

Review of the Economy for the First Six Months of 2007

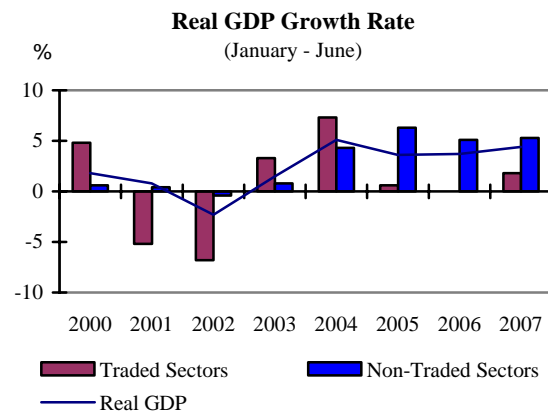
Overview

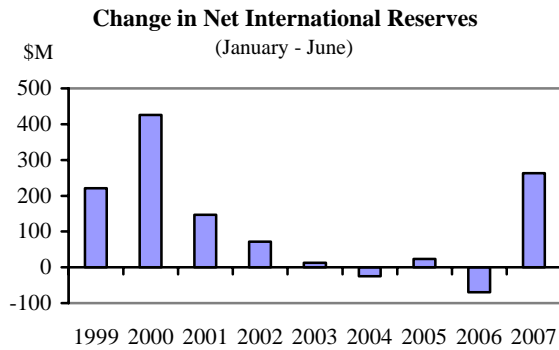
The Barbados economy improved during the first six months of 2007, recording growth in real GDP, higher holdings of foreign reserves and lower inflation. In addition, credit slowed owing to the tight monetary environment, and unemployment remained within single digits.

Real economic activity in Barbados grew by an estimated 4.4% for the first six months of 2007, some 0.7 percentage points greater than the rate of expansion experienced in the corresponding period of 2006. As has been the case over the last two years, the rise in real output was driven mainly by growth in the non-traded sectors.

In line with the 5.3% increase in the output of the non-traded sectors, the merchandise trade balance deteriorated over the first half of 2007 compared to the corresponding period of the previous year. Nonetheless, the external current account balance improved as the country benefited from higher travel

credits during the review period. This outturn, coupled with the strong performance of the external capital and financial account, led to a \$262.7 million increase in the net international reserves (NIR) of the monetary authorities during the January to June period of 2007, the largest first half increase in the NIR since 2000. This increase included investment related inflows for a number of projects.





The significant foreign inflows contributed to a faster build-up in domestic deposits when compared to the same period in 2006. With the pace of credit expansion lagging behind that of deposits, the relatively tight liquidity conditions that were experienced in the banking sector since 2004 eased somewhat during the period under review.

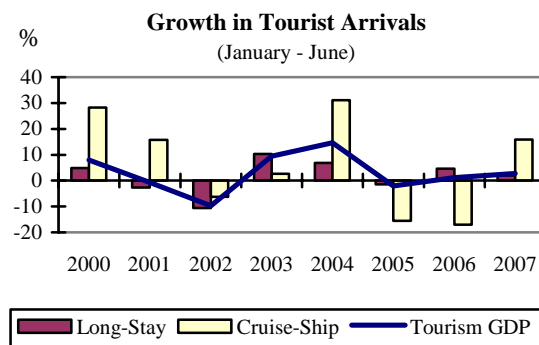
The Central Government recorded a fiscal deficit between January and June, a turnaround from the surplus registered in the first half of the preceding year. The deterioration in the fiscal accounts reflected the combination of sluggish tax revenue and higher current expenditure. The deficit was financed from domestic sources.

Real Sector

During the first two quarters of 2007, there was an increase in real tourism output, as the hosting by Barbados of some of the Cricket World Cup matches led to a strong second quarter performance. In April and May long-stay tourist arrivals rose by about 15.6% and

this helped to lift the rate of growth of tourism GDP to 2.8% for the first six months, after a decline of 3.8% in the first quarter.

Long-stay tourist arrivals rose by an estimated 1.9% during the review period, compared to the 4.6% expansion reported for the comparable period of 2006. Data for the first five months of the year suggest that arrivals from the United Kingdom and Canada grew by 3.8% and 3.4%, respectively, and were particularly strong at the beginning of the second quarter. In contrast, the number of tourists visiting from the United States of America, Germany and CARICOM contracted, an outcome partially attributed to a hike in fares earlier in the year. Of particular note, arrivals from the rest of the world more than doubled when compared to the corresponding period of 2006.



