

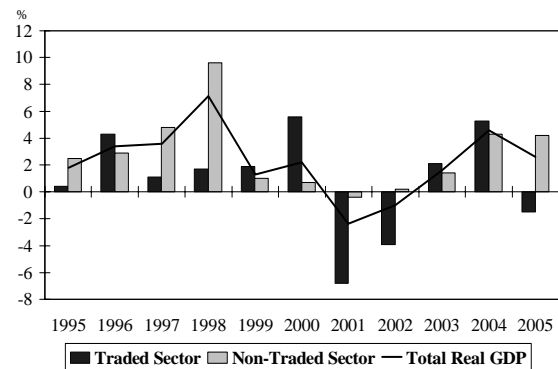
## Review of the Economy For the First Nine Months of 2005

### Overview

The Barbadian economy performed reasonably well during the first nine months of the year, expanding by an estimated 2.6%. Though this was 2.0 percentage points below the rate for the same period in 2004, it was above the average for the past five years. The rise in real economic activity mainly reflected growth in the non-traded sectors, which outstripped a modest decline in traded activity. However, because of continued growth in imports, along with a fall-off in tourism receipts, the external current account remained in deficit. This deficit was partially financed by capital inflows. Consequently, the net international reserves (NIR) of the monetary authorities fell by only \$33.0 million during the review period, significantly less than the decline in the corresponding period one year ago. Central Government's fiscal deficit improved by about \$2.9 million, on account of faster growth in total revenue, particularly corporate tax receipts.

Liquidity in the banking system tightened somewhat during the review period, as the rate of growth in commercial bank credit to the non-financial private sector more than doubled the rate of increase in domestic deposits. The Central Bank maintained

Real GDP Growth Rate  
(January-September)



an active policy of monetary tightening in an effort to slowdown credit and spending, especially consumer spending, in order to improve the current account of the balance of payments.

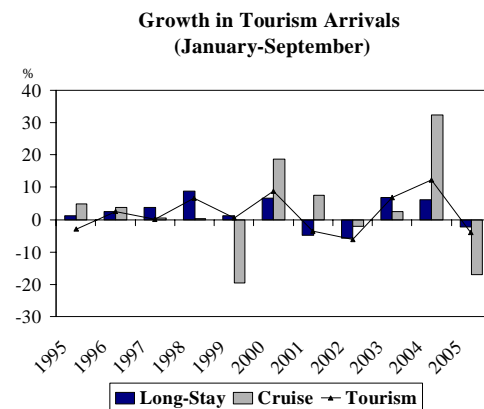
The inflation rate at the end of June 2005 was significantly higher than last year, as rising energy prices continued to drive up the retail price index.

Meanwhile, the average rate of unemployment at end-June 2005 decreased to 8.9% from 9.6% in the similar period of the previous year. This brought the unemployment rate to its lowest recorded level in over 20 years.

### Sectoral Performance

Over the January to September period of 2005, real tourism value-added is estimated to have declined by 4.1%, in contrast to the comparable nine months of 2004 and 2003 when tourism GDP rose by 12.3% and 6.8%, respectively. Data to the end of August 2005 indicate that long-stay arrivals declined by 2.4%, largely reflecting downturns in the Canadian and the United Kingdom (UK) source markets. Arrivals from Canada fell by 10.7% on account of reduced airlift capacity, while the number of visitors from the UK and Continental Europe contracted by 7.7% and 11.9%, respectively. Long-stay tourists from the United States also declined by 0.8%. In contrast, visitors from CARICOM increased by 10.6%, boosted by a sharp rise (15.1%) in arrivals from Trinidad and Tobago.

Cruise passenger arrivals shrank by 17.3% between January and August 2005, following an extraordinary expansion of 31.0% in the corresponding period of 2004. This year's outturn was primarily attributed to increased competition from homeland ports along the north eastern and south eastern coasts of the US, as well as



high fuel costs.

The final numbers for sugar production for the year showed that owing to favourable weather conditions, sugar production for the 2005 crop season totalled approximately 38,240 tonnes, about 11.3% or 3,880 tonnes above the amount produced last year. However, during the three quarters under review, output of non-sugar agriculture experienced a moderate reduction (2.4%), as contractions in milk

production and fish landings outweighed a small increase in chicken production.

