EXECUTIVE BOARD MEETING

EBS/20/103
Correction 1

May 29, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **The Bahamas—Request for Purchase Under the Rapid Financing Instrument**

Board Action:	The attached corrections to EBS/20/203 (5/26/20) have been provided by the staff:
Evident Ambiguity	**Page 11**
Factual Errors Not Affecting the Presentation of Staff's Analysis or Views	**Pages 4, 5, 6, 7, 8**
Questions:	Ms. Weber, WHD (ext. 34013) Mr. Oshima, WHD (ext. 36670) Mr. Cevik, WHD (ext. 36695)

(IDB) and the Caribbean Development Bank (CDB), will be able to bridge about 60 percent of this financing gap, helping contain the still-significant drawdown of international reserves. Reserves are expected to decline to about US$1.3 billion in 2020 and to remain at similar levels thereafter.

The Bahamas: Impact of COVID-19 and Hurricane Dorian on Balance of Payments

(In millions of U.S. dollars)

	2020			
	Pre-hurricane/pandemic	Post-hurricane/pandemic	Change	
			mln US$	percent of GDP
Current account balance	**-1359**	**-1953**	**-594**	**(5.2)**
Exports of goods and services	4924	1765	-3159	**(27.8)**
Services (including travel)	4151	1371	-2780	**(24.5)**
Exports (including re-exports)	773	394	-379	**(3.3)**
Imports of goods and services	-5789	-3367	2422	**21.3**
Services (including travel)	-2331	-1458	872	**7.7**
Imports (including goods procured in ports)	-3459	-1909	1550	**13.6**
Oil	-487	-188	299	**2.6**
Capital goods	-827	-741	86	**0.8**
Other	-2145	-979	1166	**10.3**
Foreign direct investment	555	265	-290	**(2.5)**
Other investment (including government borrowing)	829	701	-128	**(1.1)**
Government	47	647	600	**5.3**
Other private flows including domestic banking	781	54	-728	**(6.4)**
BOP financing needs	**...**	**...**	**-1012**	**(8.9)**
Financing 1/			**1012**	**8.9**
IMF (RFI)			252	**2.2**
IDB			180	**1.6**
CDB			50	**0.4**
MIGA guaranteed commercial loans			88	**0.8**
International reserves 2/			442	**3.9**

Sources: The Bahamian authorities; and IMF staff calculations.

1/ Part of the financing by other IFIs that is related to ~~the~~ hurricane Dorian has already been disbursed. Staff assumes that a quarter of the ~~$350 million of~~ commercial loans associated with the World Bank's Multilateral Investment Guarantee Agency (MIGA) will be externally issued and disbursed in 2020. Of the $320 million of IDB loans under discussion, about 40 percent ~~$125 million~~ (of which 20 percent ~~$25 million~~ are investment loans recorded above the line) are assumed to be disbursed in 2020.

2/ The change in reserves under the pre-hurricane/pandemic was an increase in the amount of about US$25 million.

RISKS

5. The main risks facing The Bahamas arise from a more severe and long-lasting COVID-19 pandemic and vulnerability to future hurricanes. The impact of the pandemic depends on its propagation and duration, the success of global and local containment measures, and the effectiveness of policy responses. Disruption of international supply chains, tourism, and travel (including within the archipelago) could have deeper effects than currently expected. The human and economic costs of the local outbreak could also be substantial, given limited capacities of the healthcare system. Vulnerability to hurricanes persists, especially as fiscal and financial buffers are used to respond to Hurricane Dorian and the COVID-19 pandemic.

AUTHORITIES' RESPONSE TO THE CRISIS

6. As part of a comprehensive pandemic response strategy, the authorities have established Economic Recovery, Tourism Response, and National Food Committees. The Economic Recovery and Tourism Response Committees will guide the country's COVID-19 response and advise on ways to jumpstart the economy following the crisis, with a focus on job-creation and stimulating small business development, especially in the tourism industry. The Food Committee will enhance the collaboration among public institutions, the private sector and civil society organizations to improve food distribution, especially to the most vulnerable groups.

The Bahamas: COVID-19 Fiscal Stimulus Measures in FY2019/20–FY2020/21

Measure	Details	Total B$ Mln	Total % GDP
Tax Credit & Tax Deferral Programme To Support Business Payroll.	Companies with a minimum of 25 employees and annual sales of B$3 million retaining at least 80 percent of staff	180	1.5
Business Continuity Loan Program for Small Businesses And Payroll Grants	Loans ranging from $5k to $300k, to cover operating costs.	80	0.7
Subvention to key SOEs	$3M per month for BPL; $4M per month for WSC	63	0.5
Health Care 1/		45.2	0.4
Income Support to Self-Employed	$200 per week; valid business license	43.2	0.4
Social Assistance-Food Vouchers	B$100 every second week will be targeted primarily to persons within the hospitality industry.	24	0.2
Family Island Emergency Order Execution	Specifically to be used for any COVID-19 related expenditure	1.8	0.0
Total		**437.2**	**3.7**

Sources: Ministry of Finance; and IMF staff estimates

1/ Purchase of medical and surgical supplies, ventilators, oxygen tanks, vehicles, and bio waste bins, emergency flights, sanitation of medical facilities, and quarantine site expenses.

