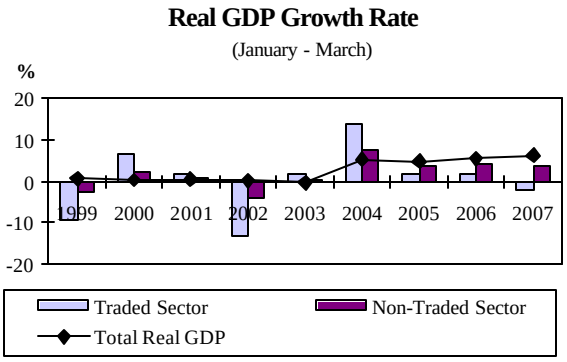
Review of the Economy
For the First Quarter of 2007

Overview

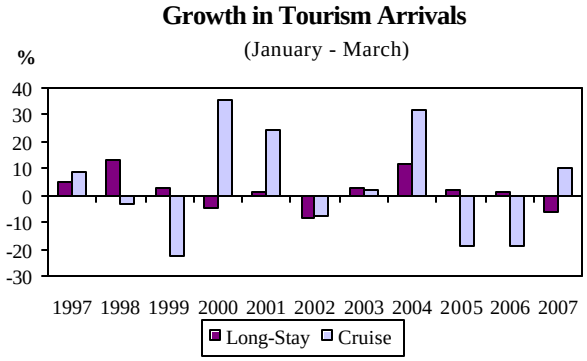
During the first quarter of 2007, the Barbadian economy expanded by an estimated 3.7%, compared to 4.1% over the corresponding three months of 2006. Growth continued to be driven primarily by strong performances in the non-traded sectors, led by distribution and transportation services. The external current account deficit deteriorated slightly during the review period, reflecting comparatively higher levels of imports and foreign interest payments. Nevertheless, the net international reserves (NIR) of the monetary authorities rose by $132.4 million during the first three months of the year, compared to $45.9 million one year prior, on account of strong capital inflows.

Commercial bank credit to the non-financial private sector grew at a slower rate during the first quarter than in the same period of 2006, a reflection of the contractionary monetary measures implemented in recent years. Additionally, in line with the increased foreign inflows, domestic deposits expanded at a rate nearly 2.0 percentage points faster than in the equivalent period of 2006. Nonetheless, liquidity in the banking system remained tight as Government continued to finance its operations primarily from domestic sources.



Sectoral Performance

Real tourism value-added decreased by approximately 3.8% in the corresponding period of 2007, as the sector had not yet seen the anticipated strong increase in arrivals for Cricket World Cup (CWC). Preliminary estimates suggest that long-stay arrivals contracted by 6.0%, primarily owing to a significant fall-off in visitors from CARICOM, possibly on account of cricket enthusiasts delaying their travel until the cricket matches begin in the second quarter. Notably, the cruise industry performed well with arrivals surging by 10.4%, a partial turnaround from declines of approximately 18.5% in the previous two first quarters.

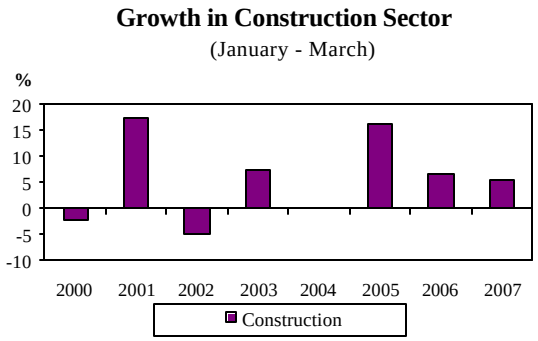


Over the review period, manufacturing output rose by an estimated 0.9%, following an expansion of 4.4% in the first three months of 2006. Food production increased by 3.2%, a reversal from the 1.5% downturn recorded one year ago. Growth in non-metallic mineral products slowed significantly to an estimated 1.0% from 30.4% one year earlier, primarily on account of some slowing in construction activity. Additionally, output in electronics and chemicals fell marginally, in contrast to expansions of 4.4% and 5.6%, respectively, during the first three months of 2006.

Owing to the timing of the start of the crop, sugar production rose by only 0.7%, following significant increases in the corresponding periods of 2005 and 2006. Output in the non-sugar agriculture and fishing sector grew by 0.9%, relative to an expansion of 1.5% in the January-March period last year. A boost in the stock of lactating cattle through importation resulted in a 3.2% pick-up in milk production, after three years of contraction in the industry. However, the other components – chicken, food crops and fish catches – were estimated to be unchanged over the review period.

