**LAPSE OF TIME**

SM/18/87

April 20, 2018

To: Members of the Executive Board

From: The Secretary

Subject: **The Bahamas—Staff Report for the 2018 Article IV Consultation**

| | |
|---|---|
| Board Action: | Executive Directors' **consideration** on a lapse of time basis as management has determined it meets the established criteria. |
| Deadline to Request Board meeting: | **Wednesday, May 2, 2018**<br>**12:00 (noon)** |
| Proposed Decision Deemed Approved: | Friday, May 4, 2018 |
| Provisional Board Meeting Date: (if requested) | Friday, May 4, 2018 |
| Proposed Decision: | Page 21 |
| Publication: | Not yet decided*<br>Press Release will be based on the staff appraisal if there is no request for a Board discussion. |
| Questions: | Mr. Valencia, WHD (ext. 36355)<br>Mr. Ronci, WHD (ext. 38549) |
| Document Transmittal in the Absence of an Objection and in accordance with Board policy: | Monday, April 30, 2018—WTO<br>After Board Consideration—Caribbean Development Bank, Inter-American Development Bank |

***At the time of circulation of this paper to the Board, the authorities have indicated that they need more time to consider whether they will consent to the Fund's publication of this paper. Publication will only proceed upon the receipt by the Fund of the member's explicit consent.**

# THE BAHAMAS

## STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

April 19, 2018

**Context**: The Bahamian economy has turned the corner. Growth is expected to pick up to 2½ percent in 2018, supported by the completion and opening of the tourist resort Baha Mar and a stronger U.S. economy. But without resolute implementation of structural reforms, medium-term growth would remain subdued. Public debt ratios have improved due to upward revisions to GDP, but fiscal deficits remain above debt-stabilizing levels. Prime Minister Minnis' administration has committed to tackling fiscal and structural challenges as central tenets of its agenda.

**Key policy advice**

**Fiscal policy.** Fiscal consolidation, with a strong focus on reducing current expenditure, is critical to maintain market confidence and ensure fiscal sustainability. Introducing a fiscal rule, as part of a medium-term fiscal framework, should help lock in the expected gains from consolidation and enhance fiscal discipline. Setting up a savings fund for natural disasters, as part of a multilayer disaster risk financing strategy, should strengthen fiscal and economic resilience.

**Structural reforms.** Addressing longstanding structural bottlenecks is critical to lift medium-term growth, including by moving swiftly to the implementation phase of the credit bureau; advancing energy sector reforms; reducing the administrative burden on businesses; and reducing skill gaps in the labor market. Ongoing governance reforms and stepping up efforts to fight crime should further enhance the business environment.

**Monetary and financial policies.** Encouraging banks to step up efforts to restructure nonperforming loans should support the recovery; and strong compliance with AML/CFT and tax transparency standards should help stem pressures on correspondent banking relationships and preserve the integrity of the financial sector. Stricter limits on central bank lending to the government should further strengthen the credibility of the peg.

**Advice from previous Article IV Consultations:** In line with past Fund advice, the authorities are taking steps to trim the wage bill; introduce a credit bureau; strengthen tax revenues, which began with the introduction of the VAT in 2015; and reduce central bank lending to the government. The authorities have implemented key FSAP recommendations and are taking steps to strengthen their AML/CFT framework.

Approved By
**Cheng Hoon Lim (WHD) and Johannes Wiegand (SPR)**

Discussions took place in Nassau during March 7–20, 2018. The team comprised F. Valencia (Head), Q. Chen and M. Ronci (all WHD), and M. Gislén (SEC). R. Young (OED) participated in the concluding meetings. P. Cifuentes (WHD), S. Mbaye (FAD), and K. Tanyeri (ITD) contributed from headquarters. The mission met with Deputy Prime Minister and Minister of Finance Turnquest, Central Bank Governor Rolle, other senior government officials, and representatives of the private sector and civil society.

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## APPENDIX

# ECONOMIC AND POLITICAL CONTEXT

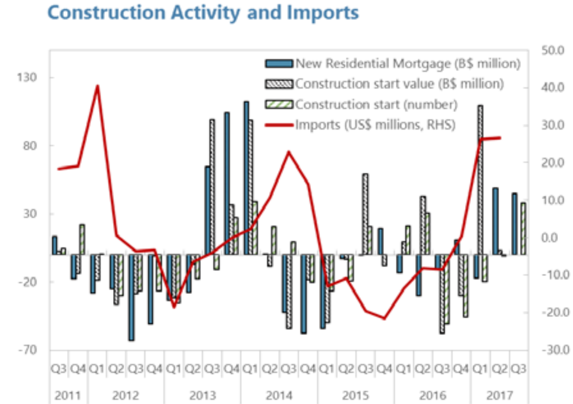
**1. The Bahamian economy has turned the corner, although significant challenges remain.** After a steady decline in real GDP over 2013-2015, economic activity is picking up. Near-term growth performance is improving on the back of the much-awaited opening of the mega tourist resort Baha Mar[1] and a stronger U.S. economy. But without bold action to tackle longstanding structural bottlenecks, medium-term growth would remain subdued. Commercial banks remain well capitalized and liquid, but are cautious to lend in an enviornment with poor borrower quality, a legacy of the prolonged recession. Public debt ratios have improved due to major upward revisions to GDP, but fiscal deficits remain above debt-stabilizing levels.

**2. The Minnis' administration has committed to tackle fiscal and structural challenges.** Prime Minister Hubert Minnis' political party, The Free National Movement (FNM), received a strong mandate in the May 2017 general election to change the economic course, securing 35 of the 39 seats in the lower house of Parliament. The administration has announced fiscal austerity measures and intends to table fiscal responsibility legislation. However, Mr. Minnis has also promised introducing a zero-rate VAT for some food items, which would have to be weighed against fiscal sustainability objectives. The administration is also embarking on governance reforms, and is taking steps to liberalize the economy, including by modestly relaxing capital flow management measures (CFM) and committing to seek WTO accession by 2019.

# RECENT DEVELOPMENTS

**3. Real GDP is estimated to have expanded by 1.3 percent in 2017.** Economic activity has been supported by the completion of Baha Mar, new FDI-financed projects, and post-hurricane reconstruction activity. However, air tourist arrivals declined 4 percent in 2017, as 50 percent of hotel room capacity in the Grand Bahama Island remains out of commission after the passage of Hurricane Matthew in 2016. Baha Mar created about 4,000 jobs by March 2018, which helped reduce the unemployment rate to 10.1 percent in November 2017, from 11.6 percent one year earlier (Figure 1). The decline took place despite a sharp increase in labor force participation to 81 percent, up from 76 percent. The fall in unemployment has been more

**Construction Activity and Imports**

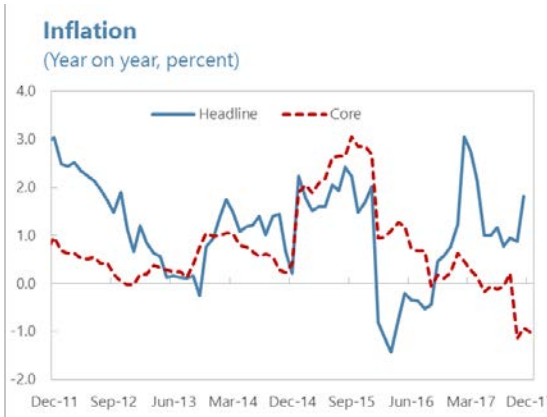



Source: Central Bank of The Bahamas.

[1] Originally conceived in 2005, the construction of Baha Mar, a US$4 billion resort, broke ground in 2011. However, multiple delays in completing the project forced the developer to declare bankruptcy in the summer of 2015. A new owner resumed construction of the resort in late 2016. The resort opened its first and second phase in April and November of 2017, respectively, and it is scheduled to fully open in the Spring of 2018. Once fully open for business, the resort has the potential to employ between 5,000–7,000 workers, about 2–3 percent of the labor force.

pronounced among the young with the youth unemployment rate falling to 22 percent, from 26 percent. The national accounts have been substantially revised due mainly to improved coverage, resulting in a 27-percent increase in the level of nominal GDP. [2]

**4. Inflation remains low despite higher oil prices.** Headline year-on-year inflation reached 1.8 percent in December 2017, up from 0.8 percent in December 2016, driven by an increase in housing and transportation services—which include components sensitive to fuel prices.



Sources: Department of Statistics, and IMF staff calculations.

**5. The fiscal deficit is declining due mainly to lower capital spending.** In FY2017, ending in June, the central government fiscal deficit reached 5.8 percent of GDP, up from 2.8 percent of GDP a year earlier, due to post-hurricane cleanup and reconstruction and lax spending control in the run-up to the general elections. Central government debt reached 57 percent of GDP in FY2017 (Figure 2). Last August, the new administration announced across-the-board spending cuts, the nonrenewal of some temporary workers' contracts, and a hiring freeze. Data for the first 7 months of FY2018 show a decline in the deficit to 1.6 percent of GDP, 1.2 percentage points of GDP lower than a year earlier, excluding the one-off purchase of promissory notes issued by Resolve.[3] The Bahamas avoided a new sovereign rating downgrade and successfully placed an external bond.[4] [5]

**6. Commercial banks remain liquid and well capitalized.** Financial system assets are concentrated in the offshore sector, with strict firewalls between the domestic and offshore banking sectors (Figure 3). Seven commercial banks, four of which are subsidiaries of foreign banks, dominate the domestic financial sector, and their balance sheets appear sound. As of December 2017, the average capital adequacy ratio stood at 33.3 percent, well above the regulatory requirement of 17 percent and liquid assets represented 29 percent of total assets, and more than double the statutory minimum. The stock of nonperforming loans (NPLs)—concentrated in mortgages—declined to 9.2 percent of total loans, from 11.4 percent at end-2016. The decline followed mainly

[2] The national account system was rebased to 2012 (Informational Annex, p. 9).

[3] Resolve is a government-owned special purpose vehicle (SPV) which purchased nonperforming loans at face value from the majority state-owned Bank of The Bahamas in 2016 and 2017 and paid with its own promissory notes. The central government is redeeming the first set of promissory notes for B$100 million from the Bank of The Bahamas at face value in this fiscal year. Staff estimated the fair value of the notes at 20 percent, with the difference recorded as a capital transfer for the central government, adding 0.7 percent of GDP to spending. Currently, the authorities have no plans for an additional purchase of promissory notes from the Bank of The Bahamas.

[4] In November 2017, the authorities placed a 10-year bond for US$750 million at a 6 percent yield, which was nearly 4 times oversubscribed.

[5] After downgrading the sovereign rating in 2016, Moody's and S&P reaffirmed their respective sovereign ratings for The Bahamas last year, noting prospects for debt stabilization under the new administration. Moody's and S&P rate The Bahamas Baa3 (lowest investment grade), and BB+/B (non-investment grade), respectively.

from a large disposal of NPLs by the Bank of The Bahamas (BOB), a majority state-owned commercial bank.[6] The disposal allowed BOB to strengthen its capital adequacy ratio to 42 percent.

**Financial Soundness Indicators**

(Domestic commercial banks)

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|
| Capital/risk-weighted assets 1/ | 26.1 | 31.7 | 31.2 | 30.9 | 27.9 | 33.3 |
| Excess liquid assets 2/ | 99.6 | 115.1 | 112.8 | 126.1 | 134.8 | 161.7 |
| Liquid assets/deposits | 32.4 | 35.6 | 35.7 | 38.2 | 39.6 | 44.5 |
| NPLs/total loans | 13.9 | 15.4 | 15.3 | 14.2 | 11.4 | 9.2 |
| Provisions/NPLs | 43.0 | 39.2 | 51.2 | 58.5 | 70.6 | 74.7 |
| Return on assets | 1.7 | 0.7 | 0.5 | 2.5 | 2.2 | 2.3 3/ |
| Return on equity | 6.3 | 2.7 | 2.1 | 9.5 | 8.6 | 8.6 3/ |

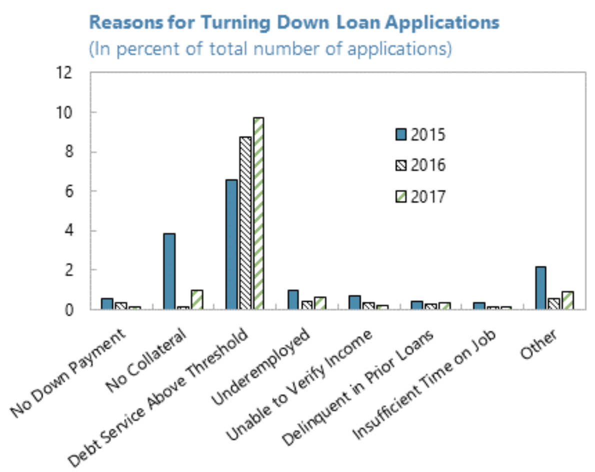
Sources: Central Bank of The Bahamas; and IMF staff calculations.

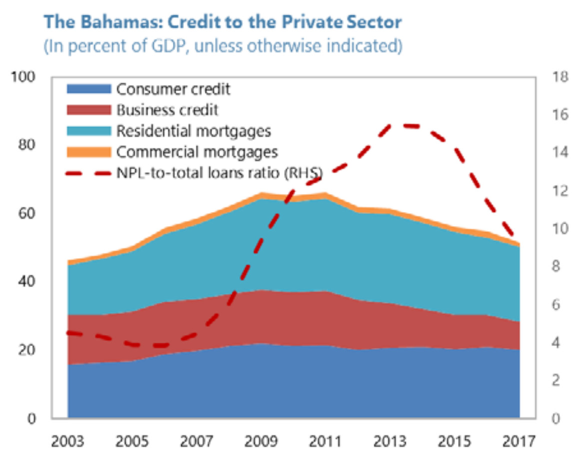
1/ Minimum requirement is 17 percent.

2/ In percent of statutory minimum requirement.

3/ End of September 2017.

**7. Despite ample balance sheet space, banks are cautious in making new loans.** Persistent weakness in economic activity coupled with a debt overhang problem has strained households' debt-servicing capacity, constraining their access to credit. A central bank survey of bank lending conditions consistently shows an excessively high debt-service-to-income ratio as the most common reason for rejecting loan applications. At the same time, weak economic activity has also affected businesses' profitability.[7] Therefore, banks have been reluctant to lend in an environment where the absence of a credit bureau and book-keeping tradition, combined with a prolonged recession, make it more challenging to screen borrowers. Large intermediation spreads—which in addition to limited competition also reflect a risk premium on lending—have widened significantly since the global financial crisis (Figure 4). These factors have kept credit to the private sector, excluding NPLs, broadly flat. Pressures on correspondent banking relationships (CBR) have not resulted in major disruptions so far.[8]



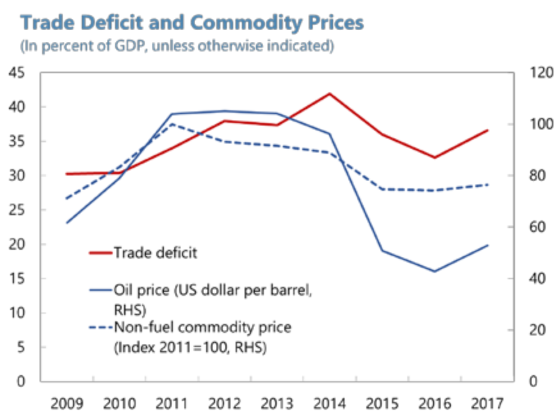

Source: Central Bank of The Bahamas, and IMF staff calculations.

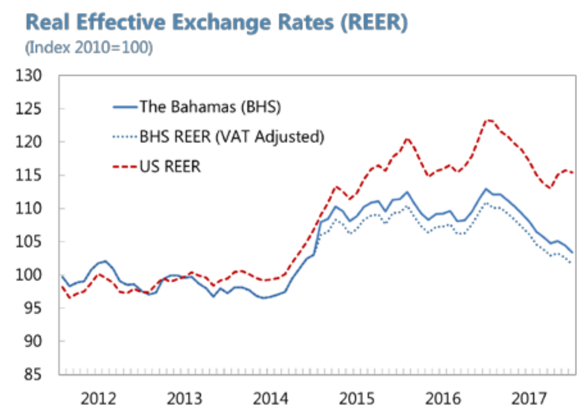
[6] The bank sold B$168 million of NPLs at book value to Resolve.

[7] Staff analysis presented in an annex of the 2017 Article IV Staff report concludes that weak economic activity has been the main driver of weak bank credit provision to the private sector. However, as banks became reluctant to lend in an environment with poor creditworthiness of borrowers, a self-reinforcing feedback loop likely emerged.

[8] Staff analysis in the 2017 Article IV Selected Issues Paper shows that the direct contributions of the offshore sector to the economy have remained broadly stable despite pressures on CBR.

**8. The external sector position is weaker than suggested by fundamentals and desirable policy settings.** The current account deficit is estimated to have widened to 16.4 percent of GDP in 2017, from 7.7 percent of GDP in 2016 (Figure 5). The increase is 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 2017 cyclically-adjusted current account deficit, after deducting FDI-related imports, is estimated to be 2.2 percentage points of GDP above the level consistent with fundamentals and desirable policy settings (Annex I). As of end-2017, the Bahamian dollar depreciated 4.3 percent in real effective terms relative to the 2017 average as the U.S. dollar weakened vis-a-vis other major currencies. In staff's view, the currency is overvalued by about 0–10 percent. Foreign reserves strengthened to US$1.4 billion by end-2017, equivalent to 3.6 months of imports of goods and services, boosted by the sovereign external bond placement in November. The current level of reserves is adequate under traditional benchmarks.




Sources: Central Bank of The Bahamas, INS, WEO, and IMF staff calculations.

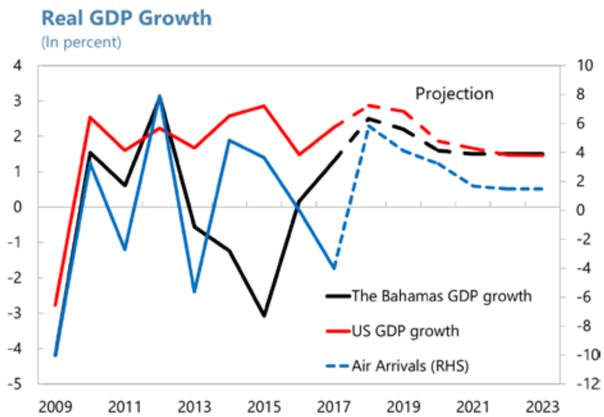
**9. The authorities have tabled legislation to strengthen governance and the rule of law.** This legislation includes i) a constitutional amendment, passed by Parliament in 2017, to create an independent Office of the Director of Public Prosecutions; ii) a bill to create the Office of the Ombudsman; and iii) a bill to set up a new code of conduct for public officials, establish an Integrity Commission to investigate alleged cases of corruption, and deepen the financial disclosure responsibilities of public officials. The Integrity Commission Bill and the Ombudsman Bill were tabled in 2017 and are expected to be debated this year.

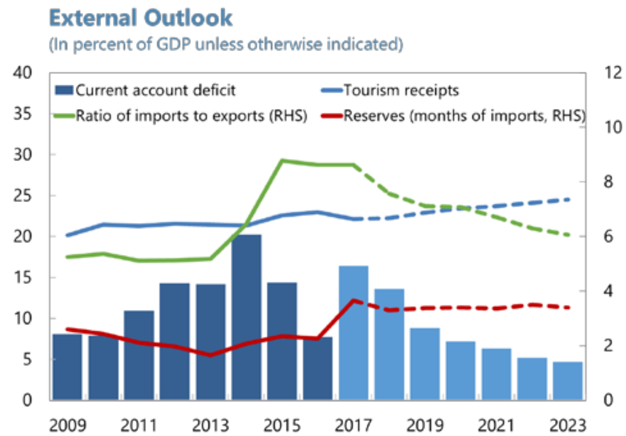
# OUTLOOK AND RISK

**10. Real GDP growth is projected to pick up to 2¼ – 2½ percent in 2018-2019 and to stabilize at 1½ percent over the medium term.** The baseline scenario is predicated on stronger global growth, particularly in the United States;[9] the full opening of Baha Mar; and a pickup in foreign direct investment. Baha Mar is projected to contribute 2¼ percentage points to real

[9] The recent U.S. tax reform will impact The Bahamas through its macroeconomic effects as the fiscal impulse in the United States is expected to translate into higher tourism activity in The Bahamas.

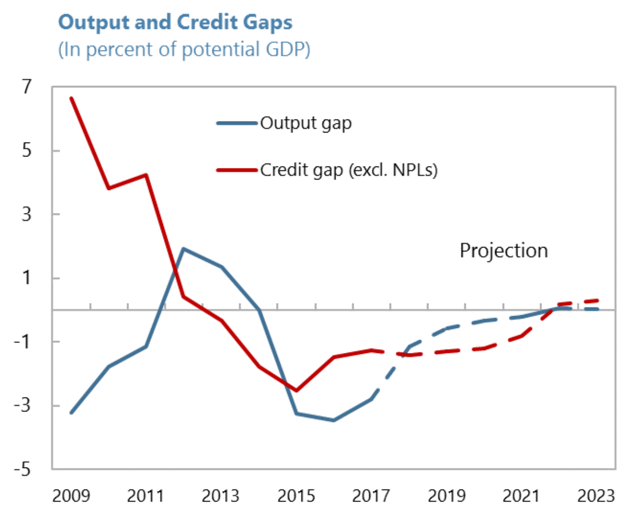
GDP growth, cumulatively, over 2017–2019, through higher investment, tourism activity, and employment. Medium-term growth is projected to remain at 1½ percent, reflecting significant structural impediments. The current account deficit is projected to narrow over the medium term, on the back of larger tourism receipts and lower imports due to the completion of Baha Mar and fiscal consolidation.




Sources: The Bahamian authorities, World Economic Outlook, and IMF staff calculations.

**11. The flow of bank credit to the private sector is expected to improve gradually**. Stronger economic activity and further declines in unemployment should improve households' access to credit. Commercial banks have the balance sheet space to support a pickup in credit demand. Improving economic conditions should also support a faster reduction in banks' NPLs and further support the recovery. Under the baseline scenario, bank credit to the private sector would slowly pick up to grow at annual rates of around 2.5–3.0 percent by 2021–2023, leading to a gradual closing of the credit gap.




Source: IMF staff calculations.

**12. Risks to the outlook are skewed to the downside (Annex II).** Weaker-than-projected U.S. growth or tourism activity would lead to lower economic activity. A tightening of global financial conditions could lead to lower-than-projected foreign investment inflows. Natural disasters and the intensification of pressures on CBR are additional near- and medium-term risks. On the domestic side, failure to implement fiscal consolidation or structural reforms could undermine investor confidence and reduce projected foreign investment flows. On the upside, lower oil prices, higher-than-projected U.S. growth and FDI flows, or bigger-than-expected boost from Baha Mar would lead to stronger growth (Annex III).

***Authorities' Views***

**13. The authorities broadly agreed with staff's projections and risk assessment.** The authorities underscored the commitment of the administration to tackle fiscal imbalances and structural impediments. They also agreed with the external position assessment.

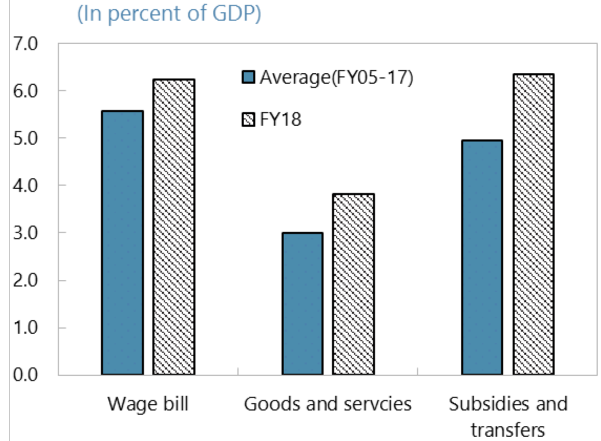
# KEY POLICY ISSUES

## A. Fiscal Policy

**14. Sharp increases in public debt call for decisive fiscal consolidation efforts to rebuild fiscal buffers and maintain market confidence.** Under staff's baseline scenario, expenditure restraint would reduce the fiscal deficit from 5.8 percent of GDP in FY2017 to 2.7 percent of GDP in FY2018, and to about 1½ percent of GDP in the medium term. Central government debt would peak at 57.4 percent of GDP in FY2018 and would gradually decline to stabilize at around 55 percent of GDP by FY2023. Under this baseline, the debt sustainability heat map points to low to moderate risks to debt sustainability. However, sizable contingent liabilities[10] and exposure to natural disasters pose significant downside risks to the fiscal outlook with a combination of adverse shocks putting the debt-to-GDP ratio on an upward trajectory (Annex IV).

**15. Strong adherence to the announced fiscal consolidation plan would put public indebtedness on a firmly downward trajectory.** The authorities' fiscal consolidation targets, announced last June in the FY2018 budget, envisage a reduction in the fiscal deficit to 2.7 percent of GDP in FY2018, and to 1.8 percent and 0.8 percent of GDP for FY2019 and FY2020, respectively. For FY2018, the budget included an increase in tax collection and lower spending due to ongoing revenue administration reforms and dissipation of one-off effects from Hurricane Matthew and the elections. The fiscal target for FY2018 is within reach, despite the unbudgetted purchase of Resolve promissory notes, although at the expense of lower-than-budgeted capital spending. During the mid-year budget review in March, the authorities reiterated their commitment to meet the FY2018 deficit target. Staff recommended an additional adjustment of 2 ¼ percent of GDP to bring the deficit to ½ percent of GDP by FY2021—the medium-term target under the proposed fiscal rule (para. 17)—to put the public debt-to-GDP ratio on a firmly downward trajectory. Staff urged the authorities to identify measures to undertake this adjustment with a strong focus on reducing current spending and avoid an undue compression of capital spending. Staff emphasized the following areas:

**Current Public Expenditure**
(In percent of GDP)




Sources: Ministry of Finance; and IMF staff calculations.

