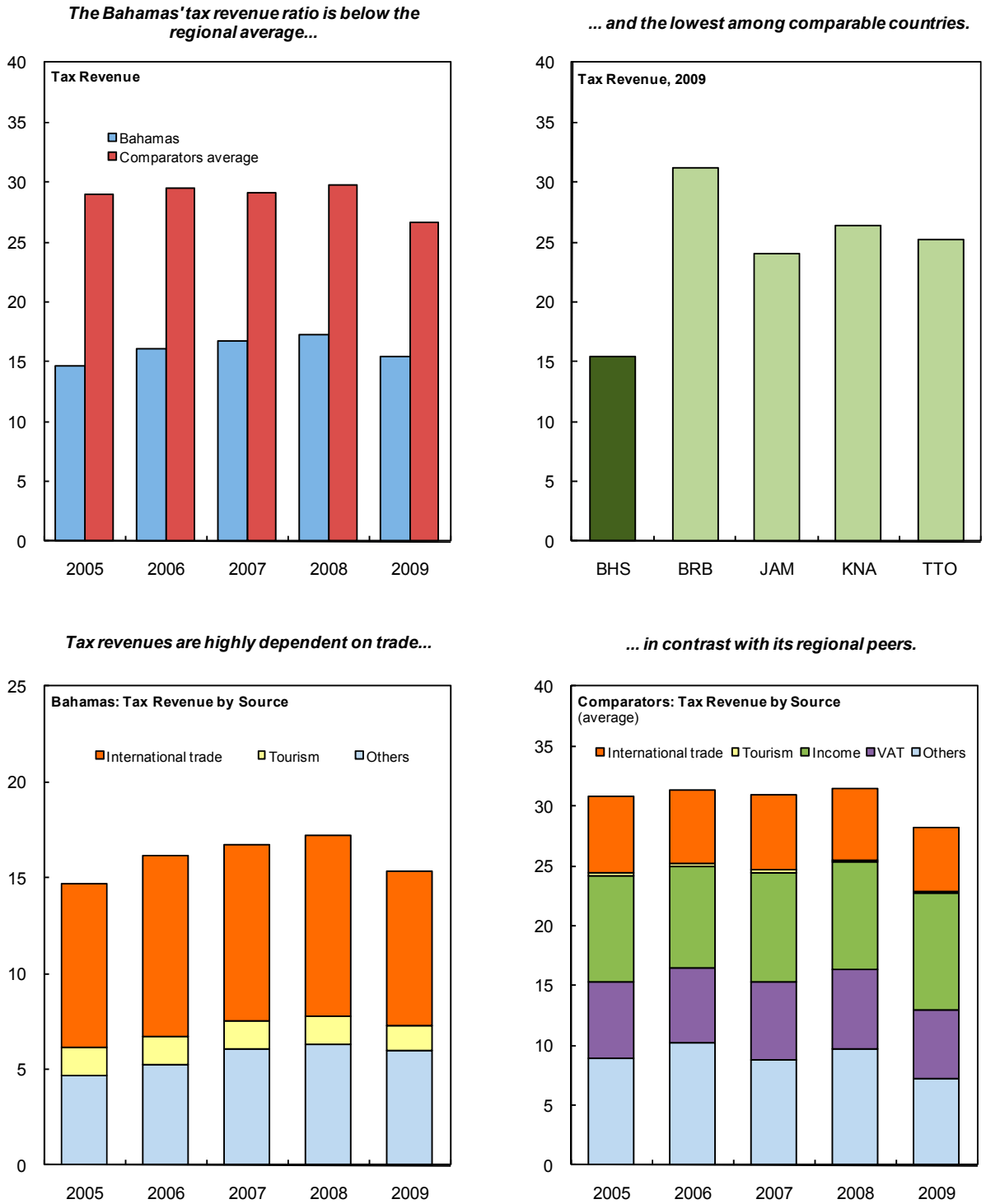


Sources: IMF, Information Notice System; and Fund staff calculations.

1/ The equilibrium values are computed using the purchasing power parity (PPP) and equilibrium real exchange rate approach as in Vitek (2010).

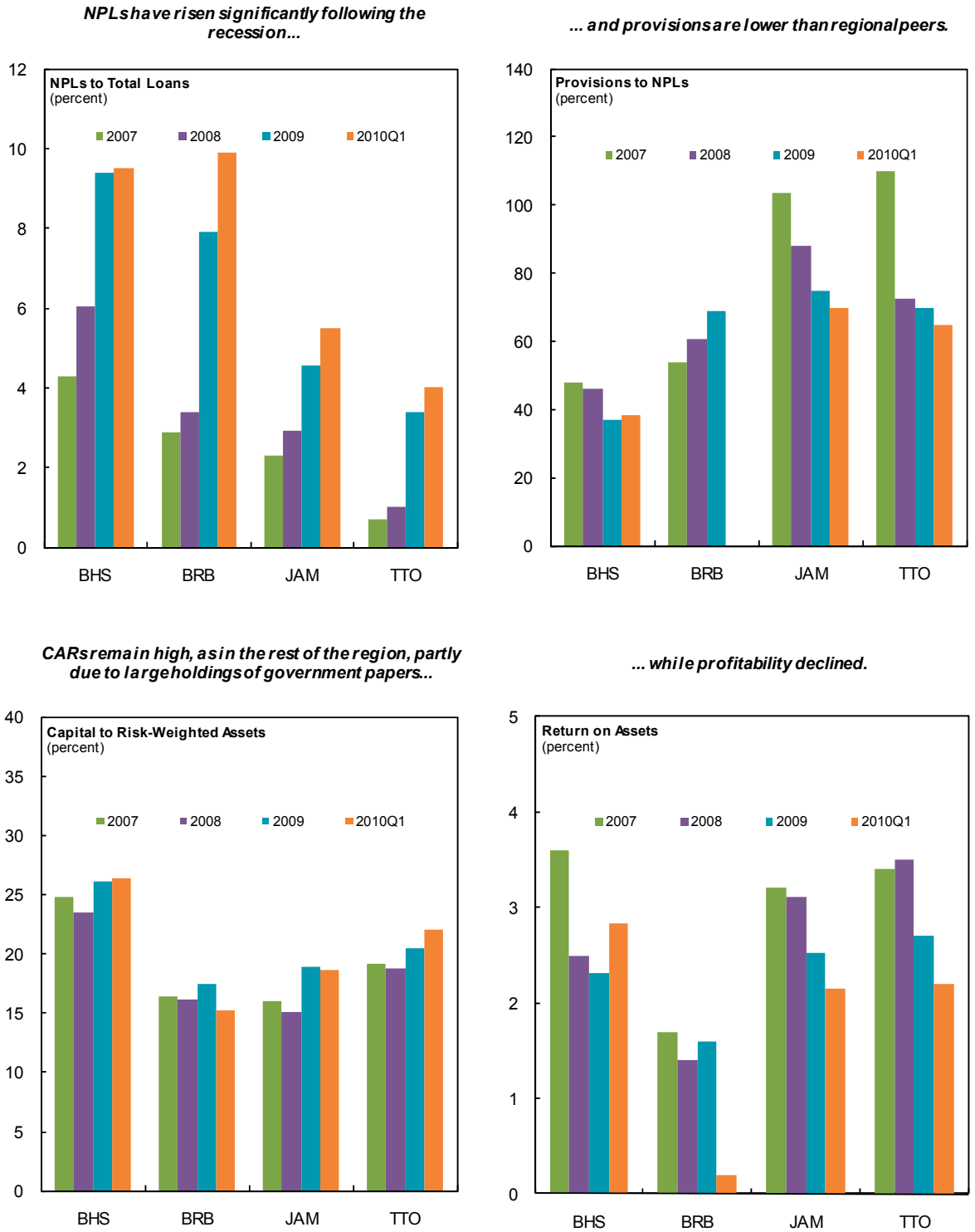
2/ The current account (CA) norm is computed using the estimated parameters from the panel regression in Vitek (2010), and Staff medium-term projections for the conditioning variables. In particular, the CA norm depends positively on the country's oil trade balance, the level of net foreign assets, relative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

