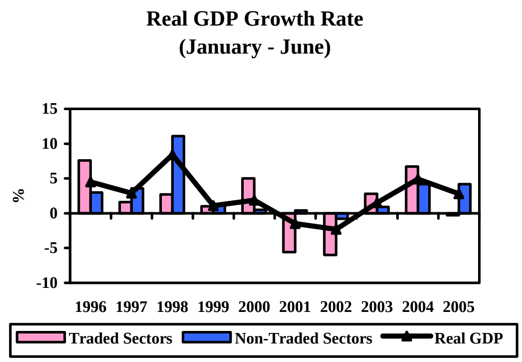
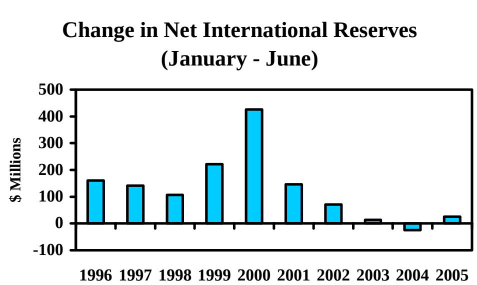
Review of the Economy
for the First Six Months of 2005

During the first six months of 2005 the Barbadian economy grew by an estimated 2.8%, compared to 5.0% over the same period of 2004, as tourism activity declined after last year's extraordinary increase. In addition, continued strong consumer import demand and higher international fuel prices contributed to a deterioration in the external current account. The NIR of the monetary authorities rose by $22.6 million at the end of June 2005, in contrast to a decrease recorded in the corresponding period of 2004, boosted by $30.2 million in inflows for the Grantley Adams International Airport project and the repatriation of $14.8 million in funds previously invested under the second-tier reserve programme. Government registered a modest fiscal deficit, as growth in expenditure outpaced that of revenue.



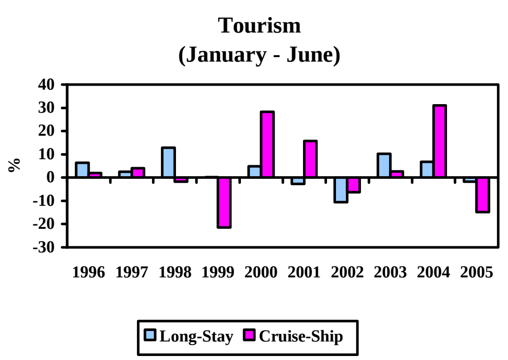
Meanwhile, liquidity in the banking system contracted further as commercial banks drew on their holdings of excess liquid assets to finance strong credit growth as there



was a lagged response to the increase in interest rates.

Sectoral Performance

Real value-added in the tourism industry declined by an estimated 3% during the first half of 2005. This contrasts with the extra ordinary expansion of 14.6% in the industry over the comparable period of 2004. Data to the end of April indicate that long-stay visitor arrivals rose by 1.3%. Arrivals from the United States and CARICOM went up by 4.6% and 11.1%, respectively. In contrast, arrivals from Canada and the United Kingdom fell by 14.2% and 1.0%, respectively. However, weaker performances were estimated for May and June and therefore provisional numbers indicate a small decline in long stay arrivals for the January to June period.



Cruise arrivals, contracted by 14.8%, after advancing by about 30% in the previous year. In addition, the industry this year has been challenged primarily by the increasing popularity of ‘homeland’ cruising from United States ports, operational difficulties at the Puerto Rico hub and slow capacity growth.

Due to favourable weather conditions, the amount of sugar produced during the January to June period of 2005 is estimated to have grown for the first time within the last five years. Sugar production during the period was approximately 37,800 tonnes, 3,400 tonnes more than during the comparable period of 2004. In contrast, non-sugar agricultural output recorded a marginal decline during the review period, owing to decreases in fish landings (4.3%) and milk production (5.3%), which offset an expansion in chicken production (4.6%).