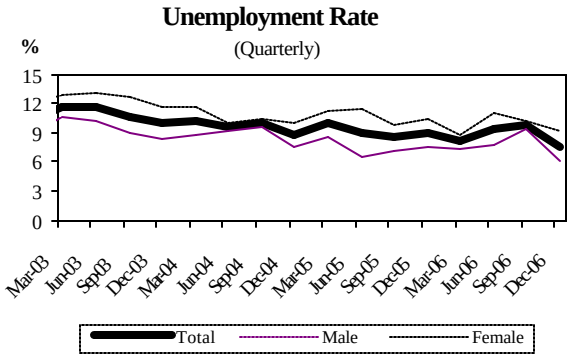
Construction activity expanded by approximately 5.4% during the first quarter, after growing by 6.5% one year prior, as the construction boom that started two years ago began to abate. With the increased activity surrounding CWC, output in the transportation, storage and communications as well as the business and other services

sectors grew by a robust 7.4% and 6.5%, respectively, while wholesale and retail trade expanded by 7.1%, compared to 5.4% in 2006.

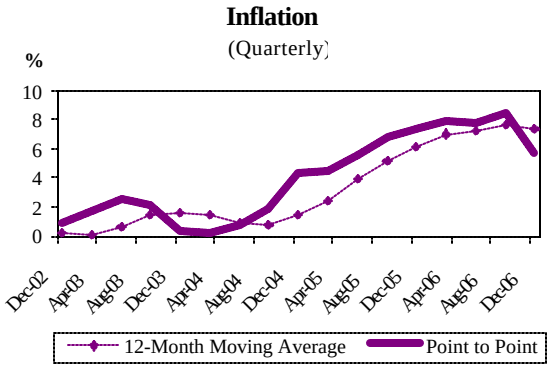


During 2006, five hundred and thirty-four new companies were registered in the international business and financial services sector, compared to four hundred and twenty-eight in 2005. Licences were issued to 391 international business companies, nine lower than in the previous year. One hundred and thirty-three societies with restricted liability, eight exempt insurance companies and four new offshore banks were approved for operation. One exempt insurance management company was registered during the review period.

The sustained levels of economic activity translated to declining unemployment but also contributed to inflationary pressures. At the end of last year, the unemployment rate had fallen 0.4 percentage points to 8.7%, the lowest on record, and a similar single-digit unemployment rate is expected for the review period.



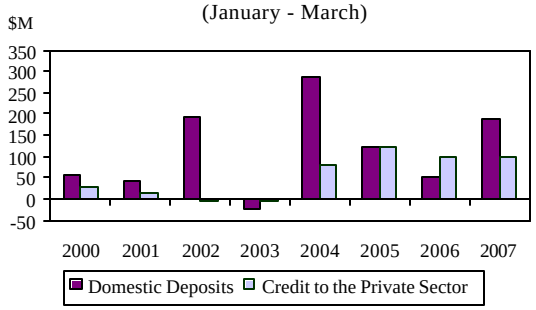
The moving average inflation rate at the end of January remained relatively high at 7.0%, compared to 6.4% one year ago. Major increases were recorded for housing (9.0%), household operations and supplies (8.3%) and food (8.0%). Notably, the point-to-point rate of 4.9% was well below the moving average figure, suggesting that, in the absence of significant external shocks, the moving average rate should continue to decline over the next few months.



Growth in credit to the non-financial private sector slowed to 2.3% ($98.1 million) in the first quarter from 2.6% ($98.6 million) in the corresponding period one year ago.

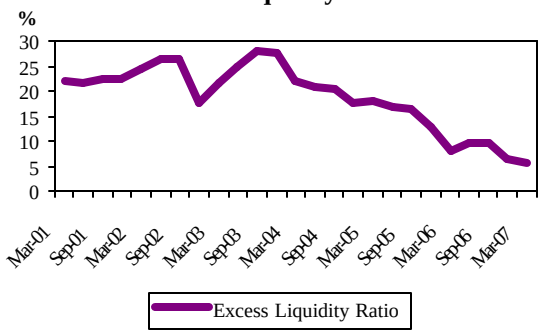
In contrast, the stock of domestic deposits in the financial system rose by 3%, or $186.9 million, during the period under review, following a marginal increase of 0.9% or $50.1 million at the end of March 2006, owing to a significant pick-up in deposits of both public and private financial institutions.

