Monthly Economic and Financial Developments (MEFD)

December 2018

Remarks by the Governor

The Central Bank monitors economic and financial sector trends on an ongoing basis to ensure that its policies stay consistent with the objective of protecting the value of the Bahamian currency, and that confidence and stability is maintained in the financial system. Our analysis draws out relationships between the performance of the economy and its impact on the health of the financial system; we also assess the extent to which financial sector developments can be influenced to support progress on the economy; and the Bank takes note of potential risks that could affect the outlook for the economy.

Our emphasis is always on whether policies can be adjusted to steer the economy and financial sector in the right direction.

The Bank's Monetary Policy Committee (the MPC) does this assessment on a monthly basis. Every quarter, the MPC expands its published analysis to a more in-depth view of economic developments.

The latest assessment covers monetary and economic developments for the period up to December 2018.

Based on the available indicators, the economy continued to grow at a modest pace in December, and was improved overall for 2018. This reflected the strong gains in tourism, along with steady stimulus from foreign investments, which fuelled construction sector activity. A key indicator of the economy's uptrend was the strongly elevated level of foreign currency inflows through the banking sector and equally robust domestic demand for foreign exchange, for payments for imported goods and services. The data show, for example, that gross foreign exchange inflows through commercial banks increased by about $1.1 billion to $5.5 billion during 2018, while outflows through banks kept strong pace, increasing at almost an identical rate. The elevated foreign exchange outflows, spoke to supplies imported to support tourist operations, investment projects; and to higher spending by Bahamian households and businesses more generally.

Addressing tourism, indicators strengthened most in the stopover segment, particularly evident in data on vacation rentals and international departure trends, both which captured the entire year. New Providence was the strongest magnet for stopover visitor growth (due to the increased room inventory from Baha Mar). For the vacation rental component, New Providence leads the market with the largest share of inventory and better occupancy rates; however, the Family Islands and Grand Bahama averaged faster vacation rental growth in 2018. Cruise sector growth was also stronger in the destinations outside of the capital.

Data on actual expenditure on FDI projects is not available at the same timeliness as tourism. However, based on projects already in the development phase, mainly in the tourism sector, some support for domestic construction is being upheld. In addition, new projects have either broken ground or are about to start throughout The Bahamas.

The economy's strengthening, as data from the Department of Statistics show, generated higher employment, but not at a fast enough pace to reduce the unemployment rate. This is an important indicator in assessing the health of the lending environment, and prospects around the speed of non-performing loans (NPL) reduction.

Before turning to the monetary and financial sector development, a brief comment on oil prices and the fiscal developments is necessary.

International fuel prices rose through most of 2018, but closed lower in December. Whether this also moderated the year-long uptrend in the fuel surcharge is not yet known as the electricity price data is not yet available for December. However, in the preliminary Exchange Control data, it did not contribute to any increase in the total oil bill. Otherwise, both the fuel surcharge and the mid-year increase in the VAT caused elevated consumer price inflation though September, in comparison to the same period in 2017.

In public finances, some reduction in the deficit was evident during the first half of the fiscal year. However, the relative switch to domestic financing through the banking system, and at least one public entity's swapping of foreign currency debt into local currency caused a larger seasonal decline in bank liquidity during the final month of the year and similarly, for the year.

External reserves followed the same pattern, ending both December and 2018 lower near $1.2 billion. The Central Bank anticipated this outcome. The public sector largely drew down liquidity which it created in 2017, through the external borrowing which occurred. External reserves, however, remained at healthy levels, and continued to experience a net positive contribution from the private sector in 2018.

Beyond the expansion in credit to the public sector, commercial bank lending to the private sector contracted again in 2018, even though at a moderated pace. This was across mortgages, consumer lending and commercial loans.

Banks remained focused on reducing the non-performing loans (NPL) overhang. In this regard, although the December data revealed some increase in arrears in the shorter-term category of overdue loan payments, NPLs, or delinquencies of over 90 days continued to fall. In fact, for the year, the NPL total fell by approximately $50.5 million and NPLs decreased as a shared of total private loans to 9.1% from 9.9% at the end of 2017. Nevertheless, the fluctuation in short-term arrears throughout the year underscore that, at the margin, a sufficient number of borrowers still teeter on the brink of difficult financial circumstances. It should be noted that, other than write-offs and debt restructuring, domestic banks are also protecting their balance sheets by continuing to increase their provisions for credit losses, which are now budgeted at 85% of all non-performing loans.

Assessing the outlook, the Central Bank expects continued gradual improvement in financial sector indicators, as the economy expands further in 2019. This should maintain the tone for more gradual decrease in NPLs and further improvement in banking sector balance sheets. The outlook is also more positive for external reserves growth. However, in the absence of a more accelerated pace of FDI inflows, employment gains would remain substantially tied to tourism growth; and would require sustained, stronger inroads to keep up with labour force participation expansion.

There is nothing in the outlook that would prompt any change in the Central Bank's current monetary policy stance. There are no material negative threats to external reserves. Liquidity in the banking system should remain elevated, with the Central Bank, staying focused on soaking up some of the excess through additional sales of the Bank's holdings of government debt in the secondary market. There is scope for private sector credit to expand moderately, especially if the Government were able to achieve the targeted reduction in its own borrowing needs, in line with its medium-term fiscal consolidation strategy. As for the banking sector taking a more open posture to lend, the on streaming of the credit bureau should set the stage for better quality lending in the future.