Figure 4. The Bahamas: Tax Revenue Regional Comparison 1/
(In percent of GDP)



Sources: National authorities; and Fund staff estimates.
1/ Regional comparators include Barbados, Jamaica, St. Kitts and Nevis, and Trinidad and Tobago.

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



Sources: International Financial Statistics; National authorities; and Fund staff estimates.
1/ Regional comparators include Barbados, Jamaica, and Trinidad and Tobago. Data for Barbados are preliminary.

Table 1. The Bahamas: Selected Economic Indicators

	2007	2008	2009	Staff Projections					
				2010	2011	2012	2013	2014	2015
(Annual percentage changes, unless otherwise indicated)									
Real sector 1/									
Real GDP	1.9	-1.7	-4.3	0.5	1.5	2.5	2.5	2.5	2.5
Nominal GDP	5.4	-1.0	0.9	2.2	2.9	4.0	4.5	4.5	4.5
Consumer price index (annual average)	2.5	4.5	2.1	1.7	1.4	1.4	2.0	2.0	2.0
Consumer price index (end of period)	2.9	4.5	1.3	1.7	1.2	1.7	2.0	2.0	2.0
Unemployment rate (in percent) 2/	7.9	8.7	14.6	...	...	...	...	...	...
Financial sector									
Credit to the nonfinancial public sector	11.5	16.1	9.3	20.9	16.0	12.5	10.4	9.3	8.8
Credit to the private sector	9.7	5.1	0.9	0.1	0.7	2.4	3.3	3.4	3.4
Liabilities to the private sector	9.6	5.1	1.8	3.5	4.2	5.3	5.8	5.8	5.8
External sector									
Exports of goods and services	8.7	2.9	-16.1	6.1	5.5	7.6	4.8	4.1	4.1
<i>Of which:</i> Travel receipts (gross)	6.4	-1.6	-10.0	1.4	6.3	8.8	5.0	4.1	4.1
Imports of goods and services	4.6	1.5	-18.8	8.5	4.7	6.1	4.5	3.6	3.7
(In percent of GDP, unless otherwise indicated, on a calendar year basis)									
Central government									
Revenue and grants	18.0	19.6	18.1	17.5	18.1	18.9	19.4	19.6	19.8
Current expenditure	18.0	19.0	19.3	19.4	19.6	19.8	19.9	20.0	20.1
Capital expenditure and net lending	3.1	3.2	4.2	3.2	3.1	3.1	3.0	3.0	3.0
Primary balance	-1.2	-0.5	-3.3	-2.6	-1.8	-1.1	-0.5	-0.2	-0.1
Overall balance	-3.0	-2.6	-5.5	-5.1	-4.6	-4.0	-3.6	-3.4	-3.3
Central government debt	35.7	37.8	45.0	48.7	51.5	53.2	53.8	54.3	54.6
External sector									
Current account balance	-17.8	-15.9	-12.6	-13.9	-13.7	-13.2	-12.9	-12.5	-12.1
Change in net international reserves (increase -)	0.6	-1.5	-3.4	-0.3	-1.7	0.6	0.5	0.3	0.2
External public debt (end of period)	4.6	6.1	10.4	10.6	10.8	10.8	10.7	10.6	10.5
Memorandum items:									
Gross international reserves (end of period; millions of U.S. dollars)	454.2	562.9	818.4	842.0	972.5	926.2	882.9	854.7	839.1
In months of next year's G&S imports	1.2	1.8	2.4	2.4	2.6	2.4	2.2	2.0	1.9
In percent of reserve money	67	87	118	117	130	118	106	97	90
External debt-service ratio 3/	6.6	6.6	25.7	6.9	6.8	12.2	7.0	6.6	6.7
GDP (in millions of Bahamian dollars)	7,381	7,309	7,377	7,538	7,757	8,066	8,431	8,812	9,210

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

1/ Revised national accounts data.

2/ 2009 figure based on October Interim survey.

3/ In percent of exports of goods and services. The increase in 2009 reflects repayment of internal forex loan of US\$185 million to domestic banks.

