

Review of the Economy For the First Three Months of 2006

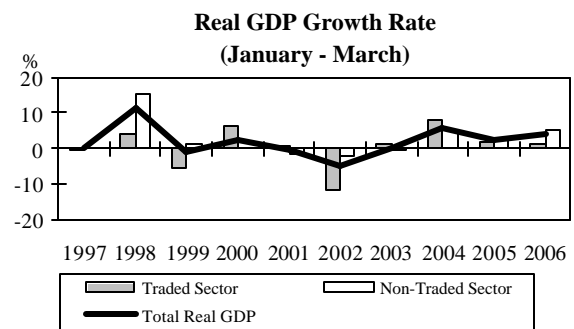
Overview

The Barbadian economy expanded by an estimated 4.4% in the first quarter of 2006, marking its seventh consecutive quarter of real GDP growth above 3%. The non-traded sectors continued to fuel this expansion, bolstered by the ongoing construction boom, while a pick-up in tourism and manufacturing activity boosted traded output. Amid all of this, unemployment remained low, while inflation showed signs of moderating.

In keeping with the outturn in the traded sectors, exports of goods and net services receipts increased modestly, while import growth slowed, resulting in a narrowing of the external current account deficit. This improvement, together with stronger net capital inflows, led to a rise in the Net International Reserves (NIR) of about \$45.4 million, which surpassed the first-quarter changes in 2004 and 2005.

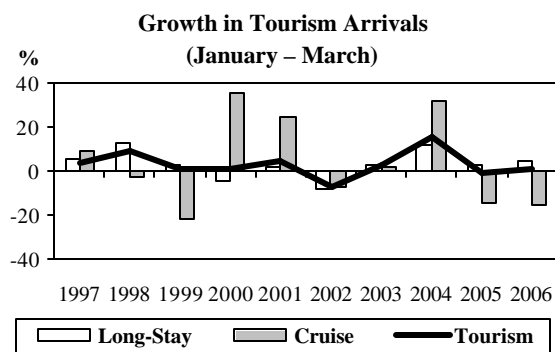
The slowdown in import growth partly reflected the dampening effect of tighter monetary policy on credit demand. However, while credit growth moderated somewhat, it continued to outpace deposit accumulation, leading to a further tightening of liquidity and a corresponding rise in Treasury bill rates.

Despite this increase in its cost of funds, Government recorded a budgetary surplus. Buoyant tax revenues mostly accounted for this surplus, offsetting higher expenditure in the lead-up to Cricket World Cup.



Sectoral Performance

The tourism industry staged a partial recovery during the first three months of 2006, growing by just under 1%. This followed a 2.2% decline in the corresponding period of 2005, when an 18.8% contraction in cruise passenger arrivals lowered overall growth. It is estimated that the cruise segment fell by a further 15.2% during the review period, as cruise lines continued to operate closer to the US mainland in the face of rising fuel costs. However, long-stay tourism compensated for the shortfall, expanding by approximately 4.1%. Data up to February showed that the CARICOM market had the single largest increase in long-stay visitors, in the order of 15.5%, driven by strong growth in arrivals out of Trinidad and Tobago. Canada, the US, the UK and Continental Europe were up 6.2%, 2.8%, 2.6% and 1.3% respectively, reflecting economic growth in these markets.

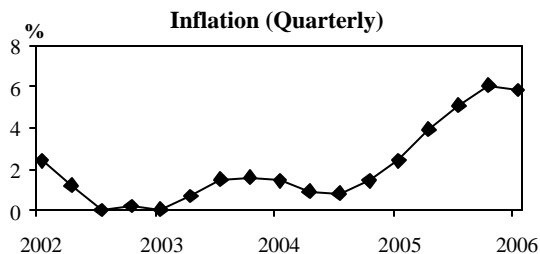


Output in the manufacturing industry rose by approximately 2.4% during the review period, after recording marginal growth a year earlier. Increased production of beverages and chemicals were the key factors in this performance.

