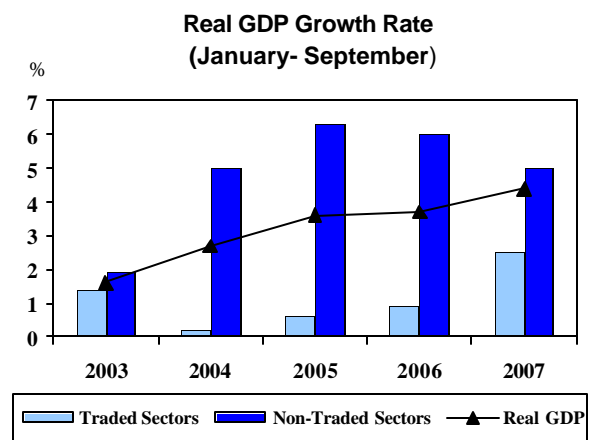


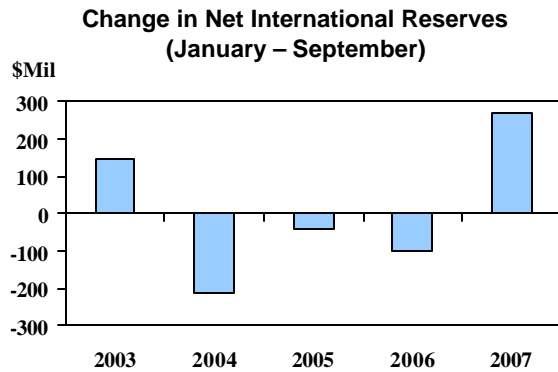
# Review of the Economy For the First Nine Months of 2007

## Overview

The Barbados economy continued to grow strongly during the first nine months of 2007. Real economic activity expanded by an estimated 4.4%, following an increase of 3.7% in the corresponding nine-month period of 2006. A significant boost in tourism arrivals, particularly during the second quarter, provided most of the impetus behind the rise in output in the traded sectors. This outturn, combined with broad-based gains in the non-traded sectors, contributed to a lower average rate of unemployment for the first half of 2007, while the rate of inflation declined moderately.



Higher tourism receipts arising from the strong growth in arrivals, along with the significant inflows on the capital and financial account led to a \$269.0 million increase in the net international reserves (NIR).

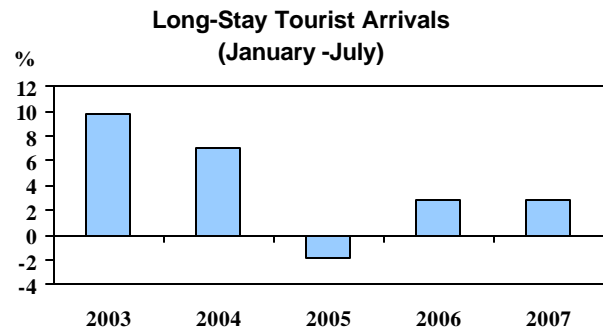


The acceleration in the pace of expansion in foreign reserves contributed to a faster rate of growth in domestic deposits, which outpaced the rate of increase in credit to the non-financial private sector. These conditions led to higher levels of excess liquidity within the banking system during the period under review. Consequently, the bulk of the financing requirements for Central Government's fiscal deficit, which was above the figure registered in the corresponding period of 2006, came from domestic entities.

### **Real Sector**

During the January to September period of 2007, output in the foreign exchange earning sectors rose by 2.5%, following sluggish outturns for the corresponding periods of both 2005 and 2006. The tourism sector continued to be the key driver of activity within the traded

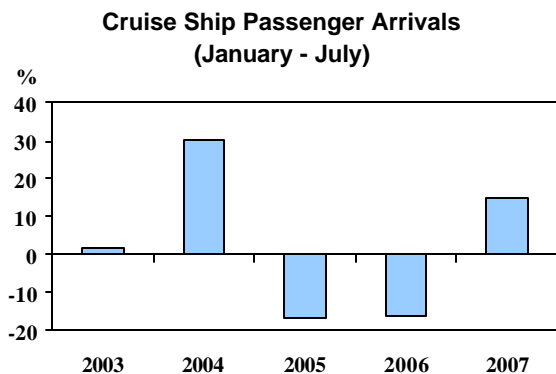
sectors. After the reduction in real tourism value added in the first quarter of the year, the industry regained momentum in both the second and third quarters, and grew by an estimated 3.1% in the first nine months of the year. After declining by nearly 7% in the first quarter, visitor arrivals showed a spike of 13.6% during the second quarter of 2007, relative to an increase of 8.4% in the comparable period of 2006.