[10] The combined debt of state-owned enterprises reached 14 percent of GDP in 2017, which includes the promissory notes issued by Resolve.

- *Trimming the wage bill,* through a gradual rationalization of public sector jobs—as private sector job creation strengthens—and wage restraint.

- *Turning SOE's self-sufficient*, by ensuring that the price for their services allow recovery of costs and by restructuring these corporations and other public entities to improve their efficiency and reduce their dependence on transfers from the central government. A first essential step is the establishment of effective financial oversight over these entities.

- *Reforming the civil servants' pension system,* by moving to a contributory regime in the near term and to a defined-contribution scheme in the medium term.[11] Addressing also imbalances at the National Insurance Board (NIB)[12] by adopting the recommendations included in the last actuarial report should reduce fiscal contingent liabilities.

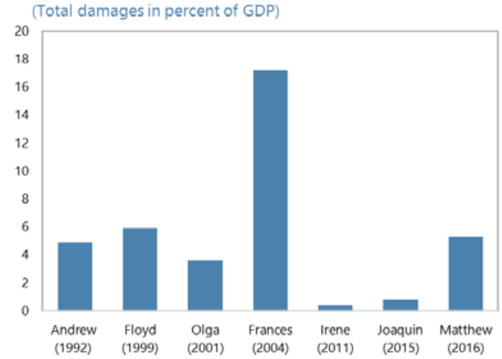
**16. Setting up a savings fund for natural disasters, as part of a multilayer disaster risk-financing strategy, should strengthen fiscal and economic resilience.** A multilayer approach to disaster risk financing is considered appropriate and cost effective. As part of this approach, and in line with Fund advice to other Caribbean economies, staff recommended setting up, over the medium term, a natural disasters savings fund of a target size between 2–4 percent of GDP, with annual inflows for ½ percent of GDP (Box 1). In addition, insuring public assets and encouraging the broader use of private insurance, including through financial literacy training and targeted subsidies, would reduce fiscal contingent liabilities. Investing in resilient infrastructure and maintaining up-to-date building codes, land use, and zoning guidelines are also critical elements of an adequate disaster risk management strategy.

### Box 1. Strengthening Natural Disaster Resilience: A Savings Fund Proposal

*The exposure of The Bahamas to recurrent natural disasters calls for a multilayer disaster risk financing strategy. As part of this approach, staff proposes the creation of a savings fund of target size ranging 2–4 percent of GDP.*

**Motivation**. Over the last 30 years, The Bahamas has recorded annual average damages from natural disasters (NDs), including both to public and private sector assets, at close to 1.5 percent of GDP, higher than the Caribbean regional average of 1.2 percent of GDP. Four out of the eight hurricanes that hit The Bahamas since 1990 resulted in estimated total damages—public and private—of at least 5 percent of

The Bahamas: Natural Disaster Damage, 1990-2016
(Total damages in percent of GDP)




Sources: EM-DAT adjusted for 2017 GDP revision, WEO, and IMF Staff calculations.

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[11] The civil servants' pension system is unsustainable. Government employees draw pensions at retirement without contributing to the system while employed. Staff analysis in the 2016 Article IV Staff report noted that accrued government pension liabilities totaled B$1.5 billion in 2012 and would rise to B$3.7 billion by 2030 as the population ages.

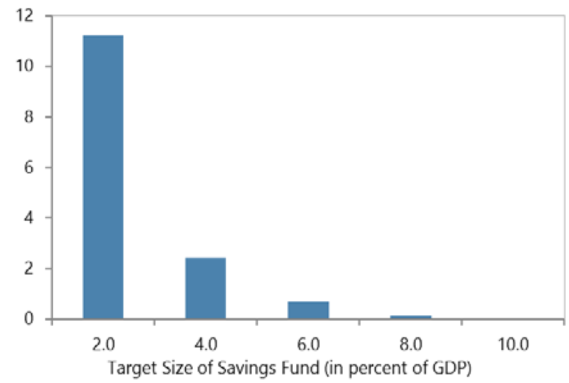
[12] NIB provides pensions, unemployment insurance, and other short-term benefits to insured employees. Total expenses in benefits surpassed total income in 2016 and under current policies, and NIB's reserves would be depleted by 2029.

### Box 1. Strengthening Natural Disaster Resilience: A Savings Fund Proposal (concluded)

GDP, implying a probability of a disaster of that magnitude of close to 15 percent in any given year. The Bahamas has traditionally absorbed the fiscal consequences of these shocks through re-prioritization of spending and/or worsening fiscal deficits, often forcing a rapid accumulation of debt. However, increased reliance on risk reduction and preparedness policies are preferable than relying entirely on *ex post* intervention as financing can be made available immediately and likely at more affordable costs.[1]

**Methodology.** To determine the target size of the savings fund, staff estimated a vector auto-regression (VAR) model over 1985–2016, including the cyclical components of government revenues, primary expenditure, and real GDP (see Selected Issues Paper for details). To isolate fluctuations in these variables not driven by natural disasters, the system included US real GDP, US REER, oil prices, and dummy variables to account for specific events such as the introduction of the VAT, electoral years, and September 2001. After controlling for these sources of shocks, outliers in the distribution of residuals are assumed to be driven by natural disasters. Using a Monte Carlo experiment, staff simulated possible fiscal outcomes and focused on events with a probability of occurrence of 15 percent or less, under the premise that contingent funds in the budget would be the first line of defense for smaller, higher-frequency events.

**Probability of Fund depletion**
(In percent)

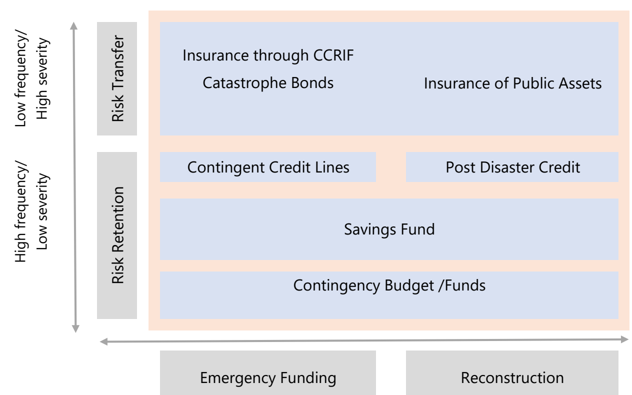



Source: IMF staff calculations.

**Results.** A savings fund of size between 2 and 4 percent of GDP to cover the fiscal impact of natural disasters would be depleted only with 11 percent probability or less. The fund would require annual inflows for ½ percent of GDP during normal years.

A tiered approach to disaster risk financing—an approach including different financial instruments for different layers of risk—is appropriate and cost effective (GFDRR and World Bank, 2014). Self-insurance or risk retention, including through contingent funds in the budget, the proposed savings fund, and the recently requested contingent loan from the IDB for US$100 million, should be used to confront the more frequent, less severe shocks. Risk transfer through the Caribbean Catastrophe Risk Insurance Facility (CCRIF), of which The Bahamas is a member, and insurance of public sector assets should be used to confront more severe events. Catastrophe bonds could also help to insure against the most severe disasters.

**Risk Layering Strategy for Disaster Risk Financing**




Sources: GFDI Sources: GFDRR and World Bank Group (2014).

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[1] Small States' Resilience to Natural Disasters and Climate Change – Role for the IMF (2016)

**17. Staff welcomed the authorities' plans to table fiscal responsibility legislation.** Draft legislation is currently being prepared with Fund technical assistance and is expected to be tabled in Parliament in May together with the FY2019 budget. The fiscal rule should include a permanent ceiling on the fiscal deficit no larger than 1 percent of GDP with annual deficit targets set at ½ percent of GDP to allow space for automatic stabilizers to operate.[13] These targets, binding from FY2021 on, would allow space to accummulate savings in the proposed natural disasters fund. To further avoid procyclicality, the rule should also i) cap the growth rate of current expenditure at the estimated long-run growth of nominal GDP; and ii) include exceptional circumstances clauses to be triggered only when confronted with significant negative shocks. In addition to the rule, the framework should mandate incorporating in the budget process an assessment of near and medium-term fiscal risks and mitigating policies; and it should include enhanced reporting requirements. Staff noted that completing ongoing reforms to the public financial management system, as recommended through the Fund's technical assistance, is critical for the effectiveness of a medium-term fiscal framework.

### Box 2. Calibrating a Fiscal Rule for The Bahamas

**Well-designed fiscal frameworks are structured around two elements: a medium-term anchor and one (or several) operational target(s) to guide annual budgets**. A natural anchor is the central government debt ratio, which helps guide expectations and (if prudently calibrated) ensures the sustainability of public finances. Debt anchors need to be complemented with operational targets, such as deficit and spending ceilings, that guide fiscal policy towards the medium-term fiscal anchor.

**Staff proposed a debt anchor of 50 percent of GDP.** This level of debt is the lower bound among three approaches. The first approach corresponds to the median debt level among emerging markets with investment grade sovereign rating across the three major rating agencies. The second approach identified an initial debt level such that negative shocks would increase debt to above 70 percent of GDP—the DSA critical debt level for emerging markets—only with a small probability. The third approach looks at the highest level of debt that could be sustained under a prolonged economic slowdown without requiring a primary surplus above 2 percent of GDP, (Escolano and others, 2014). These three approaches yielded a range between 50–71 percent of GDP. Staff favors an anchor at the lower end of this range due to the sizable contingent liabilities of the central government; the need to keep a prudent debt level under an exchange rate peg; and to put the debt-to-GDP ratio on a downward trajectory from the current level of 58 percent of GDP.[1]

**Staff proposed a deficit ceiling of 1 percent of GDP and a cap on current expenditure growth of 3 percent as operational targets.** Allowing for a transition period of three years covering FY2018–FY2020, a deficit target of 1 percent of GDP from FY2021 onwards would ensure convergence to the debt anchor by FY2028. The target fiscal deficit is backed out from a debt dynamics equation relating the initial stock of debt, the target fiscal deficit, expected long-term nominal GDP growth, an assumed convergence horizon, and the debt target (see Selected Issues Paper for details). To create space for the accumulation of savings in staff's proposed fund for natural disasters, the target should be reduced to ½ percent of GDP. To limit procyclicality, setting the permanent ceiling at a somewhat higher level, 1 percent of GDP, would allow accommodating real GDP growth shocks of up to 1 standard deviation without breaching the deficit ceiling. The exceptional circumstances clause would provide the option of additional flexibility when confronted with more significant negative shocks. The cap on growth of current spending consistent with the proposed ceiling—assuming revenues remain constant as a share of GDP—is equal to the expected potential nominal GDP growth. Under the staff's baseline scenario, this growth rate would imply setting a cap of 3 percent.

[1] The 2012 World Economic Outlook presents evidence suggesting stronger growth performance over the subsequent 15 years among countries where debt is falling compared to countries where debt is rising, controlling for the initial level of debt.

[13] The Bahamas does not have income tax; therefore, automatic stabilizers are small.

**18. Strengthening tax revenues is critical to protect social and infrastructure spending.** Laudable efforts to strengthen fiscal revenues, including through the introduction of the VAT in 2015 and revenue administration reforms,[14] helped lift tax revenues from 11.6 percent of GDP in FY2014 to 16 percent of GDP in FY2017. The recently revised national accounts—revealing an economy much larger than previously thought—show significant scope to further increase tax revenues. Staff advised the authorities to continue strengthening tax revenues with the intention to make the tax system more progressive; protect infrastructure and social spending; and to offset a reduction in import duties under an eventual WTO accession. Staff recommended the authorities to consider better-targeted tools than introducing a zero-rate VAT on some food items to help low-income households.

***Authorities' Views***

**19. The authorities agreed on the need to reduce current expenditure and to strengthen tax revenues.** They are taking steps to gradually trim the wage bill and have asked SOE's to prepare plans to become self-sufficient. They also acknowledged the need to reform the pension system. The authorities highlighted that the reduction in capital spending is temporary and in response to their ongoing efforts to identify priorities. In addition, they expect to rely more on Public Private Partnership (PPP) in the future to fund infrastructure investment. They will continue their efforts to strengthen tax revenues, particularly as they seek WTO accession. They are carefully reviewing the potential impact of a zero-VAT rate on some food items and noted that this option may be easier to administer than conditional cash transfer programs, which have been difficult to manage in the past.

**20. The authorities agreed with staff's proposed fiscal rule targets.** They welcomed staff's proposed calibration of the fiscal rule, which they plan to include in the draft fiscal responsibility legislation. The bill is expected to be sent to Parliament in late May.

**21. The authorities welcomed staff's recommendation on the savings fund.** They also highlighted other efforts in improving preparedness and risk reduction, including seeking a contingent credit line from the IDB for US$100 million; their membership with CCRIF; planned investments in sea walls and in enhancing coastal protection; and updating the building code following a Caribbean-wide study on best-practices.

## B. Structural Policies

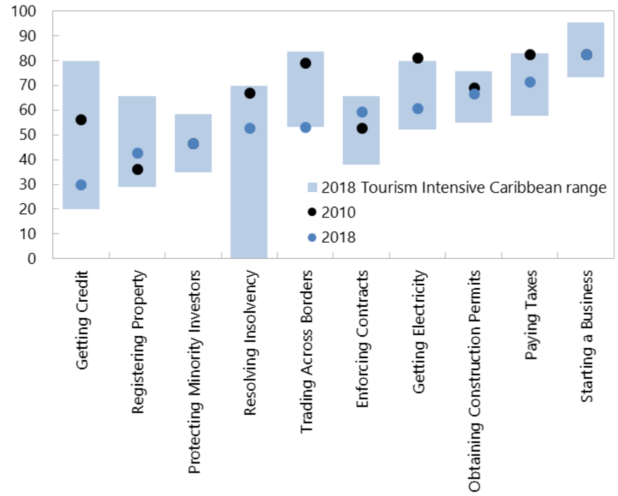
**22. Long-standing structural impediments continue to constrain private investment and growth.** The Bahamas continues to lag most Caribbean peers in terms of distance to the frontier in the World Bank's ease of doing business index (DBI),[15] particularly due to onerous administrative processes, high costs of trading across borders, lack of reliable and affordable electricity, and low access to credit. The strength of the currency in real effective terms and real wages growing faster

[14] The Ministry of Finance initiated in 2017 a revenue enhancement project to reduce tax leakages, and improve IT and data systems to strengthen compliance with VAT, customs, and other areas. The project included also training to enhance tax administration capabilities.

[15] While there is uncertainty around point estimates when using the DBI for comparison with peers, the distance to frontier measures, relative to best practice, show a deterioration for The Bahamas since 2010.

than productivity have further eroded cost competitiveness (Figures 6 and 7). Moreover, skill gaps stop many young graduates from entering or remaining in the labor market, which together with increasing labor costs and the narrow economic structure have kept unemployment levels high.

**The Bahamas Doing Business Indicators**
(Distance to Frontier, from 0 to 100, where 0: lowest and 100: best)




Source: The World Bank.

**23. Decisive structural reforms are needed to unlock growth, particularly as a gradual liberalization of the economy advances.** The authorities announced a partial relaxation of exchange controls, effective since last February, to ease the administrative burden on private sector transactions, particularly for small and medium-size enterprises; the Parliament passed the Commercial Enterprise Act, which facilitates the issuance of work permits to foreign workers of enterprises facing a shortage of domestic skilled workers; and the authorities have committed to seek WTO accession by end-2019. Staff stressed that these efforts should be complemented with bold action to put the public debt-to-GDP ratio on a downward trajectory and to alleviate structural impediments to reap the full benefits from greater integration with the global economy. A more competitive economy would also facilitate a further strengthening of foreign reserve buffers. Staff emphasized the following priorities:

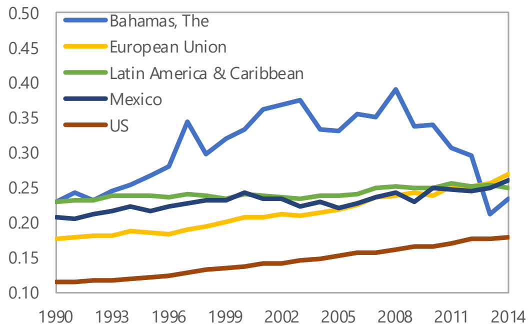
- *Advancing energy sector reforms should improve the reliability of the electricity grid and reduce costs.* These reforms should aim at i) upgrading infrastructure in electricity generation, transmission, and distribution; ii) improving energy efficiency among users; and iii) exploiting the potential for cleaner energy sources, including wind and solar power.[16] Increasing private sector participation in the electricity sector, with adequate regulatory oversight; moving forward with the issuance of the rate-reduction bond;[17] and continue improving governance at the state-owned electricity company are necessary steps to advance energy sector reforms. Unifying the planning and implementation of energy policy in one institution would facilitate interagency coordination.
- *Streamlining administrative processes to improve the ease of doing business.* Modernizing government registration/filing processes and establishing intra agency information exchange systems will improve efficiency and are necessary to establish a "one-stop shop" for businesses; *Streamlining the review and approval processes at The Bahamas Investment Authority; and rationalizing regulatory requirements for starting a business. Ongoing efforts to improve*

[16] Using a Vector Error Correction Model staff estimated that a 1 percent improvement in energy efficiency—defined as energy consumption per unit of carbon emission—could increase real GDP per capita by 0.17 percentage point within 2 to 5 years. These effects are comparable to those found for OECD and other Caribbean countries.

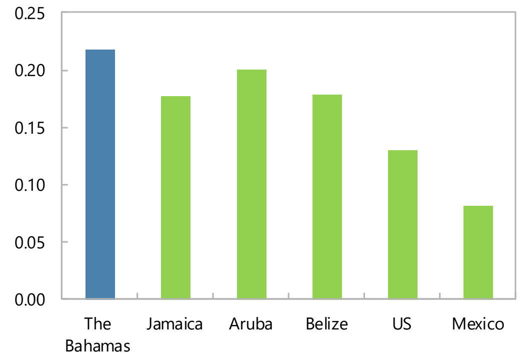
[17] The Electricity Rate Reduction Bond Act of 2015 stipulates the issuance of rate reduction bonds (RRB) by the state-owned electricity company, backed with revenues from an electricity price surcharge. The proceeds, estimated at US$650 million, would be used to refinance the company's legacy debts and fund new investment.

*governance and stepping up efforts to fight crime should further enhance the business environment.*[18]

**Energy efficiency** 1/
(GDP per unit of energy)




**Residential electricity rates** 2/
(US cents per kWh)




Sources: World Bank, US Energy Information Administration (EIA), Mexico's Federal Electricity Commission (CFE), countries' electricity companies, and IMF staff calculations.
1/ Energy efficiency is the ratio between real GDP (in US dollars, adjusted for purchasing power parity) and total energy consumption (mega joules, MJ).
2/ Average rates reported by EIA, CFE, and countries' electricity companies in 2017.

- *Expanding vocational and apprenticeship programs to help reduce skills mismatches and youth unemployment.* Staff recommended moving forward with the implementation of the National Apprenticeship Program (NAP),[19] to increase the skill set of the young and reduce youth unemployment. More broadly, improving the quality of education should boost human capital and support long-term employment. Finally, improving and disseminating online skills databases and job placement services should help facilitate the matching process between employers and job seekers.

- *Steadfast implementation of the credit bureau to improve access to credit in the medium term.* Staff commended the authorities for tabling legislation to create the country's first credit bureau, in line with past Fund advice. Parliament passed the bill in early 2018. Staff recommended the authorities to move swiftly with the implementation of the credit bureau as it will take time to populate its database.

### *Authorities' Views*

**24. The authorities agreed with the recommended priorities as they are in line with the National Development Plan.**

- On the energy front, they noted that they have appointed a new board and management at the state-owned Bahamas Power and Light (BPL). In addition, a tender has been held to sign an

[18] Research featured in IMF (2017), "*Unleashing Growth and Strengthening Resilience in the Caribbean*," estimates that a 10 percent reduction in crime rates could yield an 8-percent increase in company's sales for tourism-dependent economies.

[19] The NAP is a program funded and designed by the Inter-American Development Bank (IADB). The NAP is designed to target young workers with a one-year on-the-job and off-the-job training in three identified key areas: internet technology, marine, and medical services. Empirical evidence shows that vocational programs can improve wages and increase retention (Acemoglu and Piscke, 1998); and they can increase employment among the young (Hanushek and others, 2017). See Selected Issues Paper for an analysis of labor markets.

agreement with a private entity to build a new power plant with capacity to generate 80 MW. Finally, BPL is planning on issuing the rate reduction bond in early 2019 to refinance its legacy debt and fund additional infrastructure.

- On enhancing the business environment, the cabinet is currently reviewing specific recommendations issued by the Ease of Doing Business Committee, appointed last summer, some of which have already been implemented. They also noted that the anticorruption reform package will strengthen governance and the rule of law, and stressed their commitment to fight crime.
- On strategies to reduce youth unemployment, the National Training Agency has put in place a pre-apprenticeship program to train young people. In addition, the Department of Labor has revamped the online skills and vacancies database, and has increased the outreach activities, including by conducting 4 successful job fairs since last summer, which attracted 4,000 participants, mostly unemployed young people, 900 of which were hired. The authorities are preparing draft amendments to update the National Apprenticeship Act, which is a necessary step to implement the National Apprenticeship Program. The Ministry of Education was cognizant of skill gaps among the young and noted that they are emphasizing vocational training within the high-school curriculum and plan also to increase teacher training to improve the quality of teaching.
- On the credit bureau, the bill is expected to be signed into law soon and the central bank is now requesting updated proposals from potential operators. The authorities expect to grant a license to the chosen operator by end-2018.

## C. Monetary and Financial Sector Polices

**25. The monetary stance remains appropriate.** The Bahamian dollar is pegged to the U.S. dollar, helping preserve price stability. In addition, the country mantains a capital flow management (CFM) system that allows the central bank some room to control domestic liquidity, mainly through cash reserve requirements. Under the current environment of negative output and credit gaps, staff noted that the current accommodative monetary stance remains appropriate.

**26. Moving forward with the planned amendments to the central bank law would bring it closer to international best practices and strengthen the peg's credibility.** A steady increase in central bank lending to the government led to a breach of statutory limits in early 2017. The external sovereign bond placement from last year helped to reduce the central bank's exposure to the government to levels below the statutory limits. Staff welcomed this reduction and recommended moving forward with the planned amendments to the central bank law, as recommended in the Fund's technical assistance. These amendments include provisions to improve central bank governance; clarify its objectives; and tighten limits to central bank lending to the government.

**27. A more proactive approach to accelerate the resolution of NPLs should support the economic recovery.** The central bank's intensified monitoring of NPLs is welcome as it will encourage a faster resolution of these loans, particularly as economic conditions improve. Developing real estate price indices would further facilitate the determination of fair value and the resolution of NPLs. The Bank of The Bahamas has strengthened its capital position, but it still requires a sustainable business model, free from political interference, to keep fiscal contingent liabilities contained.

**28. Strong compliance with AML/CFT and tax transparency standards should help mitigate the withdrawal of CBR and safeguard the integrity of the financial sector.** The authorities are taking steps to strengthen their AML/CFT framework for domestic and offshore institutions. They have amended legislation to subject general insurance companies to some of the AML/CFT requirements, and have created a separate Analytics Unit at the central bank to perform risk-focused assessments, request annual reporting, and support more targeted examinations. Staff noted that it is critical to work closely with the CFATF and the FATF to promptly address the strategic deficiencies in the AML/CFT regime identified in the 2017 Mutual Evaluation Report (MER). The authorities have also committed to implement the OECD's international standards on tax transparency for the automatic exchange of financial account information. The authorities have also committed to implement the Base Erosion and Profit Shifting (BEPS) minimum standards to tackle BEPS.[20]

**29. Staff welcomed progress in implementing FSAP recommendations (Box 2, Annex VI).** The Central Bank of The Bahamas (CBOB) has continued strengthening its regulatory and supervisory framework and making progress in implementing the Basel II and III frameworks. CBOB's stress tests continue to show resilience of the banking system to large shocks.

### Box 3. Financial Sector Regulation and Supervision: Update

- **Risk-based supervisory framework**. The CBOB has continued to improve its risk-based supervisory framework. CBOB introduced the concept of "evergreening" to enhance the risk assessment process, intended to map the risk outlook of financial institutions and establish triggers for supervisory action.
- **Crisis management**. The CBOB has prepared draft amendments to various laws to align The Bahamas' framework with recommended international standards, which are pending to be sent to Parliament.
- **Banks' stress tests**. The most recent credit stress tests conducted by the CBOB continue to suggest that, even under the most severe scenario of a 200-percent increase in the level of nonperforming loans over a period of 3 years, the banking system's capital adequacy ratio would remain well above the 17 percent regulatory minimum requirement. Liquidity stress tests show no material impact on banks' balance sheets because of the continued excess liquidity in the banking system.
- **Basel II/III**. The CBOB has completed implementation of Basel II and the capital component of Basel III. Commercial banks are subject to Basel III capital reporting since 2013. CBOB is now focused on completing the remaining elements of Basel III, the countercyclical capital buffer, and liquidity coverage ratios. CBOB is also simplifying its Basel II (Minimum Disclosure requirements) and Basel III regulatory framework, consistent with the proportionality principle set out by the Basel Committee.
- **Insurance sector risk-based capital regime.** The Insurance Commission (IC) has strengthened onsite inspections and introduced a risk-based capital regime for long-term insurance companies. The IC plans to conduct a 3-year pilot program to also include general insurance companies in their risk-based capital regime.