The cruise industry benefited from an expansion in the number of arrivals during the period under review. Arrivals rose by

15.2% over the January to May period, a partial reversal of the near 20% decline experienced in the first six months of the previous year. This performance is the result of an increased number of ship calls to the island, as well as longer itineraries compared to 2006. The industry also reaped some benefits from the hosting of the Cricket World Cup, as some visitors were lodged on cruise ships during the matches.

Value-added from the sugar industry grew by 0.6%, in contrast to a decline of 12.0% in the first six months of 2006, despite the late start of the harvest, while the non-sugar agriculture and fishing sector remained sluggish. During the first half of 2007, the production of milk, chicken and other meats rose moderately (2.0%, 3.0% and 1.2%, respectively); but these improvements were partially offset by reduced fish landings. Overall, output of the non-sugar agriculture and fishing sector grew by just 0.6%.

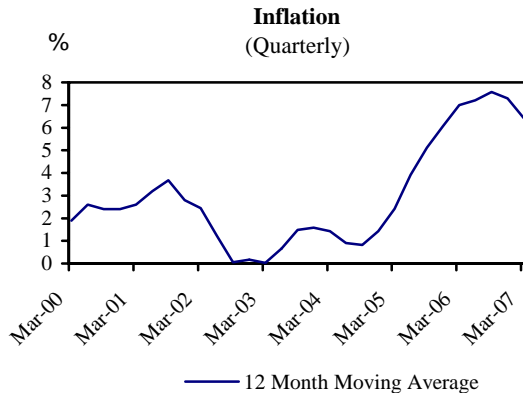
The output of the manufacturing sector in the January to June period of 2007 was unchanged from the preceding year. Beverages and tobacco registered a 7.2% increase, in contrast to a reduction of more than 15% in the prior year. Food processing and wooden furniture increased, but the production of electronic components and other non-metallic mineral products, declined.

The hosting of the Cricket World Cup yielded some benefits for the wholesale and retail, utilities and transportation, storage and communications sectors, which grew by 6.3%, 7.3% and 6.5%, respectively, compared to 5.0%, 6.5% and 5.3% in the corresponding period of 2006. Construction activity, the driver of the expansion of the non-traded sectors since 2005, moderated during the first half of 2007, growing by 5.2% relative to 6.7% in the same period of 2006. This slowdown is partly as a result of the completion of several large projects in time for the hosting of the Cricket World Cup.

During the first six months of 2007, some 300 new licences were awarded to international business and financial services firms, compared to 224 in the equivalent period of 2006. Of the new licences, 208 were issued for international business companies, 92 to societies with restricted liability and 4 to exempt insurance companies. Two new licences were granted to offshore banks during the review period but there were no new licensees in the similar period of 2006.

The increased economic activity spurred a reduction in the average level of unemployment for the first three months of the year, as the average unemployment rate contracted by 0.3 percentage points to 7.8%.

The average unemployment rate for males fell by almost a full percentage point to 6.7% while the average rate for females reached 8.9%, a slight increase from 8.8% one year earlier.

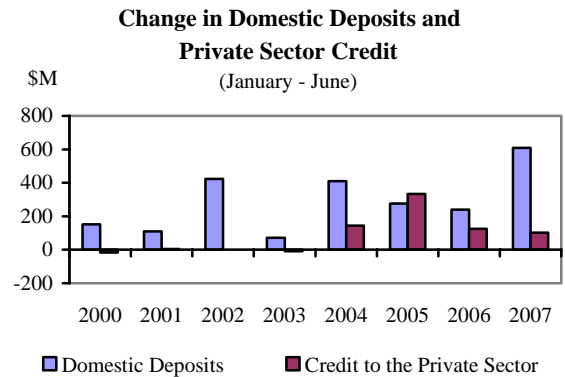


The moving average rate of inflation was 6.2% at the end of April, a decrease of 0.8 percentage points when compared to the end of April 2006. This improvement occurred as a result of the pass-through effects of declines in international oil prices.

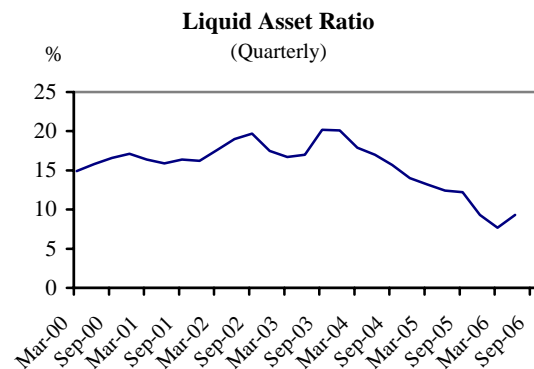
Financial Sector

During the first six months of 2007, growth in domestic deposits increased by 10.1%, more than double the growth rate recorded in the corresponding period of 2006. This outturn was occasioned by two main factors. Firstly, the country registered higher foreign capital inflows during the review period and these were deposited in the banking system. Secondly, the government raised its borrowings and reduced some of its deposit holdings at the central bank. The latter

injected previously sterilised deposits into the banking sector and contributed to the more than \$600 million expansion in domestic deposits.



