

# Review of the Economy for 2006

## Overview

The Barbadian economy expanded for the fifth consecutive year in 2006, recording an estimated growth rate of 3.5%, which is slightly below the increase of 2005 but significantly above the average rate of 2.8% for the last five years. However, the rise in real economic output was again driven by the non-traded sectors, while the traded sectors turned in only a modest performance. Despite a disappointing outturn in cruise passenger arrivals, tourism value-added grew during 2006, owing to a pick-up in long-stay arrivals and represented a reversal of the sector's downturn in 2005. This expansion in tourism, along with a marginal decline in retained imports and strong growth in the exports of goods and services, led to an improvement in the external current account deficit. However, the deficit was still large enough to offset the increased inflows on the capital and financial account, resulting in a fall of \$36 million in

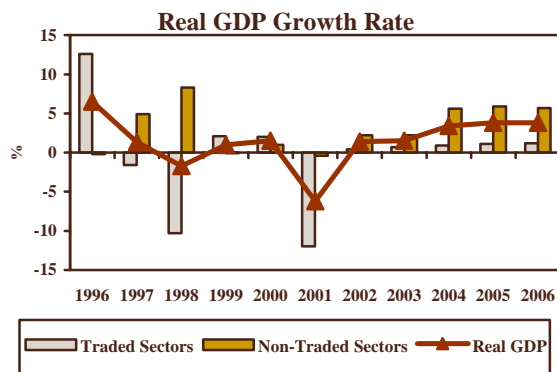
the net international reserves (NIR). Underlying the decrease in imports was a slowdown in the pace of expansion of credit to the non-financial private sector, which nonetheless exceeded the increase in domestic deposits, leading to a contraction in liquidity in the banking system.

Government's fiscal position improved, as the deficit, estimated at 1.7% of GDP, was about 2.7 percentage points lower than that for 2005.

The rate of inflation, measured by changes in the retail price index, rose during 2006, owing to higher oil prices, especially in the first half of the year.

## Sectoral Analysis

### Real Sector

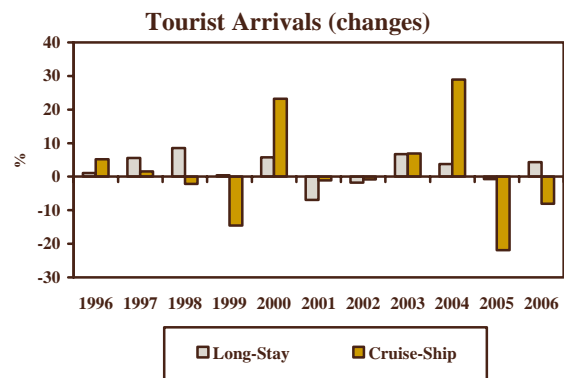


During 2006, real tourism output grew by an estimated 2.5%, reversing the 2.2% decline experienced in 2005, as a rise in long-stay tourism more than outstripped a fall-off in cruise passenger arrivals.

Long-stay tourists were up by approximately 4.3%, a turnaround from the 0.7% decrease recorded in 2005, mainly on account of commendable increases in the UK (4.7%), USA (3%) and Canadian (6.8%) markets, as airlift capacity out of those markets expanded. In addition, visitors from Trinidad and Tobago and other CARICOM countries rose by 15.3% and 1.3% respectively, while those from Germany were up by 12.4%.

After a rather weak outcome in the first half of the year, cruise passenger arrivals recovered in the second half to post an

overall contraction of 8.1% for 2006, which is a significant improvement on the 21.9% reduction experienced in the prior year. Cruise liners were forced in 2005 to make a number of itinerary adjustments in the face of escalating fuel costs, leading to a drop in the number of ship calls to Barbados during that year and continuing into 2006.



Output in the agricultural sector declined during 2006, as the production of raw sugar fell below 2005's level. The cane crop yielded only 33,701.8 tonnes of raw sugar, 12% below the previous year's total, owing mainly to a reduction in acreage planted. In addition, unfavourable weather conditions during the planting and harvesting periods lowered the yield per acre from 25.3 to 19.1 tonnes of cane.