[20] In December, The Bahamas signed the OECD's Multilateral Convention on mutual administrative assistance in tax matters (MAC), and the Multilateral Competent Authority Agreement (MCAA). BEPS refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations. On March 13, The Bahamas was added to the European Union list of non-cooperative jurisdictions for tax purposes.

***Authorities' Views***

**30. The authorities agreed that the monetary stance remains appropriate and with the need to move forward with modernizing the central bank law.** The central bank agreed that there was no need to modify cash reserve requirements at this juncture. Moreover, the central bank plans to further reduce its exposure to the government in the near term by selling government advances to commercial banks, which will help mop up some of the excess liquidity in the system. The draft amendments to the central bank law are ready and the public consultation process is expected to begin in the coming weeks.

**31. The authorities are confident that their increased monitoring of NPLs will lead to a faster resolution of these loans.** The central bank has mandated banks to report on a quarterly basis the status of the top 20 NPLs. The authorities expect that this approach will encourage banks to resolve NPLs faster, with visible results expected by end-2018. Reforms to the property tax system, and automation of transfer taxes, offer opportunities to develop property value databases. They noted that the Bank of The Bahamas now has a sound balance sheet, which should improve its institutional brand and future prospects.

**32. Addressing deficiencies in the AML/CFT framework is a top priority for the authorities.** The authorities noted that, in addition to creating a new AML/CFT Analytics Unit, they have increased outreach and capacity building activities; they are preparing guidance notes on "Financial Crimes Risk Management" and "Proliferation and Proliferation Financing"; and an AML penalties framework and related guidelines. They expect that all domestic banks will reduce to zero the level of unverified and active accounts by end-March. In coordination with other financial sector regulators, the central bank plans to issue an annual report on AML/CFT risks.

**33. The authorities reiterated their commitment to tackle BEPS.** The authorities noted that legislation is currently being drafted to give effect to the implementation of the BEPS minimum standards and to address gaps in their current regulatory regime identified by the EU Code of Conduct Group (COCG). The authorities expect to table this legislation in Parliament by end-April 2018, which includes provisions to mandate financial reporting to large multinational corporations operating in The Bahamas.

## D. Data

**34. The authorities should step up efforts to improve the quality and ensure a timely dissemination of statistics.** Staff welcomed recent improvements to the national accounts statistics as well as the commitment to adopt the International Public Sector Accounting Standards (IPSAS) on an accrual basis by 2022. Efforts should also include moving forward with the production of quarterly GDP statistics; publishing and adhering to a data release calendar; improving labor market data, including by conducting unemployment surveys more frequently; and developing an estimate of the International Investment Position.

## STAFF APPRAISAL

**35. The Bahamian economy has turned the corner but significant challenges remain.** Near-term economic prospects are improving, with real GDP growth projected to reach 2½ percent in 2018, on the back of the phased opening of Baha Mar, a stronger U.S. economy, and a pickup in FDI. However, significant structural impediments require bold policy action to unlock medium-term growth. Public debt ratios have declined on the back of a sizable upward revision to nominal GDP, but fiscal deficits remain above debt-stabilizing levels. External reserve buffers have improved; however, the external position is weaker than the level suggested by fundamentals and desirable policy settings.

**36. Fiscal consolidation, with a focus on reducing current expenditure, is critical to maintain market confidence and reverse the upward trend in the public debt-to-GDP ratio**. The FY2018 target is within reach. However, measures still need to be identified to bring the deficit down to desirable levels while avoiding an undue compression of capital spending. The authorities should focus on i) trimming the wage bill; ii) turning SOE's self-sufficient; and iii) reforming the unsustainable civil servants' pension system. Addressing also imbalances at the National Insurance Board (NIB) should reduce fiscal contingent liabilities. The Bank of The Bahamas has strengthened its capital position, but it still requires a sustainable business model, free from political interference, to keep fiscal contingent liabilities contained.

**37. Increased reliance on preparedness and risk reduction policies, including by setting up a natural disasters savings fund, should enhance fiscal and economic resilience.** The Bahamas should create a savings fund with a target size between 2–4 percent of GDP, by setting aside ½ percentage point of GDP annually during non-disaster years. In addition, insuring public assets and encouraging the broader use of private insurance, including through financial literacy training and targeted subsidies, would reduce fiscal contingent liabilities. Investing in resilient infrastructure and maintaining up-to-date building codes, land use, and zoning guidelines are also critical elements of an adequate disaster risk management strategy.

**38. The planned fiscal responsibility legislation is welcome.** The framework should include a permanent ceiling of 1 percent of GDP on the fiscal deficit and a cap on the growth rate of current expenditure equal to the estimated long-run growth of nominal GDP. To allow space for automatic stabilizers to operate, annual budgets should target a deficit of ½ percent of GDP. Strong adherence to these targets over the medium term would keep debt on a firmly downward trajectory and would allow accumulating savings into a natural disasters fund. Completing ongoing reforms to the public financial management system is critical for the effectiveness of a medium-term fiscal framework.

**39. The authorities should continue strengthening fiscal revenues** with the intention to make the tax system more progressive; protect infrastructure and social spending; and offset a reduction in import duties under an eventual WTO accession. Introducing a zero-rate VAT for some items should be avoided as there can be better-targeted tools to assisst low-income households.

**40. Lifting growth in the medium term requires resolute implementation of structural reforms.** Priorities include advancing energy sector reforms to improve the reliability of the electricity grid and reduce costs; streamlining administrative processes to improve the ease of doing business; expanding vocational and apprenticeship programs to help reduce skills mismatches and youth unemployment; and steadfast implementation of the credit bureau to improve access to credit.

**41. Moving forward with the planned amendments to the central bank law would bring it closer to international best practices and would strengthen the peg's credibility.** The reduction in central bank lending to the government is welcome. The planned amendments, which include provisions to improve central bank governance; clarify its objectives; and tighten limits to central bank lending to the government, should lead to a more robust legislation.

**42. Strong compliance with AML/CFT and tax transparency standards should help mitigate the withdrawal of CBR and safeguard the integrity of the financial sector.** Steps to strengthen the AML/CFT framework and to comply with tax transparency standards, including by committing to implement the OECD's international standards on tax transparency, are welcome. It is critical to work closely with the CFATF and the FATF to swiftly address the strategic deficiencies in the AML/CFT regime identified in the 2017 Mutual Evaluation Report (MER).

**43. It is proposed that the next Article IV consultation take place on the standard 12-month cycle.**

# Proposed Decision

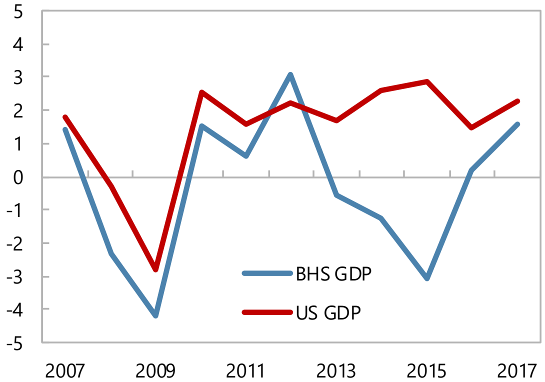
The Executive Board endorses the thrust of the staff appraisal in the report for the 2018 Article IV consultation with The Bahamas (SM/18/87, 04/20/18).

It is expected that the next Article IV consultation with The Bahamas will take place on the standard 12-month cycle.

## Figure 1. The Bahamas: Growth, Inflation, and Labor Markets

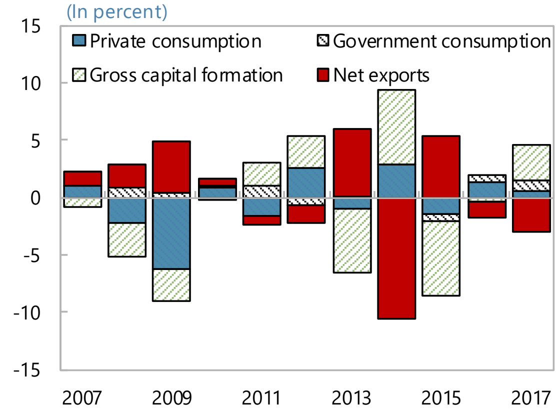
*Real GDP growth bounced back in 2016 and is estimated to have strengthened in 2017 …*

**Real GDP Growth**
(Percent)



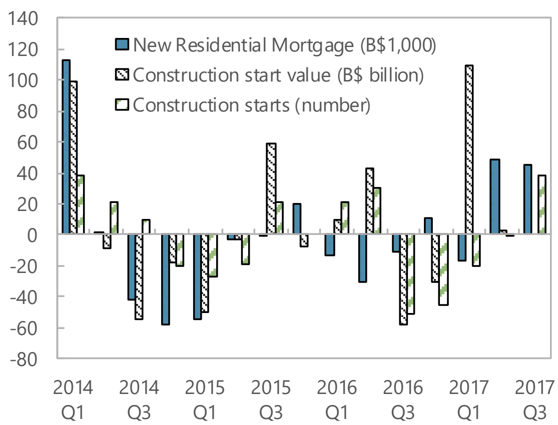

*…supported by increased investment….*

**Contributions to Real GDP Growth**
(In percent)



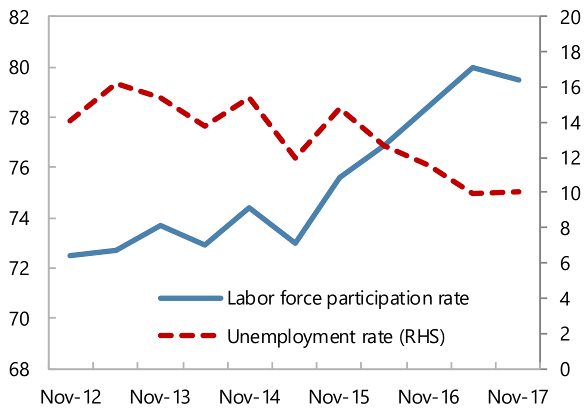

*…reflected in a pickup in construction activity.*

**Construction indicators**
(In percent, year-on-year growth rates)



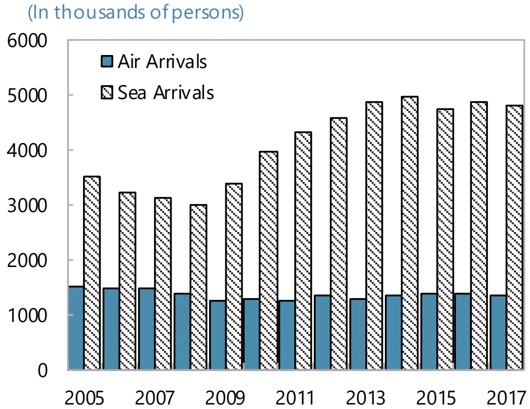

*The unemployment rate is falling, even with higher labor force participation.*

**Labor Force Participation and Unemployment Rate**
(In percent)



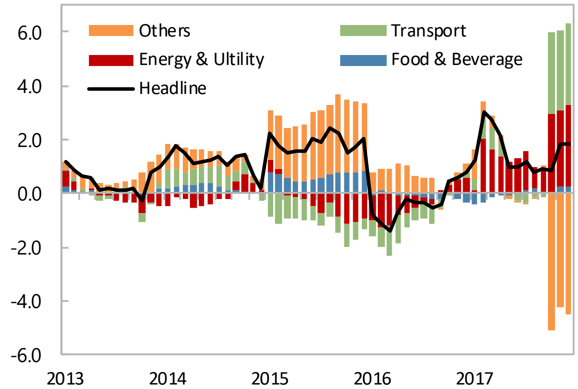

*However, tourism activity has remained flat following the passage of Hurricane Matthew in 2016.*

**Tourist Arrivals**
(In thousands of persons)




*Inflation remains low despite an uptick due to higher oil prices.*

**Inflation**
(In percent, year-on-year)

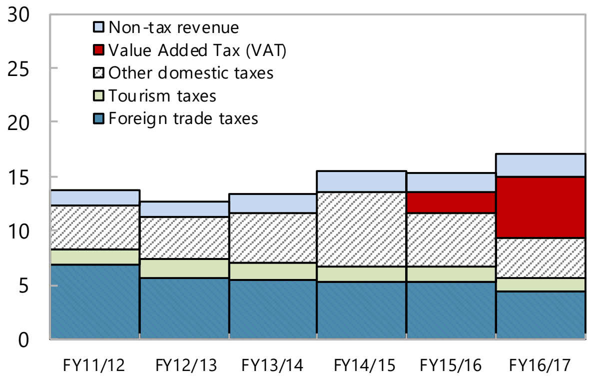



Sources: The Bahamian authorities, IMF World Economic Outlook, and IMF staff calculations.

## Figure 2. The Bahamas: Fiscal Developments 1/

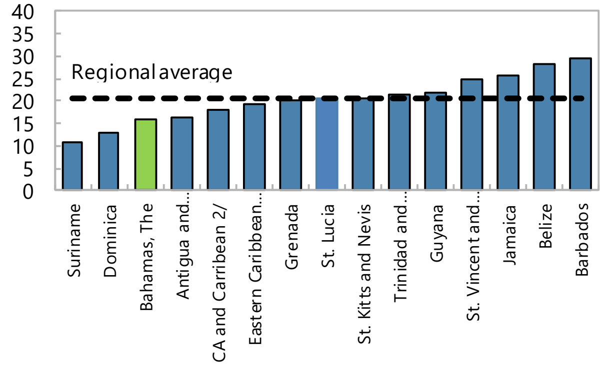
*The introduction of the VAT and revenue administration reforms boosted tax revenue...*

**Revenue**
(In percent of GDP)



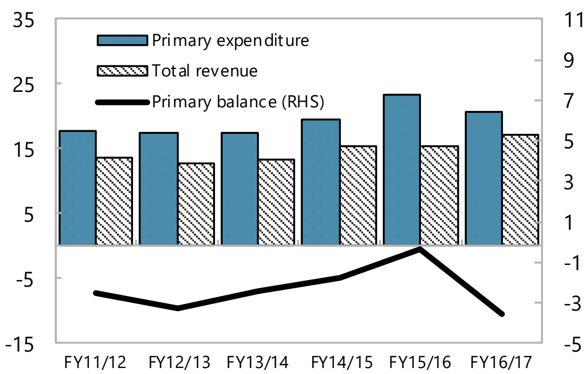

*...but it remains below the regional average.*

**Tax Revenues, 2017 (estimates)**
(In percent of GDP)



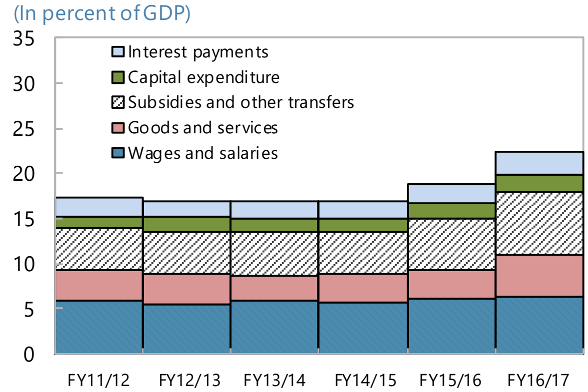

*Higher revenues helped to contain primary deficits*

**Contribution to the primary balance**
(In percent of GDP)



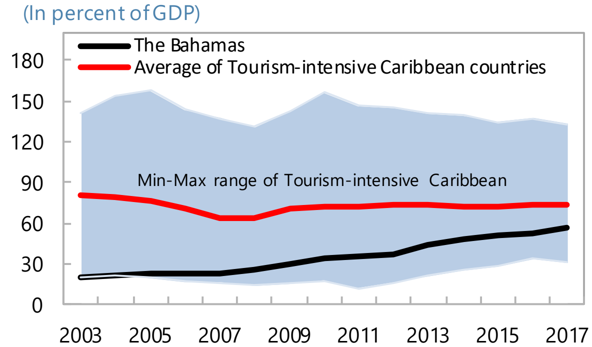

*...despite continued increases in spending.*

**Expenditure**
(In percent of GDP)



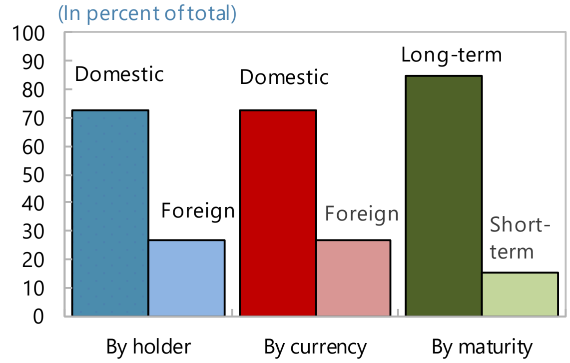

*Central government debt rose faster than peers' debt...*

**Public Debt in Tourism-Intensive Caribbean Economies**
(In percent of GDP)




*... but the debt profile remains skewed towards domestic holders and currency, and long term.*

**Debt profiles, 2017**
(In percent of total)

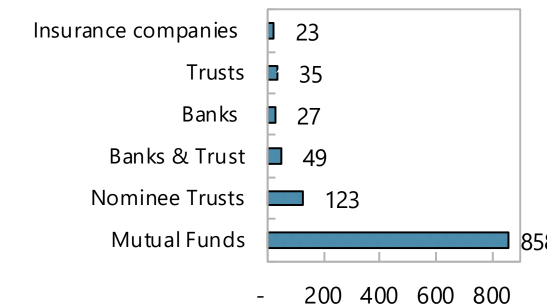



Sources: The Bahamian authorities; and IMF staff calculations.
1/ Central government fiscal year ending June 30.

## Figure 3. The Bahamas: Financial System Structure

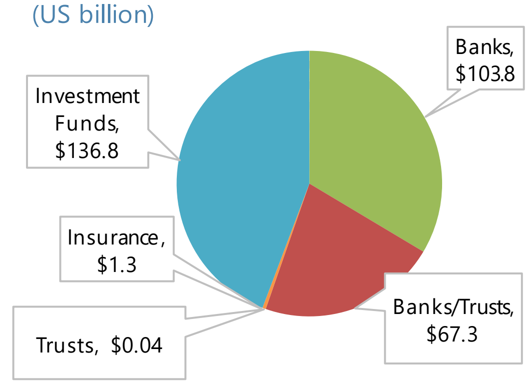
*The offshore sector comprises a diverse and large number of players…*

**Offshore financial system**
(number)



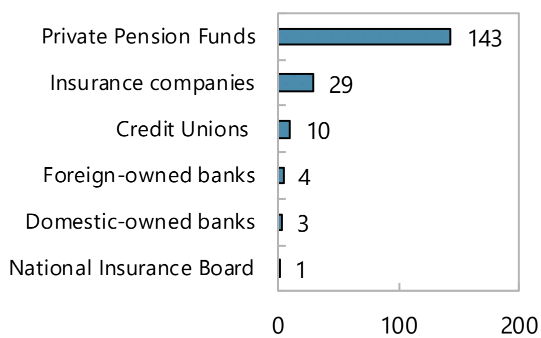

*… with assets estimated at US$309 billion in 2017.*

**Offshore sector's assets 1/**
(US billion)



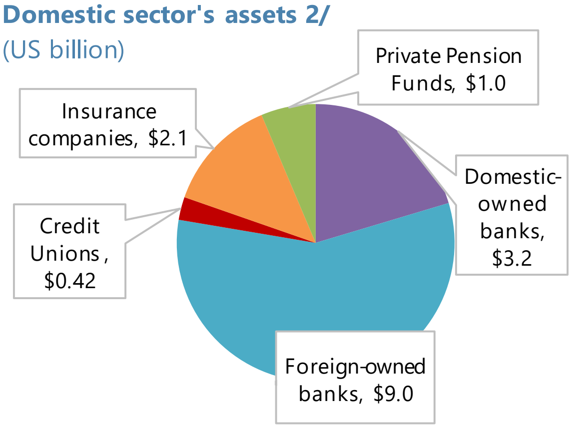

*The domestic financial sector has a smaller number of players…*

**Domestic financial system 2/**
(number)



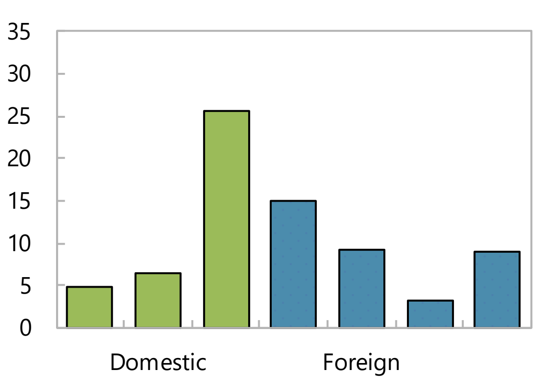

*…with assets estimated at US$18 billion in 2017.*

**Domestic sector's assets 2/**
(US billion)



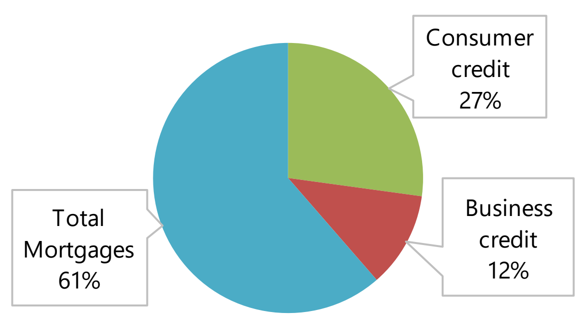

*Two domestic banks out of the 7 have NPLs above 10 percent.*

**NPL ratios by bank, end-2017**




*NPLs are concentrated in mortgages.*

**NPLs composition, end-2017**



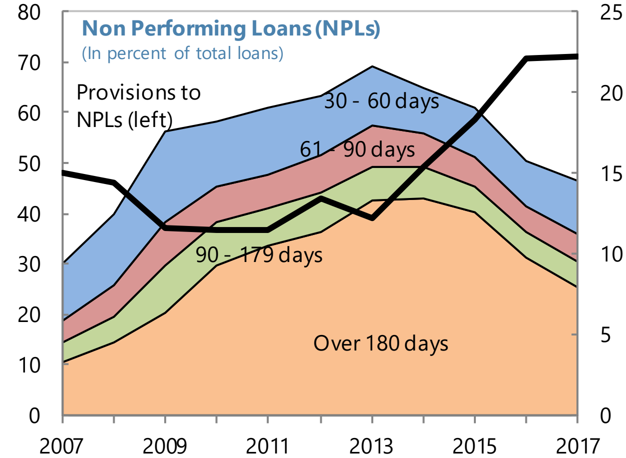

Sources: Central Bank of The Bahamas; Insurance Commission of The Bahamas; and Fund staff calculations.

1/ Investment Funds' data refers to 2016.

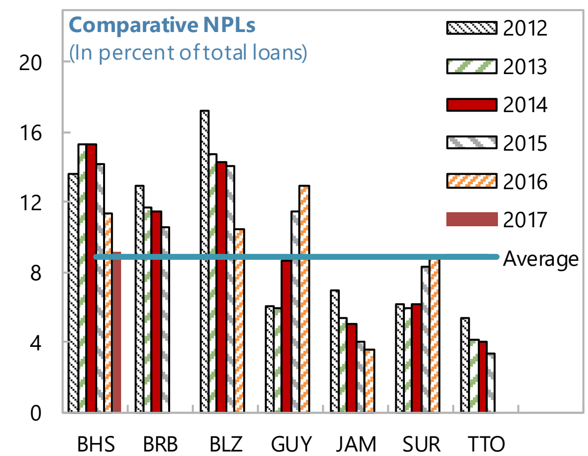
2/ Includes only domestic banks and subsidiaries of foreign banks.