Output of the manufacturing sector grew by about 2.7% over the first nine months of 2005, compared to a marginal expansion in the same period a year earlier and an average January-September decline of 1.8% between 2000 and 2004. Greater output of beverages and tobacco and chemicals offset downturns in the electronics and garments sub-sectors.

Construction activity led sectoral growth, rising by an estimated 8.2% in the review period, which compares favourably with a rise of 3.8% in the corresponding nine months of 2004 and an average growth of 3.5% for the same period over the past five years. The continued growth in the construction industry was spurred largely by residential housing projects as well as work associated with preparations for Cricket World Cup 2007. Accordingly, valued-added in the mining and quarrying industry expanded by

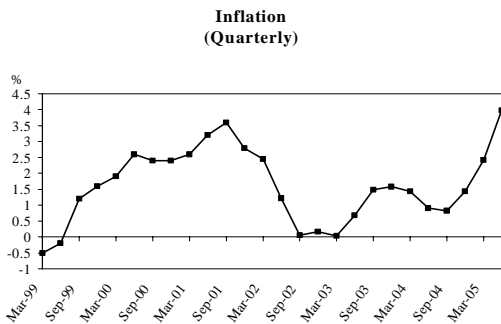
approximately 2.1%, about 0.7 percentage points more than the increase in the previous year.

Boosted by relatively strong consumer demand, the wholesale and retail sector and the transportation, storage and communication industry registered growth of 2.7% and 4.2%, respectively. Activity in the electricity, gas and water industry also went up, rising by 5.8%, compared to 2.4% in the same three quarters of 2004.

A total of 311 new licences were issued to the international business and financial services sector between January and September 2005, 47 more than in the corresponding period of 2004. Of the new licences, 269 were granted to international business companies, up from 209 a year earlier, while 31 licences went to societies with restricted liability. In addition, 8 exempt insurance companies and 3 exempt insurance management companies were established during the review period.

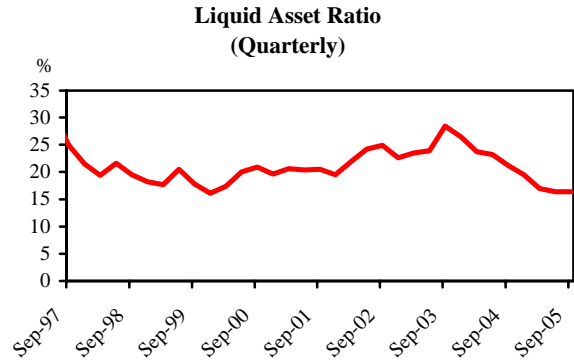
The rate of unemployment at the end of June 2005 was estimated at 8.9% or about 0.7 percentage points below the rate at end-June 2004. The male unemployment rate fell from 9.2% to 6.4%, while the rate for females rose to around 11.5% from 10.0% one year ago.

At the end of June 2005, the average rate of inflation was approximately 4.0%, compared to 0.9% at the end of June 2004. Increases in the retail price index were driven principally by the food,

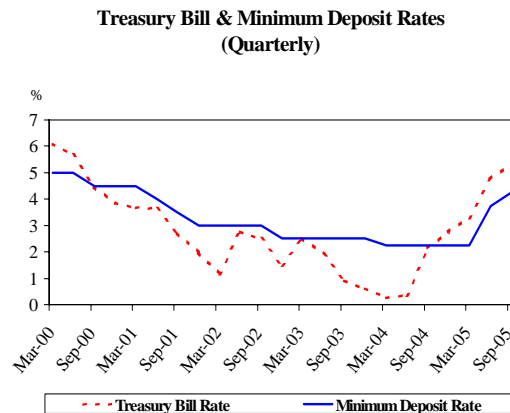


transportation and housing categories, up by 6.6%, 4.5% and 3.7%, respectively. There was also moderate growth in the remaining sub-indices,

with the exception of household operations and supplies which recorded the only decline.



Between January and September 2005, there was a contraction of liquidity in the banking system. Commercial banks reduced their holdings of treasury bills and cash reserves by \$55.8 million and \$9.0 million, respectively, and consequently, the liquid asset ratio decreased by 3.1 percentage points to 16.4% as at September 28, 2005.