7. Fiscal policy has appropriately shifted toward providing economic relief to mitigate the impact of pandemic. The authorities have introduced temporary fiscal measures of about 4 percent of GDP in response to the COVID-19 outbreak to support healthcare infrastructure, employment, small and medium enterprises, and vulnerable groups in the population. These measures come on top of the recovery and reconstruction outlays and tax exemptions following Hurricane Dorian.

8. The fiscal position is expected to deteriorate sharply this fiscal year and next. To accommodate some of the increased fiscal needs, the FY2020/21 budget introduces current spending cuts of 20 percent across ministries, excluding interest expenses and the wage bill, to be achieved through postponing non-priority programs and improving efficiency. State-owned enterprises (SOEs) need to identify savings for FY2020/21 (such as introducing user fees or cutting operating costs). A sin tax may ~~will~~ be imposed for one year on items deemed harmful (including alcohol and tobacco). Excise rates on these products could rise by 10 percent and B$5 per gallon, yielding about B$30 million in additional revenues in FY2020/21. Staff estimates that the additional measures could yield total savings of about B$175 million in FY2020/21. As a result, staff projects the overall deficit at 6.7 and 9.5 percent of GDP in FY2019/20 and FY2020/21, respectively.

The Bahamas: Additional Measures for FY2020/21 Budget

(In millions of Bahamian dollars)

	FY2020/21 Draft Budget	IMF Projection
Excise taxes (Sin tax)	30	30
Current spending (cuts)	300	195
of which : SOE spending (cuts)	21	11
Capital expenditure increase1/	122	50

Sources: Bahamian authorities; and IMF staff calculation.

1/ Capital expenditure includes capital transfers to public sectors.

9. The increased fiscal needs will be financed by a combination of domestic and external debt issuance, as well as financial support from the Fund and other IFIs. Despite the recent S&P downgrade by one notch to "BB", The Bahamas is expected to continue to have access to international bond markets albeit at significantly higher rates than before. The authorities plan a $600 million long-term external bond issuance in FY2020/21. They are also ~~close to securing~~evaluating two guarantees ~~amounting to $350 million~~ from the World Bank's Multilateral Investment Guarantee Agency (MIGA) for COVID-19 healthcare expenses and capital spending. The associated guaranteed commercial bank loans would have maturities exceeding 5~~7~~ years. Discussions are ongoing with the IDB for new credit facilities amounting to $320 million in FY 2020/2021 ~~($200 million~~ for policy loans and ~~$120 million for~~ investment loans, with maturities exceeding 20 years~~)~~.

10. The authorities have put in place contingency plans to protect priority spending. In addition to the current expenditure cuts and proposed increase in excise taxes in the FY2020/21 budget, they are reviewing public expenditure (including by SOEs) to allow the government to reprioritize spending flexibly and timely should downside risks materialize. The Ministry of Finance is also proposing a temporary tightening of expenditure controls across ministries and agencies in order to reduce non-priority spending. Freezing wages and payroll increments could provide substantial savings, especially over the medium-term.

11. The authorities remain committed to fiscal consolidation over the medium term as specified under the Fiscal Responsibility Act (FRA). The government activated the escape clause of the FRA after Hurricane Dorian hit the country. This allows the authorities to postpone the achievement of their fiscal consolidation targets (a fiscal deficit of 0.5 percent of GDP by FY2020/21 and a public debt-to-GDP ratio of 50 percent by FY2024/25) by four years. The COVID-19 crisis will delay reaching these targets further, but the authorities are steadfast to bring the fiscal deficit to 0.5 percent of GDP by FY2026/27 and the debt ratio to 50 percent of GDP by FY2030/31. They will resume various measures when the pandemic fades, including the reviews of SOE governance, investment incentives, and the pension system, enhancements to public financial management (PFM) to increase expenditure control and efficiency, and revenue administration reforms.