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

	Budget		Prel.	Staff Projections					
	FY07/08	FY08/09	FY09/10	FY09/10	FY10/11	FY11/12	FY12/13	FY13/14	FY14/15
Revenue and grants	1,424	1,324	1,415	1,302	1,348	1,464	1,592	1,684	1,776
Tax revenue	1,267	1,130	1,252	1,108	1,218	1,329	1,451	1,537	1,622
Taxes on international trade	694	595	677	566	596	670	751	793	842
Tourism taxes	107	96	97	96	126	134	140	155	162
Miscellaneous taxes	456	412	456	387	434	461	494	520	546
Other	10	27	22	60	61	63	66	69	72
Nontax revenue	157	194	141	193	130	134	140	147	153
Grants and capital revenue	0	0	22	0	0	0	0	0	0
Total expenditure	1,575	1,686	1,689	1,700	1,718	1,804	1,896	1,980	2,076
Current expenditure	1,344	1,423	1,430	1,451	1,486	1,561	1,640	1,724	1,808
Wages and salaries	552	573	580	580	585	615	641	670	700
Goods and services	289	322	301	322	317	328	342	358	374
Interest payments	143	154	177	178	204	225	247	267	286
Subsidies and transfers	360	373	373	371	380	393	410	429	448
Current balance	80	-99	-37	-150	-139	-98	-49	-40	-33
Capital expenditure	231	263	258	249	231	243	256	256	268
Capital formation	177	140	209	157	182	194	206	207	218
Capital transfers and net lending	54	123	49	91	49	49	49	49	49
Overall balance	-151	-361	-273	-398	-370	-341	-304	-296	-300
Financing	151	361	273	398	370	341	304	296	300
Foreign financing	101	50	...	174	33	35	31	30	30
Domestic financing 2/	50	313	...	224	337	306	273	266	270
Memorandum items:									
Primary balance	-8	-207	-97	-220	-166	-116	-57	-29	-14
Central government debt	2,701	3,043	...	3,495	3,831	4,141	4,415	4,663	4,907

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

1/ Fiscal year ends June 30.

2/ Includes statistical discrepancy.

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

			Budget	Prel.	Staff Projections				
	FY07/08	FY08/09	FY09/10	FY09/10	FY10/11	FY11/12	FY12/13	FY13/14	FY14/15
Revenue and grants	19.4	18.0	19.0	17.5	17.6	18.5	19.3	19.5	19.7
Tax revenue	17.3	15.4	16.8	14.9	15.9	16.8	17.6	17.8	18.0
Taxes on international trade	9.5	8.1	9.1	7.6	7.8	8.5	9.1	9.2	9.3
Tourism taxes	1.5	1.3	1.3	1.3	1.6	1.7	1.7	1.8	1.8
Miscellaneous taxes	6.2	5.6	6.1	5.2	5.7	5.8	6.0	6.0	6.1
Other	0.1	0.4	0.3	0.8	0.8	0.8	0.8	0.8	0.8
Nontax revenue	2.1	2.6	1.9	2.6	1.7	1.7	1.7	1.7	1.7
Grants and capital revenue	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	21.4	23.0	22.6	22.8	22.5	22.8	23.0	23.0	23.0
Current expenditure	18.3	19.4	19.2	19.5	19.4	19.7	19.9	20.0	20.1
Wages and salaries	7.5	7.8	7.8	7.8	7.7	7.8	7.8	7.8	7.8
Goods and services	3.9	4.4	4.0	4.3	4.2	4.2	4.2	4.2	4.2
Interest payments	1.9	2.1	2.4	2.4	2.7	2.8	3.0	3.1	3.2
Subsidies and transfers	4.9	5.1	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Current balance	1.1	-1.3	-0.5	-2.0	-1.8	-1.2	-0.6	-0.5	-0.4
Capital expenditure	3.1	3.6	3.5	3.3	3.0	3.1	3.1	3.0	3.0
Capital formation	2.4	1.9	2.8	2.1	2.4	2.5	2.5	2.4	2.4
Capital transfers and net lending	0.7	1.7	0.7	1.2	0.6	0.6	0.6	0.6	0.5
Overall balance	-2.1	-4.9	-3.7	-5.3	-4.8	-4.3	-3.7	-3.4	-3.3
Financing	2.1	4.9	3.7	5.3	4.8	4.3	3.7	3.4	3.3
Foreign financing	1.4	0.7	...	2.3	0.4	0.4	0.4	0.3	0.3
Domestic financing 2/	0.7	4.3	...	3.0	4.4	3.9	3.3	3.1	3.0
Memorandum items:									
Primary balance	-0.1	-2.8	-1.3	-2.9	-2.2	-1.5	-0.7	-0.3	-0.2
Central government debt	36.8	41.4	...	46.9	50.1	52.3	53.5	54.1	54.5
Nominal GDP (in B\$ millions)	7,345	7,343	7,457	7,457	7,647	7,911	8,248	8,621	9,011

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

1/ Fiscal year ends June 30.

2/ Includes statistical discrepancy.

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

	2004	2005	2006	2007	2008	2009
Central government debt	34.9	34.1	34.1	35.7	37.8	45.0
External	4.7	4.4	4.1	3.7	5.2	9.5
Domestic	30.1	29.7	29.9	32.0	32.6	35.5
<i>Of which: in foreign currency</i>	0.0	0.0	0.1	0.3	0.0	0.0
Public corporations' debt 1/	9.8	9.2	10.2	9.9	11.9	12.4
External	1.0	0.8	0.6	0.9	0.8	0.9
Domestic	8.8	8.4	9.6	9.0	11.1	11.6
<i>Of which: in foreign currency</i>	3.9	3.3	4.2	4.0	5.7	5.7
Total public sector 1/	44.6	43.3	44.3	45.6	49.7	57.5
External	5.7	5.1	4.8	4.6	6.1	10.4
Domestic	38.9	38.1	39.5	41.0	43.7	47.1
<i>Of which: in foreign currency</i>	3.9	3.3	4.3	4.3	5.7	5.7
Consolidated public sector 1/	32.7	31.6	33.4	35.7	39.9	47.7
External	5.7	5.1	4.8	4.6	6.1	10.4
Domestic 2/	27.0	26.5	28.6	31.1	33.8	37.3
<i>Of which: in foreign currency</i>	3.9	3.3	4.2	4.0	5.7	5.7

Source: Central Bank of The Bahamas.

1/ Government-guaranteed debt only.

2/ Excludes holdings by public corporations.

