

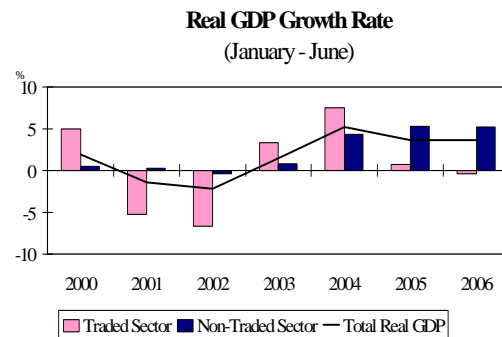
Review of the Economy For the First Six Months of 2006

Overview

During the first two quarters of 2006, the Barbadian economy grew by an estimated 3.6%, on par with the expansion in the comparable period of 2005, as continued robust growth in the non-traded sectors offset a marginal decrease in the traded sectors. With the rise in real economic activity, the unemployment rate remained low, while the inflation rate trended up, largely reflecting the rise in international oil prices.

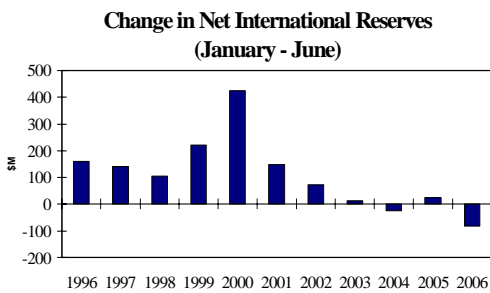
In spite of the stimulus provided by the non-traded sectors, retained imports are estimated to have decreased in the first half of 2006. Nevertheless, the value of retained imports again exceeded the receipts from domestic exports and net services leading to the fourth consecutive first-half deficit on the

external current account. With the high value of imports of fuel and capital goods, coupled with higher debt service payments, the net international reserves (NIR) of the monetary authorities declined by \$81.4 million in the six months under review, in contrast to an expansion of \$23.6 million in the same period of 2005.



Partly reflecting the dampening effect of the monetary measures implemented in the past twelve months, commercial bank credit to the non-financial private

sector registered a slower rate of growth between January and June of 2006. Nonetheless, liquidity in the banking system tightened slightly over the 6-month period, as the growth in credit still surpassed the rate of accumulation of deposits.

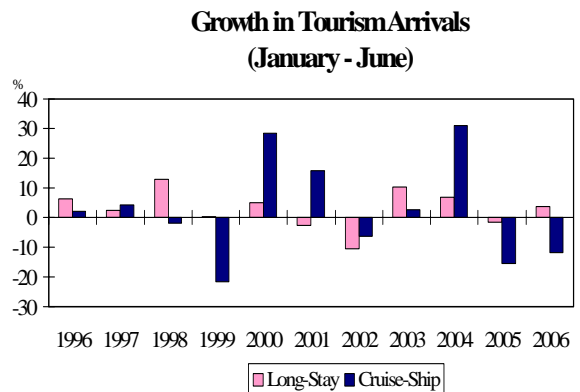


Central Government operations resulted in a fiscal surplus during the review period, as strong growth in tax revenues outstripped the expansion in both current and capital expenditure.

Sectoral Analysis

Real value-added in the tourism sector expanded by an estimated 1.2% during the first six months of 2006, contrasting with a decline of 2.0% over the corresponding period of 2005. Available data indicate that long stay arrivals grew by 4.3% between January and May of 2006, following a decrease of 0.8% for the same five-month period a year

earlier, as the economies of the major source markets continued to expand. Long-stay arrivals from CARICOM were up by 11.1%, bolstered by a 12.5% rise in arrivals from Trinidad and Tobago. Canadian tourists registered an increase of 7.4%, while the number of visitors from the United Kingdom, Continental Europe and the United States rose by 3.9%, 2.5% and 1.8%, respectively.



Cruise ship passenger arrivals declined by approximately 17.5% in the January to May period of 2006, following a contraction of 15.2% in the same five months of the previous year. The lacklustre performance of the cruise industry was largely attributed to shorter itineraries by a number of cruise lines, as well as a reduction in cruise ship calls to the island by larger vessels in response to higher fuel costs.

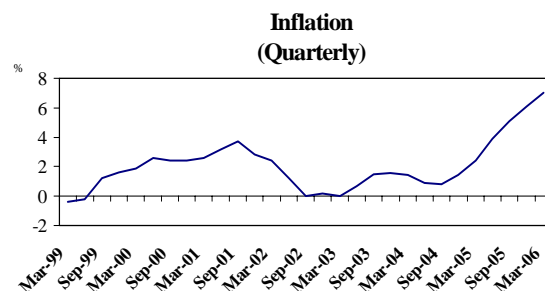
After a marginal decrease of 0.2% in the first half of 2005, manufacturing output grew by approximately 2.4% in the review period, owing mainly to increased production of non-metallic mineral products (like cement), electronics, chemicals and food processing. However, lower output was recorded for wooden furniture, beverages and tobacco and garments.