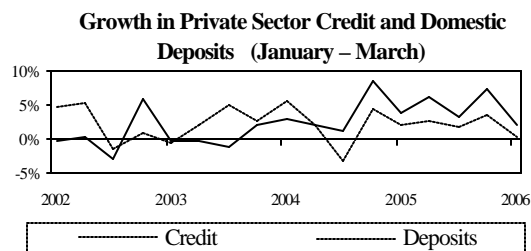
Following a more than 50% rise in the first quarter of 2005, sugar production declined by 2.8%, reflecting a cutback in acreage planted and a delayed start to the crop. Non-sugar agriculture and fishing rebounded from a 1.6% decline between January and March 2005 to post growth of 2.1%.

The construction industry advanced by 9.7%, after growing by 16.0% a year earlier. The prospect of Cricket World Cup 2007 contributed to the ongoing rise in tourism-related projects and private residential building, while work continued on several Government infrastructural projects, including road works and the redevelopment of Kensington Oval. This construction boom, along with the improvement in tourism, had positive spill-over effects on the wholesale and retail industry and transport, storage and communications, as well as business and other services, which expanded by 5.3%, 4.8% and 4.7%, respectively.

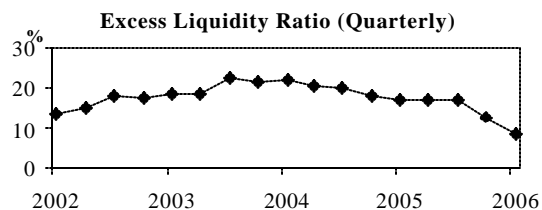
The robust outturn for both the traded and non-traded sectors was accompanied by single-digit unemployment, while the moving average inflation rate was estimated to have declined to 5.9% from 6.1% at the end of 2005.



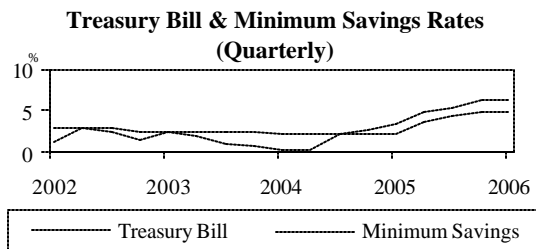
Despite the gains in terms of growth and employment and higher disposable incomes, in the context of tax cuts, higher borrowing costs as Central Bank's interest rate hikes in 2005 took effect. Consequently, growth in credit to the non-financial private sector lost much of its momentum of the previous two years, slowing from 4.0% (\$124.0 million) in the first quarter of 2005 to 2.4% (\$89.3 million) in the same quarter of 2006. Despite the increase in interest rates, the pace of deposit accumulation slowed even more, decelerating to just 0.7% (\$41.4 million) from 2.3% (\$120.3 million) a year earlier, with substantial reductions in the deposits of public and private financial institutions.



Though both credit and deposit growth slowed, growth in credit continued to outstrip that of deposits, causing liquidity in the banking system to tighten further. This was evidenced by the movement in the excess liquidity ratio, which fell to 8.2% in March 2006 from 12.7% at the end of 2005, having dropped from 17.3% in March 2005.

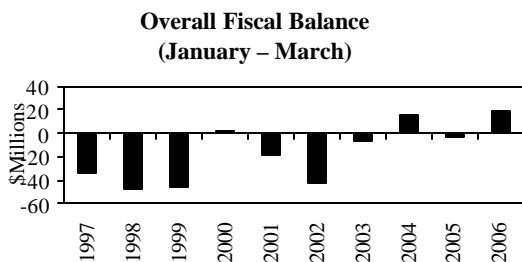


Given these tight liquidity conditions, the Treasury bill rate rose from 3.28% at March 2005 to 6.22% at the end of March 2006; it therefore remained above the minimum savings rate of 4.75% set by the Central Bank.