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

	2007	2008	2009	Staff Projections	
				2010	2011
(In millions of Bahamian dollars, end of period)					
Central Bank					
Gross international reserves	454	563	818	842	972
Net domestic assets	219	82	-124	-124	-224
Credit to nonfinancial public sector (net)	334	202	176	-10	-111
<i>Of which:</i> Central Government	336	201	181	219	255
Other	-115	-120	-300	-113	-113
Reserve money	673	645	695	719	749
Currency held by the private sector	224	206	208	215	224
Liabilities with financial institutions	449	439	487	504	525
Financial system					
Net foreign assets	-214	-141	137	195	361
<i>Of which:</i>					
Held by commercial banks and OFIs	-668	-704	-682	-647	-612
Net domestic assets	5,851	6,065	5,896	6,046	6,142
Credit to nonfinancial public sector, net	867	1,006	1,100	1,330	1,543
<i>Of which:</i> Central Government	867	924	1,024	1,254	1,467
Credit to private sector	6,218	6,537	6,596	6,605	6,649
Other	-1,234	-1,478	-1,800	-1,890	-2,051
Liabilities to the private sector (broad money)	5,637	5,924	6,032	6,241	6,502
Money	1,300	1,275	1,284	1,328	1,384
Currency	224	206	208	215	224
Demand deposits	1,077	1,069	1,076	1,113	1,160
Quasi-money	4,337	4,650	4,749	4,913	5,119
(Change in percent of liabilities to the private sector at the beginning of the period)					
Net foreign assets	0.8	1.3	4.7	1.0	2.7
Net domestic assets	8.8	3.8	-2.9	2.5	1.5
Credit to nonfinancial public sector	1.7	2.5	1.6	3.8	3.4
Credit to private sector	10.7	5.6	1.0	0.2	0.7
Liabilities to private sector	9.6	5.1	1.8	3.5	4.2
Money	1.0	-0.5	0.2	0.7	0.9
Quasi-money	8.6	5.5	1.7	2.7	3.3
(Annual percentage change)					
Net domestic assets	8.4	3.7	-2.8	2.5	1.6
Credit to nonfinancial public sector	11.5	16.1	9.3	20.9	16.0
Credit to private sector	9.7	5.1	0.9	0.1	0.7
Liabilities to private sector	9.6	5.1	1.8	3.5	4.2
Money	3.9	-2.0	0.7	3.5	4.2
Quasi-money	11.4	7.2	2.1	3.5	4.2

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

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

	2005	2006	2007	2008	2009
Financial indicators					
Broad money (12-month percentage change)	9.2	6.5	9.6	5.1	1.8
Private sector credit (12-month percentage change)	14.2	14.4	9.7	5.1	0.9
Three-month treasury-bill rate (end of period)	0.4	3.0	3.0	2.9	2.8
Domestic public debt (in percent of GDP, end of period)	38.1	39.5	41.0	43.7	47.1
External indicators					
Exports of goods and services (12-month percentage change)	11.5	3.1	8.7	2.9	-16.1
Imports of goods and services (12-month percentage change)	18.8	21.6	4.6	1.5	-18.8
Current account balance (in percent of GDP)	-9.9	-19.6	-17.8	-15.9	-12.6
Capital account balance (in percent of GDP) 1/	13.6	17.4	13.5	15.3	14.5
Gross international reserves (end of period, millions of US\$)	579	500	454	563	818
In months of merchandise imports	3.0	2.2	1.8	2.1	3.9
In months of next year's imports of goods and services	1.6	1.3	1.2	1.8	2.4
In percent of reserve money	98.5	87.7	67.5	87.3	117.8
In percent of broad money	12.0	9.7	8.1	9.5	13.6
Commercial banks, net foreign assets (end of period, millions of US\$)	-611	-754	-704	-704	-682
External public debt (in percent of GDP)	5.1	4.8	4.6	6.1	10.4
External debt service (in percent of exports of goods and services)	6.9	5.8	6.6	6.6	25.7
Central Government External debt service (in percent of government revenue)	1.9	1.9	3.7	3.4	20.4
REER appreciation (+) (end of period) 3/	3.6	-4.2	-3.6	10.3	-5.1
Banking sector risk indicators					
Foreign currency deposits, percent of total deposits	3.1	2.6	3.7	3.5	4.0
Deposits maturing within 3 months, percent of total deposits	22.3	21.4	20.7	19.7	21.5
Capital to risk-weighted assets ratio, percent	22.6	24.8	24.9	23.5	26.1
Nonperforming loans to total loans ratio, percent	4.5	4.2	4.3	6.1	9.4
Provisions to total loans ratio, percent	44.9	54.7	47.9	46.0	37.1
Pre-tax net revenue, percent of net worth	19.6	20.4	18.6	14.8	10.2
Administrative expenses, percent of total assets	3.3	3.3	3.7	3.9	3.7
Liquid assets to deposits ratio, percent	19.7	17.2	23.3	26.6	32.2
Average interest rate spread, percent	7.1	6.6	6.9	7.2	6.8

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

1/ Includes errors and omissions.

2/ The reserve adequacy threshold is based on the full coverage of foreign debt service, plus 10 percent of broad money, plus 20 percent of next year's imports of goods and services (Lipschitz and others (2006)). Foreign debt service is for the central government only.

3/ Information Notice System.

Table 8. The Bahamas: Central Government Debt Sustainability Framework, 2005-2015
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing primary balance 9/ 0.9
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
Baseline: Public sector debt 1/ o/w foreign-currency denominated	34.1	34.1	35.7	37.8	45.0	48.7	51.5	53.2	53.8	54.3	54.6	
Change in public sector debt	-0.8	0.0	1.6	2.1	7.2	3.7	2.8	1.7	0.7	0.5	0.3	
Identified debt-creating flows (4+7+12)	-0.7	-0.1	0.5	3.9	4.8	4.1	3.2	2.0	1.3	1.1	1.0	
Primary deficit	0.4	0.3	0.4	1.5	2.9	2.6	1.8	1.1	0.5	0.2	0.1	
Revenue and grants	17.2	18.3	18.7	18.8	17.8	17.6	18.1	18.9	19.4	19.6	19.8	
Primary (noninterest) expenditure	17.6	18.6	19.1	20.3	20.7	20.1	19.9	20.0	19.9	19.9	19.9	
Automatic debt dynamics 2/ Contribution from interest rate/growth differential 3/ Of which contribution from real interest rate Of which contribution from real GDP growth Contribution from exchange rate depreciation 4/ Other identified debt-creating flows Privatization receipts (negative) Recognition of implicit or contingent liabilities Other (specify, e.g. bank recapitalization)	-1.1	-0.4	0.1	2.4	1.9	1.6	1.4	1.0	0.7	0.8	0.9	
Residual, including asset changes (2-3) 5/	-0.1	0.1	1.1	-1.7	2.4	-0.5	-0.4	-0.3	-0.6	-0.6	-0.7	
Public sector debt-to-revenue ratio 1/	197.8	186.5	190.9	201.3	252.9	277.1	284.0	280.8	277.2	276.7	276.2	
Gross financing need 6/ in billions of U.S. dollars	3.2	3.6	3.5	4.7	9.5	6.0	5.6	4.9	4.7	4.5	4.5	
	209.3	248.9	261.1	344.0	698.7	455.5	434.9	391.4	395.1	393.3	414.6	
Scenario with key variables at their historical averages 7/ Scenario with no policy change (constant primary balance) in 2010-2015						48.7	50.1	51.7	53.0	54.3	55.5	1.2
						48.7	52.2	55.4	58.2	61.0	63.8	1.0
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	5.0	3.5	1.9	-1.7	-4.3	0.5	1.5	2.5	2.5	2.5	2.5	
Average nominal interest rate on public debt (in percent) 8/	5.6	5.5	5.7	5.6	6.0	5.8	5.8	5.9	6.0	6.1	6.2	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	1.8	2.2	2.3	4.9	0.6	4.1	4.5	4.5	4.0	4.1	4.2	
Nominal appreciation (increase in US dollar value of local currency, in percent)	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	3.7	3.2	3.4	0.7	5.4	1.7	1.4	1.4	2.0	2.0	2.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	6.2	9.3	4.9	4.1	-2.3	-2.2	0.5	2.9	2.1	2.2	2.5	
Primary deficit	0.4	0.3	0.4	1.5	2.9	2.6	1.8	1.1	0.5	0.2	0.1	

1/ Gross debt of the central government.