Reflecting a reduction in acreage planted and lower yield, sugar production fell by 12.0% to approximately 33,648 tonnes during the first two quarters of 2006, a reversal of the 11.3% growth experienced in the corresponding period of 2005. Similarly, non-sugar agriculture and fishing output, which registered an average January-to-June contraction of 3.3% over the last two years, decreased by a further 5.1%.

It is estimated that value-added in the construction industry expanded by 9.4% between January and June 2006, following growth of 14.0% a year earlier. The robust outturn in construction was driven principally by continued work related to preparations for Cricket World Cup 2007, in addition to several private

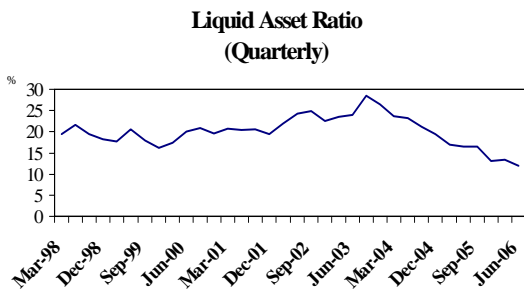
and public sector projects. Benefiting from the positive spillover effects occasioned by heightened construction activity and the improved tourism outcome, wholesale and retail trade increased by approximately 5.5%, while transport, storage and communications and business and other services both advanced by 5.2%.

During the first quarter of the year, 111 new licences were granted to the international business and financial services sector, one more than the number issued for the corresponding period of 2005. Of the new licences, 91 were for international business companies, 18 for societies with restricted liability and two for exempt insurance companies.



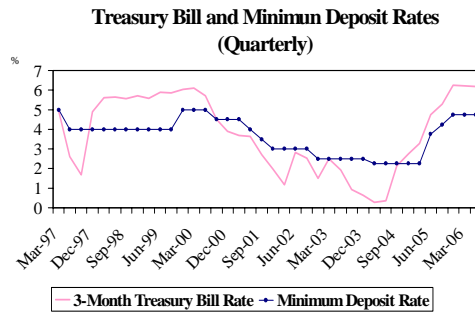
The average rate of unemployment for the first quarter of 2006 was estimated at 8.1%, down from 9.9% for the

comparable period of 2005. The unemployment rate for females decreased to 8.8% from 11.3%, while the rate for males fell to 7.4% from 8.6%. Meanwhile, at the end of March 2006, the moving average rate of inflation reached approximately 7.0%, or 4.6 percentage points above the rate at end-March 2005. The jump in the inflation rate reflected increased prices in the majority of the categories, especially housing, transportation, fuel and light as well as food.

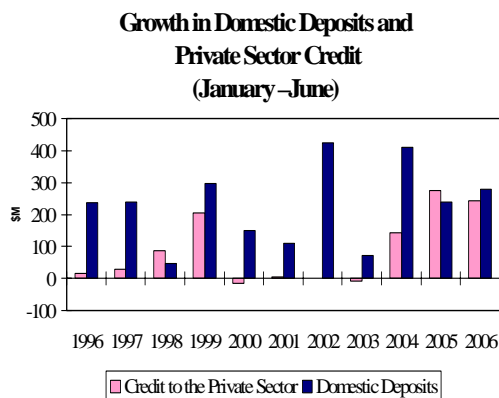


Despite some easing in the second quarter, there was an overall contraction of liquidity in the banking system during the first half of 2006, evidenced by a one-percentage point decrease in the liquid assets to deposit ratio to 12.0% at June 28, 2006. Commercial banks reduced their holdings of treasury securities during the period but increased their holdings of cash

reserves. Meanwhile, the average rate on 3-month treasury bills remained relatively high at 6.19% at June 28, 2006, although somewhat lower than the rate of 6.26% at the end of 2005.