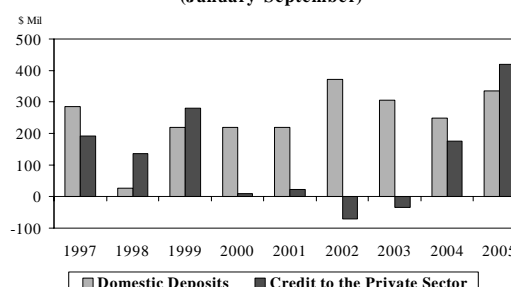


In line with the tightening liquidity in the system, the average rate on 3-month treasury bills advanced to 5.28% as at September 28, 2005, up from 2.76% at the end of 2004. Meanwhile, in an effort to contain the demand for credit and encourage saving in the economy, the Central Bank increased the minimum deposit rate on three occasions during the review period - from 2.25% at the beginning of the year to 2.75% in April, 3.75% in June and 4.25% in September 2005.

In spite of higher interest rates, credit continued to expand, rising by about 2.5% (\$86.3 million) during the third quarter of 2005. This represented partly a lag in the response to the interest rate adjustments as banks honoured outstanding commitments. Credit to the non-financial private sector advanced by an estimated 13.7% (\$419.8 million) between January and September 2005, more than twice the growth of 5.7% (\$148.2 million) in the similar period a year ago. Lending to the personal sector rose by 16.8% (\$245.1 million), driven primarily by robust demand for consumer instalment credit and new mortgages. In addition, loans to the

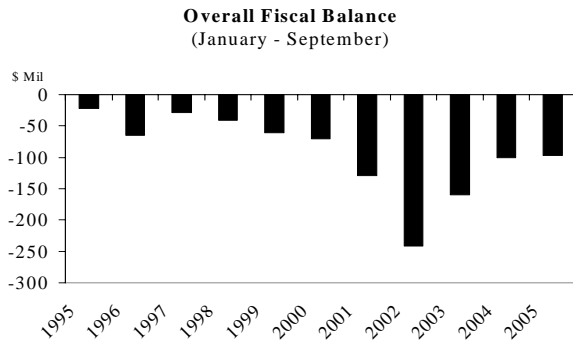
financial sector increased by 33.6% (\$37.7 million), while credit to the distribution sector surged by 18.7% (\$60.1 million), mainly attributed to funds borrowed to finance an acquisition in the industry earlier in the year.

Growth in Domestic Deposits and Private Sector Credit (January-September)



Domestic deposits expanded by approximately 6.4% (\$336.2 million) for the review period ending September 2005, after a 4.8% (\$229.6 million) expansion in the comparable period of 2004. Deposits of Central Government and statutory bodies jumped by \$6.6 million and \$151.7 million, respectively. In contrast, deposits of financial institutions fell by about \$37.5 million.

During the first three quarters of 2005, Central Government's fiscal deficit improved to \$97.6 million, approximately \$2.9 million below the comparable period of last year.

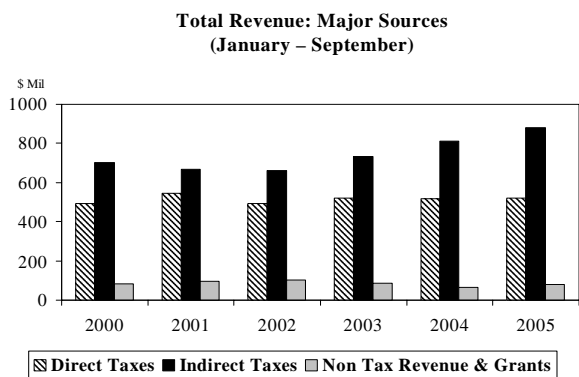


Total revenue grew by 6.3%, with expansions recorded in both direct and indirect taxes. Despite contractions in most of the sub-categories, direct tax revenue advanced by 0.7%, primarily attributed to a 28.9% surge in corporate tax receipts which were boosted by higher tax revenues from the international business and financial services sector.