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

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

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

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

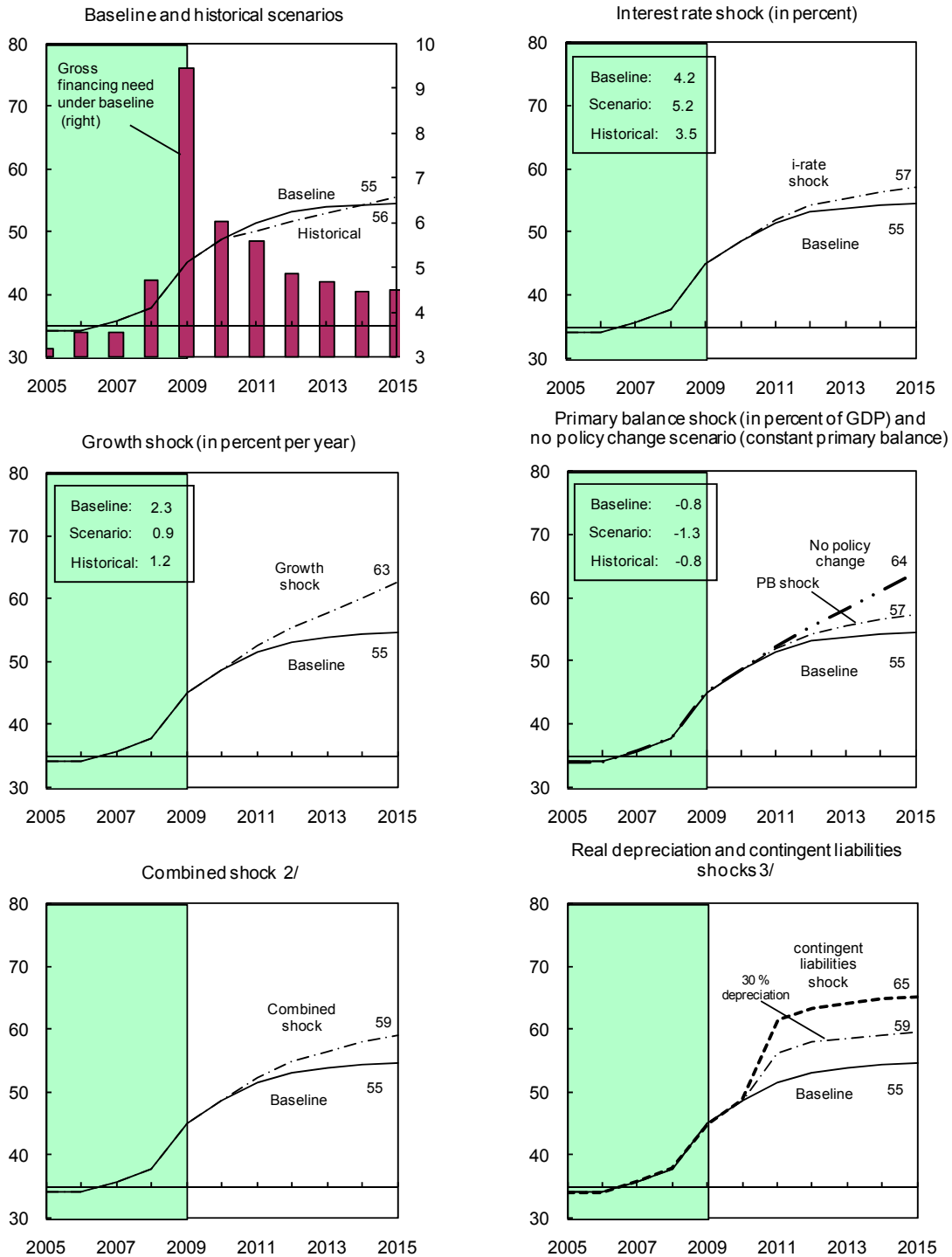
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