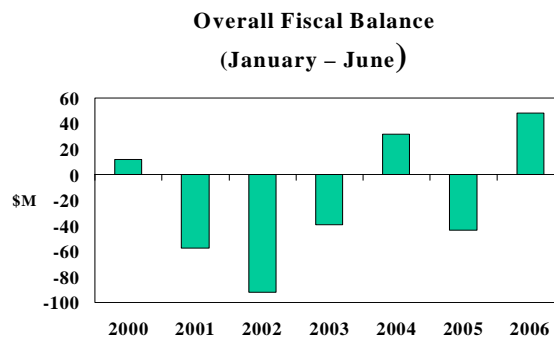
As a result of the higher interest rates established during 2005, growth in commercial bank credit to the non-financial private sector slowed to approximately 6.4% (\$242.5 million) for the period January to June 28, 2006, compared to a rise of 9.0% (\$275.2 million) over the similar period of 2005. Loans to the private sector increased by 5.6% over the first five months of 2006, driven mainly by continued demand for new residential mortgages. In addition, lending to financial institutions went up by 22.8%, while credit to the distribution, manufacturing and tourism sectors grew by 19.5%, 19.1% and 3.5%, respectively.



Domestic deposits expanded by an estimated 4.8% (\$278.7 million) between January and June 28, 2006, after increasing by 4.5% (\$238.0 million) in the corresponding period a year earlier. During the first five months of the year, deposits of private individuals rose by 4.5%, in part reflecting higher disposable incomes. Deposits of financial institutions grew by approximately 10.2%, while those of statutory bodies rose by 7.1%. In contrast, deposits of Central Government decreased by 22.6%.

Central Government registered an overall fiscal surplus of \$68.7 million for the first half of 2006, as the surplus in the first quarter of the year was only partially offset by a deficit in the second quarter. This fiscal surplus represents a

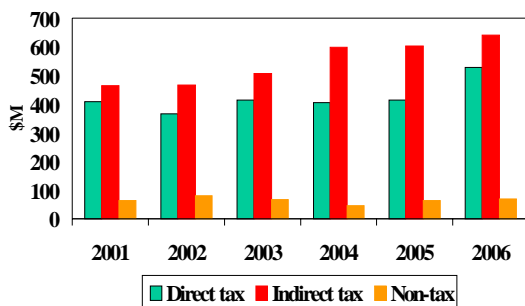
turnaround from the corresponding period of 2005 when a fiscal deficit of \$43.7 million was recorded.



Spurred primarily by robust growth in tax revenue, total revenue rose by approximately 15.0%, in comparison to 2.6% in the corresponding six months of the previous year. Direct taxes, which went up by 28.7%, provided the main impetus for the expansion in tax revenue, in spite of the reduction in the personal, corporate and property tax rates and the raising of personal allowances. Corporate tax collections surged by 36.2%, bolstered by higher receipts from the international business and financial services sector. Moreover, personal tax and property tax revenues grew by 11.8% and 41.0%, respectively.

During the first six months of 2006, revenue from indirect taxes increased by 6.3% driven principally by collections of value-added tax (VAT) and excise taxes. Receipts of VAT jumped by 11.1% compared to 2.4% one year earlier, as prepayments made at the end of 2005 were recorded early in 2006. Excise tax receipts rose by 13.3% over the review period, but collections from import duties contracted by 2.8%.

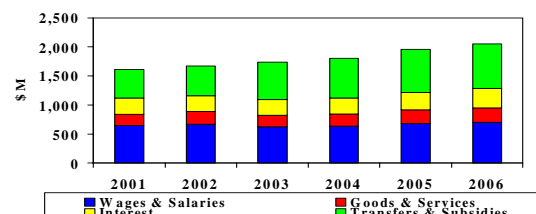
**Total Revenue: Major Sources
(January-June)**



Total government spending was higher by 4.4% during the period under review, compared to a rise of 10.1% in the same period a year prior. Current expenditure grew by approximately 5.1%, on account of increased spending on transfers and subsidies, interest payments and wages and salaries. Transfers and subsidies expanded by 9.2%, boosted by supplementary funds

granted to the University of the West Indies and the Barbados Tourism Authority. Additionally, interest outlays went up by 17.0% as a result of higher domestic and external interest payments, while wages and salaries advanced by 1.0%. Conversely, there was an 8.5% decline in expenditure on goods and services, in contrast to an expansion of 20.2% during the comparable period of 2005. Moreover, on-budget capital expenditure rose by 7.9%, after growth of 8.1% in 2005, mainly owing to greater spending on capital projects associated with preparations for Cricket World Cup 2007.

**Composition of Current Expenditure
(January – June)**



Net foreign outflows amounting to \$20.7 million were recorded during the review period, Government amortisation payments of \$50.3 million outweighed project fund inflows totalling \$29.7 million. In line with the fiscal surplus, Government reduced its net domestic

borrowing by \$48.0 million. There were substantial reductions in the holdings of government securities by commercial banks and other miscellaneous entities which outweighed a rise in Central Bank net lending to Government as well as additional holdings of government securities by the National Insurance Scheme and private non-bank entities.