Personal taxes fell by 14.1%, reflecting the downward revision of the personal income tax rate from 40.0% to 37.5% on taxable income in excess of \$24,200 and an increase in the personal allowance from \$17,500 to \$20,000. Intake of property taxes declined by approximately 10.9%.

Between January and September 2005, indirect tax receipts expanded by an estimated 8.6%, about 2.0 percentage points lower than the growth in the

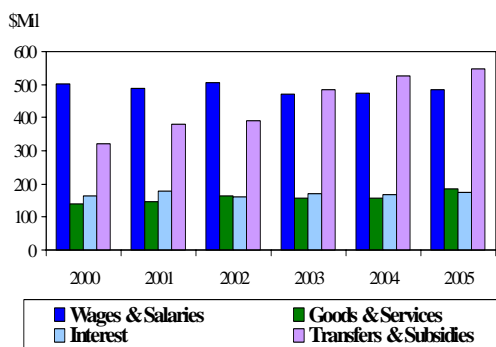
corresponding months of 2004. Excise taxes and import duties rose by 16.3% and 5.5%, respectively, compared to increases of around 16% registered a year prior. Value-added tax collections were higher by 7.0%, following a 12.0% jump in the first three quarters of 2004.



Total government expenditure increased by an estimated 5.7% during the nine months under review, contrasting with marginal declines in the same period of the previous two years. Current expenditure grew by approximately 4.8% on account of higher spending in the major categories. Outlays on goods and services rose by 16.4%, while wages and salaries advanced by 2.3%. Supplementary disbursements during the first quarter to the Transport Board, the Barbados Tourism Authority, and the University of the West Indies contributed

to an overall 3.8% growth in transfers and subsidies during the review period, compared to the 8.9% increase between January and September 2004. In addition, outlays on interest payments expanded by about 4.2% since a large decline in external interest payments was offset by a substantial rise in domestic interest payments.

Composition of Current Expenditure  
(January – September)

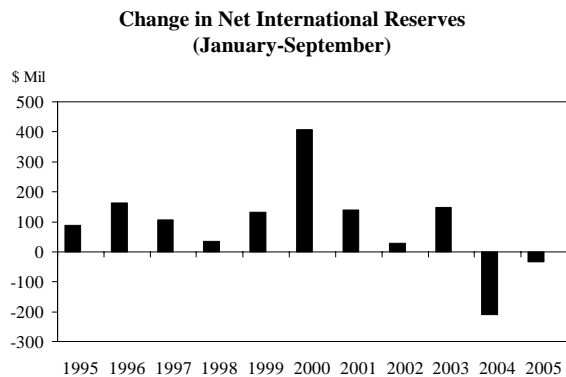


Capital expenditure grew by approximately 11.8%, partly attributed to spending in preparation for Cricket World Cup 2007. This contrasts sharply with the significant reduction (23.2%) recorded in the same nine months of 2004 when several public sector projects were completed and capital outflows to the Queen Elizabeth Hospital were reclassified as transfers and subsidies.

The Government continued to finance its deficit primarily from domestic sources. Net domestic financing was estimated at \$149.5 million, with the National Insurance Scheme and private non-bank institutions increasing their holdings of government securities by about \$150.6 million and \$115.4 million, respectively. Commercial banks contributed approximately \$94.1 million, while the Government decreased its net deposits at the Central Bank by \$12.4 million. Net foreign financing was \$35.6 million lower than in the first three quarters of 2004, as project fund inflows of \$13.8 million were overshadowed by amortisation payments of \$65.7 million.

Notwithstanding an improvement in domestic exports, the external current account deficit widened by about \$12.3 million over the review period, to \$385.8 million, owing primarily to an increase in retained imports coupled with slightly lower tourism receipts. As a result, the NIR fell by an estimated \$33.0 million during the first nine months of 2005, considerably smaller than the reduction of \$210.7 million in the corresponding period of 2004 and the lowest decline in reserves without Government