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

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

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

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



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

Table 9. The Bahamas: External Debt Sustainability Framework, 2005-2015
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/ -8.8
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
Baseline: External debt	7.7	8.4	7.7	10.9	15.2	15.5	15.5	13.3	12.5	12.1	11.7	
Change in external debt	-1.0	0.7	-0.7	3.2	4.3	0.3	-0.1	-2.2	-0.7	-0.5	-0.4	
Identified external debt-creating flows (4+8+9)	0.6	9.0	7.3	4.5	3.6	5.0	4.8	4.2	4.0	3.7	3.5	
Current account deficit, excluding interest payments	9.8	19.4	17.7	15.7	12.4	13.7	13.6	13.1	12.8	12.4	12.1	
Deficit in balance of goods and services	8.1	17.2	15.4	15.1	10.8	12.5	12.4	12.0	11.9	11.6	11.3	
Exports	46.3	44.7	46.1	47.9	39.8	41.4	42.4	43.9	44.0	43.8	43.6	
Imports	54.4	61.9	61.5	63.0	50.7	53.8	54.8	55.9	55.9	55.4	55.0	
Net non-debt creating capital inflows (negative)	-8.6	-10.1	-10.1	-11.5	-8.9	-8.8	-8.7	-8.7	-8.6	-8.5	-8.3	
Automatic debt dynamics 1/	-0.6	-0.3	-0.3	0.3	0.1	0.1	-0.1	-0.2	-0.3	-0.2	-0.2	
Contribution from nominal interest rate	0.2	0.2	0.1	0.2	0.2	0.1	0.2	0.1	0.1	0.1	0.1	
Contribution from real GDP growth	-0.4	-0.2	-0.2	0.1	0.5	-0.1	-0.2	-0.4	-0.3	-0.3	-0.3	
Contribution from price and exchange rate changes 2/	-0.3	-0.2	-0.3	-0.1	-0.6	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	-1.6	-8.3	-8.0	-1.3	0.7	-4.7	-4.8	-6.4	-4.7	-4.2	-3.9	
External debt-to-exports ratio (in percent)	16.6	18.7	16.7	22.8	38.3	37.6	36.5	30.2	28.5	27.6	26.7	
Gross external financing need (in billions of US dollars) 4/	0.7	1.4	1.4	1.2	1.0	1.1	1.1	1.1	1.1	1.1	1.1	
in percent of GDP	10.1	19.8	18.3	16.1	13.4	14.1	13.9	13.4	13.1	12.7	12.3	
Scenario with key variables at their historical averages 5/						15.5	14.9	12.8	12.3	12.4	12.6	-7.2
Key Macroeconomic Assumptions Underlying Baseline						<u>10-Year Historical Average</u>	<u>10-Year Standard Deviation</u>					
Real GDP growth (in percent)	5.0	3.5	1.9	-1.7	-4.3	1.2	2.7	0.5	1.5	2.5	2.5	2.5
GDP deflator in US dollars (change in percent)	3.7	3.2	3.4	0.7	5.4	2.5	1.7	1.7	1.4	1.4	2.0	2.0
Nominal external interest rate (in percent)	2.0	3.0	1.6	3.0	1.8	2.5	0.8	1.0	1.0	0.8	0.5	0.5
Growth of exports (US dollar terms, in percent)	11.5	3.1	8.7	2.9	-16.1	3.2	8.4	6.1	5.5	7.6	4.8	4.1
Growth of imports (US dollar terms, in percent)	18.8	21.6	4.6	1.5	-18.8	4.6	12.5	8.5	4.7	6.1	4.5	3.6
Current account balance, excluding interest payments	-9.8	-19.4	-17.7	-15.7	-12.4	-11.2	5.3	-13.7	-13.6	-13.1	-12.8	-12.4
Net non-debt creating capital inflows	8.6	10.1	10.1	11.5	8.9	7.1	3.3	8.8	8.7	8.7	8.6	8.3

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

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

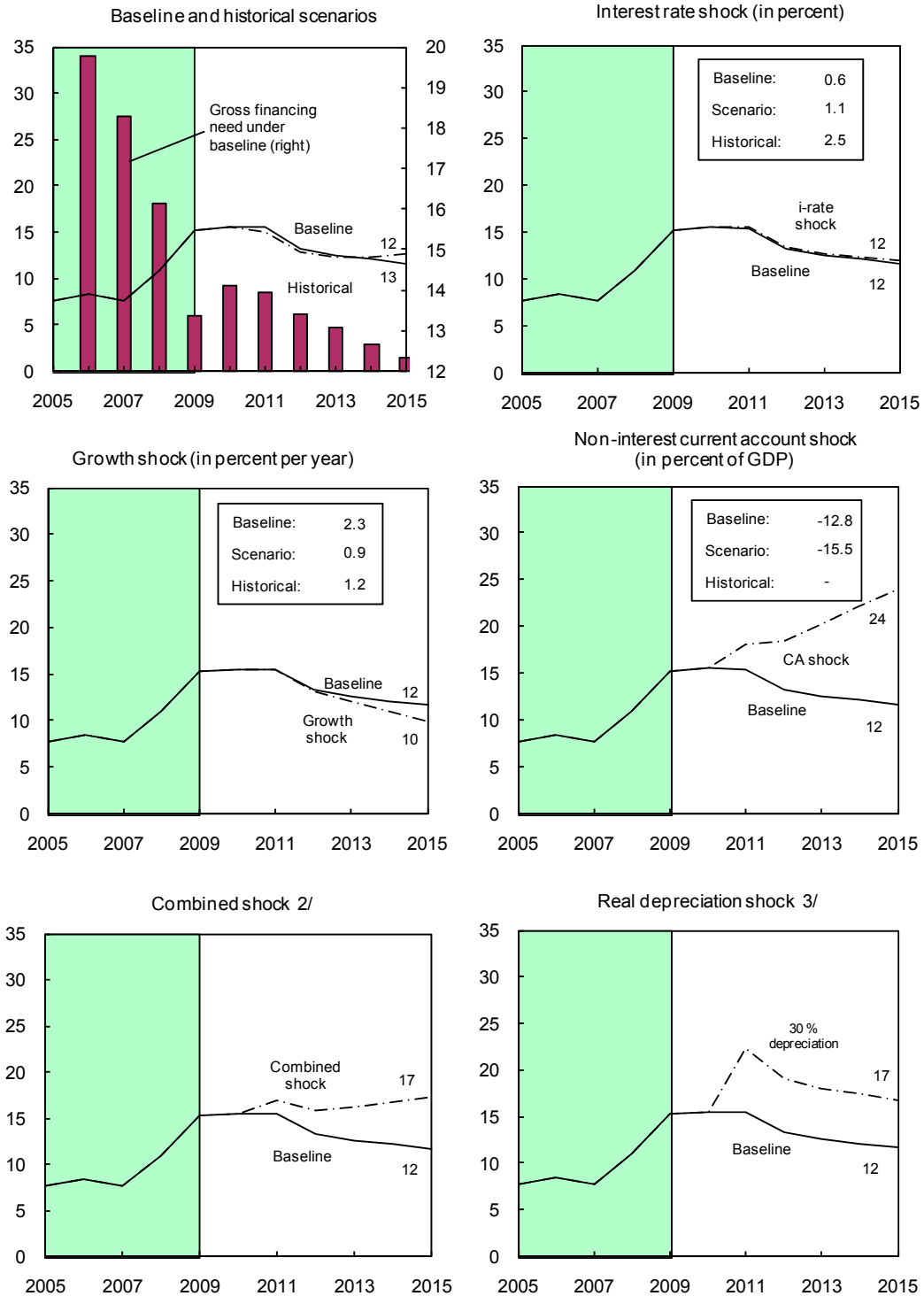
3/ For projection, line includes the impact of price and exchange rate changes.

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

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

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

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



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

1/ Shaded areas represent actual data. In 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.

Appendix I. Background and Summary of Informational Annexes

Discussions. Discussions for the 2010 Article IV consultation were held in Nassau during August 30–September 10. The mission comprised Gene Leon (head), C. Macario, and P. Liu (all WHD). T. Hockin and J. Rolle (OED) participated in the meetings. The mission met with Prime Minister Hubert Ingraham, Minister of State in Finance Zhivargo Laing, Central Bank Governor Wendy Craig, senior government officials, members of parliament, and private sector representatives.