Non-sugar agriculture and fishing rose marginally as a moderate expansion in other meat products outweighed declines in milk, chicken and fish productions. Fish catches decreased by approximately 5.7%, in comparison to a one per cent decline for 2005. Milk production fell by 13.4%, the fifth consecutive year of decline, and reflected a shortage of lactating cows. The contraction in chicken production of 5.6%, which follows three years of growth averaging over 10%, was as a result of a cut back on production as farmers depleted stocks built up in previous years.

During 2006, total manufacturing output increased by only 0.2%, after two years of growth averaging 2.7%. Buoyed by the high level of construction activity, the production of non-metallic mineral products advanced by 6.1%, the fifth successive year of expansion. Value-added in the electronics components industry grew by 10%, a turnaround from

the 22.2% drop registered in 2005, and reflected increased foreign demand. In addition, other manufacturing goods were up by 3.9%, following an expansion of 7.4% in 2005, while food processing grew by 1.5%, on par with the increase of the previous year. However, output contracted in the wooden furniture, chemicals and beverages and tobacco industries.

Following growth of 13.5% in 2005, real output in the construction industry is estimated to have advanced by a further 7% during 2006, as work continued on Cricket World Cup (CWC) related projects and other private and public ventures.

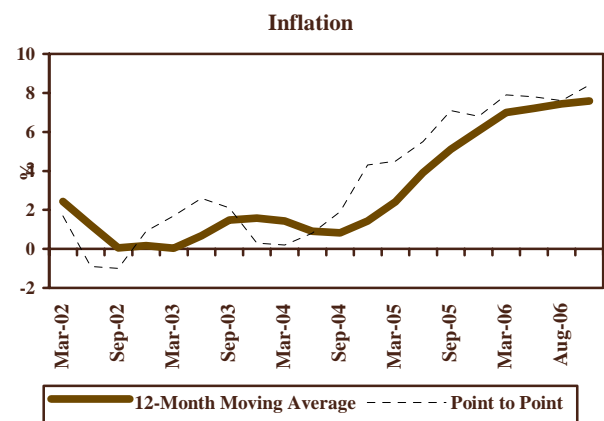
Bolstered by higher levels of disposable income, real output within the wholesale and retail industry rose by 5.3% during 2006, the fifth consecutive year of expansion. Value added in the transport, storage and communication industry also grew by 8.1%. Mining and quarrying output was 4.4% higher, due to greater

production of both crude oil and quarrying. Increased output was also recorded for electricity, gas and water, business and other services, and government services.

During 2006, 537 licences were issued to the international business and financial services sector, 109 more than those approved in 2005. 391 international business companies were licensed, compared to 372 a year earlier. At the same time 133 licences were granted to societies with restricted liability, eight to exempt companies, four to offshore banks and one to an exempt management firm.

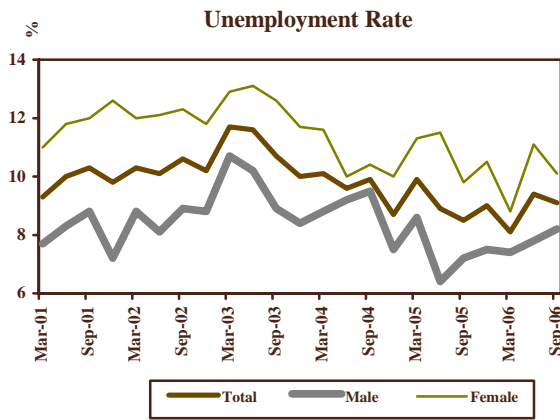
At the end of September 2006, the twelve-month moving average rate of inflation was 7.6%, compared to 5.1% for the corresponding period of 2005. The point-to-point rate was 7.8%. The main reasons for the growth in the general price level were the pass through effects from the surge in international oil prices and the upward revision of the cess during 2006,

which precipitated higher prices in all categories, with the exception of clothing and footwear. Specifically, significant price increases were reported for fuel and light (12.6%), housing (11.3%), transportation (9.6%) and food (7.1%).