Manufacturing output grew by around 1.1% during the first two quarters of 2005, in contrast to a marginal decline in the same period of 2004. This outturn reflects the expansions in beverages and tobacco, owing mainly to higher rum exports. Reductions were recorded in chemicals and food processing, while other manufacturing activities evidenced some growth.

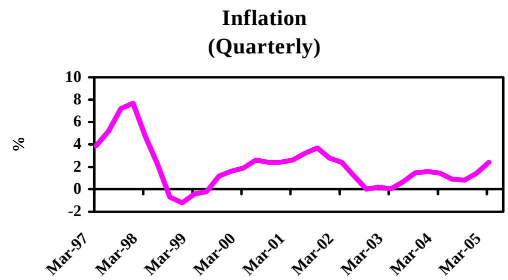
The wholesale and retail, as well as the transport, storage and communications industries recorded strong growth of 2.6% and 4.0%, respectively, as these non-traded activities benefited from robust consumer demand. Real economic activity in the electricity, gas and water industry went up by 3.6%, following growth of 2.4% in the same period of 2004. For the first quarter of 2005, electricity consumption expanded by 5.3%, with residential usage up by 6.0% and industrial consumption up by 4.7%.

Value-added in the construction industry increased by an estimated 9.6% for the first half of 2005, following a marginal increase in 2004, on account of residential housing and commercial development as well as higher Government spending on capital formation. Consequently, real output of the mining and quarrying industry went up by 3.2% compared to a marginal decline in the same period last year in order to satisfy heightened demand from the construction industry.

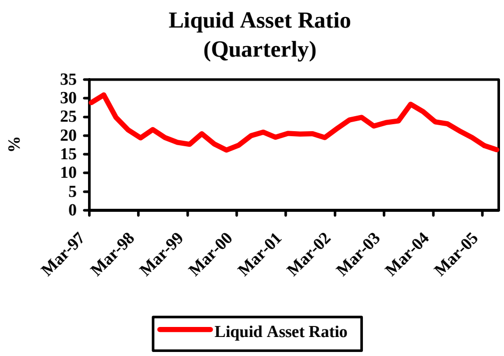
The international business and financial services sector issued 218 new licences during the first half of this year, 45 more than those granted in the same period of 2004. Of these licences 189 were for new international business companies, up from 136 in the corresponding period of 2004. Moreover, 22 societies with restricted liability were registered, 5 new exempt insurance companies were established and 2 exempt insurance management companies were formed.

The unemployment rate for the first quarter of 2005 was 9.9%, compared to 10.1 % in 2004. For females, the rate of unemployment fell from 11.6% to 11.3%, while the rate for males (at 8.6%) was marginally below that of the previous year.

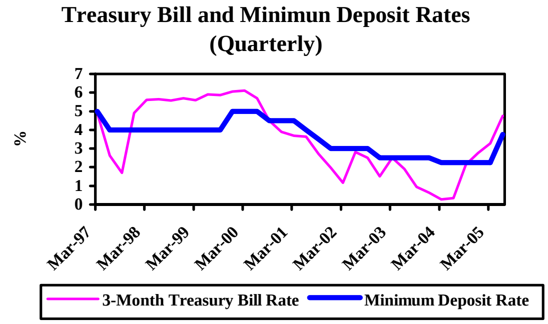
At the end of March 2005, the moving average rate of inflation was approximately 2.4%, or one percentage point higher than the rate at the end of March 2004. Higher prices were recorded in the food, housing and alcoholic beverages and tobacco categories, while reductions were registered for medical and personal care expenses, and also transportation and fuel and light.



During the January to June period of 2005 commercial banks' liquid asset ratio contracted by 3 percentage points to 16.2%. Holdings of securities and cash reserves fell by 1.7% and 14.6%, respectively.



