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Local Economic Update

Quarter 1 2019

Economic Highlights:

- The Bahamian economy grew by just 1.60% in 2018 compared to the 2.50% growth predicted by the International Monetary Fund (IMF) and 2.20% forecasted by the Government of the Bahamas.

- It is expected that real GDP for 2017 will be revised downward given the recently reported 2018 GDP was only about 0.19% higher than the $10.742 billion reported in the previous year. Average economic growth over the past six years was relatively flat at 0.30%, a convincing indication of the fragile state of the Bahamian economy.

- Government revenues for the first half of FY 2018/19 gained momentum, increasing some 14.70% to $1.01 billion compared to the previous fiscal year. The main sources of this revenue growth were stamp tax receipts, which were up $55.60 million or 106.72% and VAT receipts, which expanded 32.59% or by $81.20 million to $399.50 million. The Government is forecasting a spending bill of $2.89 billion for 2018/19, which is equivalent to $7,806.76 per capita or 23.75% of 2017 GDP.

- Government expenditures over the first half of the fiscal year were up 4.39% to $1.18 billion. The main drivers of this increase were recurrent expenditures, in particular transfers to government subsidiaries, which spiked 78.92% to $303.80 million as well as government debt interest spending, which expanded 13.55% to $160.90 million.

- The GFS deficit came in softer for the first half of FY 2018/19. At $174.30 million or 1.43% of 2017 nominal GDP, the GFS deficit for the period has contracted significantly compared to $254.0 million or 2.09% of GDP during 2017/18 and $305.48 million or 2.58% of GDP in 2016/17.

- Public sector borrowing expanded by 2.26 percentage points to $8.22 billion or 67.58% of GDP at the end of 2018. The Government is also off target on its projected debt-to-GDP ratio of 56.10% in 2018/19.

Fiscal Review for Q1 2018/19:

The dust seems to have settled on the first half of FY 2018/19 and while the country's fiscal position has improved in some areas, the government still has some ways to go to achieve economic growth that reduces unemployment and lowers the country's debt burden to more sustainable levels.

The Bahamian economy grew by just 1.60% in 2018 compared to the 2.50% growth predicted by the International Monetary Fund (IMF) and 2.20% forecasted by the Government of the Bahamas. According to the Department of Statistics, real GDP stood at $10.763 billion at the end of 2018, with output driven by the foreign currency real estate sector, wholesale and retail trade industries, financial and insurance segments, along with accommodation and food service industries. It is expected that real GDP for 2017 will be revised downward given the recently reported 2018 GDP was only about 0.19% higher than the $10.742 billion reported in the previous year. Average economic growth over the past six years was relatively flat at 0.30%, a convincing indication of the fragile state of the Bahamian economy.

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Following the increase in VAT to 12.00% on July 01, 2018, Government revenues for the first half of FY 2018/19 gained momentum, increasing some 14.70% to $1.01 billion compared to the previous fiscal year. The main sources of this revenue growth were stamp tax receipts, which were up $55.60 million or 106.72% and VAT receipts, which expanded 32.59% or by $81.20 million to $399.50 million. However, despite the overall increase, revenues have fallen short of forecasts by some 21.00%. The Minister of Finance, Peter Turnquest, in his 2018/19 Budget Communication, projected recurrent revenues of $2.64 billion for the full fiscal year. To be in line with projections, revenues should have totaled at least $1.32 billion at the mid-year mark, however, the shortfall at December 2018 was $309.00 million. The largest contributor to this shortfall was VAT receipts, which came in at 32.59% or $130.18 million lower than projected. Other areas which recorded lower than expected revenues included real property taxes (-76.25% or by $28.59 million), gaming taxes (-257.34% or by $25.22 million), business and professional license fees (-183.91% or by $52.41 million), motor vehicle taxes (-33.78% or by $4.61 million), departure taxes (-35.37% or $19.24 million) and taxes on international trade and transactions (-31.52% or by $77.22 million). Of note, stamp tax came in higher than projected, at $107.70 million compared to the projected amount of $85.92 million.

Like revenues, Government expenditures over the first half of the fiscal year were up 4.39% to $1.18 billion. The main drivers of this increase were recurrent expenditures, in particular transfers to government subsidiaries, which spiked 78.92% to $303.80 million as well as government debt interest spending, which expanded 13.55% to $160.90 million. Spending growth however was more than 21.0% below the half-year forecast of $1.44 billion, thanks to lower spending for consumption, which includes purchases of goods and services and compensation to employees, interest expense and transfers to government subsidiaries. Capital expenditure, however, was lower relative to the previous fiscal period and the forecast amount. For the fiscal half-year 2017/18, capital spending totaled $131.00 million compared to $87.00 million during the same period of FY 2018/19 and the $149.66 million forecast during the period. Significant reductions in capital expenditure relative to recurrent expenditure has demonstrated how successive administrations have spent a large percentage of government revenues on wages and benefits, while leaving a comparatively smaller percentage for investments in infrastructure, and key social services such as healthcare and education, which are essential to driving economic growth.

