



Capital Market Dynamics

Foreign Exchange ► Authorities remain committed to maintaining the Barbadian dollar's (BDS) fix to the US dollar (USD) at a rate of 2:1. Foreign reserves increased by a sluggish 3.3% y/y in 2012, with the total stock amounting to BDS1.5 billion, which covers around 4.5 months of imports.

Sovereign Debt & Credit Ratings ► Government finances and sovereign credit conditions remain challenging for Barbados. The public sector debt increased significantly in the last five years, expanding from 56% of GDP in 2008 to around 70% in 2012-13. Barbados's debt-to-GDP ratio is the second highest among the major Caribbean countries, exceeded only by the Jamaican ratio. Sovereign credit ratings for Barbados have deteriorated. Moody's revised the country's sovereign rating from "Baa3" to "Ba1" in December 2012, leaving a "negative" outlook in place. Standard & Poor's downgraded the country's rating in mid-2012 from "BBB-" to "BB+" on the back of a weak fiscal profile, challenging economic conditions and rising debt burden. Nonetheless, the rating agency maintain a "neutral" outlook as the nation enjoys political stability, strong institutions and "room to absorb mild fiscal deterioration".

Economic Outlook

Growth ► The Barbadian economy has not fully recovered from the 2009 recession and maintains a fragile outlook. We anticipate that real GDP will expand by an average of 0.8% in 2013-14. The country's output expanded by an average rate of 0.6% y/y in the 2010-11 period and it is likely to have posted a negligible 0.1% gain in 2012. The tourism, agriculture and manufacturing sectors, which together account for close to 20% of GDP, decelerated significantly in 2012, offsetting the positive contribution of construction, transport and financial services (37% of GDP). The tourism sector remains one of the major sources of growth and foreign inflows; however, despite the rebound in other tourism-intensive countries in the Caribbean region, stop-over arrivals in Barbados decreased by 6.2% in 2012, and cruise passengers fell by 15% (according to central bank estimations). Visitors from the UK and US, who represent around 60% of total arrivals, declined by around 9% in 2012, as a result of higher air passenger duties in the UK, fewer flights available and only a slow improvement in consumer spending in both countries. With the Barbadian unemployment rate around 12%, domestic demand remains subdued, which coupled with government spending limits, fiscal constraints and modest foreign investment, continues to challenge the economic outlook.

Inflation & Monetary Context ► The inflation outlook in Barbados remains dependent on international energy and food prices, given the country's limited access to natural resources and corresponding dependence on imports. As a result of the moderation in fuel and food prices through 2012, inflation decelerated from 9.5% y/y in January to 5.8% y/y in October. The central bank will likely maintain its current loose monetary stance, aiming to stimulate economic activity. The authorities estimate an inflation rate close to the 5% y/y mark for 2013.

Fiscal & Current Account Balance ► Barbados's fiscal deficit will remain challenging in the 2013-2014 period. Authorities estimate that the fiscal shortfall reached 6.4% of GDP in the first three quarters of the 2012/2013 fiscal year, more than a percentage point above last year. Personal and corporate tax revenues declined in the first three quarters of the fiscal year, while the VAT, which accounts for 40% of government tax revenue, contracted by 2.5% y/y. The majority of the deficit was financed by local investors. With a mild economic recovery, sluggish local demand, lower oil prices and a slow rebound in tourism, we anticipate that the fiscal shortfall will remain within the 4-5% range of GDP in the foreseeable future. After reaching 8.5% of GDP in 2011, the current account deficit narrowed to 5.7% in 2012, as a result of lower imports and slightly higher exports. We anticipate that the current account deficit will likely remain close to 5.5% of GDP in 2013-14 as the adverse impact from large import requirements and higher competition for Barbadian rum exports - due to US subsidies to other islands - will be offset by gains in the tourism sector and business and financial services inflows.

Institutional Framework & Political Environment

Governance ► Barbados maintains a stable political environment, with an alternate party government. Elections will be called in the coming months. Recent polls show that Prime Minister Freundel Stuart's popularity has declined as the employment and economic outlook remains weak. As a result, the opposition, the Barbados Labour Party, is expected to win the next election. Drug trafficking and money laundering will remain key issues for the incoming government, as well as increasing tax agreements with investment partners to boost the country's offshore financial sector.

Financial Sector ► The banking system in Barbados remains liquid and well-capitalized above statutory requirements. However, with a languid economic recovery and low consumer spending, credit growth has remained subdued and the non-performing loans (NPL) ratio increased to 12.7% in December from 11% a year earlier. Based on the Transparency International's Corruption Perception Index, Barbados ranks as the least corrupt country in the Caribbean and 15th of the 176 countries covered, with higher ranking implying a better quality of governance.

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