Data for the first three quarters of 2006 indicate that jobs were created in the tourism, construction and utilities sectors, which offset the losses in the manufacturing, government services and the finance, insurance and business services sectors. Consequently, the average unemployment rate of 9.1% was unchanged from that registered for the same period of 2005. The male unemployment rate rose marginally by 0.8 percentage points to 8.2%, while the

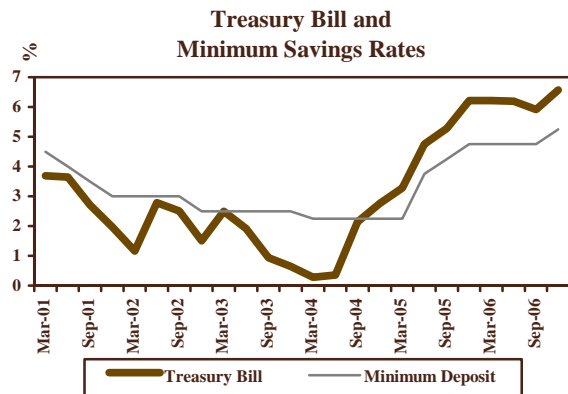
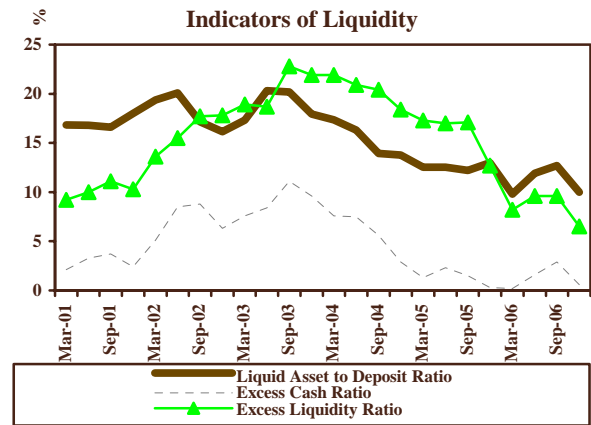
female unemployment rate fell by the same amount, to 10.1%.



### Financial Sector

Liquidity in the commercial banking system continued to tighten, with the excess liquidity ratio falling to 6.5% at the end of December 2006, some 6.2 percentage points lower than at the end of the previous year, while the ratio of liquid assets to deposits slid 3 percentage points to reach 10%. Commercial banks reduced their holdings of excess securities by almost 50% or \$354.6 million, but increased their excess cash holdings by only \$18.9 million.

Accordingly, the three-month treasury bill rate moved from 6.22% at the end of 2005 to 6.57% at the end of December 2006.

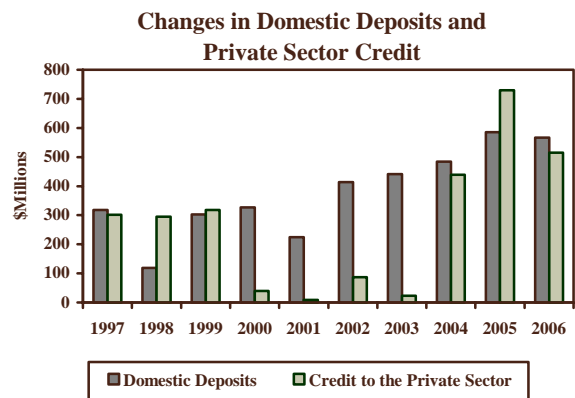


The restrictive monetary policy stance adopted by the Central Bank during 2005 to slow the growth in commercial bank credit and protect the net international reserves appears to have had an impact. The rate of expansion in credit to the non-financial private sector abated from 23.8% (\$730 million) in 2005 to 13.6% (\$519.5 million) in 2006.

Lending to the personal sector went up by 18.6% (\$336.1 million), which is 5.4 percentage points below the increase recorded in 2005. Loans for residential mortgages rose by 14.5%, in comparison to the 24.5% expansion registered in the preceding year. Consumer instalment credit outstanding advanced by 12.1%, less than half the growth experienced in 2005. Similarly, personal credit card debt outstanding was up by 10.3%, compared to 50% in 2005.

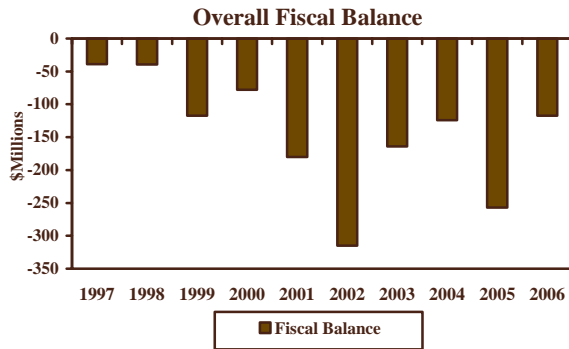
Credit extended to businesses also slowed slightly during 2006, with construction and distribution firms borrowing an additional \$49.6 million and \$54.5 million, respectively, compared to \$51.4 million and \$47.1 million respectively in the previous year. Also, tourism-related establishments and providers of professional and other services reduced their outstanding debt to commercial banks by \$7.6 million and \$29.4 million, respectively.