## Figure 4. The Bahamas: Monetary and Financial Developments

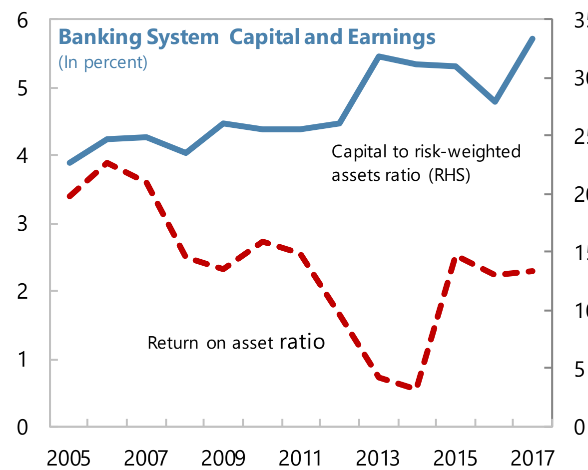
*NPLs have declined as a result of bulk NPL disposals…*



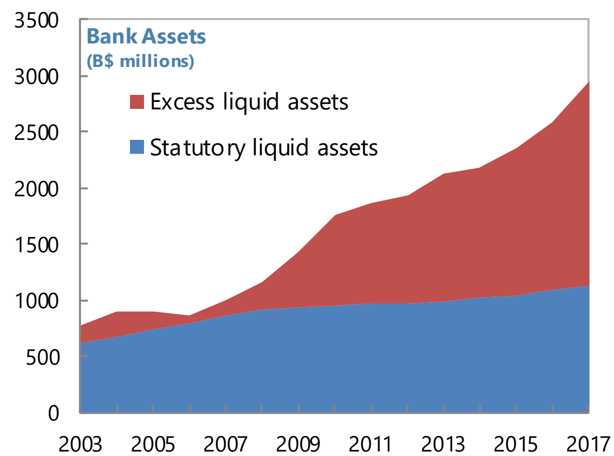

*… bringing NPLs to the region average.*



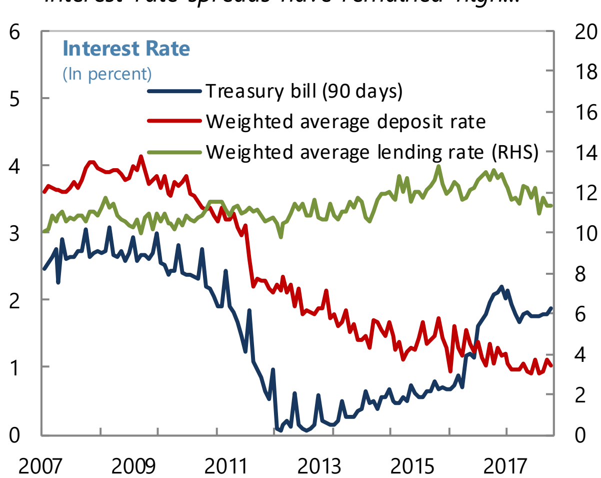

*Capital buffers remain high…*



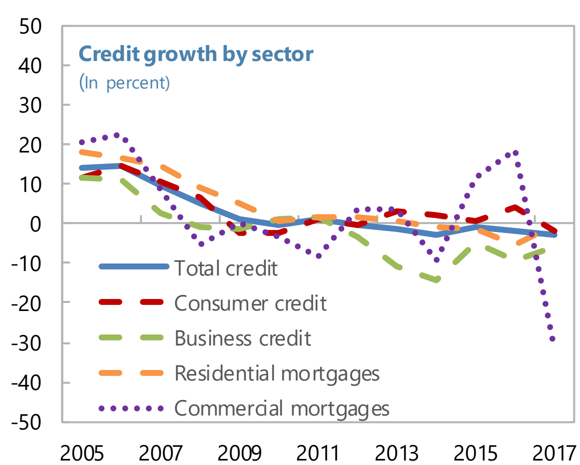

*…as well as liquidity…*




*Interest rate spreads have remained high…*




*… while credit growth remains weak.*

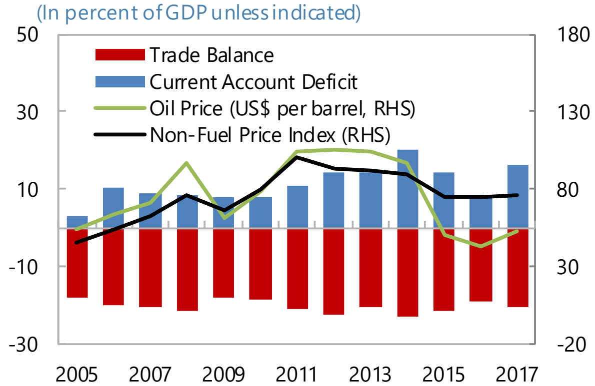



Sources: Central Bank of The Bahamas; Insurance Commission of The Bahamas; and IMF staff calculations.

## Figure 5. The Bahamas: External Sector Developments

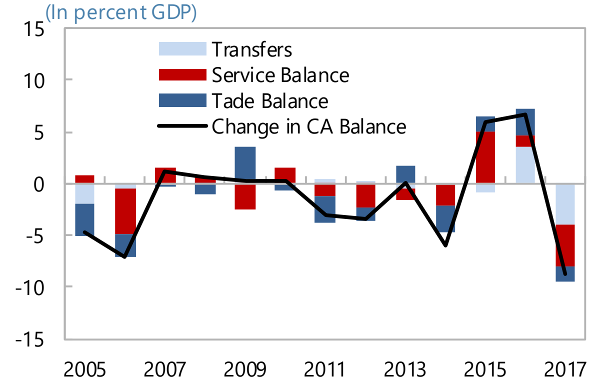
*Higher oil prices and a surge in imports related to Baha Mar…*

**External Sector Developments**
(In percent of GDP unless indicated)



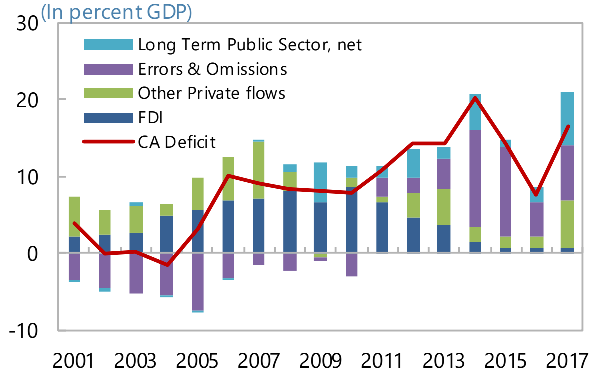

*…have increased the current account deficit…*

**Contribution to Change in Current Account**
(In percent GDP)



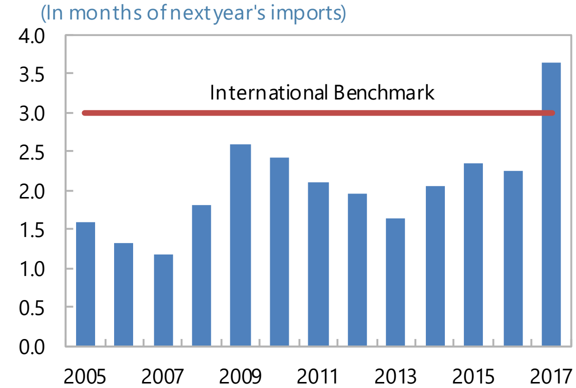

*…but increased private capital inflows and an external sovereign bond placement…*

**Current Account Balance and Capital Flows**
(In percent GDP)



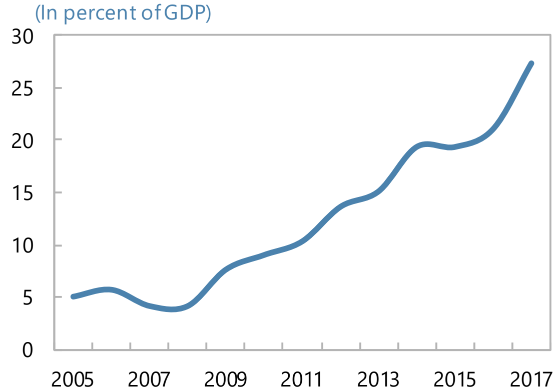

*…have strengthened foreign reserves to above standard adequacy metrics.*

**International Reserves**
(In months of next year's imports)



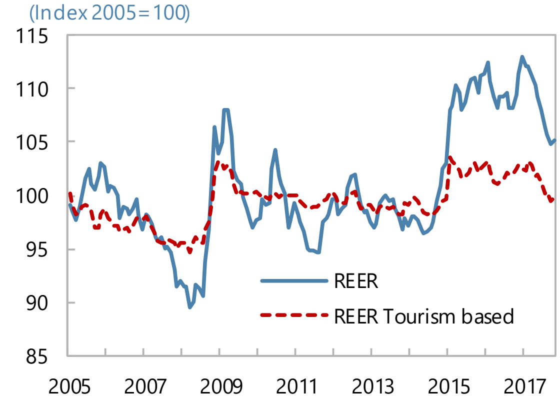

*The sovereign placement resulted in a sharp increase in external public debt.*

**External Public Debt**
(In percent of GDP)




*The currency has depreciated in real effective terms, but remains overvalued.*

**Real Effective Exchange Rate**
(Index 2005=100)

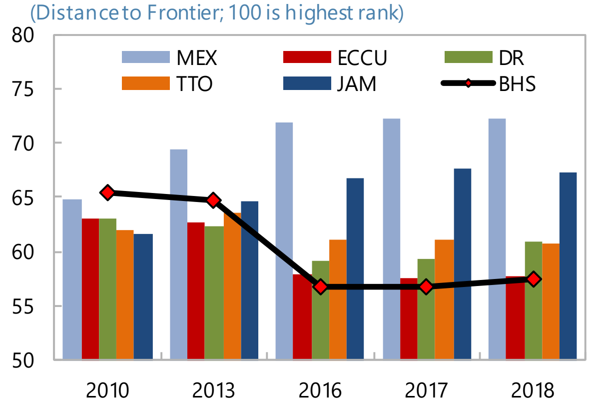



Sources: The Bahamian authorities, IMF International Financial Statistics, the World Bank's Doing Business Database, and IMF staff calculations.

## Figure 6. The Bahamas: Doing Business Indicators

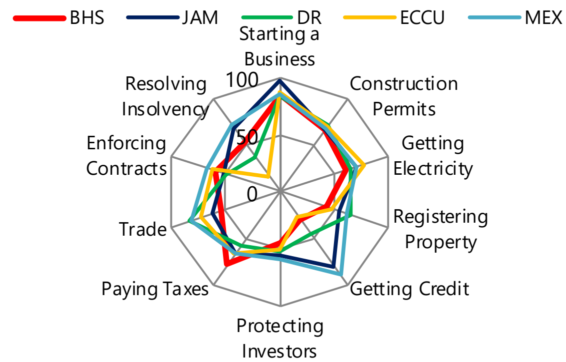
*The business environment has lost ground to competitors…*

**Ease of Doing Business Indicator**
(Distance to Frontier; 100 is highest rank)



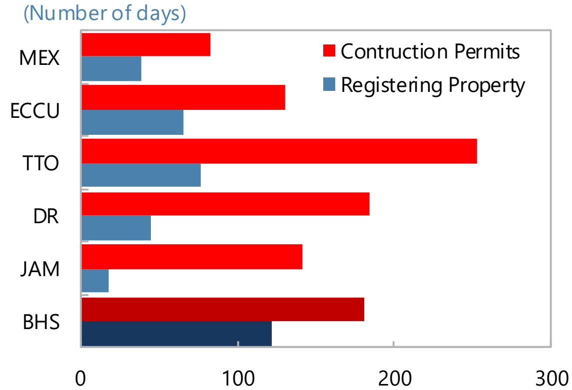

*…across a broad range of areas.*

**Business Environment Indicators, 2018**
(Distance to Frontier; 100 is highest)



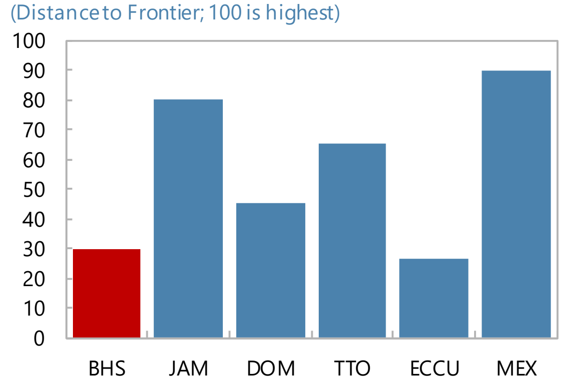

*The administrative process is long…*

**Administrative Process**
(Number of days)



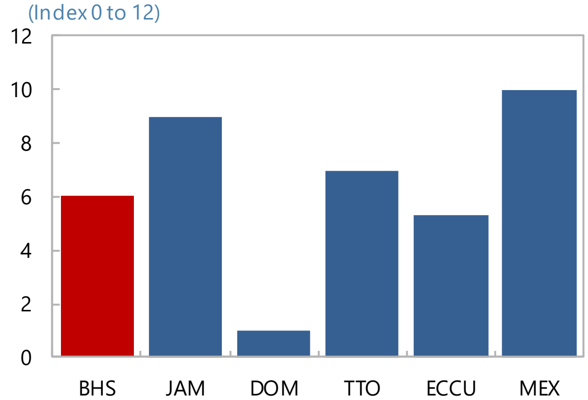

*… and accessing credit is difficult…*

**Accessing Credit Indicator**
(Distance to Frontier; 100 is highest)



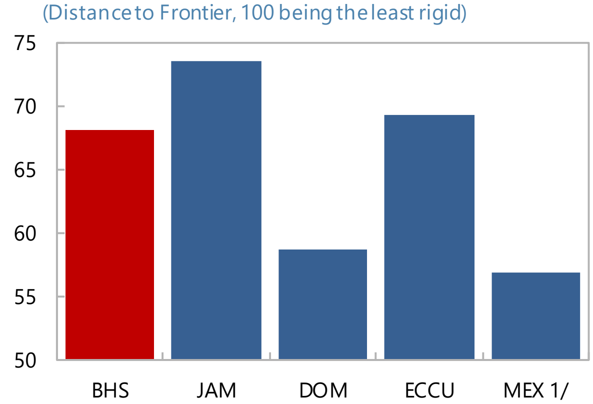

*… while there is scope to strengthen legal rights.*

**Strength of Legal Rights**
(Index 0 to 12)




*Although labor market flexibility can improve, skills gap appears to be a more important obstacle.*

**Labor Market Rigidity**
(Distance to Frontier, 100 being the least rigid)



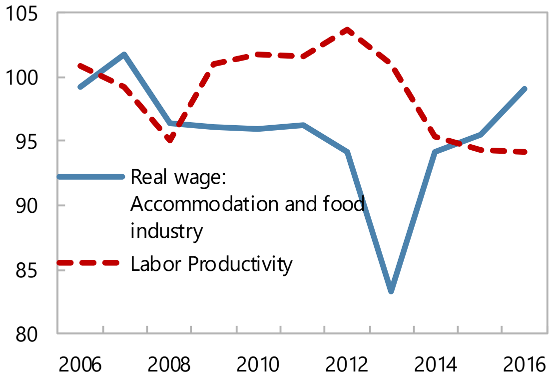

1/ Index for Mexico City.

Sources: The World Bank's Doing Business Database and IMF staff calculations.

## Figure 7. The Bahamas: Cost Competitiveness Indicators

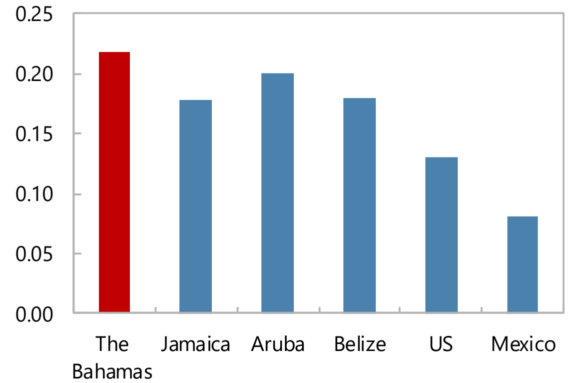
*Wages have outpaced labor productivity gains…*

**Cumulative Changes**
(Index 2004=100)



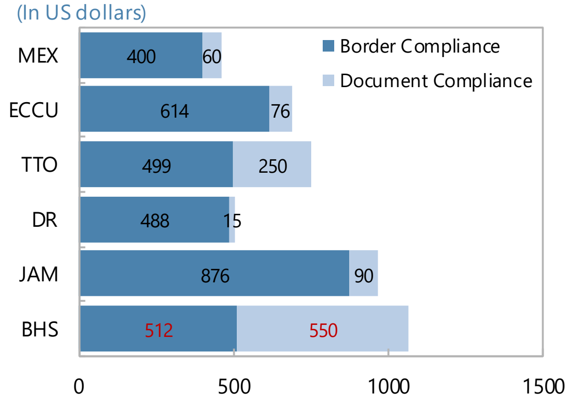

*…while electricity costs…*

**Residential rates 1/**
(US cents per kWh)



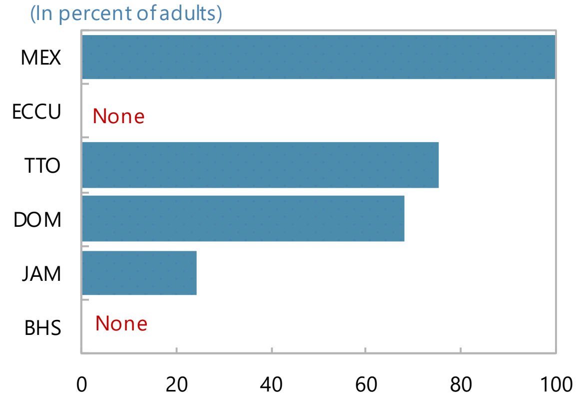

*… and costs of trade are relatively high…*

**Cost To Export**
(In US dollars)



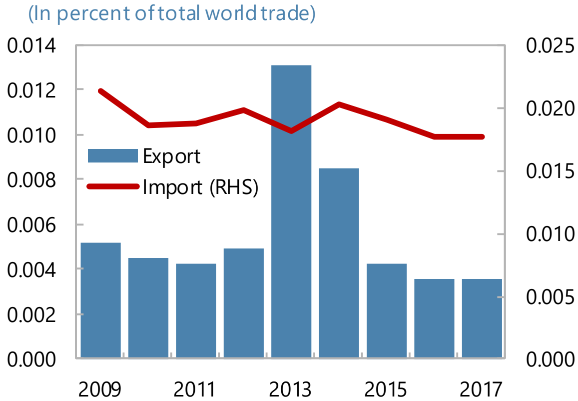

*… and credit information asymmetries increase risk premiums.*

**Credit Bureau Coverage**
(In percent of adults)



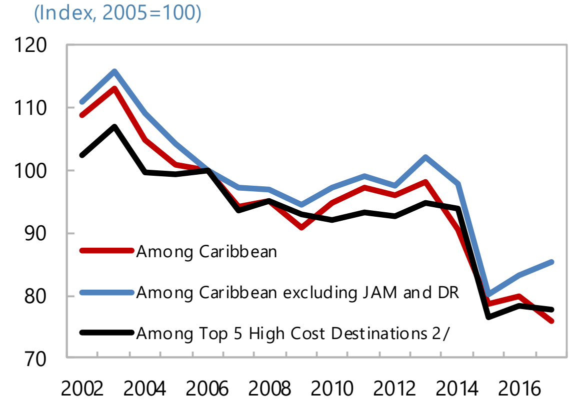

*These factors underlie decreasing shares of good…*

**The Bahamas: Importance in World Trade**
(In percent of total world trade)




*… and tourism exports in World markets.*

**The Bahamas; Share of Tourism Receipts**
(Index, 2005=100)




Sources: The Bahamian authorities, Caribbean Tourism Organization, Doing Business database (World Bank), Direction of Trade database (IMF), US Energy Information Administration (EIA), Mexico's Federal Electricity Commission (CFE), and IMF staff calculations.

1/ Average rates reported by EIA, CFE, and countries' electricity companies in 2017.
2/ Includes Grenada, Jamaica, St. Kitts and Nevis, St. Lucia, and The Bahamas.

## Table 1. The Bahamas: Selected Social and Economic Indicators

**I. Social Indicators**

| | | | |
|---|---|---|---|
| GDP (US$ millions), 2016 | 11,262 | Poverty rate (percent), 2013 | 12.8 |
| GDP per capita (US$), 2016 | 30,581 | Unemployment rate (percent), November 2017 | 10.1 |
| Population (thousands), 2016 | 368 | Infant mortality rate (per 1,000 live births), 2015 | 9.9 |
| Life expectancy at birth (years), 2015 | 75 | Human development index (rank), 2016 | 58 |
| Adult literacy rate, 15 & up (percent), 2007 | 96 | | |

**II. Economic Indicators**

| | | | | Est. | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
| (Annual percentage changes, unless otherwise indicated) | | | | | | | | | | |
| **Real sector** | | | | | | | | | | |
| Real GDP | -1.2 | -3.1 | 0.2 | 1.3 | 2.5 | 2.2 | 1.6 | 1.5 | 1.5 | 1.5 |
| Nominal GDP | 1.6 | 3.7 | 0.2 | 3.4 | 5.8 | 4.7 | 4.4 | 3.9 | 3.3 | 3.1 |
| GDP deflator | 2.8 | 6.9 | 0.0 | 2.1 | 3.2 | 2.5 | 2.7 | 2.4 | 1.8 | 1.6 |
| Consumer price index (annual average) | 1.2 | 1.9 | -0.3 | 1.5 | 2.2 | 2.5 | 2.4 | 2.3 | 2.2 | 2.1 |
| Consumer price index (end of period) | 0.2 | 2.0 | 0.8 | 1.8 | 2.4 | 2.6 | 2.3 | 2.2 | 2.2 | 2.0 |
| Unemployment rate (in percent) | 14.6 | 13.4 | 12.2 | 10.1 | 9.2 | 8.4 | 8.2 | 7.9 | 7.9 | 7.8 |
| Saving rate (percent of GDP) | 13.1 | 12.3 | 18.8 | 11.5 | 12.9 | 16.1 | 16.4 | 17.0 | 18.1 | 18.5 |
| Investment rate (percent of GDP) | 33.3 | 26.6 | 26.5 | 27.9 | 26.5 | 24.9 | 23.6 | 23.3 | 23.3 | 23.2 |
| **Financial sector** | | | | | | | | | | |
| Credit to the nonfinancial public sector | 4.0 | 7.7 | 12.3 | -3.6 | -3.7 | 6.8 | 5.5 | 4.9 | 4.4 | 4.2 |
| Credit to the private sector | -2.8 | -1.1 | -2.0 | -3.0 | 1.0 | 1.5 | 2.0 | 2.4 | 3.2 | 3.2 |
| Broad money | 1.2 | -0.3 | 8.7 | 1.5 | 5.8 | 4.7 | 4.4 | 3.9 | 3.3 | 3.1 |
| **External sector** | | | | | | | | | | |
| Exports of goods and services | -1.9 | -4.0 | -0.1 | -0.1 | 6.7 | 6.7 | 5.7 | 6.1 | 5.9 | 6.0 |
| *Of which:* Travel receipts (gross) | 1.3 | 9.5 | 2.1 | -0.5 | 6.3 | 7.9 | 6.7 | 5.1 | 4.9 | 4.8 |
| Imports of goods and services | 8.8 | -15.1 | -9.1 | 15.9 | -3.5 | -4.1 | 1.7 | 3.9 | 3.2 | 5.7 |
| (In percent of GDP, unless otherwise indicated) | | | | | | | | | | |
| **Central government** 1/ | | | | | | | | | | |
| Revenue and grants | 13.5 | 15.4 | 17.2 | 18.0 | 17.6 | 17.7 | 17.7 | 17.7 | 17.8 | 17.7 |
| Expense | 15.6 | 16.8 | 18.3 | 20.4 | 18.8 | 17.9 | 17.6 | 17.4 | 17.3 | 17.2 |
| Net acquisition of nonfinancial assets | 2.3 | 2.5 | 1.6 | 3.4 | 1.3 | 2.1 | 2.1 | 2.1 | 2.1 | 2.1 |
| Expenditure | 17.9 | 19.3 | 19.9 | 23.8 | 20.4 | 20.0 | 19.7 | 19.4 | 19.4 | 19.3 |
| Overall balance | -4.4 | -3.9 | -2.8 | -5.8 | -2.7 | -2.3 | -2.0 | -1.7 | -1.6 | -1.6 |
| Primary balance | -2.5 | -1.8 | -0.3 | -3.5 | -0.3 | 0.2 | 0.4 | 0.6 | 0.6 | 0.6 |
| Central government debt | 48.0 | 51.1 | 53.0 | 57.2 | 57.4 | 56.8 | 56.3 | 55.8 | 55.5 | 55.4 |
| **External sector** | | | | | | | | | | |
| Current account balance | -20.2 | -14.3 | -7.7 | -16.4 | -13.6 | -8.8 | -7.2 | -6.3 | -5.2 | -4.7 |
| Change in net international reserves (increase -) | -0.4 | -0.2 | -0.8 | -4.4 | 1.5 | -0.4 | -0.4 | -0.2 | -1.4 | 0.3 |
| Central government external debt | 14.5 | 14.6 | 15.5 | 22.5 | 20.6 | 20.1 | 19.7 | 19.3 | 19.0 | 18.6 |
| **Memorandum items** | | | | | | | | | | |
| Gross international reserves | | | | | | | | | | |
| (End of period; millions of U.S. dollars) | 788 | 812 | 904 | 1,414 | 1,225 | 1,273 | 1,333 | 1,358 | 1,558 | 1,512 |
| (In months of next year's G&S imports) | 2.1 | 2.3 | 2.3 | 3.6 | 3.3 | 3.4 | 3.4 | 3.4 | 3.5 | 3.4 |
| (In months of next year's non-FDI related G&S imports) | 2.3 | 2.7 | 2.6 | 4.0 | 3.6 | 3.6 | 3.6 | 3.5 | 3.8 | 8.0 |
| (In percent of reserve money) | 80 | 83 | 70 | 98 | 80 | 79 | 80 | 78 | 87 | 82 |
| External debt-service ratio (in percent of exports of G&S) | 16.0 | 5.4 | 9.7 | 20.5 | 9.7 | 11.3 | 9.1 | 6.7 | 9.6 | 4.1 |
| GDP (in millions of Bahamian dollars) | 10,844 | 11,240 | 11,262 | 11,642 | 12,319 | 12,900 | 13,461 | 13,988 | 14,446 | 14,896 |
| Output gap (percent) | 0.0 | -3.2 | -3.5 | -2.8 | -1.1 | -0.6 | -0.3 | -0.2 | 0.1 | 0.1 |

Sources: Central Bank of The Bahamas; Department of Statistics; Ministry of Finance; UNDP Human Development Report; and Fund staff projections.

1/ The data refer to fiscal years ending on June 30.