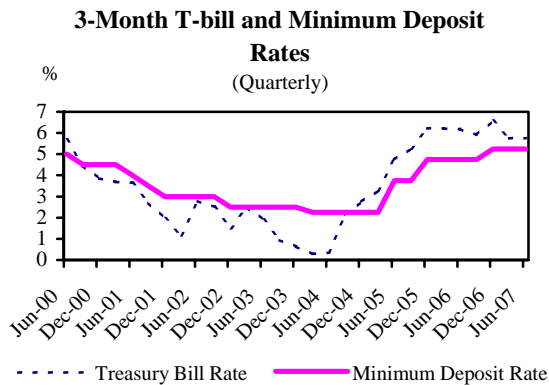
The rate of growth in credit to the non-financial private sector during the first half of the year slowed to approximately 3.4% in 2007 from 5.8% in the same period of 2006, mainly due to the delayed response to the restrictive stance taken by monetary authorities during 2006. Of particular note, lending to the personal sector, central government and statutory bodies contracted.



As a result of faster deposit growth relative to that of credit, the relatively tight liquidity

conditions in the banking system eased during the review period. As at June 27, 2007, the excess liquidity ratio was 8.9%, an increase of 2.2 percentage points from the figure registered at the end of 2006. This build-up in liquidity was underpinned by higher holdings of cash by the commercial banks, as evidenced by a ratio of excess cash to deposits of 4.2% compared to 0.6% at the end of 2006.

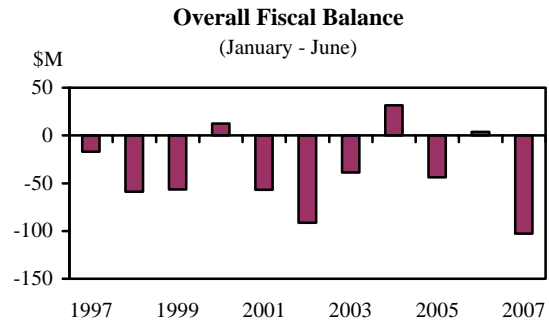
The average discount rate on 3-month treasury bills was 5.74% at the end of June 2007, relative to 6.57% at the end of December 2006.



Public Sector¹

Preliminary estimates for the first six months of the year indicate that central government operations resulted in a fiscal deficit of \$101.7 million, in contrast to a surplus of \$3.9 million in the corresponding period of 2006 and an average first-half deficit of \$39.8 million between 2001 and

2005. This outcome can be mainly attributed to higher total expenditure with only marginal growth in tax revenue.

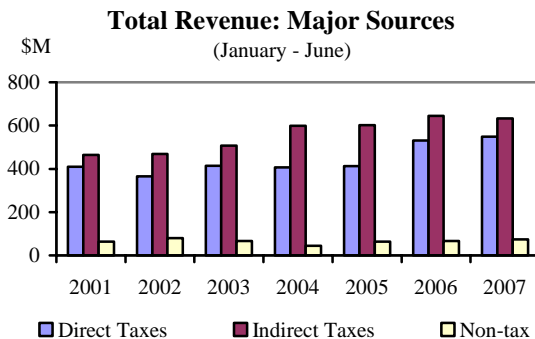


Tax receipts during the review period increased by an estimated 0.6%, compared to 15.8% for the same period of 2006, predominantly owing to an approximate 1.8% decline in indirect tax receipts, after a 7.0% increase in the similar period of the previous year. This downturn reflected the fall-off in VAT receipts, following an extraordinary performance in 2006, as well as contracting excise taxes. The upswings in the remaining indirect tax categories, mainly stamp duties, import duties and miscellaneous indirect taxes, were insufficient to offset these declines.

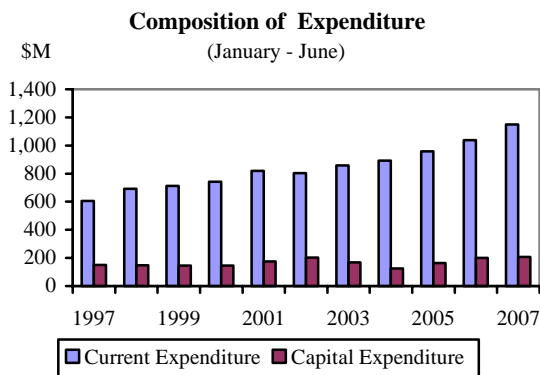
Direct tax receipts grew by just 3.5% in the same period of 2007, on account of falling personal taxes, compared to growth of 28.6% in the first half of 2006. Personal tax collections were estimated to be lower than in the corresponding period of 2006, owing to the reduction in the personal tax rate as

¹ Figures do not include off-budget expenditure.

well as an increase in the personal allowance. Moderate growth in corporate and miscellaneous tax receipts, however, sustained direct tax collections.