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

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

Technical assistance. STA has provided assistance in balance of payments and external debt accounting, government finance statistics, for the compilation of the new national accounts series, and, more recently, on the CPI and on export/import price indices. Following the 2007 Article IV consultation mission, an MCM/CARTAC mission provided advice on the adoption of indirect monetary instruments. In 2009, there was technical assistance on banking and credit union supervision from CARTAC, and on revenue administration from FAD. In early 2010, CARTAC provided support on macroeconomic forecasting.

Statistical issues. Statistical data are broadly adequate for surveillance purposes, but weaknesses remain. The central bank is the main source of macroeconomic, fiscal, and monetary data. The Department of Statistics (DOS) has upgraded and rebased the national accounts. The DOS also has an ambitious program to conduct socio-economic surveys. A preliminary version of the revised national accounts was ready in April 2010 in line with the FY2010/11 budget cycle, but was not available on the web. The operations of public corporations are not compiled into a consolidated set of public sector accounts.

Relations with the Inter-American Development Bank (IDB). As of August 19, 2010, the active portfolio of the IDB stood at US\$161 million, of which US\$64 million were disbursed. In March of 2010, the IDB approved the new Country Strategy with The Bahamas 2010–2014. Four priority sectors were identified—energy, water and sanitation, transport, and SME development, with an emphasis on infrastructure development.

INTERNATIONAL MONETARY FUND

THE BAHAMAS

Staff Report for the 2010 Article IV Consultation—Informational Annex

Prepared by the Western Hemisphere Department

October 12, 2010

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Annexes		
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II.	Financial Relations with the Inter-American Development Bank	4
III.	Statistical Issues	5

ANNEX I. THE BAHAMAS—FUND RELATIONS

(As of September 30, 2010)

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

A. Financial Relations

II. General Resources Account:	SDR Million	Percent of Quota
Quota	130.30	100.00
Fund holdings of currency	124.04	95.20
Reserve position in the Fund	6.26	4.80

III. SDR Department:	SDR Million	Percent Allocation
Net cumulative allocation	124.41	100.00
Holdings	114.17	91.77

IV. Outstanding Purchases and Loans: None.

V. Latest Financial Arrangements: None.

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

	<u>2010</u>	<u>2011</u>	<u>Forthcoming</u>	<u>2013</u>	<u>2014</u>
			<u>2012</u>		
Principal					
Charges/Interest	0.01	0.03	0.03	0.03	0.03
Total	0.01	0.03	0.03	0.03	0.03

B. Nonfinancial Relations

VII. Exchange Rate Arrangement:

The Bahamian dollar is pegged to the U.S. dollar at B\$1 per US\$1. The Bahamas has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

VIII. Last Article IV Consultation:

The Bahamas is on a 12-month consultation cycle. The last Article IV consultation was concluded on June 5, 2009.

IX. Technical Assistance:

Department	Dates	Purpose
STA	February 2005	BOP and external debt
STA	April 2005	Government finance
STA	July 2007	National accounts
MCM/CARTAC	October 2007	Monetary policy
STA	2008/2009	Consumer Price Index
MCM/CARTAC	August 2009	Banking supervision
FAD	September 2009	Revenue administration
MCM/CARTAC	December 2009	Credit Union supervision
STA	January 2010	Consumer Price Index
STA	January 2010	Export/Import Price Index
CARTAC	March 2010	Macroeconomic forecasting
STA	May 2010	Consumer Price Index

X. Resident Representative: None.

**ANNEX II. THE BAHAMAS—FINANCIAL RELATIONS WITH
THE INTER-AMERICAN DEVELOPMENT BANK (IDB)**

A. Active Loans as of August 19th, 2010
(in U.S. dollar millions)

Purpose	Approval Date	Amount	Amount Disbursed
New Providence Transport Program	5/30/2001	43.4	42.0
Transforming Education and Training	11/30/2005	18	4.3
Supplementary Financing for the New Providence Transport Program	5/22/2008	100	17.6
Total		161.4	63.9

Source: Inter-American Development Bank.

B. Active Loans as of August 19th, 2010
(in U.S. dollar millions)

	2007	2008	2009	Proj. 2010
Loan approvals	0	100	0	50
Loan Disbursements	9.5	16.2	24.6	22.6
Repayments (principal)	5.4	6.1	7.9	4.7
Net loan flow	4.1	10.1	16.7	17.9
Interest and Charges	5.4	4.9	5.8	2.7
Net Cash Flow	-1.3	5.2	10.9	15.2

Source: Inter-American Development Bank.

Recent Country Strategy

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

ANNEX III. THE BAHAMAS—STATISTICAL ISSUES

Statistical data are broadly adequate for surveillance purposes, but weaknesses remain.

The central bank produces annual, quarterly, and monthly reports on macroeconomic developments, and monetary and fiscal data, and is the main source of information. The Department of Statistics (DOS) is completing the 2010 population census (carried out every 10 years). It has also embarked on a series of initiatives to improve the national accounts, including producing quarterly GDP data. A preliminary version of the revised national accounts was ready in April 2010 in line with the FY2010/11 budget cycle, but was not available on the web. The operations of public corporations are not compiled into a consolidated set of public sector accounts.

The DOS is also conducting comprehensive socio-economic surveys. (i) A 2006 household expenditure survey with a poverty assessment module has been completed but delays in processing the data delayed the assessment; (ii) an occupational survey will update the labor force statistics, which the DOS has begun to publish on a bi-annual basis given the recent deterioration in economic conditions; and (iii) efforts are ongoing to update and revise the CPI basket, with support from CARTAC.

The DOS is currently developing export and import price indices (XMPI) for goods and major services with technical assistance from CARTAC. The XMPI program for goods is now in full production mode, while the indices of export travel services are not yet complete due to the lack of cooperation by sampled establishments. In the near future, procedures for systematic re-sampling and re-weighting need to be addressed in order to keep the market basket representative of what is being measured.

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

The Bahamas: Table of Common Indicators Required for Surveillance
(As of October 12, 2010)

	Date of latest observation (dd/mm/yy)	Date received	Frequency of data ⁷	Frequency of reporting ⁷	Frequency of publication ⁷
Exchange Rates	Fixed				
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	01/07/10	09/10	W	M	M
Reserve/Base Money	01/07/10	09/10	W	M	M
Broad Money	01/07/10	09/10	W	M	M
Central Bank Balance Sheet	06/10	09/10	M	M	M
Consolidated Balance Sheet of the Banking System	06/10	09/10	M	M	Q
Interest Rates ²	01/08/10	09/10	W	W	M
Consumer Price Index	07/10	09/10	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	30/06/10	09/10	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	30/06/10	09/10	Q	Q	Q
External Current Account Balance	06/10	09/10	Q	Q	Q
Exports and Imports of Goods and Services	06/10	09/10	Q	Q	Q
GDP/GNP	2009	09/10	A	A	A
Gross External Debt	06/10	09/10	M	M	M
International Investment Position ⁶	NA	NA	NA	NA	NA

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

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

³ Foreign, domestic bank, and domestic nonbank financing.