## Table 2. The Bahamas: Operations of the Central Government 1/

| | | | | Est. | Staff Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | FY14 | FY15 | FY16 | FY17 | FY18 | FY19 | FY20 | FY21 | FY22 | FY23 |
| | (In millions of Bahamian dollars) | | | | | | | | | |
| **Revenue** | **1,451** | **1,702** | **1,930** | **2,061** | **2,112** | **2,233** | **2,337** | **2,430** | **2,525** | **2,603** |
| Tax revenue | 1,246 | 1,500 | 1,676 | 1,837 | 1,916 | 2,005 | 2,100 | 2,182 | 2,269 | 2,338 |
| Taxes on international trade | 595 | 578 | 506 | 583 | 593 | 586 | 608 | 625 | 653 | 671 |
| Tourism taxes | 170 | 172 | 135 | 136 | 145 | 165 | 179 | 186 | 193 | 199 |
| Other taxes | 489 | 532 | 407 | 480 | 508 | 549 | 575 | 603 | 627 | 647 |
| Value added tax (VAT) | | 219 | 628 | 638 | 671 | 706 | 738 | 769 | 796 | 822 |
| Other revenue | 205 | 201 | 253 | 224 | 196 | 227 | 238 | 247 | 256 | 264 |
| **Expenditure** | **1,927** | **2,130** | **2,240** | **2,730** | **2,440** | **2,521** | **2,595** | **2,668** | **2,755** | **2,832** |
| Expense | 1,678 | 1,853 | 2,055 | 2,340 | 2,279 | 2,256 | 2,318 | 2,380 | 2,456 | 2,524 |
| Wages and salaries | 624 | 640 | 665 | 705 | 760 | 781 | 806 | 832 | 860 | 889 |
| Goods and services | 308 | 330 | 341 | 538 | 430 | 420 | 430 | 440 | 453 | 467 |
| Interest payments | 212 | 233 | 275 | 267 | 293 | 310 | 315 | 313 | 317 | 316 |
| Subsidies and transfers 2/ | 533 | 650 | 774 | 829 | 796 | 746 | 767 | 794 | 825 | 852 |
| Capital expenditure | 250 | 277 | 185 | 390 | 162 | 265 | 277 | 288 | 299 | 308 |
| **Overall balance** | **-477** | **-428** | **-310** | **-669** | **-329** | **-288** | **-258** | **-238** | **-229** | **-229** |
| **Net incurrence of liabilities** | **477** | **428** | **310** | **669** | **329** | **288** | **258** | **238** | **229** | **229** |
| Domestic | 50 | 296 | 124 | 664 | -421 | 231 | 206 | 186 | 178 | 177 |
| Foreign | 426 | 133 | 186 | 5 | 750 | 58 | 52 | 52 | 52 | 52 |
| | (In percent of GDP) | | | | | | | | | |
| **Revenue** | **13.5** | **15.4** | **17.2** | **18.0** | **17.6** | **17.7** | **17.7** | **17.7** | **17.8** | **17.7** |
| Tax revenue | 11.6 | 13.6 | 14.9 | 16.0 | 16.0 | 15.9 | 15.9 | 15.9 | 16.0 | 15.9 |
| Taxes on international trade | 5.5 | 5.2 | 4.5 | 5.1 | 4.9 | 4.6 | 4.6 | 4.6 | 4.6 | 4.6 |
| Tourism taxes | 1.6 | 1.6 | 1.2 | 1.2 | 1.2 | 1.3 | 1.4 | 1.4 | 1.4 | 1.4 |
| Other taxes | 4.5 | 4.8 | 3.6 | 4.2 | 4.2 | 4.4 | 4.4 | 4.4 | 4.4 | 4.4 |
| Value added tax (VAT) | | 2.0 | 5.6 | 5.6 | 5.6 | 5.6 | 5.6 | 5.6 | 5.6 | 5.6 |
| Other revenue | 1.9 | 1.8 | 2.3 | 2.0 | 1.6 | 1.8 | 1.8 | 1.8 | 1.8 | 1.8 |
| **Expenditure** | **17.9** | **19.3** | **19.9** | **23.8** | **20.4** | **20.0** | **19.7** | **19.4** | **19.4** | **19.3** |
| Expense | 15.6 | 16.8 | 18.3 | 20.4 | 19.0 | 17.9 | 17.6 | 17.3 | 17.3 | 17.2 |
| Current expenditure | 15.6 | 16.8 | 18.3 | 20.4 | 19.0 | 17.9 | 17.6 | 17.3 | 17.3 | 17.2 |
| Wages and salaries | 5.8 | 5.8 | 5.9 | 6.2 | 6.3 | 6.2 | 6.1 | 6.1 | 6.1 | 6.1 |
| Goods and services | 2.9 | 3.0 | 3.0 | 4.7 | 3.6 | 3.3 | 3.3 | 3.2 | 3.2 | 3.2 |
| Interest payments | 2.0 | 2.1 | 2.4 | 2.3 | 2.4 | 2.5 | 2.4 | 2.3 | 2.2 | 2.2 |
| Subsidies and transfers 2/ | 5.0 | 5.9 | 6.9 | 7.2 | 6.6 | 5.9 | 5.8 | 5.8 | 5.8 | 5.8 |
| Capital expenditure | 2.3 | 2.5 | 1.6 | 3.4 | 1.3 | 2.1 | 2.1 | 2.1 | 2.1 | 2.1 |
| **Overall balance** | -4.4 | -3.9 | -2.8 | -5.8 | -2.7 | -2.3 | -2.0 | -1.7 | -1.6 | -1.6 |
| **Net incurrence of liabilities** | **4.4** | **3.9** | **2.8** | **5.8** | **2.7** | **2.3** | **2.0** | **1.7** | **1.6** | **1.6** |
| Domestic | 0.5 | 2.7 | 1.1 | 5.8 | -3.5 | 1.8 | 1.6 | 1.4 | 1.2 | 1.2 |
| Foreign | 4.0 | 1.2 | 1.7 | 0.0 | 6.3 | 0.5 | 0.4 | 0.4 | 0.4 | 0.4 |
| **Memorandum items** | | | | | | | | | | |
| Primary balance (In millions of B$) | -265 | -195 | -35 | -403 | -36 | 21 | 57 | 76 | 88 | 87 |
| In percent of GDP | -2.5 | -1.8 | -0.3 | -3.5 | -0.3 | 0.2 | 0.4 | 0.6 | 0.6 | 0.6 |
| Central government debt (In millions of B$) | 5,160 | 5,637 | 5,965 | 6,550 | 6,879 | 7,167 | 7,425 | 7,663 | 7,892 | 8,121 |
| In percent of GDP | 48.0 | 51.1 | 53.0 | 57.2 | 57.4 | 56.8 | 56.3 | 55.8 | 55.5 | 55.4 |
| Nominal GDP (In millions of B$) | 10,760 | 11,042 | 11,251 | 11,452 | 11,980 | 12,609 | 13,180 | 13,724 | 14,217 | 14,671 |

Sources: Ministry of Finance; and Fund staff projections.

1/ Fiscal year ends June 30.

2/ Includes a reclassification of capital transfers to public entities for about 1 percent of GDP into current transfers.

**Table 3. The Bahamas: Outstanding Stock of Public Debt**
(In percent of GDP) 1/

| | 2010 | 2011 | 2012 | 2013 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|
| **Central government debt** | **36.9** | **37.8** | **41.0** | **46.7** | **46.7** | **51.5** | **52.5** | **56.1** | **61.7** |
| External | 7.2 | 7.9 | 9.7 | 11.1 | 11.1 | 14.5 | 14.6 | 15.5 | 22.5 |
| Domestic | 29.6 | 29.9 | 31.3 | 35.5 | 35.5 | 37.0 | 37.9 | 40.6 | 39.2 |
| *Of which:* in foreign currency | 0.7 | 0.0 | 0.0 | 1.2 | 1.2 | 0.0 | 0.3 | 0.0 | 0.0 |
| **Public corporations' debt** | **10.7** | **11.3** | **12.8** | **12.7** | **12.7** | **14.0** | **13.8** | **14.1** | **13.9** |
| External | 1.9 | 2.4 | 3.9 | 4.0 | 4.0 | 4.9 | 4.8 | 6 | 5 |
| Domestic | 8.8 | 8.9 | 8.8 | 8.8 | 8.8 | 9.1 | 9.1 | 8.5 | 8.7 |
| *Of which:* in foreign currency | 4.3 | 4.1 | 4.0 | 3.7 | 3.7 | 3.3 | 3.2 | 2.4 | 2.2 |
| **Total public sector** | **47.5** | **49.1** | **53.8** | **59.4** | **59.4** | **65.5** | **66.4** | **70.1** | **75.1** |
| External | 9.1 | 10.4 | 13.7 | 15.1 | 15.1 | 19.4 | 19.4 | 21.1 | 27.3 |
| Domestic | 38.5 | 38.8 | 40.2 | 44.3 | 44.3 | 46.1 | 47.0 | 49.1 | 47.8 |
| *Of which:* in foreign currency | 5.0 | 4.5 | 4.0 | 4.9 | 4.9 | 3.3 | 3.5 | 2.4 | 2.4 |
| **Consolidated public sector** 2/ | **40.6** | **42.3** | **47.0** | **53.0** | **53.0** | **59.4** | **60.6** | **64.8** | **70.4** |
| External | 9.1 | 10.4 | 13.7 | 15.1 | 15.1 | 19.4 | 19.4 | 21.1 | 27.7 |
| Domestic 2/ | 31.5 | 32.0 | 33.4 | 37.9 | 37.9 | 40.0 | 41.2 | 43.7 | 42.7 |
| *Of which:* in foreign currency | 5.0 | 4.5 | 4.0 | 4.9 | 4.9 | 3.3 | 3.5 | 2.4 | 2.4 |

Source: Central Bank of The Bahamas.

1/ Calendar year basis.

2/ Excludes central government debt holdings by public corporations.

## Table 4. The Bahamas: Balance of Payments

| | | | | Est. | Staff Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
| | (In millions of U.S. dollars) | | | | | | | | | |
| **Current account balance** | **-2,193** | **-1,610** | **-868** | **-1,909** | **-1,674** | **-1,136** | **-968** | **-885** | **-752** | **-700** |
| Goods (trade balance) | -2,510 | -2,434 | -2,150 | -2,404 | -2,216 | -2,173 | -2,109 | -2,129 | -2,102 | -2,136 |
| Domestic exports | 524 | 372 | 357 | 388 | 405 | 422 | 437 | 502 | 569 | 638 |
| Domestic imports | -3,012 | -2,790 | -2,497 | -2,779 | -2,607 | -2,580 | -2,530 | -2,615 | -2,655 | -2,758 |
| Oil | -488 | -332 | -309 | -401 | -492 | -483 | -478 | -472 | -475 | -493 |
| Capital goods | -720 | -615 | -669 | -890 | -538 | -430 | -302 | -317 | -286 | -299 |
| Other domestic imports | -1,804 | -1,843 | -1,518 | -1,488 | -1,577 | -1,667 | -1,751 | -1,826 | -1,894 | -1,966 |
| Other net exports | -22 | -16 | -11 | -13 | -14 | -15 | -15 | -16 | -17 | -17 |
| Services | 689 | 1,280 | 1,406 | 996 | 1,204 | 1,598 | 1,682 | 1,775 | 1,855 | 1,884 |
| Travel (net) | 2,073 | 2,264 | 2,292 | 2,134 | 2,350 | 2,548 | 2,730 | 2,876 | 3,022 | 3,157 |
| Travel (credit) | 2,317 | 2,537 | 2,622 | 2,504 | 2,739 | 2,956 | 3,154 | 3,316 | 3,478 | 3,645 |
| Travel (debit) | -244 | -273 | -329 | -371 | -389 | -408 | -424 | -439 | -456 | -488 |
| Other services | -1,384 | -984 | -886 | -1,138 | -1,146 | -951 | -1,048 | -1,102 | -1,168 | -1,273 |
| Income and transfers | -371 | -457 | -124 | -502 | -662 | -561 | -541 | -531 | -505 | -448 |
| **Capital and financial account** | **2,239** | **1,635** | **960** | **2,420** | **1,485** | **1,184** | **1,027** | **911** | **953** | **653** |
| Capital transfers | -11 | -20 | -14 | -26 | -28 | -29 | -30 | -31 | -32 | -33 |
| Long-term public sector | 505 | 101 | 219 | 813 | 82 | 345 | 49 | 165 | -53 | 150 |
| Commercial banks' NFA | -162 | 30 | -306 | 26 | -1 | -24 | -20 | -19 | -13 | -21 |
| Foreign direct investment | 168 | 70 | 74 | 74 | 293 | 503 | 343 | 374 | 334 | 349 |
| Other private capital 1/ | 1,739 | 1,454 | 987 | 1,532 | 1,139 | 389 | 686 | 422 | 717 | 208 |
| **Overall balance** | **46** | **24** | **92** | **510** | **-189** | **48** | **59** | **26** | **200** | **-46** |
| **Change in net international reserves** (increase -) | **-46** | **-24** | **-92** | **-510** | **189** | **-48** | **-59** | **-26** | **-200** | **46** |
| | (In percent of GDP) | | | | | | | | | |
| **Current account balance** | **-20.2** | **-14.3** | **-7.7** | **-16.4** | **-13.6** | **-8.8** | **-7.2** | **-6.3** | **-5.2** | **-4.7** |
| Goods (trade balance) | -23.2 | -21.7 | -19.1 | -20.7 | -18.0 | -16.8 | -15.7 | -15.2 | -14.6 | -14.3 |
| Domestic exports | 4.8 | 3.3 | 3.2 | 3.3 | 3.3 | 3.3 | 3.2 | 3.6 | 3.9 | 4.3 |
| Domestic imports | -27.8 | -24.8 | -22.2 | -23.9 | -21.2 | -20.0 | -18.8 | -18.7 | -18.4 | -18.5 |
| Oil | -4.5 | -3.0 | -2.7 | -3.4 | -4.0 | -3.7 | -3.5 | -3.4 | -3.3 | -3.3 |
| Capital goods | -6.6 | -5.5 | -5.9 | -7.6 | -4.4 | -3.3 | -2.2 | -2.3 | -2.0 | -2.0 |
| Other domestic imports | -16.6 | -16.4 | -13.5 | -12.8 | -12.8 | -12.9 | -13.0 | -13.1 | -13.1 | -13.2 |
| Other net exports | -0.2 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 |
| Services | 6.4 | 11.4 | 12.5 | 8.6 | 9.8 | 12.4 | 12.5 | 12.7 | 12.8 | 12.7 |
| Travel (net) | 19.1 | 20.1 | 20.4 | 18.3 | 19.1 | 19.8 | 20.3 | 20.6 | 20.9 | 21.2 |
| Travel (credit) | 21.4 | 22.6 | 23.3 | 21.5 | 22.2 | 22.9 | 23.4 | 23.7 | 24.1 | 24.5 |
| Travel (debit) | -2.2 | -2.4 | -2.9 | -3.2 | -3.2 | -3.2 | -3.1 | -3.1 | -3.2 | -3.3 |
| Other services | -12.8 | -8.8 | -7.9 | -9.8 | -9.3 | -7.4 | -7.8 | -7.9 | -8.1 | -8.5 |
| Income and transfers | -3.4 | -4.1 | -1.1 | -4.3 | -5.4 | -4.3 | -4.0 | -3.8 | -3.5 | -3.0 |
| **Capital and financial account** | **20.6** | **14.5** | **8.5** | **20.8** | **12.1** | **9.2** | **7.6** | **6.5** | **6.6** | **4.4** |
| Capital transfers | -0.1 | -0.2 | -0.1 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 |
| Long-term public sector | 4.7 | 0.9 | 1.9 | 7.0 | 0.7 | 2.7 | 0.4 | 1.2 | -0.4 | 1.0 |
| Commercial banks' NFA | -1.5 | 0.3 | -2.7 | 0.2 | 0.0 | -0.2 | -0.2 | -0.1 | -0.1 | -0.1 |
| Foreign direct investment | 1.5 | 0.6 | 0.7 | 0.6 | 2.4 | 3.9 | 2.5 | 2.7 | 2.3 | 2.3 |
| Other private capital 1/ | 16.0 | 12.9 | 8.8 | 13.2 | 9.2 | 3.0 | 5.1 | 3.0 | 5.0 | 1.4 |
| **Overall balance** | **0.4** | **0.2** | **0.8** | **4.4** | **-1.5** | **0.4** | **0.4** | **0.2** | **1.4** | **-0.3** |
| **Change in net international reserves** (increase -) | **-0.4** | **-0.2** | **-0.8** | **-4.4** | **1.5** | **-0.4** | **-0.4** | **-0.2** | **-1.4** | **0.3** |
| **Memorandum items** | | | | | | | | | | |
| Gross international reserves | | | | | | | | | | |
| (End of period; millions of U.S. dollars) | 788 | 812 | 904 | 1,414 | 1,225 | 1,273 | 1,333 | 1,358 | 1,558 | 1,512 |
| (In months of next year's G&S imports) | 2.1 | 2.3 | 2.3 | 3.6 | 3.3 | 3.4 | 3.4 | 3.4 | 3.5 | 3.4 |
| Nominal GDP (millions of U.S. dollars) | 10,844 | 11,240 | 11,262 | 11,642 | 12,319 | 12,900 | 13,461 | 13,988 | 14,446 | 14,896 |

Sources: Central Bank of The Bahamas; Department of Statistics; and Fund staff projections.

1/ Includes errors and omissions.

## Table 5. The Bahamas: Summary Accounts of the Central Bank and the Financial System

| | 2014 | 2015 | 2016 | 2017 | Staff Projections 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|
| | (In millions of Bahamian dollars, end of period) | | | | | | |
| **Central Bank** | | | | | | | |
| Gross international reserves | 788 | 812 | 904 | 1,414 | 1,225 | 1,273 | 1,333 |
| Net domestic assets | 193 | 168 | 388 | 36 | 309 | 333 | 344 |
| Credit to nonfinancial public sector (net) | 504 | 485 | 713 | 386 | 666 | 698 | 716 |
| *Of which:* Central Government | 521 | 494 | 717 | 396 | 371 | 321 | 271 |
| Other | -310 | -317 | -325 | -351 | -358 | -365 | -372 |
| Reserve money | 981 | 980 | 1,292 | 1,450 | 1,534 | 1,606 | 1,676 |
| Currency held by the private sector | 375 | 389 | 426 | 439 | 464 | 486 | 507 |
| Liabilities with financial institutions | 606 | 591 | 866 | 1,011 | 1,070 | 1,120 | 1,169 |
| **Financial system** | | | | | | | |
| Net foreign assets | 286 | 280 | 679 | 1,162 | 974 | 1,047 | 1,126 |
| *Of which* : Commercial banks and OFIs | -502 | -532 | -225 | -252 | -251 | -227 | -206 |
| Net domestic assets | 6,105 | 6,094 | 6,252 | 5,875 | 6,472 | 6,751 | 7,010 |
| Credit to nonfinancial public sector, net | 2,206 | 2,376 | 2,668 | 2,571 | 2,476 | 2,644 | 2,791 |
| Central Government, net | 2,021 | 2,198 | 2,551 | 2,389 | 2,293 | 2,462 | 2,608 |
| Credit to private sector | 6,367 | 6,300 | 6,171 | 5,983 | 6,043 | 6,133 | 6,256 |
| Other | -2,468 | -2,583 | -2,587 | -2,679 | -2,047 | -2,027 | -2,036 |
| Liabilities to the private sector (broad money) | 6,390 | 6,374 | 6,930 | 7,037 | 7,446 | 7,797 | 8,137 |
| Money | 1,996 | 2,071 | 2,461 | 2,654 | 2,808 | 2,941 | 3,069 |
| Currency | 233 | 247 | 281 | 293 | 310 | 324 | 338 |
| Demand deposits | 1,763 | 1,825 | 2,180 | 2,361 | 2,499 | 2,616 | 2,730 |
| Quasi-money | 4,394 | 4,303 | 4,470 | 4,383 | 4,638 | 4,857 | 5,068 |
| | (Change in percent of liabilities to the private sector at the beginning of the period) | | | | | | |
| Net foreign assets | 3.8 | -0.1 | 6.2 | 7.0 | -2.7 | 1.0 | 1.0 |
| Net domestic assets | -2.6 | -0.2 | 2.5 | -5.4 | 8.5 | 3.7 | 3.3 |
| Credit to nonfinancial public sector | 1.4 | 2.7 | 4.6 | -1.4 | -1.4 | 2.3 | 1.9 |
| Credit to private sector | -2.9 | -1.1 | -2.0 | -2.7 | 0.9 | 1.2 | 1.6 |
| Liabilities to private sector (broad money) | 1.2 | -0.3 | 8.7 | 1.5 | 5.8 | 4.7 | 4.4 |
| Money | 5.6 | 1.2 | 6.1 | 2.8 | 2.2 | 1.8 | 1.6 |
| Quasi-money | -4.5 | -1.4 | 2.6 | -1.2 | 3.6 | 2.9 | 2.7 |
| | (Annual percentage change) | | | | | | |
| Net domestic assets | -2.6 | -0.2 | 2.6 | -6.0 | 10.2 | 4.3 | 3.8 |
| Credit to nonfinancial public sector | 4.0 | 7.7 | 12.3 | -3.6 | -3.7 | 6.8 | 5.5 |
| Credit to private sector | -2.8 | -1.1 | -2.0 | -3.0 | 1.0 | 1.5 | 2.0 |
| Liabilities to private sector (broad money) | 1.2 | -0.3 | 8.7 | 1.5 | 5.8 | 4.7 | 4.4 |
| Money | 21.6 | 3.8 | 18.8 | 7.9 | 5.8 | 4.7 | 4.4 |
| Quasi-money | -6.0 | -2.1 | 3.9 | -1.9 | 5.8 | 4.7 | 4.4 |

Sources: Central Bank of The Bahamas; and Fund staff projections.

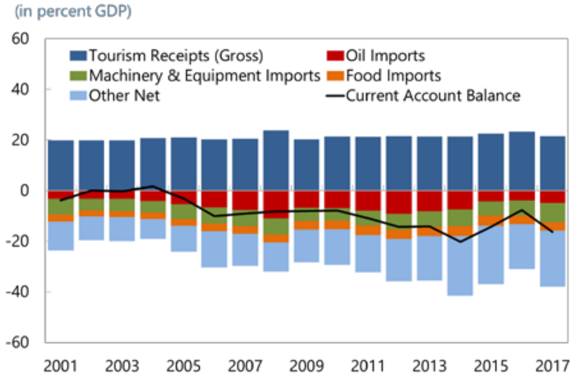
# Annex I. External Sector Assessment

*Staff assesses the 2017 external sector position as weaker than the level suggested by fundamentals and desirable policy settings. However, reserve accumulation soared in 2017 due to an external sovereign bond placement in November, bringing foreign reserve to levels above most traditional adequacy metrics. Despite stronger reserve buffers, vulnerabilities remain, including exposure to natural disasters, eroded competitiveness, and significant structural bottlenecks. In the context of a strong commitment to the exchange rate peg, structural reforms alongside fiscal consolidation are critical to strengthen external buffers.*

## A. Context and Recent Developments

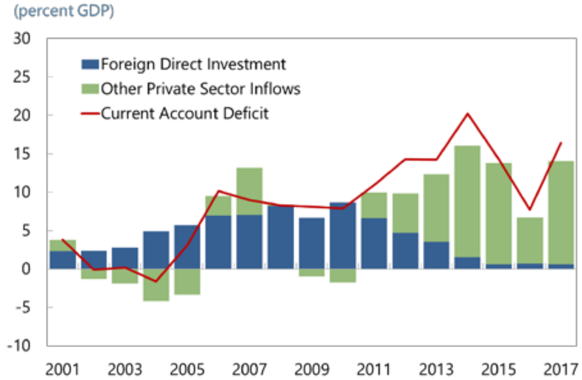
**1. The Bahamas carries sizable current account deficits owing to its relatively narrow economic base.** As a small open service economy, it relies heavily on imports to meet its infrastructure and development needs. Goods imports have steadily increased to nearly six times that of exports, resulting in trade deficits above 15 percent of GDP in recent years. Machinery and equipment and manufactured goods imports—a sizable portion of which constitute inputs to investment and infrastructure projects—comprise about one third of imports, while oil and food imports amount to another 30 percent. On the services side, net inflows, mainly tourism receipts, have averaged about 20 percent of GDP. Consequently, The Bahamas' current account deficit has ranged between 8 and 18 percent of GDP during the past decade, with financing concentrated in FDI and other private capital inflows.[1] While reserve accumulation had been modest in recent years, the authorities boosted reserves significantly in 2017 through an external sovereign bond issuance.

**Current Account Balance**
(in percent GDP)




Sources: The Bahamian authorities and Fund staff estimates.

**Current Account Balance and Capital Flows**
(percent GDP)




Sources: The Bahamian authorities and Fund staff estimates.

**2. The current account deficit widened in 2017, on the back of increased construction activity, weak tourism performance, and rising oil prices.** Fluctuations in the current account deficit in recent years have been heavily influenced by imports related to the construction of the FDI-financed Baha Mar resort, whose construction halted in 2015, after the developer declared

[1] Other private flows include the real estate and external debt component of FDI investment.

bankruptcy. Completion work resumed in late 2016 by a new owner, widening the current account deficit to an estimated 16.4 percent of GDP in 2017, from 7.7 percent of GDP in 2016. While Baha Mar explains the bulk of the increase in the current account deficit, rising oil prices, and weak tourism activity also played a role. Hurricane Matthew, which hit The Bahamas in October 2016, impacted the tourism sector significantly, with 50 percent of hotel room capacity in the Grand Bahama island being left out of commission. After nine months of weak tourism activity, air tourist arrivals picked up in the last quarter of 2017, but they still declined 4 percent for the year. Capital and financial inflows surged to almost 14 percent of GDP explained by Baha Mar and a government placement of a long-term bond for US$750 million, which resulted in foreign reserves accumulation for almost 5 percent of GDP.