This outturn was primarily related to the expansion in the number of visitors from the non-traditional and the UK markets during the period of the Cricket World Cup (CWC) 2007 as well as the continued growth in the USA and Canadian markets. During the first seven months of 2007, arrivals from the UK were up by 6.6%, after an increase of 4.2% in the corresponding period of 2006. Stay-over visitors from the USA and Canada rose by 3.0% and 5.0%, respectively, while the number of tourist

arrivals from the rest of Europe grew by 7.8%. Conversely, tourist arrivals from Trinidad and Tobago and other CARICOM countries declined by 9.0% and 22.6%, respectively, partly resulting from the reorganisation of the regional airline carriers and the increased cost of travelling in the earlier part of the year. During the corresponding period of 2006, visitor arrivals from these regional markets rose by 10.4% and 3.0%, respectively.

After declining by 16.0% in the January to July period of 2006, cruise ship passenger arrivals rebounded in the first seven months of 2007 to grow by 15.1%. This reflected the increase in the number of ship calls that resulted from both the cricketing activities held in the earlier part of this year and the reduction in fuel costs in the latter part of 2006.



Over the first nine months under review, real output from the non-sugar agricultural and fishing sector grew by 4.9%, following a reduction of 1.3% in the corresponding period of 2006. The pick-up in the industry emanated mainly from higher production of milk and chicken as well as greater fish catches. Output of milk rose by 8.0%, in contrast to a decline of 12.2% registered in the comparable period of last year, while chicken production and fish catches increased by 6.2% and 22.4%, respectively.

Real economic activity in the manufacturing sector remained virtually unchanged during the first three quarters of 2007. The main sub-categories that recorded expansions over the review period were beverages and tobacco and chemicals, which were up by 13.0% and 0.7%, respectively, following contractions of 13.8% and 2.6% in the corresponding period of 2006. Output in the wooden furniture industry was 1.2% higher over the review period. In contrast, electronics, food processing and non-metallic products all registered declines.

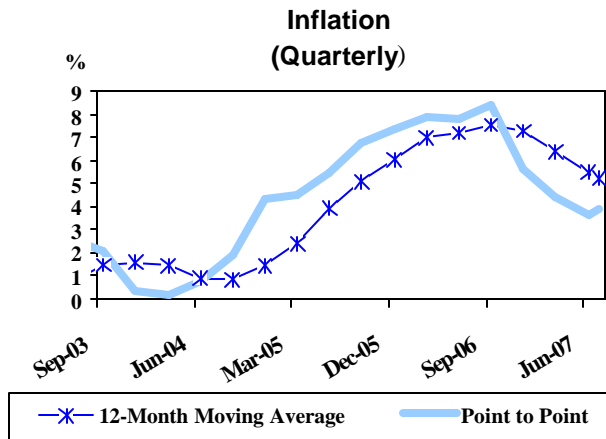
Activity in the non-traded sectors remained buoyant, growing by approximately 5.0% for the first three quarters of 2007, on par with the expansion registered in the corresponding period of 2006. Output was propelled by construction, wholesale and retail activity as well as transport, storage and communication.

The construction sector increased by 5.1%, as work continued on both public and private road infrastructural programmes as well as residential and commercial developments. Real value-added in the wholesale and retail industry expanded by an estimated 5.8%, slightly higher than the growth rate recorded last year, partly reflecting the moderate rise in retained imports. Boosted by growth in other sectors, real value-added in transport, storage and communication rose by 5.9%, after an upturn of 4.8% in the corresponding period of 2006. In the mining and quarrying sector, output continued to be sluggish primarily a result of lower levels of oil production during the year.

During the first three quarters of 2007, four hundred and seventy new licenses,

sixty-five more than those approved for the corresponding period of 2006, were issued to international business and financial services firms. Three hundred and thirty-four new international business companies were registered, ten more than in the comparable period one year prior. In addition, one hundred and twenty-six societies with restricted liability, six exempt insurance companies, one exempt insurance management company and three offshore banks were approved for operation.