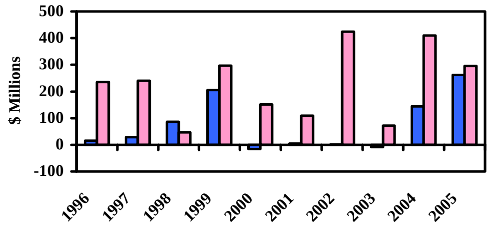
Consequently, the average discount rate on three-month treasury bills rose by about two percentage points to 4.75% at end of June 2005, while the Central Bank increased the minimum deposit rate from 2.25% to 2.75% effective April 1, 2005 and then to 3.75% from June 1, 2005.



Despite higher interest rates credit continued to be robust. Credit to the non-financial private sector climbed by about 9.0% ($275.2 million) over the first half of the year, following an increase of 5.5% in the comparable period of 2004. With continued strong growth in the demand for new mortgages, lending to the personal sector resulted in an increase of 11.0% or more than twice the rate of expansion during the first six months of 2004. Similarly, credit to the distribution firms surged by 22.1%, primarily due to borrowings to finance an acquisition in the industry.

The growth in credit reflects a lag in the response to higher interest rates as projects in the pipeline continued.

Growth in Domestic Deposits and Private Sector Credit (January –June)

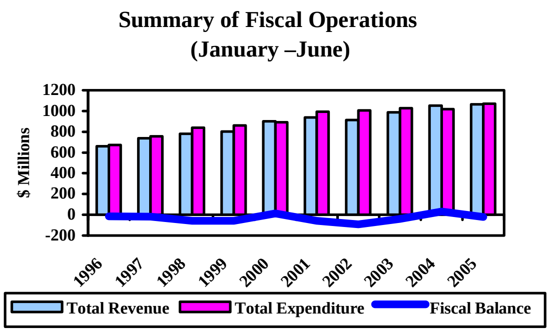


Domestic deposits grew by approximately 4.6% or $238.0 million for the first six months of 2005, compared to deposit growth of 8.5% in the similar period of 2004. Deposits of Central Government and statutory bodies expanded by $43.4 million and $54.1 million, respectively. In contrast, financial institution deposits declined by $11.2 million, as lower public financial institution deposits were partially offset by an increase in the deposits of private financial institutions.

Due to a pick up in capital expenditure and a decline in personal tax collections, Central Government operations resulted in a fiscal deficit of $20.0 million during the January to June period of 2005, in contrast to a surplus of $31.6 million over the same period in the previous year. Total revenue remained almost unchanged when compared to the corresponding period of 2004. Corporate tax receipts, as a result of improved profitability, grew by an estimated 29.2% during the review period, and compensated for a 15.3% contraction in personal taxes. The decline reflects the downward revision of the personal tax rate from 40% to 37.5% on taxable income in excess of $24,200 and an increase in the personal allowance by $2,500.

During the first half of 2005 indirect tax declined by 2.8% as the expansions in Value Added Taxes and other taxes were offset by reductions in excise taxes and import duties. Excise taxes fell by 24.8%, as a result of an offsetting transaction between government and a public sector enterprise. Likewise, import duties contracted by 0.7%.

Total government expenditure is estimated to have risen by 5.1% to reach $1071.4 million at the end of June 2005, in contrast to a decline of less than one percent in the corresponding period of the previous year. Current expenditure advanced by an estimated 5.6%, owing to higher outlays on transfers and subsidies (10.2%), goods and services (12.9%) and wages and salaries (2.4%). Supplemental disbursements to the Barbados Tourism Authority, the Transport Board and the University of the West Indies during the first quarter were responsible for the rise in transfers and subsidies. However, interest outlays decreased by 3.9%, on account of lower external interest payments. Capital expenditure grew by an estimated 2.1% during the first half of 2005.