**3. The external accounts are expected to strengthen gradually over the medium-term.** The anticipated boost in tourism receipts from the opening of Baha Mar and stronger U.S. growth will provide an important offset to imports related to new FDI projects. An expected modest decline in oil and commodity prices will also help improve the current account over the medium-term. While the growth impulse from Baha Mar and higher U.S. growth is temporary, tourism receipts are expected to continue strengthening as FDI projects currently in the pipeline come on stream. On balance, the current account deficit is projected to gradually converge to around 5 percent of GDP over the medium term and, reserves are expected to remain above 3 months of imports.

## B. External Stability Assessments

**4. Model-based estimates point to a 2017 external position that is weaker than suggested by fundamentals and desirable policy settings.** The findings are based on two panel regressions of the current account and the real effective exchange rate, respectively, that estimate "norm" values consistent with economic fundamentals and desirable policy settings.[2] Results from these separate EBA-lite regression approaches point to an overvalued currency, although models differ on the magnitude of overvaluation with estimates ranging between 9.8 and 12.3 percent.

**Table 1. Exchange Rate Assessment**

| | CA Aproach Adjusted | REER Approach |
|---|---|---|
| Actual CA 1/ | -6.5% | |
| Cyclically adjusted CA | -6.8% | |
| CA norm | -4.2% | |
| Cyclically adjusted CA norm | -4.6% | |
| CA gap | -2.2% | |
| o/w Policy gap | -0.3% | |
| Elasticity | -0.23 | |
| **REER gap** | **9.8%** | **12.3%** |

1/ Adjusted to exclude FDI-related goods and service imports.

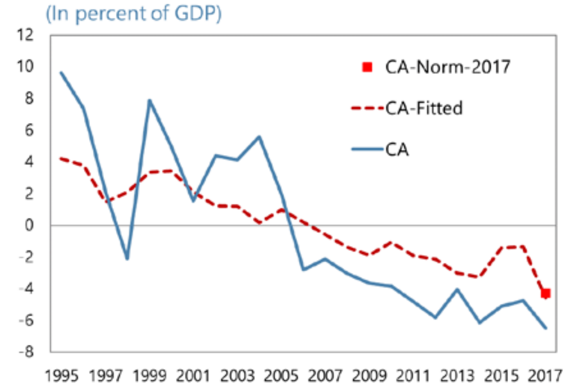
## C. The Current Account (CA) Model

**5. The CA model is limited in its ability to analyze countries that are heavily dependent on tourism income.** The model does not effectively capture potentially strong and sustained future

[2] The external sustainability approach is not used owing to the lack of official net international investment position data. The EBA-lite approach uses an estimate of the net foreign asset (NFA) position derived from capital account flows and estimates of external indebtedness. Given the small elasticity for NFA in the panel regressions results are relatively insensitive to alternative estimates.

tourism inflows that justify relatively large infrastructure-driven CA deficits in the near-term.[3] To correct for this, FDI-related goods and services imports are excluded, leading to an adjusted CA deficit of 6.8 percent of GDP in 2017.[4]

**External Stability Assessment: CA Model**
(In percent of GDP)

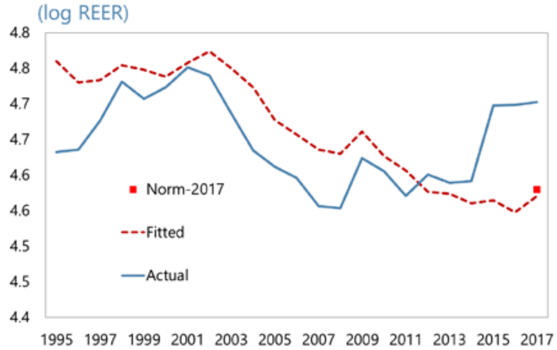



6. **After accounting for Bahamas-specific factors, the cyclically-adjusted CA balance and cyclically-adjusted norm are estimated at -6.8 and -4.6 percent of GDP respectively.** The resulting CA gap is -2.2 percent of GDP, after accounting for desirable macroeconomic policies settings, where the policies include fiscal consolidation, increased financial deepening, and a modest relaxation of the capital flow management (CFM) system. The model estimates that a REER adjustment of 9.8 percent is needed to align the current account balance with economic fundamentals.

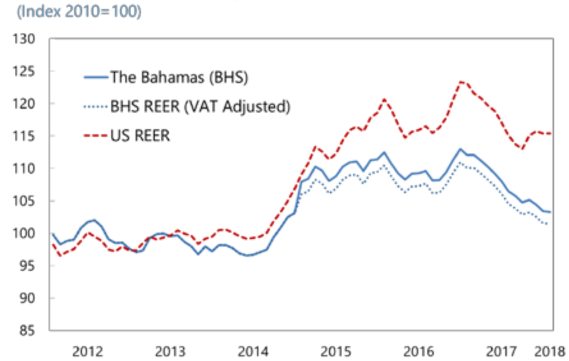
## D. The Real Effective Exchange Rate Index (I-REER) Model

7. **The real effective exchange rate model suggests a gap in 2017 of about 12 percent.** The model finds that the average REER for 2017 was 12.3 percent stronger than the level deemed consistent with fundamentals and desirable policy settings. Following an appreciation of the Bahamian dollar over 2014-2016, attributed in large part to the appreciation of the U.S. dollar, the Bahamian dollar depreciated 2 percent in real effective terms, on average, in 2017. As of end-2017, it had depreciated an additional 4.3 percent, relative to the 2017 average, partially correcting the 12 percent REER gap suggested by the model. The current level of the REER is broadly at the long-term average.

**External Sector Assessment: I-REER Model**
(log REER)




**Real Effective Exchange Rates (REER)**
(Index 2010=100)



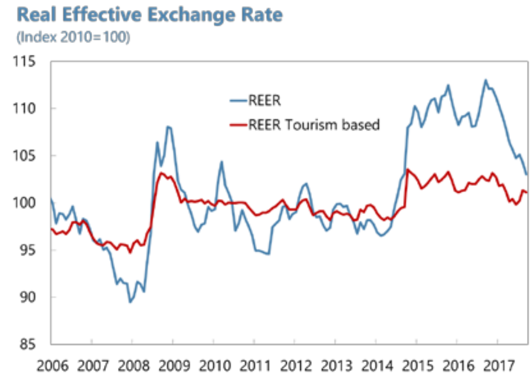

Sources: INS, and IMF staff calculations.

[3] The limitations of the model are reflected in the poor fit of the panel CA estimation for The Bahamas and, consequently, the results from the standard CA model are not reported.

[4] The adjustment assumes that 80 percent of capital goods imports and 100 percent of construction services imports are related to FDI.

## E. Cost and Structural Competitiveness

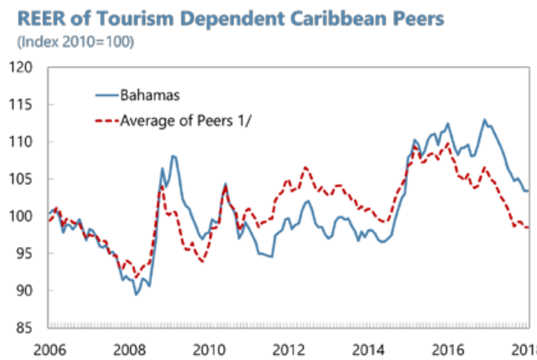
**8. Several indicators point to an erosion in cost and structural competitiveness in recent years** (Figures 6 and 7). From a cost perspective, despite the depreciation of the currency in real effective terms, the value of The Bahamas' REER remains above the average among key tourism competitors (Jamaica and the Dominican Republic) with more flexible exchange rate arrangements. The risks to tourism competitiveness are mitigated somewhat by the large share of US tourists in total arrivals. The tourism-weighted REER has historically been more stable and declined 0.7 percent in 2017. However:



Sources: INS and IMF staff calculations.

- Real wages in The Bahamas have been rising faster than labor productivity in recent years and the costs of electricity are relatively high (Figure 7).

- Finally, the World Bank's "Doing Business Indicators" suggests that The Bahamas has steadily lost ground from a business climate perspective since 2013 relative to the frontier, despite regaining some ground in 2017. The country still scores poorly in administrative processes, infrastructure, access to credit, ease of trading across borders, and protecting minority investors.



1/ Includes Barbados, ECCU, Dominican Republic, and Jamaica.
Sources: INS and IMF staff calculations

## F. Reserve Adequacy

**9. Following the recent external sovereign bond issuance, foreign reserves have reached adequate levels for normal times according to most adequacy metrics.**

- International reserves stood at US$1,414 million (3.6 months of next-year's imports) at end-2017, above the traditional benchmark of 3 months of next year's goods and services imports. If FDI-related goods and services imports are excluded, reserves stood at 4.3 months of next year's imports at end-2017.

**Reserve Adequacy Metrics 1/**

| | 2017 | 2018 | Average 2019-2023 |
|---|---|---|---|
| 3 months (next year's goods and service Imports) | 122 | 110 | 116 |
| 3 months (next year's non-FDI related goods imports) | 139 | 122 | 123 |
| 20 percent of broad money (M2) | 97 | 81 | 84 |
| 100 percent of Central Bank's demand liabilities | 150 | 124 | 129 |
| Short Term Debt | 2816 | 2441 | 2622 |
| Risk-weighted measure | 111 | 93 | 97 |
| Revised risk-weighted measure | 156 | 130 | 136 |
| SIDS Measure | 72 | 59 | 58 |

1/ 100 equals adequate level.

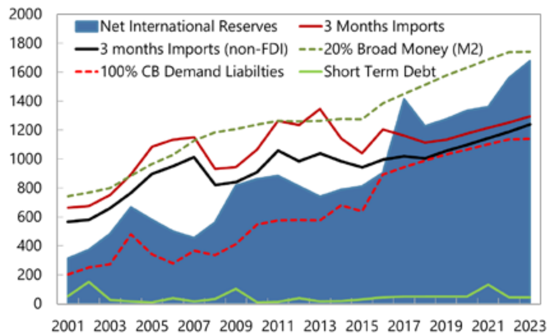
- International reserves stood at 150 percent of Central Bank liabilities and well above 100 percent of external short-term debt at end-2017.

- Reserves also stood at 111 percent of the level suggested by the Fund's risk-weighted metric, which attempts to measure the adequacy of reserves in avoiding crises and reducing their severity. The metric requires coverage against medium and long-term external liabilities, in addition to coverage of short-term debt and broad money.

- Accounting for the presence of capital flow measures (CFM), [5] the revised risk-weighted measure assesses reserve coverage at 156 percent, above the recommended 100–150 percent range.

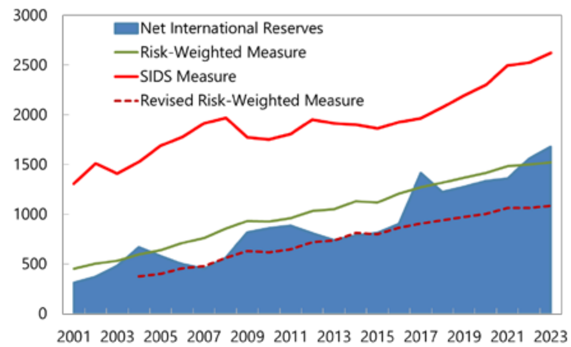
- However, according to the framework proposed by Mwase (2012),[6] which considers challenges specific to small island developing states (SIDS) and their exposure to natural disasters, reserves remain below adequate at 72 percent of recommended levels. The framework does not, however, consider private reinsurance flows, which in The Bahamas reached almost US$300 million following Hurricane Matthew.

**Reserve Adequacy: Selected Metrics**
(In US$ millions)




Sources: The Bahamian authorities and IMF staff calculations.

**Reserve Adequacy: Alternative Metrics**
(In US$ millions)




Sources: The Bahamian authorities and IMF staff calculations.

[5] Apart from 2009, when they briefly fell to zero, net portfolio investment and other private capital flows have always been positive, thus supporting reserves accumulation. All outward capital transfers require Exchange Control approval, and outflows on resident-owned capital are restricted. In principle, inward investment in shares and other securities by nonresident is unrestricted. However, the Central Bank's approval is required for the sale and issuance of capital and money market instruments by nonresidents in the local market.

[6] Mwase, N. (2012): "How Much Should I Hold? Reserve Adequacy in Emerging Markets and Small Islands", IMF Working Paper 12/205.

# Annex II. Risk Assessment Matrix[1]

| Potential Deviations from Baseline | | | | |
|---|---|---|---|---|
| **Source of Risk** | **Up/ Downside** | **Relative Likelihood[1]** | **Impact[1]** | **Policy Response** |
| **Tighter global financial conditions**. An abrupt change in global risk appetite could lead to sudden, sharp increases in interest rates and associated tightening of financing conditions. | ↓ | **High** | H | Structural reforms to increase competitiveness and fiscal consolidation to strengthen fiscal and external buffers. |
| **Further pressure on traditional bank business models,** with possible knock-on effects on the broader financial sector including through additional pressures on CBR. | ↓ | **Medium** | M | Strengthen compliance with AML/CFT and tax transparency standards and ensure effective implementation, including for the offshore sector; Continue monitoring the status of CBRs; Effectively communicate efforts undertaken by banks and authorities to address perceived risks. |
| **Weaker-than-expected global growth**:<br>Significant US slowdown and its spillovers<br>Structurally weak growth in key advanced economies. | ↓<br>↓ | **Medium**<br>**High** | H<br>H | Structural reforms to increase competitiveness and fiscal consolidation to strengthen fiscal and external buffers. |
| **Higher- or lower-than-projected boost to tourism activity from Baha Mar** | ↕ | **Medium** | H | Structural reforms to increase competitiveness and attract new FDI-financed investments and fiscal consolidation to strengthen fiscal and external buffers. |
| **Higher-than-expected FDI flows** | ↑ | **Medium** | M | |
| **Natural disasters** | ↓ | **High** | H | *Enhance ex-ante* preparedness and risk reduction strategies, including by maintaining a prudent public balance sheet, establishing a savings fund, and adequate disaster risk insurance strategies. |
| **Lower energy prices** | ↑ | **Low** | M | Accelerate the pace of energy sector reform. |
| **Delays in fiscal consolidation or in implementing structural reforms** | ↓ | **Medium** | H | Enhance communication strategy explaining factors behind the delay and announce and implement corrective measures swiftly. |
| [1] Low (L), Medium (M), High (H). | | | | |

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

# Annex III. Alternative Scenarios for FDI and Tourism Activity

**1. Background.** The Bahamas' economy is strongly dependent on tourism activity with over 6 million people visiting the country annually—mostly from the United States— and tourism receipts accounting for more than 20 percent of GDP. Most of the country's tourism infrastructure is funded through foreign direct investment.

**2. Projected FDI flows and tourism receipts are subject to upside and downside risks.** The Central Bank of The Bahamas reports a value of about 2.7 billion dollars (about 24 percent of GDP) in FDI projects in the pipeline, excluding completion of Baha Mar. Moreover, a recent application has been filed before the National Economic Council for the development of a tourist resort in the Grand Bahama Island with estimated investments of US$2.5 billion dollar over the next 10 years. Furthermore, there are plans for the construction of a US$5.5 billion oil storage facility in the Grand Bahama Island. Therefore, there are significant upside risks to staff's baseline outlook for FDI cumulative flows of about US$2 billion, excluding Baha Mar. At the same time, external risks associated with U.S. growth and global financial conditions, as well as the risk of policy slippages imply downside risks to the FDI outlook. Equally two-sided are the risks around the outlook for tourism activity, related mainly to Baha Mar and the occurrence of natural disasters.

**3. Staff estimated a small simultaneous equations model to assess the growth path under various risk scenarios.** The model consists of five key macroeconomic equations:

(Output Gap)
$$Y_t = \varphi \cdot Y_{t-1} + r \cdot T_{gap\ t} + \sigma \cdot FDI_{gap\ t} + \varepsilon_Y$$

(Phillips curve)
$$\pi_t = \lambda \cdot \pi_{t+1} + (1-\lambda) \cdot \pi_{t-1} + \beta \cdot Y_t + \varepsilon_\pi$$

(Okun's law)
$$u_{gap\ t} = \tau_1 \cdot u_{gap\ t-1} + \tau_2 \cdot Y_t + \varepsilon_{u_{gap}}$$

$$T_t = T_{trend\ t} + T_{gap\ t}$$

(Tourism block)
$$T_{trend\ t} = (1-\mu) \cdot T_{trend\ t-1} + \mu \cdot T_{trend}^{SS} + \varepsilon_{T_{trend}}$$

$$T_{gap\ t} = r_1 \cdot T_{gap\ t-1} + \varepsilon_{T_{gap}}$$

$$FDI_t = FDI_{trend\ t} + FDI_{gap\ t}$$

(FDI block)
$$FDI_{trend\ t} = (1-\nu) \cdot FDI_{trend\ t-1} + \nu \cdot FDI_{trend}^{SS} + \varepsilon_{FDI_{trend}}$$

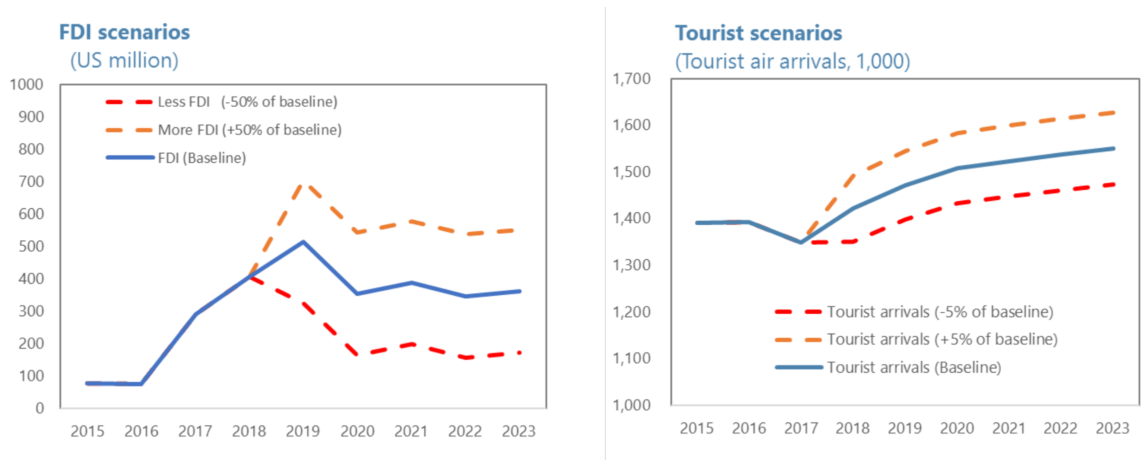
$$FDI_{gap\ t} = \sigma_1 \cdot FDI_{gap\ t-1} + \varepsilon_{FDI_{gap}}$$

Where Y is the output gap, *π* is inflation, *u* is the unemployment rate, *T* is air tourist arrivals and *FDI* is Foreign Direct Investment in percent of GDP. Output gap, FDI gap, and tourism gap refer to deviations for each corresponding variable from their long-term trend. The model parameter values and the variances of shock terms for these equations are estimated using Bayesian estimation techniques, using data on GDP, the CPI, the unemployment rate, air tourist arrivals and FDI flows at an annual frequency over 1961–2016.

**4. FDI scenarios.** Staff considered two scenarios, one in which cumulative FDI flows are about 50 percent lower than in the baseline—which may be the result of deterioration of confidence resulting from lack of action to address structural bottlenecks or a deterioration in the global environment, including unexpected tighter financing conditions. On the upside, staff considered higher FDI flows in 50 percent, which could stem from materialization of all FDI projects in the pipeline and the recently proposed tourist resort and oil-storage facility.

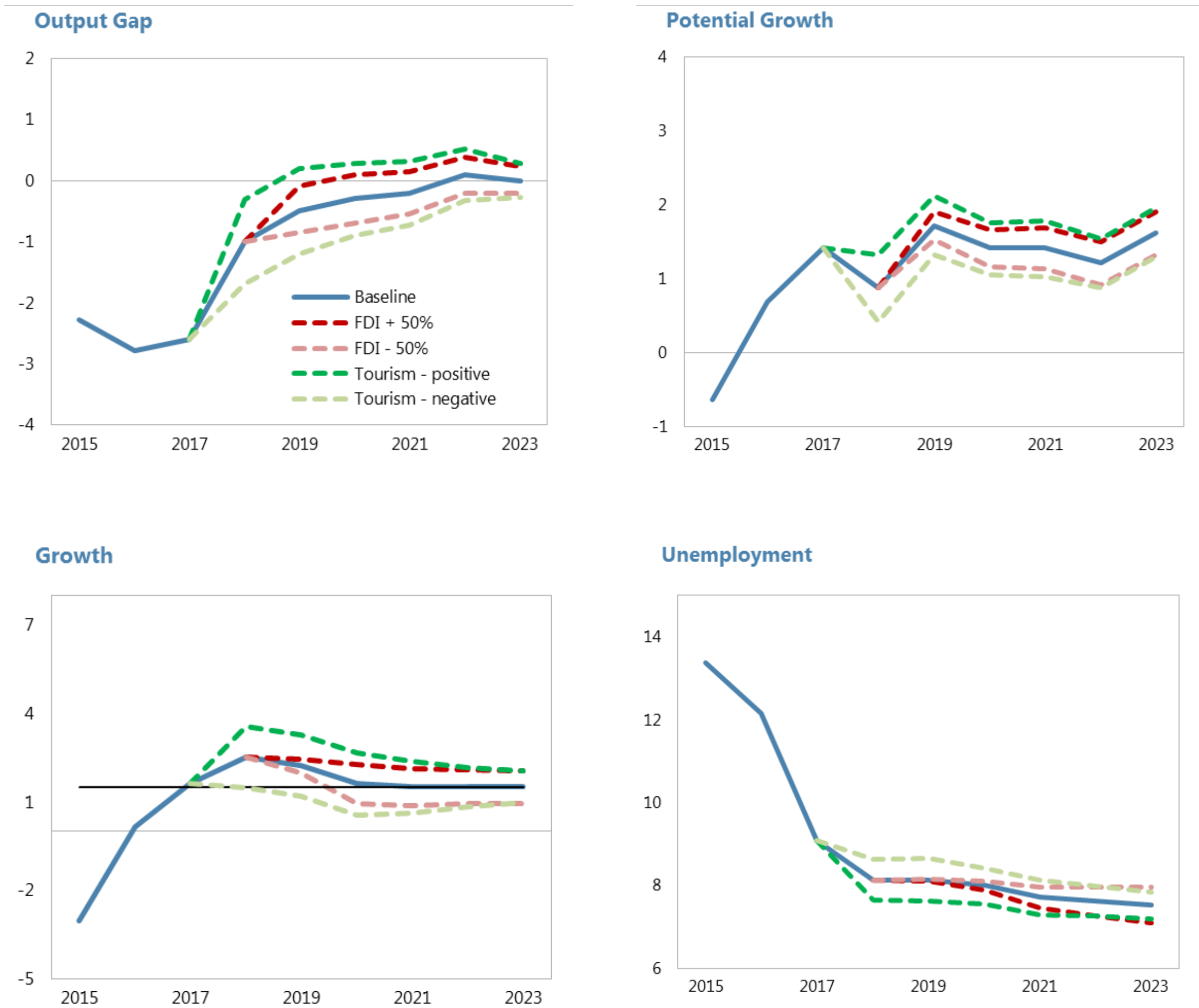
**5. Tourism activity scenarios.** Staff considered two scenarios. One simulating a weaker-than-expected recovery in air tourist arrivals corresponding to a level that is 5 percent lower than the baseline during 2018–2023, possibly reflecting lower boost from Baha Mar than projected. On the upside, staff considered stronger tourism activity, with air tourist arrivals remaining 5 percent above the baseline in 2018–2023, stemming possibly from stronger-than-expected boost from Baha Mar and expanded airlift connections.

**The Bahamas: Scenarios Assumptions**




**6. Results.** Under the positive FDI shock, the output gap would close in 2019 as higher FDI brings real GDP growth to around 2¼ – 2½ percent, resulting also in a faster decline in unemployment. Potential growth also increases as additional FDI leads to higher capital accumulation. The effects carry through symmetrically under the negative FDI shock. Higher-than-expected tourism activity would also lift growth initially to 3 – 3½ percent and to about 2 – 2½ percent in the medium term. On the other hand, under the negative shock to air tourist arrivals, real GDP growth would fall to close to 1 percent—from a baseline of 2½ percent in 2018—and would remain below 1½ percent throughout the projection period. Unemployment would rise to around 9 percent initially and decline more slowly than in the baseline scenario.

**The Bahamas: Scenarios for FDI and Tourism Activity**




Source: IMF staff estimates.