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Thanks to higher tax receipts, which resulted from the increase in VAT, the GFS deficit came in softer for the first half of FY 2018/19. At $174.30 million or 1.43% of 2017 nominal GDP, the GFS deficit for the period has contracted significantly compared to $254.0 million or 2.09% of GDP during 2017/18 and $305.48 million or 2.58% of GDP in 2016/17. If the Government is to achieve its target deficit of 1.80% of GDP, the wiggle room for increase during the next half of FY 2018/19 is no more than 26.0%. Although the deficit decreased to $174.30 million, net Government borrowing was higher at $275.72 million or 3.47% during the period, which is an indication of off-budget spending items. Public sector borrowing expanded by 2.26 percentage points to $8.22 billion or 67.58% of GDP at the end of 2018. The Government is also off target on its projected debt-to-GDP ratio of 56.10% in 2018/19. Again, a significant reduction in borrowing coupled with realizing growth projections are essential if the Government wishes to achieve its self-imposed fiscal targets.

The level of unemployment in the Bahamas remains relatively high, increasing to 25,135 persons or 10.70% of the labor force in November 2018, compared to 10.10% a year earlier. The youth unemployment rate continues to be painstakingly high at 23.10%. On the other hand, in the twelve months to November 2018, employment levels increased by 6,830 to a record high of 210,560 persons. Not surprisingly, half of this increase is attributed to New Providence, 23% from Grand Bahama and 27.0% from Abaco. Notwithstanding the 1.60% increase in the economic growth rate for 2018, any positive effect on unemployment appears to be minimal to non-existent given the jump in the unemployment rate to 10.70%.

Tourism and External Reserves:

The tourism sector is and will continue to be, at least in the foreseeable future, a key pillar of growth for the Bahamian economy. The sector's direct contribution to the economy is about $2.57 billion or

22.0% of GDP. Last year was a banner year for tourist arrivals, with the highest air and sea arrivals on record over the past twenty years. Air arrivals were recorded at 1.558 million last year, while sea arrivals hit 5.063 million in the same period, a respective increase of 16.7% and 5.50% from the previous year. Overall arrivals soared 7.90% to 6.622 million visitors, with New Providence attracting 1.168 million air arrivals and 2.609 million cruise arrivals. Airbnb rentals continue to have a positive and transformative impact on the country's tourism sector. According to the Central Bank's October 2018 Monthly Economic and Financial Development Report, total Airbnb bookings soared 50.50% in October last year, with Grand Bahama leading the way with a 44.20% increase, followed closely by a 42.60% gain in New Providence. Meanwhile, bookings in the Exuma Airbnb market expanded by 40.70%, while Abaco held its own with a 33.30% increase. While there is no readily available data on the number of Airbnb bookings, a report by Engel & Volkers, a world leading service company which specializes in brokerage of premium properties, suggests that by 2020, the Bahamas' vacation rental market will eclipse bookings at the traditional hotels. The boom in Airbnb and vacation rentals locally presents a great opportunity for tourism stakeholders to capitalize and manage the unplanned diversification in tourism accommodations, in such a way that will provide economic opportunities for Bahamians. The surge in tourist arrivals has contributed to the positive growth in foreign currency reserves over the past few years. During the last ten years, foreign currency reserves exceeded the one billion dollar mark twice: in 2017 and 2018. As at December 2018, reserves stood at $1.195 billion or 9.83% of GDP. Foreign direct investments (FDI), particularly land transactions and equity investments, also positively impacted foreign reserves, surging by $395.40 million or 363.09% for the first three quarters of 2018. At its current level, the nation's international reserves are healthy, covering more than three months of imports.

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Conclusion:

The hike in the VAT rate last year has been a key component in the Government's plan to improve the GFS deficit and normalize the country's public finances. There remains cause for concern however, given the structural challenges, such as the staggeringly high unemployment and debt levels and uneven economic growth. While the government may be basking in the modest improvements in economic growth, a bigger dilemma is the inability of this growth to translate into a lower unemployment rate and declining debt levels. If the economy is expanding in areas that do not hire Bahamians or affect Bahamians directly, it is unlikely that the unemployment rate will decrease significantly below the structural norms and long-term sustainable growth will continue to be out of reach.