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Local Economic Update

Quarter 3 2018

Economic Highlights:

- The International Monetary Fund (IMF) in its 2019 World Economic Outlook revised the economic growth estimate for the Bahamas for 2018 from 2.50% to 2.30%. This slight decline was attributed to the escalation of international trade tensions amongst the United States, the European Union, Canada and China, along with higher oil prices, which have stifled world economic growth.
- In its effort to "enhance transparency and integrity in government", the Minister of Finance, Mr. K. Peter Turnquest has fulfilled a budgetary promise with the release of a Q1 2018/19 fiscal snapshot on October 30, 2018. Based on the numbers reported, both government revenues and expenditures, along with direct government debt, increased during the period, while the GFS deficit contracted.
- The public finances recorded mixed results during Q1 2018/19. On the positive side, in comparison to the same fiscal period last year, the increase in the Value Added Tax (VAT) rate to 12.0% has boosted VAT receipts by 22.0% or $35.83 million to $199.40 million and contributed to the 13.25% increase in overall government revenues to $513.80 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.
- The largest expenditure items are compensation to employees, which includes wages and salaries, allowances, National Insurance payments, and pensions and gratuities ($930.30 million or 32.21% of spending), goods and services ($601.40 million or 20.82% of spending), interest on public debt ($346.80 million or 12.01% of spending) and subsidies or transfers to public institutions ($386.40 million or 13.38% of spending).
- At first glance, the Government appears to have made significant strides in improving the GFS deficit during the period. However, subsequent adjustments made to the Q1 2017/18 expenditure numbers mask the true size of the reduction in the GFS deficit.
- Public sector debt moved higher in Q1 2018/19 by $136.50 million or 1.88% to $7.38 billion, representing 60.70% of 2017 GDP, compared to 53.86% during the corresponding period last year.
- Foreign visitor arrivals to the Bahamas improved during the first eight months of 2018. The country welcomed 4.52 million visitors, up 5.40% from the 4.29 million visitors to the Bahamas last year.

Fiscal Review for Q1 2018/19:

The public finances recorded mixed results during Q1 2018/19. On the positive side, the increase in the Value Added Tax (VAT) rate to 12.0% has boosted VAT receipts by 22.0% or $35.83 million to $199.40 million and contributed to the 13.25% increase in overall government revenues to $513.80 million. Major expansions in taxes were realized for import and excise taxes (up by $25.03 million or 19.64%) and stamp taxes (up by $23.63 million or 76.85%). During the period, revenue collections slipped for gaming taxes (down $2.73 million or 30.63%) and departure taxes (down $4.78 million or 13.83%). Having only collected 18.82% of total VAT receipts for the first three months of 2018/19 and 19.38% of total revenues, the Government still has some ways to go in order to achieve its goal of collecting $1.06 billion in VAT receipts and $2.65 billion in total revenues for 2018/19.

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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. The largest expenditure items are compensation to employees, which includes wages and salaries, allowances, National Insurance payments, pensions and gratuities ($930.30 million or 32.21% of spending), goods and services ($601.40 million or 20.82% of spending), interest on public debt ($346.80 million or 12.01% of spending) and subsidies or transfers to public institutions ($386.40 million or 13.38% of spending). In essence, $2.26 billion or 78.41% of the Government's spending budget was allocated to the day-to-day operating costs of the public services sector. In Q1 2018/19, Government current spending expanded by $39.10 million or 8.01%. The focus areas for this increase were goods and services, and transfers to public institutions. Of note, interest on government debt and compensation to employees contracted by 0.92% and 4.10% respectively. Capital expenditure, which includes physical assets like roads, hotel property purchases, equipment and the bailout of financial institutions, was recorded at $38.70 million, of which $27.50 million or 71.06% in 2018/19 was allocated to the acquisition of non-financial assets.