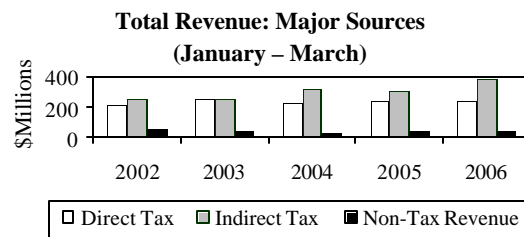
The \$71.0 million reduction in the stock of Treasury bills outstanding between

December 31, 2005 and March 31, 2006 was consistent with this higher rate. It also reflected the fact that Government had more flexibility in financing its operations, since it recorded a surplus. In effect, growth in total revenue exceeded the rate of increase in total expenditure, producing a surplus of approximately \$114.3 million. This represented a significant reversal from the situation in the first quarter of 2005, when revenue grew more slowly than expenditure, yielding a deficit of \$3.7 million.

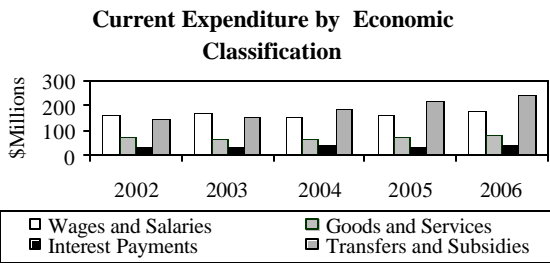


Total revenue surged by an estimated 25.0% during the quarter, underpinned by strong growth in tax revenues. Direct taxes accounted for much of this, growing by 42.4% despite the lowering of the personal, corporate and property tax rates and the raising of personal allowances. This was the result of the increase in economic activity, which was reflected in a significant recovery in personal income tax collections, as well as large increases in the intake of corporate, property and other taxes.

Notably, there was also a spike of about 21.1% in indirect taxes, as pre-payments of value-added tax (VAT) and import duties made in 2005 were recorded in early 2006, contributing to sharp increases of around 40.2% and 9.0% respectively in those two categories.



Total spending by Government was up 4.8% in the review period, down from 7.9% a year earlier. Current expenditure rose by 2.7% overall, as supplementaries granted to the Barbados Tourism Authority, the Transport Board and the University of the West Indies were partly responsible for a 14.1% increase in transfers and subsidies. However, most of the other sub-categories recorded declines; of these, the strongest decrease was recorded for interest payments, which fell by 38.8%. In addition, on-budget capital spending was up by 4.2%, following on from growth of 10.5% a year earlier, as Government expanded its capital works programme in anticipation of Cricket World Cup.

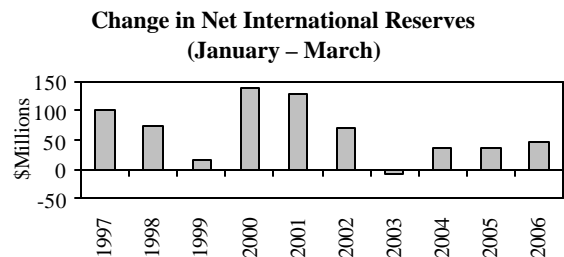


With the fiscal accounts showing a surplus, the net financing position at the end of the quarter was negative. Net domestic financing was estimated at minus \$104.0 million, due to a significant reduction in commercial banks' holdings of Government securities and a build-up in Government's deposits with the Central Bank. On the foreign financing side, there was also a net outflow of \$10.3 million, with amortisation payments of \$14.8 million outweighing project fund inflows of \$4.5 million.

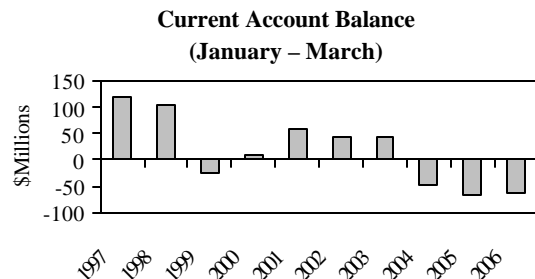
For the fiscal year ending March 2006, the budget deficit was estimated at \$131.1 million or 2.1% of GDP, compared to \$142.6 million or 2.5% of GDP in the previous fiscal year. Total revenue advanced by approximately 12.9% to \$2,167.7 million, whereas total expenditure rose by around 11.5% to \$2,298.8 million.

During the quarter under review, the NIR expanded by an estimated \$45.4 million, up from \$37.4 million and \$36.0

million in the corresponding periods of 2004 and 2005, while the second-tier reserves remained unchanged. The increase in the NIR was the result of substantial gains on the capital and financial account, as well as an improvement in the external current account deficit.