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

⁵ Including currency and maturity composition.

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

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



INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 10/155
FOR IMMEDIATE RELEASE
December 6, 2010

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

IMF Executive Board Concludes Article IV Consultation with The Bahamas

On October 27, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with The Bahamas.⁹

Background

The global crisis had a profound impact on the Bahamian economy. During 2009, tourist arrivals declined by 10 percent and foreign direct investment fell by over 30 percent, leading to a sharp contraction in domestic activity and an increase in unemployment. The lower demand, together with lower import prices, helped reduce inflation and narrow the external current account deficit to about 12.5 percent of GDP. External borrowing and the one-off Special Drawing Rights (SDR) allocation (US\$179 million) more than covered the current account deficit, and gross international reserves increased to about 2.5 months of imports.

The downturn deteriorated the fiscal position. Revenues declined, while the authorities maintained spending broadly in line with the budget (strengthening the social safety net and accelerating investment spending) to mitigate the demand shock. As a result, the central government deficit rose by 0.5 percentage points to 5.3 percent of Gross Domestic Product (GDP) in the fiscal year 2009/10. Central government debt also increased, reaching 47 percent of GDP at end June 2010, about 10 percentage points higher than before the crisis.

Although the sharp fall in activity reduced bank lending and weakened the loan portfolio, the banking system remains well capitalized and there is ample liquidity. Non-performing

⁹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

loans have increased, recently more so from commercial loans, but stress tests conducted by the authorities suggest that the banking system has adequate buffers to withstand a further deterioration, while continuing to comply with capital requirements.

While near-term growth prospects remain weak, the medium-term outlook is somewhat more favorable. Real GDP is projected to grow modestly in 2010, as tourist arrivals rebound, but a return to the trend growth rate of about 2.5 percent is likely by 2012 if global conditions improve. The external current account deficit, which will widen somewhat in 2010 and 2011, is expected to narrow over the medium term, from higher tourism receipts and continued foreign direct investment. Nonetheless, the fiscal outlook is of concern, with the ratio of central government debt to GDP projected to continue rising over the medium term.

Executive Board Assessment

Directors noted that a sharp contraction in domestic activity amidst the global downturn has weakened the fiscal position and banks' balance sheets. Prudent macroeconomic policies have now laid the foundations of a recovery, but the outlook remains exposed to downside risks. In order to boost economic prospects, Directors encouraged the authorities to build adequate buffers against external shocks and address vulnerabilities in the fiscal domain and in the financial sector.

Directors commended the authorities for their commitment to medium-term fiscal adjustment and their strategy to reverse the recent rise in the public debt-to-GDP ratio. They welcomed the revenue and spending measures adopted in the budget, but considered that contingency measures might be needed to achieve the desired reduction in the fiscal deficit. Directors noted that broader reforms to the tax system and public finance management would also be needed over the medium term to sustain improvements in the fiscal position.

Directors considered that the longstanding peg to the U.S. dollar has provided an appropriate nominal anchor and served the country well. They took note of the staff's assessment that the current level of the exchange rate is broadly in line with long-term fundamentals. To ensure that the peg remains adequately supported, Directors encouraged the authorities to build up foreign exchange reserves over time as needed.

Directors commended the authorities efforts to strengthen the financial system and their close cooperation with supervisors in other jurisdictions. They welcomed recent enhancements in the oversight of the financial sector and in the legal framework for security markets. Directors considered that rising non-performing loans at banks remain a concern, and that close monitoring is warranted. They also encouraged the authorities to continue strengthening the prudential framework of nonbank institutions.

Directors agreed that far-reaching structural reforms are necessary to lift medium-term growth prospects. They welcomed the authorities' plans to improve business conditions,

including for small and medium-sized enterprises, and to strengthen public infrastructure in a manner consistent with the fiscal consolidation strategy.

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

The Bahamas: Selected Economic Indicators

	2007	2008	2009	Proj. 2010
(Annual percentage changes, unless otherwise indicated)				
Real sector 1/				
Real GDP	1.9	-1.7	-4.3	0.5
Nominal GDP	5.4	-1.0	0.9	2.2
Consumer price index (annual average)	2.5	4.5	2.1	1.7
Consumer price index (end of period)	2.9	4.5	1.3	1.7
Unemployment rate (in percent) 2/	7.9	8.7	14.6	...
Financial sector				
Credit to the nonfinancial public sector	11.5	16.1	9.3	20.9
Credit to the private sector	9.7	5.1	0.9	0.1
Liabilities to the private sector	9.6	5.1	1.8	3.5
External sector				
Exports of goods and services	8.7	2.9	-16.1	6.1
<i>Of which:</i> Travel receipts (gross)	6.4	-1.6	-10.0	1.4
Imports of goods and services	4.6	1.5	-18.8	8.5
(In percent of GDP, unless otherwise indicated, on a calendar year basis)				
Central government				
Revenue and grants	18.0	19.6	18.1	17.5
Current expenditure	18.0	19.0	19.3	19.4
Capital expenditure and net lending	3.1	3.2	4.2	3.2
Primary balance	-1.2	-0.5	-3.3	-2.6
Overall balance	-3.0	-2.6	-5.5	-5.1
Central government debt	35.7	37.8	45.0	48.7
External sector				
Current account balance	-17.8	-15.9	-12.6	-13.9
Change in net international reserves (increase -)	0.6	-1.5	-3.4	-0.3
External public debt (end of period)	4.6	6.1	10.4	10.6
Memorandum items:				
Gross international reserves (end of period; millions of U.S. dollars)	454.2	562.9	818.4	842.0
In months of next year's G&S imports	1.2	1.8	2.4	2.4
External debt-service ratio 3/	6.6	6.6	25.7	6.9
GDP (in millions of Bahamian dollars)	7,381	7,309	7,377	7,538

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

1/ Revised national accounts data.

2/ 2009 figure based on May survey.

3/ In percent of exports of goods and services. The increase in 2009 reflects repayment of internal forex loan of US\$185 million to domestic banks.