Due to the overall expansion in economic output, more jobs were created at the end of the second quarter of 2007, primarily in the construction, wholesale and retail, general services, transportation and communication industries. The average unemployment rate was 8.0%. The rate for males dipped by 0.7 percentage points to 6.9%, while that for females fell by 1.0 percentage point to 9.0%.



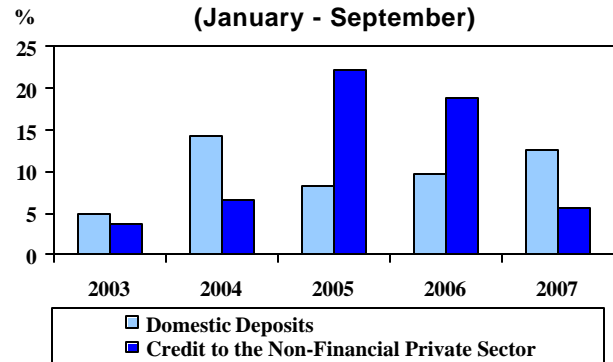
The twelve-month moving average rate of inflation was 5.2% at the end of July 2007, down from the 7.4% registered in the corresponding period of 2006. Reductions in prices were recorded for housing, fuel and light, clothing and footwear, transportation and education but there were higher prices in the food, alcoholic beverages and tobacco categories. The point-to-point rate of inflation, at 3.9%, was approximately 3.8 percentage points lower than the rate reported in the comparable period of 2006.

### Financial Sector

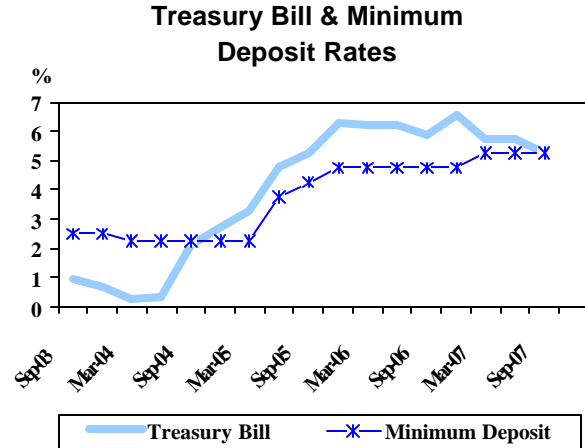
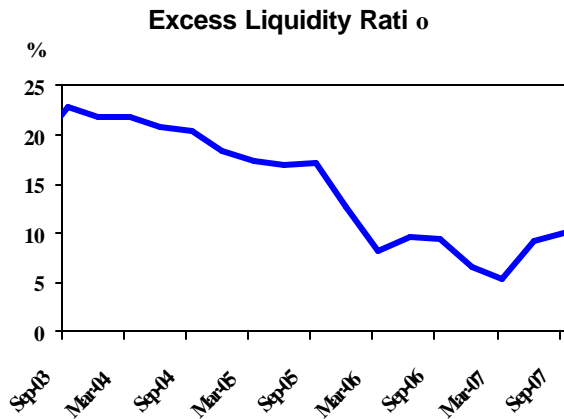
Growth in credit to the non-financial private sector slowed to 5.6% in the first nine months of 2007, from 8.1% in the corresponding period one year ago. Distributive firms, statutory bodies and

individuals reduced their borrowings relative to last year.

**Changes in Commercial Banks' Credit to the Non-Financial Private Sector as Domestic Deposits (January - September)**



At the end of the review period domestic deposits had risen by approximately 12.6%, doubling the rate recorded in the similar period of 2006. The growth in deposits was mainly attributed to the substantial inflows on the capital and financial account. In addition, Government's borrowing and the draw down on their special deposits from the Central Bank, which were eventually deposited in the financial system, also contributed to the significant rise in domestic deposits. In particular, deposits of statutory bodies as well as those of private and public financial institutions showed substantial increases.