The Bahamas: Fiscal Financing, FY19/20 and 20/21
(In millions of U.S. Dollars 1/)

	FY2019/20		FY2020/21	
	Pre-hurricane / pandemic 2/	Current	Pre-hurricane / pandemic 2/	Current
Financing needs	**193.8**	**843.6**	**112.2**	**1209.2**
Percent of GDP	*1.5*	*7.1*	*0.8*	*10.3*
Fiscal deficit	**193.8**	**802.6**	**112.2**	**1122.2**
Percent of GDP	*1.5*	*6.7*	*0.8*	*9.5*
Changes in revenue (+: decrease)		504.3		730.2
Tax measures for Hurricane Dorian		232.5		169.8
Tax measures for Covid-19		60.0		120.0
Shortfall due to the contraction		211.8		440.4
Changes in expenditure (+: increase)		104.5		279.8
Dorian-related measures		182.7		109.7
Covid19-related measures		44.4		134.8
Expenditure cuts		-274.3		-194.8
Other expenditure policies, net		151.7		230.0
Financing support		**41.0**		**87.0**
Business continuity loan program (COVID-19)		20.0		45.0
Temporary support to utility-related SOEs		21.0		42.0
Financing sources	**193.8**	**461.7**	**112.2**	**659.2**
Percent of GDP	*1.5*	*3.9*	*0.8*	*5.6*
Domestic, net	155.0	533.9	89.8	123.8
External, net	38.8	-72.2	22.4	535.4
Gap	**0.0**	**381.9**	**0.0**	**550.0**
Percent of GDP	*0.0*	*3.2*	*0.0*	*4.7*
Potential financing sources		**381.9**		**550.0**
IMF		251.9		-
IDB 3/		80.0		200.0
CDB		50.0		-
World Bank MIGA guaranteed commercial loans		-		350.0
Memorandum				
Nominal GDP (mil. of US$)	12950.9	11965.2	13398.0	11793.2
Overall balance (% of GDP)	-1.5	-6.7	-0.8	-9.5
Government debt (% of GDP)	61.9	72.3	60.0	82.6

Sources: The Bahamian authorities; and IMF staff calculations.
1/ Exchange rate of Bahamian dollar and U.S. dollar is fixed to 1.
2/ "Pre-hurricane/pandemic" refers to the 2019 AIV.
3/ Loans for investment projects are included in "External, net".

12. The authorities plan to follow best practices in procurement and contract awards. The Cabinet recently re-established the Audit Committee to strengthen the implementation of recommendations by internal and external audits. The authorities intend to finalize the Public Procurement ~~Law~~Bill—which will modernize the existing procurement system and bring it in line with international best practice—by end-June this year. The new Public Financial Management (PFM) Bill and Public Debt Management Bill are under internal review and will be submitted to ~~Cabinet~~ Parliament by end-~~June~~December.

13. The Central Bank of the Bahamas (CBOB) has kept interest rates unchanged and focused on protecting the peg to the U.S. dollar. The CBOB has maintained the policy rate at a historically low level of 4 percent. Recent measures aimed at ensuring liquidity in the foreign exchange market include: (i) suspending dividend payments by domestic and foreign-owned financial institutions; (ii) providing more latitude to commercial banks to supply foreign exchange to the public before approaching the CBOB to replenish such funds[2]; (iii) suspending access to foreign exchange for international capital market and real estate investments; and (iv) requesting the National Insurance Board (NIB) to repatriate some of its external assets (about $60 million). Measure (ii) is an easing of a capital flow measure (CFM) on inflows and measures (iii) and (iv) are assessed as a tightening of CFMs on outflows under the IMF's Institutional View (IV).

14. The CBOB has encouraged domestic banks and credit unions to consider loan moratoria. The arrangement provides for a 3-month deferral against repayments on credit facilities that were negatively impacted by the COVID-19 crisis and requires the resumption of payments, with accrued interest, when the financial circumstances of borrowers improve. Some financial institutions have already announced credit support that could extend beyond the 3-month period. The CBOB has provided guidance that loans in good standing before the onset of the pandemic will not be reclassified as a consequence of the deferral against repayments. However, if at the end of the forbearance period loans are not performing, banks will have to reevaluate and reclassify them as needed. Banks have been asked to report monthly on their loan portfolio to enable the CBOB to monitor the impact of the payment deferral on their credit quality.

DEBT SUSTAINABILITY

15. Despite the severe shocks of Hurricane Dorian and COVID-19, public debt remains sustainable. In the baseline scenario, the public debt-to-GDP ratio increases from 61.8 percent in FY2018/19 to 82.6 percent by FY2020/21, and then gradually declines to 79.2 percent over the medium term. The authorities remain committed to pursuing the fiscal targets under the FRA after the pandemic wanes. Nevertheless, considering the expected increase in the debt level, the projected debt path remains vulnerable to substantial downside risks, including from a more severe and long-lasting COVID-19 pandemic and vulnerability to future hurricanes. The authorities have extended maturities through financing support from international financial institutions, limiting the

[2] The CBOB lowered the ceiling on the Bahamian $ Open Position on foreign exchange transactions to the maximum of 5 percent of Tier-1 capital and removed the more binding limit of $5 million on net long exposures.

impact on gross financing needs over the medium term but leading to a significant increase in external debt.