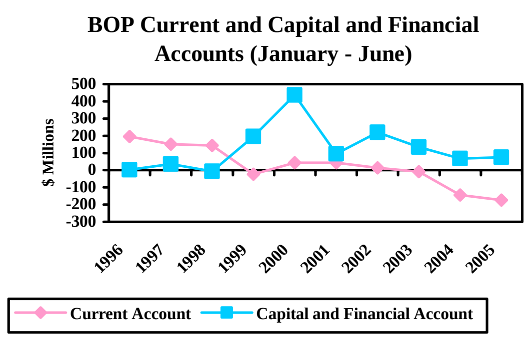


The fiscal deficit was financed mainly from domestic resources. Net domestic financing was estimated at $37.4 million, with commercial banks and the National Insurance Scheme expanding their holdings of Government securities by $26.9 million and $23.0 million, respectively. However, net foreign financing was below that in the comparative period of 2004, as amortisation payments of $32.0 million were only partially offset by inflows of project funds.

Despite an improvement in domestic exports, the deficit on the external current account widened due to the continued growth in retained imports and a slowdown in the rate of increase of tourism receipts. For the first six months of 2005, the external current account deficit was estimated at $173.8 million, or about $29.5 million higher than the deficit in the corresponding period of 2004.

With the decline in tourism output, net receipts from services were sluggish during the first half of the year, but domestic exports rose by an estimated 16.5% to $212.9 million during the review period. Sugar exports rose 10.6% to $43.9 million during the period. Between January and April exports of chemicals and electronic components grew by $5.3 million and $1.7 million, respectively. Similarly, food and beverages increased by $7.8 million, due in part to higher rum exports ($3.4 million).

Retained imports rose by an estimated 6.2% during the period compared to increases of 19.2% and 16% in 2004 and 2003 respectively, as a result of expansions in consumer and intermediate goods imports. For the first four months of the year, imports of consumer goods grew by 10.9%, as an increase in the food and beverages category of 16% outweighed a 1.3% decline in motorcar imports. The increase in consumer imports reflects a



trend of higher disposable incomes owing to reduced tax liability and increases in labour payments. Likewise, intermediate goods imports went up by 14.8%, reflective of a significant upturn in imports of construction materials. However, imports of capital goods fell by 17.8% because of a decrease in machinery imports.

The surplus on the capital and financial account was estimated at $74.4 million, about $7.8 million more than the surplus recorded over the corresponding period of the previous year. Net long-term private capital inflows totalled an estimated $132.8 million, compared to $82.8 million in 2004, while net long-term public sector outflows fell by $25.6 million to $30.6 million. In addition, short-term capital inflows were estimated at $5.3 million, a reduction of $7.9 million when compared to the previous year.

Outlook

Real gross domestic product is expected to expand by between 2.0% and 3.0% in 2005. The growth in economic activity should be led mainly by the non-traded sectors of the economy as tourism value-added is unlikely to be higher than it was last year.

Boosted primarily by strong demand for residential housing and Government's preparation for World Cup 2007, real economic activity within the construction industry is forecasted to increase, stimulating growth in the wholesale and retail trade and business and other services.

Reflecting higher energy prices, retail price inflation for the twelve months ending December 2005, should be between 2.5% and 3.5%, compared to the 1.4% rate observed at the end of 2004.

As a result of a pickup in total expenditure, Government's fiscal deficit, as a percentage of GDP, is likely to be a little higher than the 2.2% rate recorded in 2004. Growth in total revenue is projected to be driven primarily by greater corporation and indirect tax receipts, while total expenditure will be higher as a result of increased capital outlays.

The external current account deficit is expected to improve somewhat to 9.5% of GDP, due in part to a slower rise in the demand for retained imports and higher receipts from domestic exports and net services. Additionally, continued investment in real estate and tourism ventures should again boost net capital inflows. As a result, the NIR loss is likely to be significantly lower this year than the decline experienced in 2004.

During 2005, growth in credit is predicted to be slightly slower than in 2004. Credit to the non-financial private sector is projected to rise further, though much more slowly than the 17.0% rate recorded in 2004.

July 26, 2005