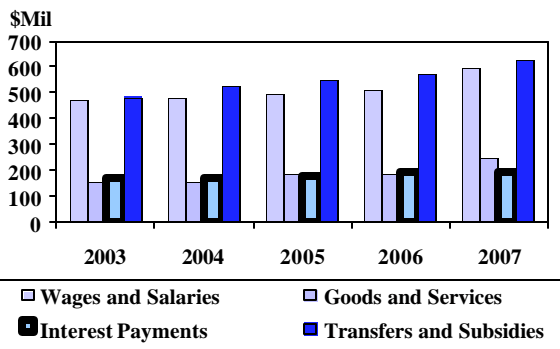


With deposit growth surpassing the expansion in new credit, the excess liquidity ratio rose by 3.4 percentage points to 10.0% at the end of the review period. The level of excess cash reserves grew to \$365.2 million compared to \$159.4 million in the corresponding period of 2006. The increased level of liquidity within the financial system continued to influence the rate on the three-month treasury bills. The rate fell from 6.57% at the end of December 2006 to 5.24% at end-September 2007. In contrast to the first quarter of this year, commercial banks continued to roll over and increase their holdings of treasury bills during the second and third quarters.

### Public Sector

Preliminary estimates for the period January to September 2007 indicate that central government recorded a fiscal deficit of \$159.0 million, approximately \$92.8 million more than in the previous year. The higher deficit was reflective of the significant rise in current expenditure relative to the moderate increase in tax revenue. With the high level of liquidity in the financial system, Government obtained its financing from domestic sources, particularly from the non-bank private sector and commercial banks.

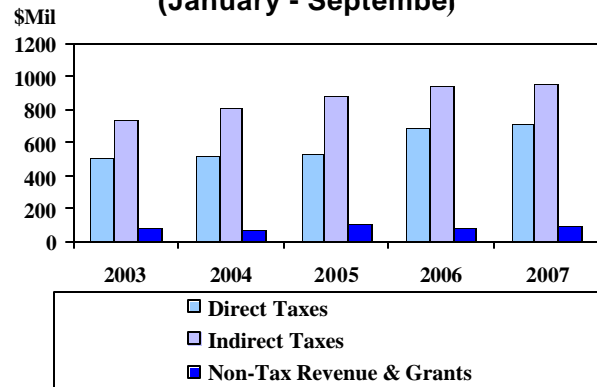
**Composition of Current Expenditure  
(January - September)**



Current expenditure rose by 10.3% during the first three quarters of 2007, propelled mainly by higher outlays on wages and salaries, goods and services and transfers and subsidies. Payments for wages and salaries were up by approximately 11.9%, primarily a result of the 7.5% increase in public workers' wages and salaries that were due in 2006 but paid in April of this year. Spending on goods and services expanded by 38.9% after a moderate contraction of 3.2% in the similar period of 2006 owing to the reclassification of some items previously recorded under capital expenditure. Supplementary payments to the University of West Indies and the Transport Board along with payments in favour of Harrison Cave Redevelopment Project and CWC 2007 led to a 4.7% rise in transfers and subsidies. Capital expenditure fell by

4.7% in the first nine months of 2007, following an expansion of 16.3% in the equivalent period of 2006 when preparations were in train for the hosting of CWC 2007.

**Total Revenue  
(January - September)**



Total tax revenues rose by 3.6%, compared to an upturn of 15.3% in the corresponding period one year ago. The slower growth in tax collections mainly resulted from lower collections of both direct and indirect tax receipts. Direct taxes increased by 5.5% during the review period, approximately one quarter of the expansion registered in the comparable period of 2006. Personal tax receipts were up by a modest 0.1%, while corporate tax receipts rose by 10.2% due to the widening of the tax base. Conversely, property taxes fell by 2.5% following an upturn of 40.6% in the similar period of 2006.