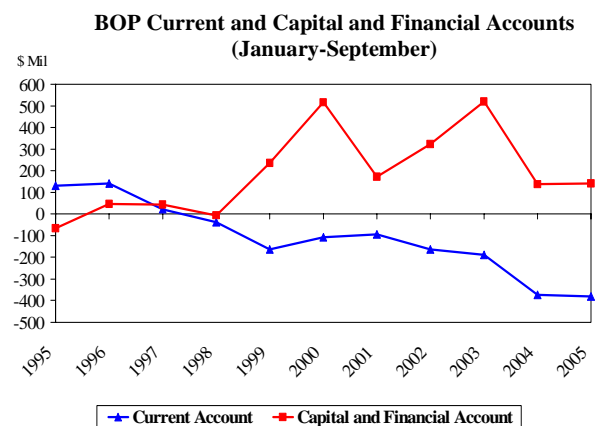
borrowings for the past 13 years. Therefore, the stock of foreign reserves, at approximately \$1.16 billion, remained healthy, covering about 22.4 weeks of imports.



Retained imports rose by approximately 4.6% during the period, after expanding by 13.5% and 14.4% in the comparable nine months of 2003 and 2004, respectively. The growth in retained imports was mainly driven by larger imports of intermediate and consumer goods, although both categories increased at a slower pace than in the previous year. In contrast, capital goods imports contracted during the period, after successive January-September increases in the last three years.

Domestic exports expanded by an estimated 13.5% (\$36.9 million) in the first three quarters of 2005, well in

excess of the 6.5% (\$16.7 million) growth in the same period in 2004. Sugar exports fell by about 1.4% to approximately \$44.3 million, while exports of food and beverages rose significantly due partly to higher exports of rum. Chemical exports also experienced a notable increase. Net receipts from services recorded modest growth, tempered by a marginal decline in travel credits.



The capital and financial account registered an estimated surplus of \$140.2 million for the January-to-September period, almost on par with the surplus in the corresponding period a year ago. Net long-term private capital and financial inflows grew by approximately \$59.1 million to \$299.3 million, while net long-term public sector outflows diminished by about \$30.7

million to \$64.3 million. Additionally, short-term capital inflows were estimated at \$3.9 million, down from \$256.0 million in 2004.

### **Outlook for the rest of 2005**

The economy is expected to register an acceptable level of economic growth in 2005. Real GDP is projected to increase by between 2.5% and 3.0% in 2005, with growth propelled primarily by the non-traded sectors. Real tourism value-added is likely to fall below last year's level, the combined effect of a marginal downturn in long-stay arrivals and a substantial decline in cruise ship passengers.

The economy is expected to be led principally by the construction sector, where real economic activity is projected to rise, benefiting largely from robust demand for residential housing and ongoing preparations for the Cricket World Cup 2007. It is anticipated that higher levels of construction activity would boost output in the wholesale and retail industry. Moreover, increases in real value-added are also forecasted for the business and other services and

transportation, storage and communications industries.

With high energy prices expected to persist throughout the year, retail price inflation at the end of December 2005 should be much higher than the 1.4% rate recorded at the end of 2004.

The projected growth in total revenue for 2005 is likely to be slightly outpaced by the expansion in total expenditure, resulting in a modest widening of Government's fiscal deficit. Nevertheless, the fiscal deficit as a percentage of GDP is expected to remain around the 2.3% registered a year earlier. The anticipated rise in total revenue should reflect broad-based increases in indirect taxes combined with substantially larger corporate tax receipts. Personal taxes are, however, forecasted to contract for the second consecutive year. Current expenditure is projected to be higher, owing principally to greater outlays for transfers and subsidies, wages and salaries and goods and services, while capital spending is expected to rise partly on account of preparations for Cricket World Cup 2007.

It is anticipated that credit growth should slow in the fourth quarter of the year. As a result, growth in lending to the private sector for 2005 is likely to be on par with the rate of expansion in 2004, despite the increases in interest rates throughout the year. Furthermore, the rise in credit is expected to exceed the rate of accumulation of deposits and, therefore, liquidity in the commercial banking system should remain relatively tight.

For the year 2005, the external current account deficit is projected to shrink below current levels. The improvement in the external current account is likely to result from a stronger anticipated increase in domestic exports, moderately higher receipts from net services and a notable slowing in the growth of retained imports. Furthermore, additional investment in real estate and tourism-related projects is expected to raise net capital inflows. Consequently, the loss in the NIR is forecasted to be significantly smaller during 2005 than in 2004.

**October 28, 2005**