

# IMF Report Summary

## Has The Bahamas Really Turned the Corner?

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The International Monetary Fund (IMF) recently concluded its 2018 Article IV consultation with The Bahamas and released its country report. The IMF conducts regular surveillance on its member countries, typically on an annual basis, as per the IMF Articles of Agreement. As a part of the surveillance process, the IMF monitors member countries' policies along with their economic and financial developments and provides advice to "achieve economic stability, prevent financial crises and improve living standards". In addition to member surveillance, the IMF provides financial assistance and capacity development, in the form of technical assistance and training. The IMF's primary mission is to ensure the stability of the international monetary system.

The idea of the IMF developed after the economic instability of the Great Depression. At the Bretton Woods Conference of 1944, 44 country representatives built a framework for the proposed International Monetary Fund. In 1945, 29 countries officially signed the IMF's Articles of Agreement, and the IMF's membership has now grown to 189 countries. The Bahamas joined the IMF shortly after independence on August 21, 1973. As a member, The Bahamas has several obligations including sharing information on the country's financial and economic developments, agreeing to the code of conduct in the IMF Articles of Agreement, and paying a quota subscription. The IMF typically holds discussions with Government and Central Bank officials during their annual visits to evaluate the country's outlook. This year's discussions were held March 7 – 20, 2018.

Key findings in the IMF's report included:

- The IMF estimated that real GDP expanded by 1.30 percent in 2017. This growth was attributed to the completion of Baha Mar, new FDI-financed projects, and post-hurricane reconstruction activity. It should be noted however, that actual economic growth for 2017 came in at 1.40 percent. Projected GDP growth for 2018 - 2019 is 2.25 – 2.50 percent and growth is expected to stabilize at 1.50 percent over the medium term. These projections assume "stronger global growth, particularly in the United States; the full opening of Baha Mar; and a pickup of foreign direct investment.
- Debt to GDP: Projected debt to GDP for FY2018 is 57.40 percent, and this is expected to decline to a level of 55 percent by FY2023.
- The fiscal deficit stood at 5.80 percent of GDP at the end of FY2017. A fiscal deficit occurs when the government's expenditures exceed its revenues. This deficit increased by 2.80 percentage points during FY2017 due to post-hurricane cleanup and an increase in spending before the general elections. Data from the first 7 months of FY2018 shows a decline in the fiscal deficit to 1.60 percent of GDP representing a decline of 1.20 percentage points versus the previous year.
- Air tourist arrivals declined by 4 percent in 2017. Numbers for the beginning of 2018 look promising, with mega resorts Baha Mar and Atlantis reporting high occupancy for the winter season.
- Despite high liquidity and strong capital adequacy ratios at commercial banks, the

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level of lending remains low largely due to “excessively high debt-service-to-income-ratios” and “weak economic activity”. Non-performing loans declined significantly from 11.40 percent of total loans in 2016 to 9.20 percent in 2017. This was mainly due to Resolve’s purchase of non-performing loans from The Bank of the Bahamas. In addition, the banks’ interest spreads are high due to low deposit rates and high loan rates.

- The current account deficit increased to 16.40 percent of GDP in 2017 versus 7.70 percent of GDP in 2016. A country has a current account deficit when the value of goods and services it imports is greater than its exports. The increase in the deficit is reportedly due to “a surge in imports of goods and services related to the completion of Baha Mar, the recovery in oil prices, and lower tourism receipts due to the impact of Hurricane Matthew on hotel infrastructure”. The current account deficit is projected to decrease over the medium term due to a pickup in tourism, lower imports once Baha Mar is completed, and fiscal consolidation.

The IMF proposed the following initiatives to improve the economy:

- Reduce current spending by trimming the wage bill and making State Owned Enterprises (SOEs) self-sufficient.
- Reform the civil servants’ pension system. The majority of civil servants are in non-contributory defined benefit pension plans. Accrued government pension liabilities as of 2012 were \$1.5 billion and are projected to rise to \$3.7 billion by 2030 as the population ages. Many governments worldwide have moved towards a defined-contribution scheme, which reduces the liability to the government.
- Set up a natural disaster fund between 2 – 4 percent of GDP to protect against the increasing risk of hurricanes. The IMF’s report noted that four of eight hurricanes hitting the Bahamas since 1990 resulted in damages of at least 5 percent of GDP, which has had a major impact on the country’s finances. The suggestion was also made to insure public assets, invest in resilient infrastructure, update building codes and have strict zoning guidelines.
- Strengthen tax revenues and make the tax system more progressive. The IMF commended past efforts to increase revenues through the introduction of VAT. However, the IMF also noted that the government’s proposed removal of VAT on breadbasket items may not be the best option as this could reduce revenues.
- Structural reforms: advancing energy sector reforms, improving the ease of doing business, reducing unemployment by expanding vocational and apprenticeship programs, and developing the credit bureau to improve access to credit.
- Compliance with Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) Acts and tax transparency standards to protect the financial services sector.

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The following are key government initiatives noted in the IMF’s report:

- The government has been examining the public sector and is gradually trimming the wage bill through nonrenewal of temporary workers’ contracts and hiring freezes. Capital spending has been reduced, and there are plans to fund future infrastructure developments via Public Private Partnerships (PPP).
- The government has since released the Fiscal Responsibility Bill for public consultation. Deputy Prime Minister and Minister of Finance the Hon. Peter Turnquest stated that it “sets guiding principles and rules for the way the government spends and accounts for the people’s money”. The IMF recommended that these rules should

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include a fiscal deficit ceiling of 1 percent of GDP, a cap on the growth of expenditure of 3 percent and exceptional circumstances clauses for negative shocks only.

- The Central Bank has requested proposals for the establishment and operation of a credit bureau. The average person in the Bahamas is heavily indebted, and the establishment of a credit bureau would provide a level of comfort for lenders and force consumers to become more responsible with their finances.
- There are plans to improve disaster preparedness and reduce the risk of damage from disasters. The government also plans to invest in sea walls and other coastal protection measures along with updating the building code. The IMF noted that the government welcomed their recommendation to start a natural disaster fund.

After several years of negative to low growth, the economy seems to be on a positive trajectory. The government has made it its mission to get the economy back on track. However, to say that we have turned the corner seems premature. As noted in the IMF's report, the following are threats to the Bahamas' economic growth: weaker than projected US growth leading to lower tourism activity and lower economic activity, the threat of natural disasters, and the failure of the government to implement fiscal consolidation or structural reforms leading to lower foreign direct investment. Two major issues that need to be tackled are the high unemployment and debt levels. The Bahamas' unemployment rate actually increased from 9.90 percent in May 2017 to 10.10 percent in November 2017 and youth unemployment is extremely high at 22 percent. There is an inverse relationship between unemployment and economic growth. "Okun's law states that for a 1 percent decrease in unemployment to occur, the economy must grow by approximately 2 percent." Prior to the 2008 recession, the Bahamas' unemployment rate stood at 7.80 percent. The current growth rate and forecasted growth rates for the medium term are not enough to put a dent in the country's unemployment levels. While Baha Mar has improved employment in the tourism sector by providing 4,000 jobs, we must also find ways to create jobs in other industries, in order to decrease the overall unemployment rate. As at December 2017, the National Debt (including contingent liabilities) stood at \$7.88 billion versus \$7.04 billion a year earlier. It is important that the government find ways to increase revenues and decrease expenditures so that the level of debt is more sustainable. We hope that over the coming months additional initiatives will be introduced which will allow us to turn the corner and progress on a smooth path towards economic prosperity.

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