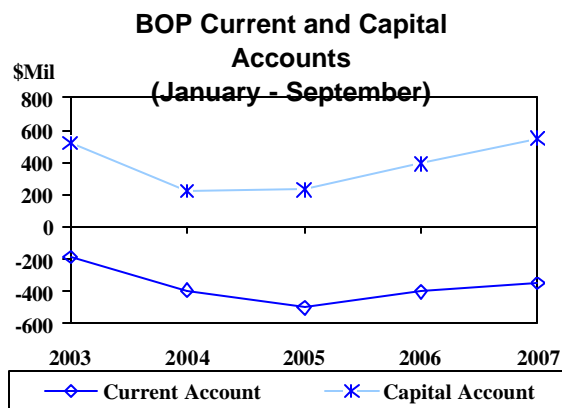
Indirect tax receipts grew by 2.3% over the review period, significantly below the growth rate recorded one year ago. Despite the improved economic performance, value-added tax receipts were up by 1.8%, on top of an expansion of 12.1% in the corresponding period of 2006 when tax payments received at the end of 2005 were registered in the first quarter of 2006. Import duties rose by 12.1% during the first nine months of this year, in contrast to the decline of 9.3% reported in the comparable period of 2006 when retained imports fell owing to the monetary and fiscal measures implemented throughout 2005. On the other hand, excise taxes fell by 11.4%, after an upturn of 11.0% in the corresponding period one year prior.

### **External Sector**

Notwithstanding the modest decline in earnings from the export sector and the increase in retained imports, the external current account deficit improved slightly over the first nine months of 2007, due mainly to the significant increase in travel credits during the second and third quarters of 2007. The deficit fell to approximately

\$381.2 million during the January to September period of 2007; this was \$85.8 million below the deficit in the previous year. Domestic exports decreased slightly, as strong growth in the sale of beverages and tobacco (29.4%) and chemicals (9.5%) was more than offset by contractions in all the other categories. Net receipts from services grew by 13.8%, fuelled principally by the upswing in tourism activity that led to a 9.6% rise in travel credits.

In contrast, retained imports were up by 5.5%, after a reduction of 3.3% in the comparable period of 2006 and a rate of growth of 15.6% over the corresponding period in 2005. Imports of consumer goods grew by 6.9%, buoyed by increased purchases of food and beverages, vehicles and pharmaceuticals. Similarly, intermediate goods expanded by 7.7% due primarily to greater purchases of iron, steel and fuel. Conversely, capital goods were down by 3.6%, following a rise of 12.2% in the identical period of 2006 owing to the winding down and completion of some major public and private sector projects.



The capital and financial account recorded an estimated surplus of \$684.6 million over the nine-month period of this year, almost twice as high as one year ago. Net long-term private sector capital inflows, mainly for tourism-related projects and the purchasing of real estate amounted to approximately \$265.6 million or \$28.8 million in excess of the previous year's figure. Similarly, funds received by a statutory corporation relating to a bond issue in the first quarter of 2007 boosted the net long-term public capital inflows by \$82.1 million, in contrast to net capital outflows of \$39.4 million registered in the corresponding period of 2006. Short-term capital inflows rose by \$227.4 million during the review period, reflecting pre-shipment financing for the sugar harvest and inflows related to the airport project.

### Outlook for the Rest of the Year and for the First Quarter of 2008

Real economic activity is expected to grow between 4.0% to 4.5% for 2007 and about 3.5% in the first quarter of 2008, driven by strong performances in both the traded and non-traded sectors. The tourism sector is anticipated to spearhead growth in the traded sectors, with modest contributions from non-sugar agriculture and fishing. Manufacturing output should remain relatively flat but a slight pick-up is expected in the first quarter of 2008. The robust growth in the non-traded sectors should continue for the remainder of the year, led by strong performances in wholesale and retail and the construction sub-sectors. With the continued expansion in economic activity, the average rate of unemployment is expected to remain below 10% for 2007.

With the projected improvement in the tourism sector, the expansion in travel credits should be higher in 2007 than in 2006, thus outweighing the lacklustre performance of the export earning sectors and the anticipated increase in

retained imports. Consequently, the deficit on the external current account should be around 6.8% of GDP for the year 2007, down from the 8.4% witnessed in 2006. The NIR is projected to record a healthy surplus in 2007 as long-term private sector capital inflows are expected to remain strong.

Government's fiscal deficit is anticipated to reach around 2.5% of GDP, approximately 1.0 percentage point above the ratio registered one year ago.

Despite the projected rise in new loans during the fourth quarter of this year owing to the seasonal activities, on current trend, commercial bank credit is unlikely to reach the rate of growth experienced in 2006. At the same time, domestic deposits should continue to expand robustly, fuelled primarily by the projected strong growth in private capital inflows. Consequently, liquidity in the financial system should remain high for the remainder of 2007 and continue into the first quarter of 2008.

**October 31, 2007**