# Annex IV. Public and External Sector Debt Sustainability Analysis[1]

*The central government debt-to-GDP ratio has risen more rapidly than in other Caribbean tourism-intensive economies, although a substantial upward revision in the national accounts has reduced the stock to 57 percent of GDP in FY2017. Under staff's baseline scenario, debt would decline to around 55 percent of GDP in the medium term due to expenditure restraint. The debt sustainability heat map points to low to moderate risks to debt sustainability. However, a combination of adverse shocks would put the debt ratio on an upward trajectory. Sizable fiscal contingent liabilities, vulnerability to natural disasters, and subdued medium-term growth, underscore the importance of fiscal consolidation, complemented with structural reforms to lift potential growth.*

1. **Debt stock and gross financing requirements.** Central government debt reached 57.2 percent of GDP in FY2017 (ending in June), more than doubling over the past decade, owing to tepid economic growth and weaker-than-budgeted fiscal consolidation. The increase in debt prompted downgrades by two rating agencies in 2016, but prospects for debt stabilization under the new administration avoided new downgrades in 2017. Under the baseline scenario, staff projects debt to peak at 57.4 percent of GDP in FY2018, reflecting fiscal deficits still above debt-stabilizing levels, and would decline to around 55 percent of GDP over the medium term due to projected expenditure restraint. Gross financing requirements are projected to decline from 12 percent of GDP in FY2018 to about 5 percent of GDP in the medium term, reflecting fiscal consolidation efforts and lower amortization needs.

2. **Debt profile and vulnerabilities.** Despite continued increases in debt, its composition remains favorable in terms of maturity, but has deteriorated somewhat in terms of currency. Foreign currency debt is projected at 36 percent of total debt in FY2018 (up from 27 percent in FY2017), while short-term debt, denominated entirely in domestic currency, represents only 14 percent of total debt. The weighted average maturity for the government's domestic and external bonds is 8.5 and 11 years, respectively. Ample liquidity in the domestic banking system and a captive investor base mitigates rollover concerns. Although the debt level and gross financing needs are below the vulnerability thresholds for emerging market comparators, a combination of adverse shocks could put the debt on an upward trajectory. External financing requirements are at the upper early warning threshold for emerging markets due to a sizable current account deficit. Overall, the heat map points to moderate risks to debt sustainability.

3. **Realism of baseline assumptions.** Staff projects real growth to average 1.8 percent over the medium term. Inflation is expected to remain low (2.4 percent), while the primary balance is projected to gradually improve to 0.6 percent by the end of the forecast period. Past growth forecasts errors are largely explained by a substantial revision to the national accounts in 2017, which showed lower growth than previously thought as well as large unexpected events such as the bankruptcy of Baha Mar in 2015, and natural disasters. Meanwhile, past projections for the primary balance appear to have been relatively optimistic, while inflation has turned out better than expected. Staff's projected primary balance path is feasible, as the projected primary deficit reduction between 2018 and 2023 is much lower than the reduction observed between 2013 and 2016.

[1] GDP numbers have been translated from calendar to fiscal year basis for consistency with fiscal numbers.

**4. Macro–fiscal stress test**. Shocks to the baseline macro–fiscal variables could significantly worsen the debt path, while the gross financing needs would only increase moderately. Staff simulated four shock scenarios: a real GDP growth shock, a primary balance shock, real interest rate shock, and real exchange rate shock.[2] The real interest rate shock would push debt to about 59 percent of GDP at the end of the projection period, up from a baseline level of 55 percent of GDP. The remaining shocks yield similar outcomes, with debt rising to 57–58 percent of GDP. The real exchange rate shock remains the least significant as the bulk of debt is denominated in local currency. Gross financial requirements are, however, most sensitive to the real interest rate shock and would double to 10 percent of GDP in FY2023. A combined macro–fiscal shock would raise debt to 66 percent of GDP, and gross financing requirements to 12 percent of GDP in FY2023.

## Additional Adverse Scenarios

**5. Staff considered several additional adverse scenarios:** related to (1) failure to implement fiscal consolidation, (2) persistent weakness in the economy together with lack of fiscal consolidation, (3) occurrence of natural disasters, and (4) materialization of contingent liability risks:

- **Failure to consolidate and persistent economic weakness.** Staff considered two scenarios: (1) a constant primary balance, and (2) primary balance and growth equal to their historical averages. Under the first approach, the primary balance is assumed to remain at the projected level for FY2018 (-0.4 percent of GDP), with the other variables, except the real effective interest rate, remaining at the same levels as in the baseline scenario. In this scenario, debt would rise to 60 percent of GDP by FY2023. Under the second approach, real GDP growth and the primary balance are set equal to the average for the past decade of -0.5 percent and -1.9 percent of GDP, respectively, from FY2018 onwards. In this scenario, the real effective interest rate is also assumed to increase by 172 basis points, which corresponds to the difference between the historical average and projected average under the baseline scenario. Under this severe adverse scenario, the debt burden would rise sharply to 77 percent of GDP over the medium term with gross financing requirements also rising to 15 percent of GDP.

- **Natural disasters.** Given the exposure of The Bahamas to natural disasters, staff simulated a shock more drastic than Hurricane Matthew. Staff assumed a temporary reduction in real GDP growth of 0.5 percent for FY2019 and FY2020. With lower tax revenue and larger fiscal spending due to post-hurricane cleanup and reconstruction, the primary balance would worsen by 3.6 percent and 2.6 percent of GDP over the same period, and the debt would increase to 64 percent of GDP by FY2023. Staff's proposed savings fund would help smooth the fiscal impact of such a natural disaster shock.

- **Fiscal contingent liabilities.** The analysis has focused on the central government in absence of consolidated public-sector data. Nonetheless, fiscal risks emanating from public entities and the public pension system are significant, and could affect the debt path if they materialize. Moreover,

[2] The four shocks include: 1) a half-standard deviation reduction in real GDP growth, 2) a one-standard deviation increase in the primary deficit, 3) 485 basis points increase in projected interest rates from the average for the past 6 years, and 4) a 10-percent real exchange rate shock.

debt of public entities amounted to 13.6 percent of GDP in FY2017, of which 6.2 percent of GDP is explicitly guaranteed by the central government. Staff assumed a contingent liability shock of 3 percent of GDP in FY2019. The materialization of this shock would push central government debt to about 60 percent of GDP in FY2023 while gross financing needs would rise to 10 percent of GDP.

**6. External Debt.**[3] The stock of public external debt increased by 6.2 percentage points of GDP in 2017 reaching an estimated 27.3 percent of GDP by end-year. The increase is primarily accounted for by the US$750 million external sovereign bond placement in November. Under the baseline scenario, external debt is projected to rise to 27.6 percent of GDP in 2019 reflecting the planned issuance of a rate reduction bond by the state-owned electricity company, then fall to 26 percent of GDP at the end of the forecast horizon. Bound test results suggest that the external public debt profile is moderately sensitive to shocks to the non-interest current account and real exchange rate. A permanent increase in the non-interest current account deficit by 0.5 percent of GDP relative to the baseline beginning in 2018 would put the public external debt ratio on an increasing trajectory reaching 36.1 percent of GDP by 2023. A permanent one-time 30 percent depreciation in real effective terms in 2018 would shift the external debt level up by 12.3 percent of GDP relative to the baseline over the projection period.

[3] Defined as central government and public corporate debt as the stock of private-sector external debt is not available.

## The Bahamas: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(In percent of GDP unless otherwise indicated)

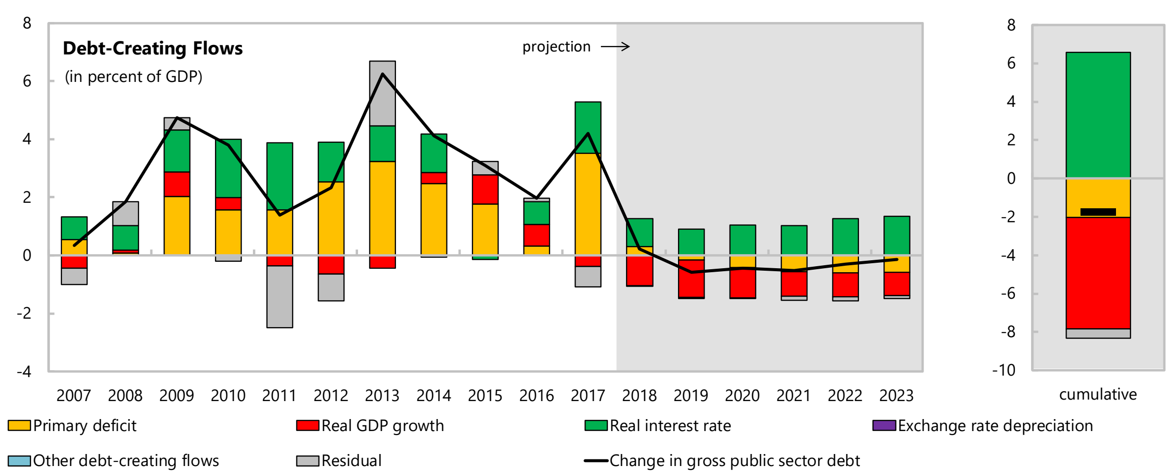
### Debt, Economic and Market Indicators [1/]

| | Actual | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2007-2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
| Nominal gross public debt | 36.5 | 53.0 | 57.2 | 57.4 | 56.8 | 56.4 | 55.9 | 55.6 | 55.4 |
| Public gross financing needs | 2.3 | 1.3 | 4.6 | 11.7 | 5.7 | 4.6 | 4.9 | 4.0 | 5.4 |
| Real GDP growth (in percent) | -0.2 | -1.5 | 0.7 | 1.9 | 2.3 | 1.9 | 1.5 | 1.5 | 1.5 |
| Inflation (GDP deflator, in percent) | 1.4 | 3.4 | 1.0 | 2.6 | 2.9 | 2.6 | 2.5 | 2.1 | 1.7 |
| Nominal GDP growth (in percent) | 1.1 | 1.9 | 1.8 | 4.6 | 5.3 | 4.5 | 4.1 | 3.6 | 3.2 |
| Effective interest rate (in percent) [3/] | 5.4 | 4.9 | 4.5 | 4.5 | 4.6 | 4.6 | 4.5 | 4.4 | 4.2 |

| As of March 15, 2018 | | |
|---|---|---|
| Sovereign Spreads | | |
| Spread (bp) 2/ | | 278 |
| CDS (bp) | | n.a. |
| Ratings | Foreign | Local |
| Moody's | Baa3 | Baa3 |
| S&Ps | BB+ | BB+ |
| Fitch | n.a. | n.a. |

### Contribution to Changes in Public Debt

| | Actual | | | Projections | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2007-2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | cumulative | debt-stabilizing primary balance [8/] |
| Change in gross public sector debt | 3.1 | 2.0 | 4.2 | 0.2 | -0.6 | -0.4 | -0.5 | -0.3 | -0.1 | -1.8 | |
| Identified debt-creating flows | 3.1 | 1.8 | 4.9 | 0.2 | -0.5 | -0.4 | -0.4 | -0.2 | 0.0 | -1.3 | |
| Primary deficit | 1.8 | 0.3 | 3.5 | 0.3 | -0.2 | -0.4 | -0.6 | -0.6 | -0.6 | -2.0 | 0.5 |
| Primary (noninterst) revenue and grants | 13.5 | 17.2 | 18.0 | 17.6 | 17.7 | 17.7 | 17.7 | 17.8 | 17.7 | 106.3 | |
| Primary (noninterest) expenditure | 15.3 | 17.5 | 21.5 | 17.9 | 17.5 | 17.3 | 17.2 | 17.1 | 17.2 | 104.2 | |
| Automatic debt dynamics [4/] | 1.3 | 1.5 | 1.4 | -0.1 | -0.4 | 0.0 | 0.2 | 0.5 | 0.5 | 0.8 | |
| Interest rate/growth differential [5/] | 1.3 | 1.5 | 1.4 | -0.1 | -0.4 | 0.0 | 0.2 | 0.5 | 0.5 | 0.8 | |
| Of which: real interest rate | 1.2 | 0.8 | 1.8 | 1.0 | 0.9 | 1.0 | 1.0 | 1.3 | 1.3 | 6.6 | |
| Of which: real GDP growth | 0.1 | 0.7 | -0.4 | -1.0 | -1.3 | -1.0 | -0.8 | -0.8 | -0.8 | -5.8 | |
| Exchange rate depreciation [6/] | 0.0 | 0.0 | 0.0 | … | … | … | … | … | … | … | |
| Other identified debt-creating flows | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Privatization receipts (negative) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Contingent liabilities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Other debt-creating flows (specify) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Residual, including asset changes [7/] | 0.0 | 0.1 | -0.7 | 0.0 | 0.0 | 0.0 | -0.1 | -0.2 | -0.1 | -0.5 | |




Source: Fund Staff Calculations.

1/ Public sector is defined as central government.

2/ Bond Spread over U.S. Bonds.

3/ Defined as interest payments divided by debt stock at the end of previous year.

4/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

5/ The real interest rate contribution is derived from the denominator in footnote 4 as r - π (1+g) and the real growth contribution as -g.

6/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

7/ For projections, this line includes exchange rate changes during the projection period.

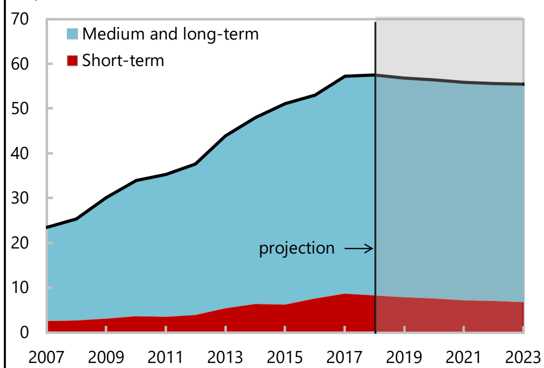
8/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

## The Bahamas: Public DSA - Composition of Public Debt and Alternative Scenarios

### Composition of Public Debt

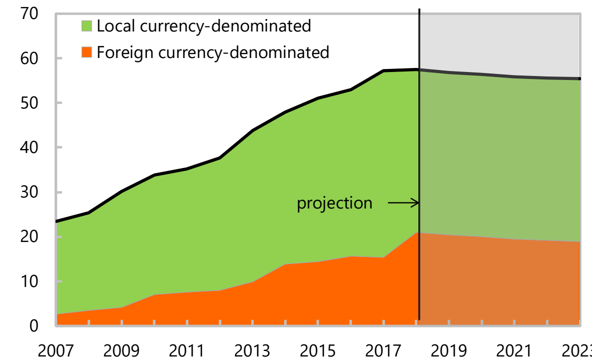
**By Maturity**

(in percent of GDP)




**By Currency**

(in percent of GDP)

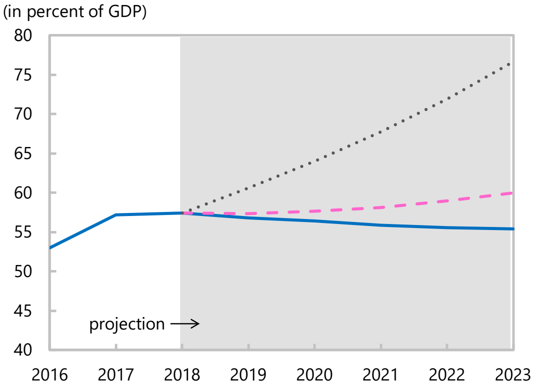



### Alternative Scenarios

Baseline    Historical    Constant Primary Balance

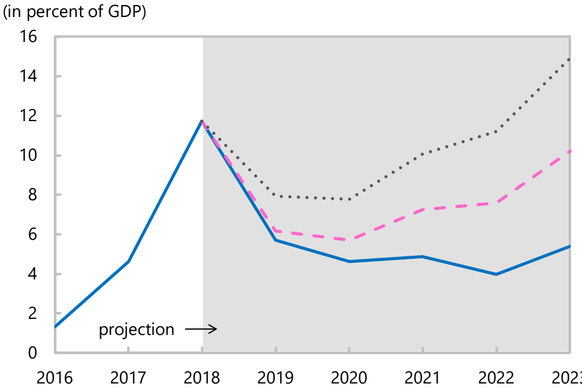
**Gross Nominal Public Debt**

(in percent of GDP)




**Public Gross Financing Needs**

(in percent of GDP)




### Underlying Assumptions

(in percent)

| **Baseline Scenario** | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| Real GDP growth | 1.9 | 2.3 | 1.9 | 1.5 | 1.5 | 1.5 |
| Inflation | 2.6 | 2.9 | 2.6 | 2.5 | 2.1 | 1.7 |
| Primary Balance | -0.3 | 0.2 | 0.4 | 0.6 | 0.6 | 0.6 |
| Effective interest rate | 4.5 | 4.6 | 4.6 | 4.5 | 4.4 | 4.2 |
| **Constant Primary Balance Scenario** | | | | | | |
| Real GDP growth | 1.9 | 2.3 | 1.9 | 1.5 | 1.5 | 1.5 |
| Inflation | 2.6 | 2.9 | 2.6 | 2.5 | 2.1 | 1.7 |
| Primary Balance | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 |
| Effective interest rate | 4.5 | 4.6 | 4.5 | 4.5 | 4.5 | 4.4 |

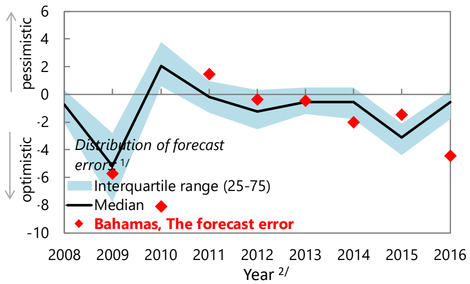
| **Histocial Scenario** | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| Real GDP growth | 1.9 | -0.5 | -0.5 | -0.5 | -0.5 | -0.5 |
| Inflation | 2.6 | 2.9 | 2.6 | 2.5 | 2.1 | 1.7 |
| Primary Balance | -0.3 | -1.9 | -1.9 | -1.9 | -1.9 | -1.9 |
| Effective interest rate | 4.5 | 4.6 | 4.7 | 4.8 | 5.1 | 5.1 |

Source: Fund Staff calculations.

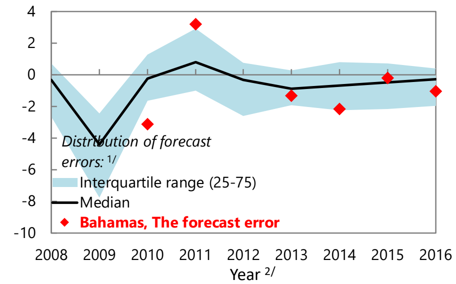
## The Bahamas: Public DSA – Realism of Baseline Assumptions

### Forecast Track Record, versus surveillance countries

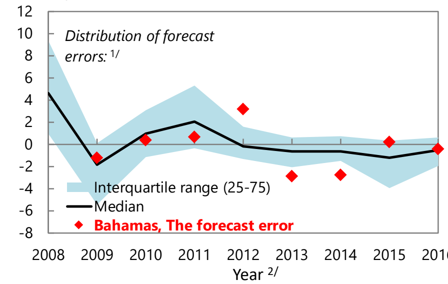
**Real GDP Growth**
(in percent, actual-projection)
Bahamas, The median forecast error, 2008-2016: **-2.03**
Has a percentile rank of: **11%**




**Primary Balance**
(in percent of GDP, actual-projection)
Bahamas, The median forecast error, 2008-2016: **-1.05**
Has a percentile rank of: **34%**

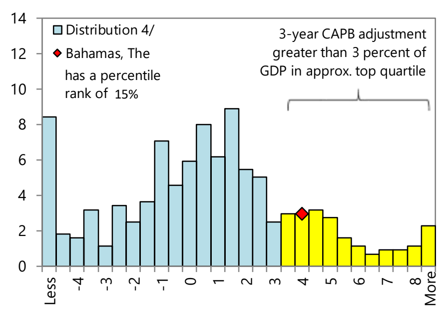



**Inflation (Deflator)**
(in percent, actual-projection)
Bahamas, The median forecast error, 2008-2016: **-0.42**
Has a percentile rank of: **20%**

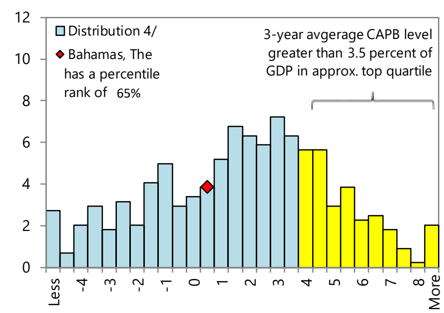



### Assessing the Realism of Projected Fiscal Adjustment

**3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)**
(Percent of GDP)

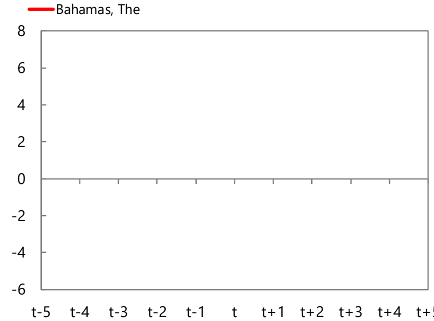



**3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)**
(Percent of GDP)




### Boom-Bust Analysis 3/

**Real GDP growth**
(in percent)



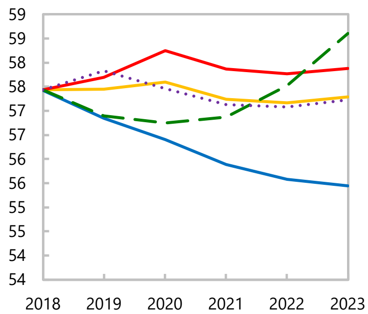

Source: Fund Staff calculations.
1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Not applicable for Bahamas, The.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

## The Bahamas: Public DSA - Stress Tests

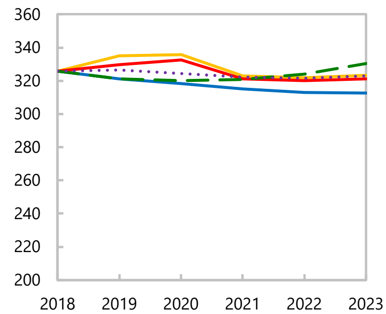
### Macro-Fiscal Stress Tests

Baseline
Real GDP Growth Shock
Primary Balance Shock
Real Exchange Rate Shock
Real Interest Rate Shock

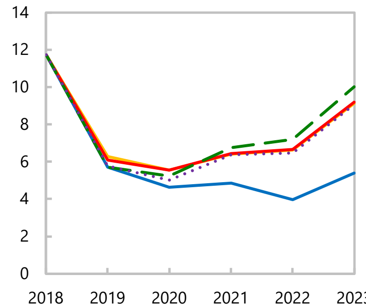
**Gross Nominal Public Debt**
(in percent of GDP)




**Gross Nominal Public Debt**
(in percent of Revenue)



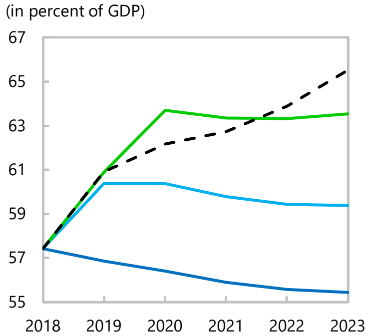

**Public Gross Financing Needs**
(in percent of GDP)



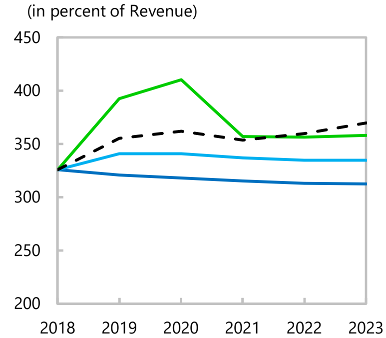

### Additional Stress Tests

Baseline
Hurricane Shock
Combined Macro-Fiscal Shock
Contingent Liability Shock

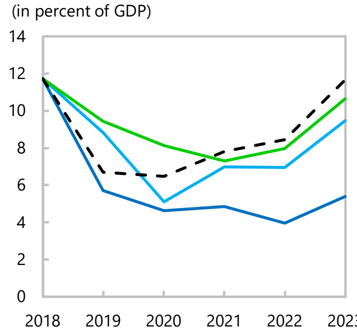
**Gross Nominal Public Debt**
(in percent of GDP)




**Gross Nominal Public Debt**
(in percent of Revenue)




**Public Gross Financing Needs**
(in percent of GDP)




### Underlying Assumptions
(in percent)

| **Primary Balance Shock** | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| Real GDP growth | 1.9 | 2.3 | 1.9 | 1.5 | 1.5 | 1.5 |
| Inflation | 2.6 | 2.9 | 2.6 | 2.5 | 2.1 | 1.7 |
| Primary balance | -0.3 | -0.4 | -0.1 | 0.6 | 0.6 | 0.6 |
| Effective interest rate | 4.5 | 4.6 | 4.6 | 4.5 | 4.5 | 4.4 |
| **Real Interest Rate Shock** | | | | | | |
| Real GDP growth | 1.9 | 2.3 | 1.9 | 1.5 | 1.5 | 1.5 |
| Inflation | 2.6 | 2.9 | 2.6 | 2.5 | 2.1 | 1.7 |
| Primary balance | -0.3 | 0.2 | 0.4 | 0.6 | 0.6 | 0.6 |
| Effective interest rate | 4.5 | 4.6 | 5.0 | 5.4 | 5.9 | 6.1 |
| **Combined Shock** | | | | | | |
| Real GDP growth | 1.9 | 1.5 | 1.1 | 1.5 | 1.5 | 1.5 |
| Inflation | 2.6 | 2.9 | 2.6 | 2.5 | 2.1 | 1.7 |
| Primary balance | -0.3 | -0.5 | -0.4 | 0.3 | 0.3 | 0.3 |
| Effective interest rate | 4.5 | 4.9 | 5.1 | 5.5 | 6.0 | 6.3 |

| **Real GDP Growth Shock** | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| Real GDP growth | 1.9 | 1.5 | 1.1 | 1.5 | 1.5 | 1.5 |
| Inflation | 2.6 | 2.9 | 2.6 | 2.5 | 2.1 | 1.7 |
| Primary balance | -0.3 | -0.2 | -0.1 | 0.6 | 0.6 | 0.6 |
| Effective interest rate | 4.5 | 4.6 | 4.5 | 4.5 | 4.5 | 4.4 |
| **Real Exchange Rate Shock** | | | | | | |
| Real GDP growth | 1.9 | 2.3 | 1.9 | 1.5 | 1.5 | 1.5 |
| Inflation | 2.6 | 6.2 | 2.6 | 2.5 | 2.1 | 1.7 |
| Primary balance | -0.3 | 0.2 | 0.4 | 0.6 | 0.6 | 0.6 |
| Effective interest rate | 4.5 | 4.9 | 4.6 | 4.6 | 4.6 | 4.5 |
| **Contingent Liability Shock** | | | | | | |
| Real GDP growth | 1.9 | 1.5 | 1.1 | 1.5 | 1.5 | 1.5 |
| Inflation | 2.6 | 2.9 | 2.6 | 2.5 | 2.1 | 1.7 |
| Primary balance | -0.3 | -2.8 | 0.4 | 0.6 | 0.6 | 0.6 |
| Effective interest rate | 4.5 | 4.7 | 4.5 | 4.4 | 4.5 | 4.4 |

Source: Fund staff calculations.