Domestic deposits in the banking system forged ahead by \$433.2 million (7.4%) in 2006, following an increase of \$487.1 million (8.8%) in 2005. This expansion was mostly attributed to growth of \$262.7 million and \$219.5 million in private individual savings and in the deposits of other financial institutions, respectively.



### ***Fiscal Sector***

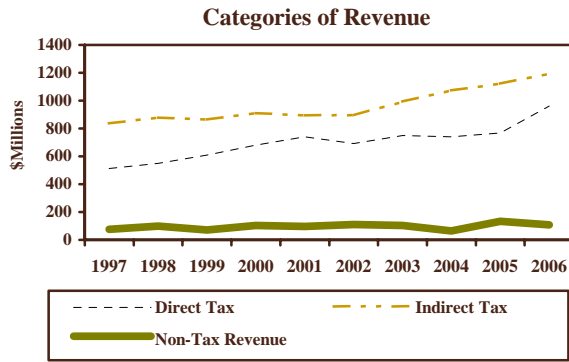
The fiscal deficit for 2006 was estimated at \$117.3 million, or 1.7% of GDP at market prices, approximately \$140.8 million less than the deficit recorded one year earlier. The improvement in the fiscal position was largely attributed to a significant increase in tax revenue.



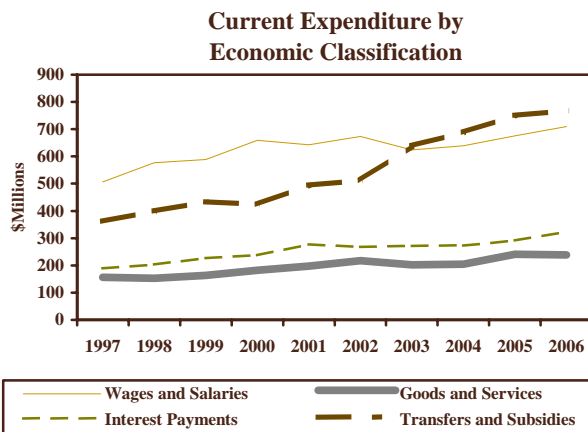
Total Government revenue rose by an estimated 12% (\$242.6 million), compared to growth of 6.6% in 2005, as both direct and indirect tax receipts registered expansions. The intake of direct taxes increased by about 25.5%, compared to 3.7% in 2005. Corporate tax revenue surged by 46.2%, up from 13.7% in 2005, owing to higher collections from the international business and financial services sector, as an increasing number of these entities became liable to pay taxes on profits. Following growth of 8.9% one year ago, property taxes rose sharply by 18.9%, on account of property revaluations, greater tax compliance and an expansion in the tax base. Salary increases during the year was the main reason for a 3.9% increase in personal tax

receipts, in contrast to a decline of 5.4% in 2005.

Indirect tax revenue rose by about 6.3% during 2006, fuelled primarily by an expansion in VAT revenue. VAT collections improved by 13.3%, occasioned by the rise in economic activity and the recording in 2006 of tax prepayments that were received towards the end of 2005. In addition, import duties grew by 6.7% (\$12.8 million). However, excise tax collections declined by 2.1%, in contrast to a 25.8% (\$35.3 million) increase reported in the previous year and is partly due to the lower rate on diesel and hybrid vehicles, which took effect from April 2006, and the fall-off in the importation of motor vehicles. Non-tax revenue shrank by an estimated 10.3%, after robust growth one year ago.



Total government expenditure increased by an estimated 4.5%, compared to growth of 12.8% in 2005. The reduction in the rate of expansion reflected slower rates of growth in all categories with the exception of interest payments and capital expenditure.