Total government expenditure during the first six months of 2007 expanded by 9.7%, compared to the 10.3% rate of increase reported in the similar period of 2006. Capital expenditure declined by 8.1% from an increase of 20.5% in the first two quarters of 2006. Of the current expenditure categories, interest payments were estimated to have declined by 3.5%, relative to a 21.5% rise in the first half of 2006. Several of the remaining categories recorded increases.



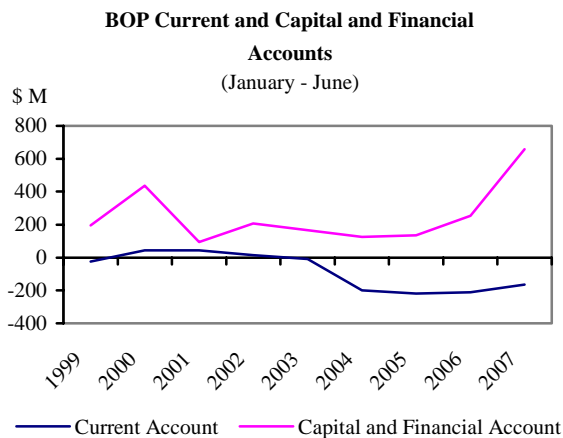
Financing for government operations was provided primarily by domestic sources during the January-June period of 2007. The Central Bank lent approximately \$11.3 million, compared to nearly \$130 million in the same period of the preceding year. Private non-bank institutions and the National Insurance Scheme contributed an estimated \$75.6 million and \$16.0 million, respectively, while miscellaneous entities added another \$26.7 million.

External Sector

During the review period, the external current account deficit improved from \$210.4 million to an estimated \$149.2 million, as a result of higher travel credits.

Retained imports rose by an estimated 4.6% over the first half of 2007, in contrast to a decline of 3.3% in the equivalent period of 2006. Consumer goods imports, one of the largest import categories, rose by 8.6%, driven by rising imports of motor vehicles, food and beverages, pharmaceuticals and other manufactured goods. The value of imports of intermediate goods also expanded during the period under review, growing by 5.9%. On the other hand, capital goods imports declined by 2.9% for the same period of 2007.

Domestic exports are estimated to have fallen by 5.3% during the January-June period of 2007, in contrast to an increase of 18.7% in the same period of 2006. Leading export categories so far for 2007 included food and beverages and chemicals, which grew by an estimated 31.7% and 5.6%, respectively. Stemming from the rebound in tourism activity and higher prices, travel credits went up by 9.7%, compared to 8.6% in 2006.



Preliminary estimates suggest that the surplus on the external capital and financial account more than doubled over the first six months of 2007 when compared to the corresponding period of the previous year. Net inflows of long-term public capital were registered in 2007 unlike 2006 when the public sector registered net capital outflows. The private sector continued to record new long-term inflows, which, in 2007, were estimated to have surpassed those registered in the prior year. Short-term inflows increased as a result of inflows for the

airport as well as pre-shipment financing for the sugar harvest.

Outlook

The Barbadian economy is forecasted to grow by around 4.0% in 2007, propelled by the continued strong expansion in the non-traded sectors. In particular, construction activity, transportation, storage and communications services, wholesale and retail trade and business and other services should underpin the growth in the non-traded sectors. Traded sector activity is expected to pick-up on account of higher projected tourist arrivals.

Based on these expectations, the average rate of unemployment should remain in single digits for the remainder of 2007 and into 2008. Inflationary pressures are also expected to ease somewhat, though this assumption hinges on the continued moderation of international oil prices.

In line with the forecasted economic expansion, deposit accumulation is projected to continue to surpass credit growth, leading to a build-up in liquidity.

Tax revenue has been somewhat sluggish and, coupled with higher expected expenditure, the fiscal deficit could expand in fiscal year 2007/08.

Despite the increased demand associated with Cricket World Cup 2007, which placed some upward pressure on the level of imports, growth in retained imports is forecasted to remain below the 8.0% average of the last five years. Domestic exports may continue to be sluggish based on the first-half performance, while travel credits should grow in line with tourist arrivals. Consequently, the external current account deficit as a percentage of GDP is likely hover around 7.5%, somewhat lower than the 8.4% recorded in 2006.

The capital and financial account is expected to remain buoyant in 2007. Consequently, the net international reserves are expected to record an increase during 2007.

July 31, 2007