Changes in Domestic Deposits and Private Sector Credit
(January - March)



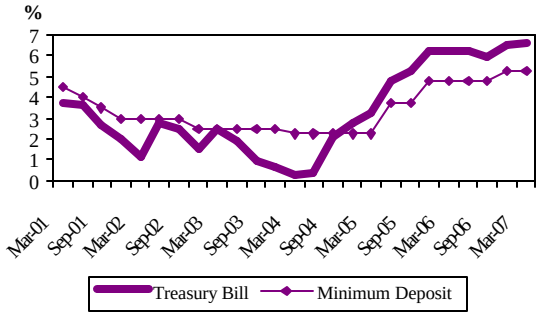
Liquidity within the financial system remained relatively tight and there was continued divestment of treasury bills by commercial banks during the quarter.

Excess Liquidity Ratio



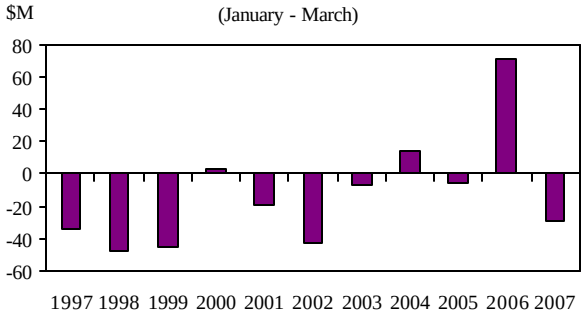
The 3-month Treasury Bill rate was 6.64% at March 28th, 42 basis points higher than the rate at the end of March last year.

Treasury Bill & Minimum Deposit Rates



Central government operations resulted in a $29.8 million deficit during the first quarter of 2007, in contrast to a surplus of $71.3 million during the corresponding period one year ago. The government financed the deficit mainly through borrowings from private non-bank and other institutions.

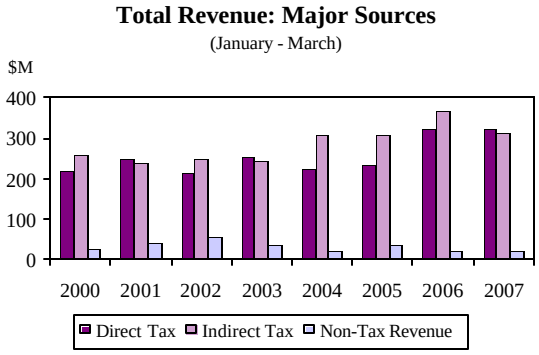
Overall Fiscal Balance
(January - March)



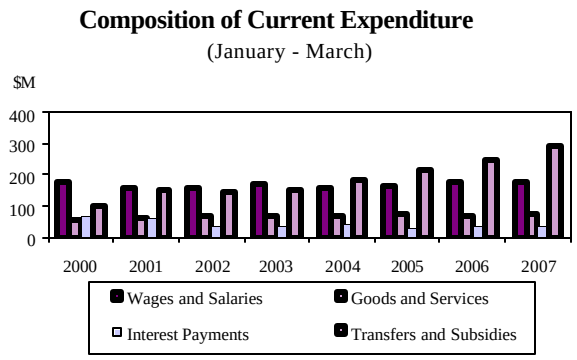
Growth in total revenue during the first quarter was less robust than in the comparable period of 2006. Direct tax receipts decreased by approximately 0.6%,

in contrast to an increase of 39.9% for the similar period of 2006. Personal tax proceeds declined by around 8.1% during the January – March period, following a rise of 11.3% one year earlier, a reflection of the upward revision of the personal allowance from $22,500 to $25,000. In addition, property tax receipts also decreased by roughly 2.6% following extraordinary growth in the first quarter of 2006, when the Government undertook a property revaluation exercise. However, corporate tax collections grew marginally, compared to a growth rate of more than 50% one year ago when the number of international business companies entering the pool of taxable institutions increased significantly.

Declines were recorded in most of the component categories for indirect tax revenue. Although higher than in 2005, value added tax (VAT) receipts were estimated to be 14.9% lower than one year prior when an extraordinarily high figure resulted from a timing discrepancy in recording VAT payments. Excise taxes were less than half the total recorded in the corresponding period of 2006, when a significant amount of outstanding monies was collected. Additionally, non-tax revenue declined by 2.6%, after contracting by 36.8% in the first quarter of last year.

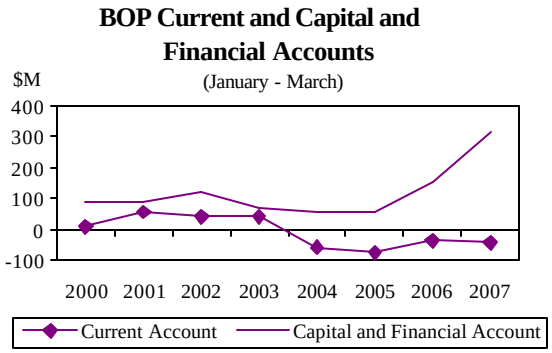


Government's current expenditure grew by 10.1% during the review period, compared to an expansion of 8.8% one year earlier. Spending on goods and services grew by 15.5%, following a contraction of 10.9% in the first quarter of 2006. Transfers and subsidies rose by 17.9%, on account of an increase in grants to a number of public institutions. Wages and salaries increased by 0.7%, compared with growth of 7.0% one year ago. Capital expenditure decreased by 16.7%, in contrast to strong growth last year, as much of the infrastructural work undertaken by the government in recent times neared completion.