At first glance, the Government appears to have made significant strides in improving the GFS deficit during the period. However, subsequent adjustments made to the Q1 2017/18 expenditure numbers mask the true size of the reduction in the GFS deficit. During the budget communication in June of this year, the Minister of Finance advised the public that $80 million of the $100 million in toxic loans transferred from the Bank of the Bahamas to RESOLVE was reclassified as capital expenditure. It appears, from the recently released "First Quarter Snapshot on Budgetary Performance" that $40 million of the $80 million write-off was reallocated to Q1 2017/18, thus inflating the expenditure number during the period. The latest Central Bank Quarterly Statistical

Digest, August 2018, records a GFS deficit of $65.61 million for Q1 2017/18, however, by 'back dating' the $40 million write-off, the GFS deficit balloons to $108.68 million and gives the perception that significant strides were made to reduce the Q1 2018/19 GFS deficit by $56.60 million or 52.0%.

Public sector debt moved higher in Q1 2018/19 by $136.50 million or 1.88% to $7.38 billion, representing 60.70% of 2017 GDP, compared to 53.86% during the corresponding period last year. One of the Minister of Finance's fiscal targets is the reduction in debt to GDP to 56.10% at the end of 2018/19. According to the Budget Communication, this target will be achieved by growing nominal GDP and reducing the deficit to 1.80% of GDP. However, when contingent liabilities, which total $700.62 million, are added to government debt, the national debt, relative to GDP expands to 66.45%. Even with the upward adjustments to nominal and real GDP, the absolute and relative debt levels continue to increase. To put a clamp on borrowing, the Bahamian economy needs real economic growth, not just nominal growth, but economic expansion that will reduce unemployment, increase wages and significantly improve Government revenues. Outside of this type of growth, government revenues will continue to be less than government spending, and the deficit will continue to expand, thus contributing to the country's high debt burden.

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Tourism and External Reserves:

Foreign visitor arrivals to the Bahamas improved during the first eight months of 2018. The country welcomed 4.52 million visitors, up 5.40% from the 4.29 million visitors to the Bahamas last year. Cruise passenger arrivals continue to represent the larger visitor group at 3.38 million or 75.0% up to August 2018 and stopover visitors at 1.14 million or just 25.0%. Islands that contributed to air arrivals growth included New Providence (up 17.2% to 840,930), Abaco (up 18.2% to 95,732), and Eleuthera, in particular North Eleuthera (up 29.1% to 48,310). Overall declines were recorded for Bimini (down 11.7% to 20,712) and Exuma (down 0.60% to 46,087). Of note, cruise arrivals to New Providence declined 10.60% from 1.82 million to 1.62 million. Tourism expenditure also increased for the first quarter of 2018, up 17.99% to $796.20 million compared to $674.80 million for Q1 2017. The improvements in overall visitor arrivals and expenditure are welcomed, given the importance of tourism to the development of the Bahamian economy. Dollars derived from tourism represent a major source of foreign currency or international reserves. This is especially significant given the softening of projects funded by foreign direct investments (FDI), another major source of international reserves, during Q1 2018. Data shows FDI dropped significantly by 95.18% to $3.50 million compared to $72.6 million recorded during the same period last year. Though the country's international reserves stand at a healthy $1.57 billion or

12.93% of 2017 GDP at the end of June 2018, foreign currency debt has also increased significantly by 50.0% from $1.76 billion at the end of June 2017 to $2.63 billion, or 21.70% of GDP at the end of June 2018. The country's import cover is three months, which is in line with global standards.

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Conclusion:

Over the past several months, there have been extensive discussions on increasing taxes and reducing deficits. The famous quote by Winston S. Churchill "I contend that for a nation to try to tax itself into prosperity is like a man standing in a bucket and trying to lift himself by the handle," is appropriate for the Bahamas at this point in time. There needs to be an intense effort by policymakers on developing an economic growth strategy that will drive private sector business growth, create sustainable, lucrative job opportunities and deliver adequate and affordable public services.