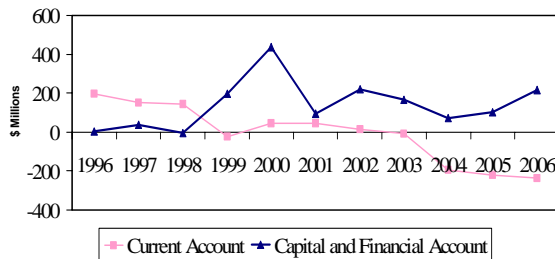
Notwithstanding a notable improvement in travel credits and a decline in retained imports, the deficit on the external current account widened somewhat during the first two quarters of 2006, owing primarily to a slowdown in the growth of domestic exports, coupled with larger estimated net outflows related to factor incomes. Accordingly, the external current account deficit was estimated at \$234.2 million, \$13.5 million more than in the same period a year ago. However the capital account was in surplus.

Retained imports are estimated to have decreased by 0.8% between January and June of 2006, contrasting with the 10.8% rise in the same period of 2005. This partly reflected the impact of the

monetary measures introduced by the Central Bank over the last year and the cess tax implemented to curb import demand. The main contributor to the decline in imports was a reduction of 12.1% in consumer good imports, attributed mostly to food and beverages, motor vehicles and other manufactured items. Furthermore, imports of intermediate goods contracted by 0.5%, due to a fall in imports of construction materials. However, capital goods imports surged by 21.4%, mainly on account of a 21.9% jump in machinery imports.

Driven mainly by higher exports of miscellaneous manufactured items, domestic exports went up by about 15.5% during January-June 2006, after increasing by 21.0% a year earlier. Electronic components and chemicals expanded over the period, while there was a reduction in food and beverage exports, owing largely to a contraction in exports of rum and other beverages. With the pick-up in tourism activity, travel credits rose by an estimated 8.3%, following 0.8% expansion in the first half of 2005.

**BOP Current and Capital and Financial
Accounts
(January - June)**



The capital and financial account recorded a surplus of approximately \$195.4 million during review period, about \$93.5 million more than the surplus achieved in the comparable six months of the previous year. Net long-term private capital inflows expanded by \$8.6 million to \$175.2 million, while net long-term public sector outflows contracted by \$13.5 million to \$30.9 million. Moreover, short-term capital inflows doubled during the period to an estimated \$86.3 million; largely related to pre-shipment financing for the sugar industry.

Outlook

Real GDP is forecasted to increase between 4.0% and 4.5% in 2006, with the non-traded sectors again providing the main impetus for growth. The expansion in the non-traded sectors should be led mainly by the construction

industry, partly the result of the intensification of activity associated with Cricket World Cup 2007. Higher levels of output in wholesale and retail trade, transportation, storage and communication and business and other services should accompany buoyant construction activity. A pick-up in traded sector activity is projected for 2006, on the strength of a turnaround in real tourism value-added and continued recovery in the manufacturing sector.

In line with a fairly healthy outcome forecasted for real economic activity, the average unemployment rate should stay in the single digits during 2006. The twelve-month moving average rate of inflation at the end 2006 is anticipated to remain around the level recorded at end-2005, as IMF projections suggest that energy prices would remain relatively high throughout the year.

With the forecasted economic expansion, the current account deficit as a percentage of GDP could remain around the level recorded in 2005. Moreover, the capital and financial account is likely to register a larger surplus during the year, mainly

attributed to higher long-term private sector inflows, and anticipated foreign borrowings by government. These capital account inflows should stem the reduction in the NIR to approximately \$95 million for the year, in spite of the substantial loss in the second quarter.

Commercial bank credit to the private sector is expected to grow at a slower rate than in 2005, as a result of the higher borrowing costs associated with the monetary measures implemented by the Central Bank of Barbados during 2005. Additionally, in line with increased economic activity and relatively higher interest rates, domestic deposits at commercial banks are also projected to rise but at a faster pace than credit. As a consequence, liquidity in the banking system is likely to increase somewhat by the end of the year.

With expansions in tax revenue forecasted to outweigh growth in government expenditures, the fiscal deficit for 2006 is projected to improve somewhat relative to the 2005 outturn. It is expected that tax revenue will be boosted by both indirect and direct

taxes, in particular, VAT and corporate tax receipts. Current expenditure is forecasted to rise at about half the rate of increase in 2005, owing primarily to slower growth in spending on transfers and subsidies and goods and services. It is anticipated that growth in capital expenditure would significantly outpace that of 2005, largely reflecting intensified spending as preparations for Cricket World Cup 2007 gather momentum.

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