BAHAMAS

Executive Briefing

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Capital Market Dynamics

Foreign Exchange ► Monetary authorities remain committed to supporting the 1:1 currency peg between the Bahamian and the US dollar. As of November, foreign reserves stood at US$648 million, 20% less than in November 2011. After the extraordinary inflows received in 2011 caused by the privatization of the state-owned Bahamas Telecommunications Company (BTC), reserves declined mainly due to fuel and debt payments in 2012. Nonetheless, last year's external reserves average (January-November) slightly exceeded the 2010 average level and is equivalent to nearly three months of imports.

Sovereign Debt & Credit Ratings ► Government finances and sovereign credit conditions will remain challenging in the foreseeable future. Public sector debt increased from 32% of GDP in 2008 to around 50% in 2011-12, representing the biggest increase among its Caribbean peers, as a result of ongoing spending in infrastructure projects. We expect the debt-to-GDP ratio to remain above the 50% mark in the coming years. Sovereign credit ratings for the Bahamas have deteriorated. Moody's downgraded the country's sovereign rating from "A3" to "Baa1" in December 2012, leaving a "negative" outlook. Standard & Poor's may downgrade the Bahamian sovereign credit rating in 2013 on the back of a weak fiscal profile; the rating agency currently maintains a "BBB" rating with a "negative" outlook.

Economic Outlook

Growth ► After two years of growth averaging less than 1% in 2010-11, the Bahamian economy accelerated to an estimated pace of 2.4% in 2012. It will likely pick up further to 2.6% in 2013. In line with the US economic revival, the local economy has shown signs of a rebound, with the tourism and construction sectors as the main contributors to growth. Stop-over arrivals increased by 4.3% y/y in the January-June period, a solid recovery after the losses registered in 2011. Additionally, cruise passenger visits expanded by 8.8% y/y from January to July with tourism receipts increasing by a solid 9.1% y/y in the first three months of 2012. The expansion of the construction sector has been the result of foreign direct investment in large-scale tourism related projects and public sector spending. The USD$3.4 billion Baha Mar resort project (expected to open in late 2014) will likely continue to boost employment levels, local income and the construction and tourism sectors in 2013; however, the modest US recovery (major source of tourist arrivals) and the economic troubles in the euro area will continue to temper the rebound in the Caribbean.

Inflation & Monetary Context ► We anticipate that inflation will remain well-controlled, but highly dependent on international commodity prices, particularly on any shifts in oil prices. Based on official data, inflation decelerated from 2.5% y/y in January to 1.8% in August. With a mild economic recovery and a persistently high unemployment, we anticipate that inflationary pressures will remain contained, with the headline figure below the 3% y/y mark, reflecting developments in international food and oil prices. The monetary policy rate has remained unchanged at 4.5% since June 2011, and despite the low effectiveness of monetary policy due to the fixed currency regime, the central bank is able to use other instruments (such as reserve requirements) to influence liquidity.

Fiscal & Current Account Balance ► The fiscal deficit should continue to increase in the 2013-14 period, as the new government maintains a loose fiscal stance through public spending measures to boost economic activity and tackle high unemployment. After the fiscal shortfall decreased to 3.8% of GDP in the 2011/2012 fiscal year (July-June), as a result of the inflows coming from the privatization of BTC, we anticipate that it will increase to around 4.2% in the 2012/2013. Additionally, we project a widening in the current account deficit to around 15% of GDP through 2013-14, as a result of an increase in imports for construction materials, despite weak domestic demand and muted employment opportunities. This will offset the positive effect coming from the improvement in the tourism sector, which is expected to continue to recover in the foreseeable future. Moreover, the Bahamian economy is highly dependent on goods and oil imports, which may further deteriorate the current account balance.

Institutional Framework & Political Environment

Governance ► The government's fiscal performance, drug-trafficking issues, high unemployment and the modest economic recovery will be the main challenges to the new administration elected in May 2012 for a five-year term. Prime Minister Perry Christie of the Progressive Liberal Party (PLP) enjoys an ample majority in the lower house of parliament, while the former ruling party, Free National Movement, has now become the opposition. This provides strong political force for the Christie government's agenda. Foreign relations, particularly with the US and China, will continue to be a key factor for tourism and investment prospects, while relations with regional neighbours will remain positive.

Financial Sector ► Private sector lending continues to be subdued as a result of low job creation and weak domestic demand. In line with this, the non-performing loans (NPL) ratio has increased significantly in recent years, reaching 13.4% of total loans in the January-September period. The World Bank's Doing Business 2013 annual report ranks the Bahamas seventh among Latin America and the Caribbean in terms of a business-friendly environments, being the second (following Trinidad and Tobago) among the Caribbean countries.

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