The external current account deficit for the quarter amounted to approximately \$27.9 million, an improvement of \$39.6 million over the previous year. The main factor behind this performance was a pick-up in travel credits of around 6.9%, which fed into an estimated 7.7% increase in net services receipts.

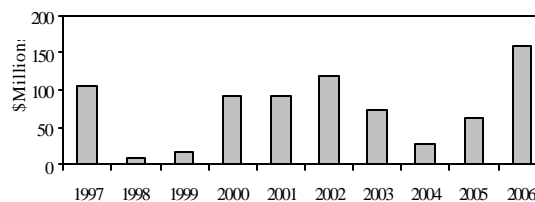


Also contributing to the current account improvement was the deceleration in import growth, which in turn was linked to monetary policy measures designed

to curb demand, as well as the Cess on selected imports. Retained imports grew at a rate of about 8.2%, a much more sustainable pace when compared to the average first-quarter rate for the previous three years of 15.7%. Preliminary data indicate that this slowdown was concentrated in the consumer goods and intermediate goods categories, with the key sub-categories in each case being food and beverages and construction materials, respectively. Conversely, imports of capital goods rose appreciably, boosted by machinery imports. Along with the slowdown in import growth, domestic exports grew by an estimated 53.4%, mainly food and beverages, electronic components and other miscellaneous items.

The capital and financial account registered a surplus of approximately \$158.2 million, more than double the size of the surplus in the first quarter of 2005. Higher net short-term capital inflows were received, mostly pre-shipment financing for sugar exports.

**Capital and Financial Account
(January – March)**



Outlook for the rest of 2006

In 2006, the Barbadian economy is expected to equal its 2005 performance, with real GDP set to grow by about 4 percent, led once more by the non-traded sectors. In the run-up to Cricket World Cup 2007, non-traded growth should continue to be driven by construction, with its positive influence on wholesale and retail, transport, storage and communications and business and other services. On the traded side, the current pick-up in tourism and manufacturing activity is projected to continue for the rest of the year, whereas sugar production is likely to decline given the reduction in acreage planted. In line with the forecasts for economic activity, the average rate of unemployment will probably remain in single digits, while inflation could slow to around 3.5% by the end of the year, provided that international oil prices stabilise as predicted by the International Monetary Fund (IMF).

To the extent that tourist arrivals are expected to improve, travel credits should also rise, contributing to an increase in net services receipts. In addition, while growth in domestic exports is likely to be tempered by lower production of sugar for export, import growth would also be constrained, as the Cess and higher interest rates continue to keep demand in check. Consequently, although the external current account deficit could widen, the deficit to GDP ratio should be reduced. Furthermore, the shortfall on the external current account should be largely offset by a healthy surplus on the capital and financial account. As a result, the decline in the NIR could be around \$100 million, which compares favourably with the underlying reserve position in 2005, excluding borrowing.

In the context of higher borrowing costs, growth in credit to the non-financial private sector is expected to continue to lose pace, particularly in the latter half of the year. On the other hand, relatively high interest rates should encourage individuals to save more, so deposits could grow a little faster. Still, tight liquidity conditions should persist.

The recording of VAT and import duties for 2005 in the first quarter of 2006 will boost the figures for the year as a whole, resulting in higher indirect taxes being reported. Direct taxes should also increase in 2006, albeit at a slower rate than in the previous year, tempered by the downward revision of the personal corporate and property tax rates and the raising of the personal allowance. It is also anticipated that Government will seek to rein in current expenditure growth, though interest payments will rise as interest becomes due on the bond raised on the international market in 2005.

With expectations of expansions in tax revenues and moderate growth in current expenditure, the on-budget fiscal deficit may not be any higher and could improve somewhat, compared to 2005, despite the planned capital works programme. This programme will involve higher capital spending on projects such as the retrofitting of the Greenland landfill, the rehabilitation of the Fairchild Street Market, the continuation of the Coastal Infrastructure Programme, as well as spending related to the Cricket World Cup 2007.

May 2, 2006