POLICY RECOMMENDATIONS

16. Staff supports the fiscal measures taken by the authorities to address the fallout from the pandemic. The focus on supporting the health care system, ensuring adequate food supply and protecting employment is appropriate. Transfers in-kind could also be considered to protect undocumented workers. Enhancing transparency by providing a separate reporting mechanism for COVID-19 expenditures, commissioning and publishing an independent, third-party audit, and publishing all public contracts as well as beneficial ownership information on companies that receive pandemic-related procurement contracts, will be critical. Effective implementation of the Public Procurement Bill~~Law~~, Public Financial Management and Public Debt Management Bills will require appropriate staffing of the macro-fiscal and debt management units at the Ministry of Finance. To prevent arrears, expenditure monitoring and reporting should be strengthened through more frequent communication between Ministry of Finance, line ministries and agencies.

17. Staff sees some room for monetary easing, but the policy stance should take into account developments in the foreign exchange market. Against the backdrop of a collapse in economic activity and limited inflation pressures, there is some room to lower interest rates. The benefits of doing so have to be weighed against the potential erosion of international reserves and structural bottlenecks in the monetary transmission mechanism. While the recent CBOB interventions could help ensure an adequate level of international reserves, the repatriation of NIB assets needs to be done in a controlled manner that avoids any potential fire-sale dynamics and preserves the NIB's financial position. The CFMs are appropriate under the IV but need to be closely monitored and removed as crisis conditions abate.

18. Staff recommends maintaining a balance between supporting economic activity and safeguarding financial stability. Loan moratoria, where considered useful for households and firms to weather liquidity shocks, should be introduced without relaxing current credit risk standards. They need to be targeted to those borrowers affected by the pandemic, to promote transparency and sound risk management, and prevent a potential buildup of financial risks and moral hazard. While moratoria should not lead to automatic reclassification of assets and an increase in loan provisions, the CBOB should provide guidance so banks' estimates of expected credit losses are robust and timely, and ask for regular loan portfolio reviews and risk assessments by banks to measure the pandemic's impact on financial conditions and asset quality.

19. Once the present crisis subsides, the focus needs to shift to rebuilding buffers and strengthening resilience:

- **Size and speed of fiscal adjustment.** Decisive and significant fiscal measures are needed to bring public debt on a clear downward path and achieve the fiscal targets under the FRA. Staff calculations suggest that to achieve the FRA debt target by 2030/31, an average primary surplus

July 1. Post-Hurricane Dorian reconstruction efforts—delayed because of the pandemic—should gain pace in the second half of 2020, as domestic containment measures are relaxed. While real GDP is expected to reach pre-crisis levels in 2023 in line with staff projections, the authorities are projecting significantly lower growth in 2021 and higher growth in 2022/2023. They expect the lingering effects of the global COVID-19 travel restrictions and consumer hesitancy to temper the pace of the recovery in tourism demand through the first half of 2021.

23. The COVID-19 pandemic will have a profound impact on public finances, including through an unprecedented loss in revenues. The authorities highlighted the severe revenue shortfalls they are experiencing, with April revenues being 50 percent lower than last year. This—together with the measures taken to save lives and livelihoods—will significantly increase budget deficits this fiscal year and next. The authorities are currently targeting a deficit of B$1326 million for FY2020/21, somewhat higher than staff's projection, given their different recovery profile.

24. The authorities share staff's views on the importance of advancing structural fiscal and governance reforms and safeguarding debt sustainability. They confirmed that the COVID-19 measures will be audited within 9 months of the end of the fiscal year, and results will be published on the government's website, ensuring efficiency and transparency of relevant spending. The government will continue to finalize the new PFM-related laws. These—together with the Fiscal Council—will further enhance fiscal management and discipline. The authorities are also committed to medium-term debt sustainability targets and view the reform of SOEs as particularly promising in generating savings over the medium-term.

25. The CBOB sees an urgent need to maintain an adequate level of international reserves. While there are no significant capital outflows at this stage, the CBOB views the recent foreign exchange measures as necessary to preserve reserve adequacy. Repatriating some of the NIB's external assets, representing a small portion of its portfolio, and allowing domestic banks greater latitude in open positions to purchase funds in the interbank market should contribute to foreign exchange liquidity. The CBOB argues that it has adequate systems to monitor the effects on the banking system of these interventions. The CBOB also highlighted their temporary nature and that they will not jeopardize recent progress in exchange control liberalization. The CBOB does not consider expansionary monetary policies to be appropriate at the current juncture. The CBOB agreed that the new central bank law should be adopted without delay.

26. The CBOB views recent financial sector measures as appropriate and in line with international best practice. The central bank is in constant consultation with international regulatory bodies and agrees on the need to carefully monitor asset quality and compliance with the regulatory regime in the financial system. The CBOB will also conduct stress tests of the banking sector to better assess the strategies, processes and risk resilience of individual institutions.