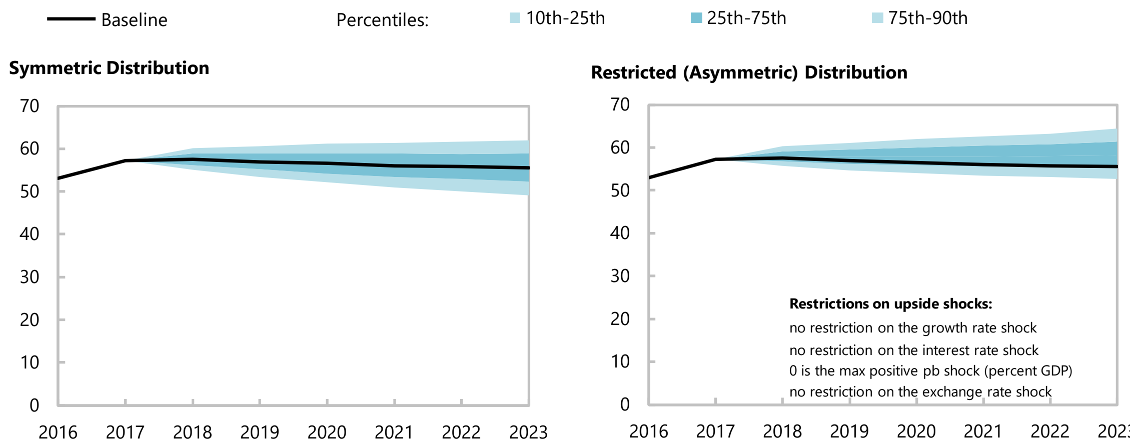
## The Bahamas: Public DSA Risk Assessment

### Heat Map

| | | | | | |
|---|---|---|---|---|---|
| Debt level 1/ | Real GDP Growth Shock | Primary Balance Shock | Real Interest Rate Shock | Exchange Rate Shock | Contingent Liability shock |
| Gross financing needs 2/ | Real GDP Growth Shock | Primary Balance Shock | Real Interest Rate Shock | Exchange Rate Shock | Contingent Liability Shock |
| Debt profile 3/ | Market Perception | External Financing Requirements | Change in the Share of Short-Term Debt | Public Debt Held by Non-Residents | Foreign Currency Debt |

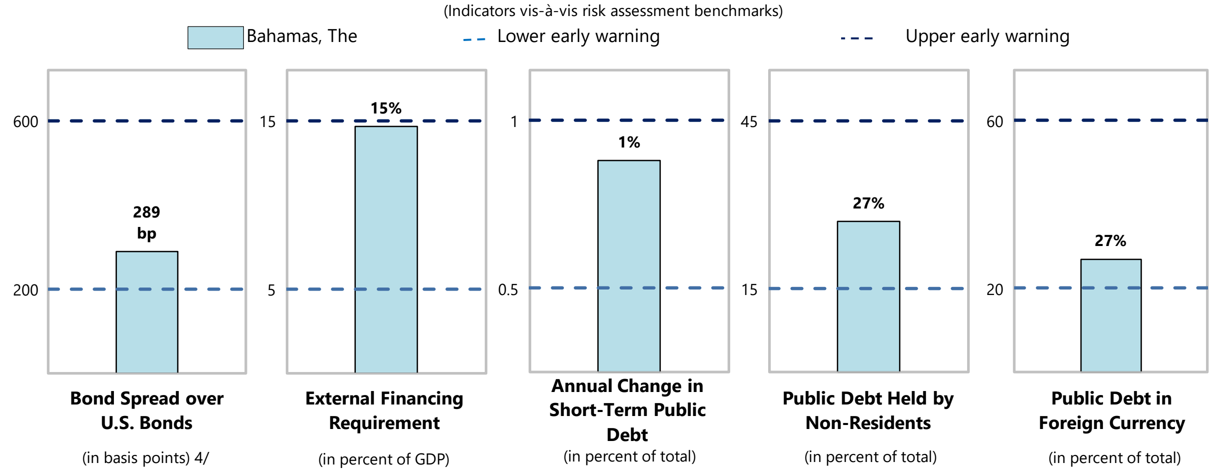
### Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)




### Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)




Source: Fund staff calculations.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

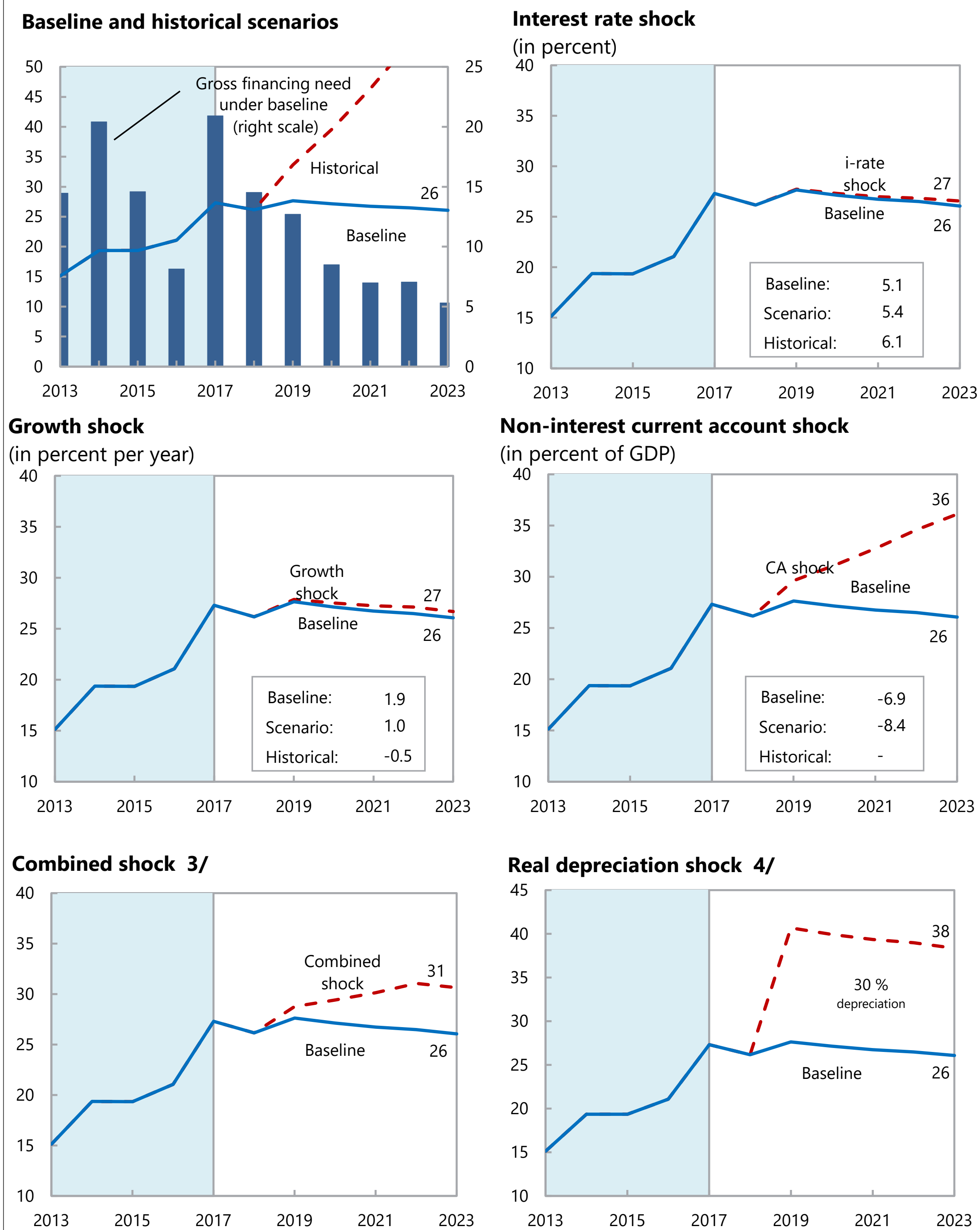
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ An average over the last 3 months, 15-Dec-17 through 15-Mar-18.

## The Bahamas: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)




Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2018.

## The Bahamas: External Debt Sustainability Framework, 2012–2023

(In percent of GDP, unless otherwise indicated)

| | Actual | | | | | | | | Projections | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | | | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | Debt-stabilizing non-interest current account 6/ |
| **Baseline: External debt** | 13.7 | 15.1 | 19.4 | 19.4 | 21.1 | 27.3 | | | **26.2** | **27.6** | **27.1** | **26.7** | **26.5** | **26.1** | **-2.3** |
| Change in external debt | 3.3 | 1.5 | 4.2 | 0.0 | 1.7 | 6.2 | | | -1.1 | 1.5 | -0.5 | -0.4 | -0.2 | -0.4 | 0.0 |
| Identified external debt-creating flows (4+8+9) | 9.1 | 10.8 | 18.6 | 13.2 | 7.2 | 15.7 | | | 10.7 | 4.5 | 4.3 | 3.3 | 2.6 | 2.0 | 0.0 |
| Current account deficit, excluding interest payments | 13.6 | 13.4 | 19.3 | 13.3 | 6.7 | 15.3 | | | 12.2 | 7.4 | 5.7 | 5.0 | 3.9 | 3.9 | 0.4 |
| Deficit in balance of goods and services | 12.8 | 12.3 | 16.8 | 10.3 | 6.6 | 12.1 | | | 8.2 | 4.5 | 3.2 | 2.5 | 1.7 | 1.7 | |
| Exports | 34.3 | 34.0 | 32.8 | 30.4 | 30.3 | 29.3 | | | 29.5 | 30.1 | 30.5 | 31.1 | 31.9 | 32.8 | |
| Imports | 47.1 | 46.3 | 49.6 | 40.7 | 36.9 | 41.4 | | | 37.7 | 34.5 | 33.7 | 33.7 | 33.6 | 34.5 | |
| Net non-debt creating capital inflows (negative) | -4.6 | -3.4 | -1.4 | -0.4 | -0.5 | -0.5 | | | -2.2 | -3.7 | -2.4 | -2.5 | -2.2 | -2.2 | 0.1 |
| Automatic debt dynamics 1/ | 0.1 | 0.9 | 0.7 | 0.3 | 1.0 | 0.8 | | | 0.7 | 0.8 | 1.0 | 0.9 | 0.8 | 0.3 | -0.5 |
| Contribution from nominal interest rate | 0.7 | 0.8 | 0.9 | 1.0 | 1.0 | 1.1 | | | 1.4 | 1.4 | 1.4 | 1.3 | 1.2 | 0.7 | -0.4 |
| Contribution from real GDP growth | -0.3 | 0.1 | 0.2 | 0.6 | 0.0 | -0.3 | | | -0.6 | -0.5 | -0.4 | -0.4 | -0.4 | -0.4 | 0.0 |
| Contribution from price and exchange rate changes 2/ | -0.3 | 0.0 | -0.4 | -1.3 | 0.0 | ... | | | ... | ... | ... | ... | ... | ... | -0.1 |
| Residual, incl. change in gross foreign assets (2-3) 3/ | -5.8 | -9.3 | -14.4 | -13.2 | -5.5 | -9.4 | | | -11.9 | -3.0 | -4.8 | -3.7 | -2.8 | -2.5 | 0.0 |
| External debt-to-exports ratio (in percent) | 39.8 | 44.5 | 59.0 | 63.7 | 69.6 | 93.3 | | | 88.6 | 91.9 | 89.0 | 85.9 | 83.0 | 79.5 | |
| **Gross external financing need (in billions of US dollars) 4/** | 1.6 | 1.5 | 2.2 | 1.6 | 0.9 | 2.4 | | | 1.8 | 1.6 | 1.1 | 1.0 | 1.0 | 0.8 | |
| in percent of GDP | 14.8 | 14.5 | 20.4 | 14.6 | 8.1 | 20.9 | 10-Year | 10-Year | 14.5 | 12.7 | 8.5 | 7.0 | 7.1 | 5.3 | |
| **Scenario with key variables at their historical averages 5/** | | | | | | | | | **26.2** | **33.7** | **39.5** | **46.4** | **54.0** | **61.9** | **-2.5** |
| | | | | | | | Historical | Standard | | | | | | | |
| **Key Macroeconomic Assumptions Underlying Baseline** | | | | | | | Average | Deviation | | | | | | | |
| Real GDP growth (in percent) | 3.1 | -0.6 | -1.2 | -3.1 | 0.2 | 1.3 | -0.5 | 2.3 | 2.5 | 2.2 | 1.6 | 1.5 | 1.5 | 1.5 | |
| GDP deflator in US dollars (change in percent) | 3.3 | 0.2 | 2.8 | 6.9 | 0.0 | 2.1 | 1.5 | 2.5 | 3.2 | 2.5 | 2.7 | 2.4 | 1.8 | 1.6 | |
| Nominal external interest rate (in percent) | 7.2 | 6.0 | 6.3 | 5.4 | 5.3 | 5.4 | 6.1 | 0.6 | 5.3 | 5.5 | 5.2 | 4.9 | 4.6 | 2.8 | |
| Growth of exports (US dollar terms, in percent) | 10.5 | -1.3 | -1.9 | -4.0 | -0.1 | -0.1 | 0.1 | 8.6 | 6.7 | 6.7 | 5.7 | 6.1 | 5.9 | 6.0 | |
| Growth of imports (US dollar terms, in percent) | 18.7 | -2.1 | 8.8 | -15.1 | -9.1 | 15.9 | 0.2 | 12.0 | -3.5 | -4.1 | 1.7 | 3.9 | 3.2 | 5.7 | |
| Current account balance, excluding interest payments | -13.6 | -13.4 | -19.3 | -13.3 | -6.7 | -15.3 | -10.9 | 4.0 | -12.2 | -7.4 | -5.7 | -5.0 | -3.9 | -3.9 | |
| Net non-debt creating capital inflows | 4.6 | 3.4 | 1.4 | 0.4 | 0.5 | 0.5 | 4.7 | 3.1 | 2.2 | 3.7 | 2.4 | 2.5 | 2.2 | 2.2 | |

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate,
e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels
of the last projection year.

# Annex V. Progress on 2013 FSAP Recommendations

| Recommendations | Status |
|---|---|
| **Banking sector** | |
| Recruit additional staff with emphasis on specialists. | Completed. |
| Amend legislation so that if Governor is removed, reasons would be publicly disclosed. | Draft in Parliament. |
| Implement, as planned, draft guidance on bank responsibilities for managing operational, interest rate, and market risk. | Completed. |
| Develop guidelines on the scope and methods of consolidated supervision. | Completed. |
| **Insurance and Pensions** | |
| Introduce a standard methodology for the valuation of long-term insurer liabilities. | Guideline on minimum standards in place. |
| Implement fully the 3-year plan towards risk-based supervision (RBS). Onsite comprehensive examinations should be initiated without delay. | Completed. |
| Develop support for consumer complaint handling. Consider establishing ombudsman. | Complain filing process has been strengthened and an independent arbitration process was introduced in 2017. |
| Amend legislation to specifically require intermediaries to establish a premium payment trust account separate from the intermediary's account. | The Insurance Act mandates a separate trust account. |
| Introduce staggered terms for Insurance Commission of The Bahamas (ICB) Board and publish reasons for removal of Board members or the Superintendent. | Drafting amendments to the Insurance Act. |
| Develop regulations for appropriate group supervision, corporate governance and risk management standards, processes and procedures and conduct onsite reviews in accordance with Insurance Core Principle (ICP) 23. | No regulations; ICB cooperates with other regulators under MOU's and colleges |
| Promulgate regulation for new pension fund legislation without delay. | Pending. |
| **Capital Markets** | |
| Replace current Investment Funds Act 2003 (IFA) and its regulations. | Draft bill under consultation. IFA is expected to be approved in 2018. |
| Delete the exclusion in the Securities Industry Act 2011 (SIA) which permits selling investment fund shares to clients without a license if that is the only securities business a person undertakes. | Pending; to be addressed as part of IFA overhaul. |
| Subject all locally resident related parties to full due diligence check in licensing investment fund. Subject managers/advisers, operators and custodians to ongoing oversight. | In progress. |
| Consider appointing a public interest oversight body for the auditing profession and The Bahamas Institute of Chartered Accountants (BICA), possibly giving the role to the Securities Commission of The Bahamas (SCB). | Pending. |
| Develop a plan, possibly as part of the NFCMP, to deal with the failure of a licensee. | In progress. |
| **Safety Net and Crisis Management** | |
| Prepare crisis management plan draft for Ministry of Finance (MoF). | In progress. |
| Implement crisis management plan. | In progress. |
| Develop a category of 'systemic banks' narrowed to those eligible for solvency support or extraordinary intervention, consistent with international practice. | Completed. |
| Develop a target ratio for Deposit Insurance Corporation (DIC) equity capital and determine primary and secondary borrowing sources. | In progress. |

Source: Central Bank of The Bahamas and Insurance Commission of The Bahamas.

# Appendix I. Draft Press Release

Press Release No. 18/x
FOR IMMEDIATE RELEASE
[May dd, 2018]

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

**IMF Executive Board Concludes 2018 Article IV Consultation with The Bahamas**

On May 4, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with The Bahamas, and considered and endorsed the staff appraisal without a meeting.[2]

Real GDP is estimated to have expanded by 1.3 percent in 2017. Economic activity has been supported by the completion of Baha Mar, new FDI-financed projects, and post-hurricane reconstruction activity. However, air tourist arrivals declined 4 percent in 2017, reflecting the impact of Hurricane Matthew on hotel infrastructure in the Grand Bahama Island. Baha Mar created about 4,000 jobs by March 2018 and helped reduce the unemployment rate to 10.1 percent in November 2017, from 11.6 percent one year earlier. Inflation remains low despite higher oil prices. Headline year-on-year inflation reached 1.8 percent in December 2017, up from 0.8 percent in December 2016.

After reaching 5.8 percent of GDP in FY2017, the central government fiscal deficit is declining on the back of lower spending. Data for the first 7 months of FY2018 show a decline in the deficit to 1.6 percent of GDP, 1.2 percentage points of GDP lower than a year earlier, excluding the one-off purchase of promissory notes issued by Resolve. The government successfully placed an external bond for US$750 million in November 2017.

Commercial banks remain liquid and well capitalized. As of end 2017, the average capital adequacy ratio stood at 33.3 percent, well above the regulatory requirement of 17 percent and liquid assets represented 29.0 percent of total assets, and more than double the statutory

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] The Executive Board takes decisions under its lapse of time procedure when it is agreed by the Board that a proposal can be considered without convening formal discussions.

minimum. The stock of nonperforming loans (NPLs) declined to 9.2 percent of total loans, from 11.4 percent at end-2016. Despite ample capital and liquidity in the system, banks remain cautious in making new loans, which has kept credit to private sector, excluding NPLs, broadly flat. Pressures on correspondent banking relationships (CBR) have not resulted in major disruptions so far.

Real GDP growth is projected at 2½ percent in 2018 and 2¼ percent in 2019 on the back of stronger growth in the United States; the phased opening of Baha Mar; and a pickup in foreign direct investment. Medium-term growth is projected to remain at 1 ½ percent, reflecting significant structural impediments.

The current account deficit is estimated to have widened to 16.4 percent of GDP in 2017, from 7.7 percent of GDP in 2016. The increase is 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. The 2017 cyclically-adjusted current account deficit, after deducting FDI-related imports, is estimated to be above the level consistent with fundamentals and desirable policy settings. Foreign reserves strengthened to US$1.4 billion by end-2017, equivalent to 3.6 months of imports of goods and services, boosted by the sovereign external bond placement in November 2017.

**Executive Board Assessment** [3]

<          >

[3] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summing up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

**The Bahamas: Selected Social and Economic Indicators**

**I. Social Indicators**

| | | | |
|---|---|---|---|
| GDP (US$ millions), 2016 | 11,262 | Poverty rate (percent), 2013 | 12.8 |
| GDP per capita (US$), 2016 | 30,581 | Unemployment rate (percent), November 2017 | 10.1 |
| Population (thousands), 2016 | 368 | Infant mortality rate (per 1,000 live births), 2015 | 9.9 |
| Life expectancy at birth (years), 2015 | 75.4 | Human development index (rank), 2016 | 58 |
| Adult literacy rate, 15 & up (percent), 2007 | 95.6 | | |

**II. Economic Indicators**

| | | | | Est. | Proj. | |
|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
| (Annual percentage changes, unless otherwise indicated) | | | | | | |
| **Real sector** | | | | | | |
| Real GDP | -1.2 | -3.1 | 0.2 | 1.3 | 2.5 | 2.2 |
| Nominal GDP | 1.6 | 3.7 | 0.2 | 3.4 | 5.8 | 4.7 |
| Consumer price index (annual average) | 1.2 | 1.9 | -0.3 | 1.5 | 2.2 | 2.5 |
| Consumer price index (end of period) | 0.2 | 2.0 | 0.8 | 1.8 | 2.4 | 2.6 |
| Unemployment rate (in percent) | 14.6 | 13.4 | 12.2 | 10.1 | 9.2 | 8.4 |
| Saving rate (percent of GDP) | 13.1 | 12.3 | 18.8 | 11.5 | 12.9 | 16.1 |
| Investment rate (percent of GDP) | 33.3 | 26.6 | 26.5 | 27.9 | 26.5 | 24.9 |
| **Financial sector** | | | | | | |
| Credit to the nonfinancial public sector | 4.0 | 7.7 | 12.3 | -3.6 | -3.7 | 6.8 |
| Credit to the private sector | -2.8 | -1.1 | -2.0 | -3.0 | 1.0 | 1.5 |
| Liabilities to the private sector | 1.2 | -0.3 | 8.7 | 1.5 | 5.8 | 4.7 |
| **External sector** | | | | | | |
| Exports of goods and services | -1.9 | -4.0 | -0.1 | -0.1 | 6.7 | 6.7 |
| *Of which:* Travel receipts (gross) | 1.3 | 9.5 | 2.1 | -0.5 | 6.3 | 7.9 |
| Imports of goods and services | 8.8 | -15.1 | -9.1 | 15.9 | -3.5 | -4.1 |
| (In percent of GDP, unless otherwise indicated) | | | | | | |
| **Central government** 1/ | | | | | | |
| Revenue and grants | 13.5 | 15.4 | 17.2 | 18.0 | 17.6 | 17.7 |
| Expense | 15.6 | 16.8 | 18.3 | 20.4 | 18.8 | 17.9 |
| Net acquisition of nonfinancial assets | 2.3 | 2.5 | 1.6 | 3.4 | 1.3 | 2.1 |
| Expenditure | 17.9 | 19.3 | 19.9 | 23.8 | 20.4 | 20.0 |
| Overall balance | -4.4 | -3.9 | -2.8 | -5.8 | -2.7 | -2.3 |
| Primary balance | -2.5 | -1.8 | -0.3 | -3.5 | -0.3 | 0.2 |
| Central government debt | 48.0 | 51.1 | 53.0 | 57.2 | 57.4 | 56.8 |
| **External sector** | | | | | | |
| Current account balance | -20.2 | -14.3 | -7.7 | -16.4 | -13.6 | -8.8 |
| Change in net international reserves (increase -) | -0.4 | -0.2 | -0.8 | -4.4 | 1.5 | -0.4 |
| External public debt (end of period) 2/ | 19.4 | 19.4 | 21.1 | 27.3 | 26.2 | 27.6 |
| **Memorandum items:** | | | | | | |
| Gross international reserves | | | | | | |
| (End of period; millions of U.S. dollars) | 788 | 812 | 904 | 1,414 | 1,225 | 1,273 |
| In months of next year's G&S imports | 2.1 | 2.3 | 2.3 | 3.6 | 3.3 | 3.4 |
| In months of next year's non-FDI related G&S imports | 2.3 | 2.7 | 2.6 | 4.0 | 3.6 | 3.6 |
| In percent of reserve money | 80 | 83 | 70 | 98 | 80 | 79 |
| External debt-service ratio (in percent of exports of G&S) | 16.0 | 5.4 | 9.7 | 20.5 | 9.7 | 11.3 |
| GDP (in millions of Bahamian dollars) | 10,844 | 11,240 | 11,262 | 11,642 | 12,319 | 12,900 |

Sources: Central Bank of The Bahamas; Department of Statistics; Ministry of Finance; UNDP Human Development Report; and Fund staff projections.

1/ The data refer to fiscal years ending on June 30.

2/ Central government and public corporate debt.