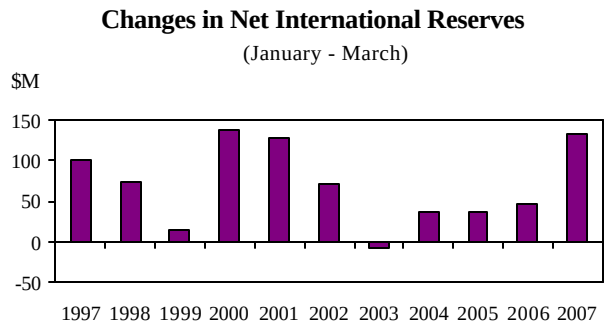


The external current account deficit deteriorated over the review period, reflecting the combination of high levels of retained imports and foreign interest payments. Retained imports expanded by 5.5%, compared to a 6.5% increase in the similar period of 2006. Consumer goods expanded by 14.3% ($37.5 million) reflecting a rise in imports of food and beverages and electronic equipment, while capital goods grew by 11.3% ($20.4 million) owing to higher imports of machinery. Intermediate goods contracted by 6.2% ($17.3 million) driven largely by declining fuel imports. Domestic exports improved by 6.7% ($8.5 million) on account of growth in food and beverages.

Net receipts from services expanded by 7.4%, representing the fifth consecutive January-March increase. In spite of the fall-off in tourism activity, travel credits still recorded modest growth of 2.6%, owing to relatively high price levels. Additionally, net income outflows expanded, reflecting higher foreign interest payments.



The surplus on the capital and financial account during the first quarter of 2007 was at $312.1 million, more than twice that recorded for the corresponding period of 2006, and the highest first quarter surplus in ten years. Net long-term inflows during the period totalled $135.6 million, almost double the amount registered in the first three months of last year. Inflows for the public sector were mainly from a bond issue on behalf of a statutory corporation, while private sector funds continued to be directed towards real estate projects. The increase in short-term capital inflows was mostly in the form of loan proceeds for the prison and airport projects as well as pre-shipment financing for the sugar harvest. Additionally, there were greater foreign currency receipts from commercial banks.



Outlook for the Rest of 2007

Real GDP in 2007 is expected to grow by between 4.0% and 4.5%, as the country is likely to reap benefits from the hosting of the CWC. Despite the anticipated rise in tourism value-added, the Barbadian economy is poised for another year of non-traded sector-led growth, with the main areas of activity concentrated in the construction, wholesale and retail and business and other services sectors. Sugar production should remain essentially unchanged, while the growth in manufacturing is expected to be modest. With the projected continued expansion in the economy, the average unemployment rate is expected to remain in single digits. The moving average rate of inflation is likely to decline to around 5.5% by the end of the year barring any negative shocks, as the pass-through effect of the deceleration in international oil prices is realised.

The external current account balance as a percentage of GDP is projected to improve during 2007. The removal of the cess at the end of February coupled with higher disposable incomes could stimulate further expansion in imports. However, domestic exports are anticipated to grow in 2007, albeit not at the extraordinary rates experienced in 2005 and 2006, while the pick-up in tourist arrivals should generate higher travel credits. The capital and financial account balance is unlikely to grow further in 2007. Consequently, in the absence of borrowing, the NIR may decline by year-end.

Credit growth should continue to slow during the remainder of the year as a result of the monetary and fiscal initiatives implemented since 2005. The expansion in economic activity and rising interest rates should serve as an incentive to increase savings, resulting in faster domestic deposit accumulation relative to credit. Liquidity in the financial system is not expected to tighten further during the year.

The central government on-budget fiscal position is expected to worsen, as slower growth in government revenue is likely to be offset by higher anticipated expenditure.

Property, corporate and indirect tax receipts are forecasted to be strong in 2007 as a result of the anticipated economic expansion, while the growth in personal tax collections should slow. Government's current expenditure is projected to grow, driven by greater spending on wages and salaries and goods and services, in particular. The rate of growth in capital expenditure is likely to be marginal this year as much of the infrastructural work has already been completed, or should be completed, by year-end.

April 30, 2007