Outlays on wages and salaries went up by 5%, compared to 5.8% in 2005, a year when there were not only increases arising from wage negotiations but also

upward revisions in salaries related to the public sector job evaluation exercise. Transfers and subsidies rose by an estimated 2.2%, roughly 7 percentage points less than the rate in 2005 and mainly because of supplementary disbursements to the University of the West Indies, Queen Elizabeth Hospital and the Barbados Transport Board. Following an increase of 17.8% in 2005, expenditure on goods and services fell by 1.3% in 2006. However, interest payments were higher by 11%, compared to an expansion of 6.9% a year ago, and reflected a rise in domestic interest rates and new debt. As a result of increased spending on preparations for CWC 2007, along with a number of projects in partnership with the private sector and with foreign affiliates, capital expenditure accelerated during 2006, expanding by an estimated 13.6%, relative to 9.3% in the previous year.

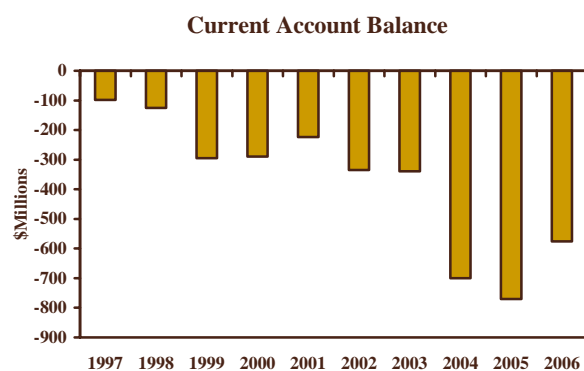
The fiscal deficit was financed from both domestic and foreign sources. With regard to foreign financing, the main injection was \$135.8 million from the re-opening of a 2035 bond on the international market in December 2006. On the domestic side, Government was a net depositor at the Central Bank, while net credit from commercial banks contracted. However, the National Insurance Scheme and private non-bank entities increased their holdings of Government securities, while additional funds in the form of divestment proceeds came from the sale of shares in the Insurance Corporation of Barbados.

During 2006, the total national debt expanded by \$129 million to an estimated \$5,041.9 million, which represented a decrease in the debt-to-GDP ratio from 79.4% in 2005 to 73.8% by year-end. Domestic debt, as a ratio to GDP, fell by 4.4 percentage points to 50.5%, while the external debt to GDP ratio declined 1.6 percentage points to 23.2%. However,

the ratio of total guaranteed debt to GDP rose from 14.6% to 16.3%, reflecting an increase in the number of public-private partnerships, such as build-operate-lease and transfer contracts, in the construction of major public-sector projects.

### **External Sector**

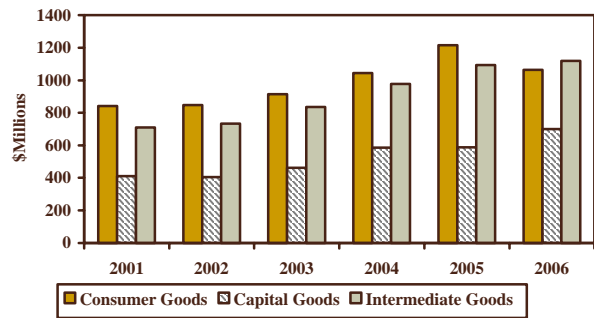
A slight contraction in retained imports and strong growth in both merchandise exports and tourism receipts led to an improvement in the external current account deficit during 2006. The deficit for the year is estimated at 8.5% of GDP, approximately 4 percentage points lower than the preceding year.



Reflecting the tighter monetary policy stance of 2005 and the ccess introduced in the same year, retained imports

decreased by approximately 0.5% in 2006, in contrast to an average growth rate of 13.5% over the previous three years. Imports of consumer goods fell by 12.6%, a turnaround of the 16.4% recorded a year ago, as all sub-categories either declined or experienced significantly slower rates of expansion. Growth in intermediate goods imports waned from 12% in 2005 to an estimated 2.3% in 2006, on account of a slowdown in the importation of construction materials and other intermediate manufactured goods, as well as a drop in expenditure on fuels, which reflects a levelling off of international oil prices. In contrast, higher purchases of machinery by the manufacturing industry for the production of construction materials, along with increased importation of telecommunications equipment by local cellular phone distributors, led to a 19% surge in capital goods imports during 2006.

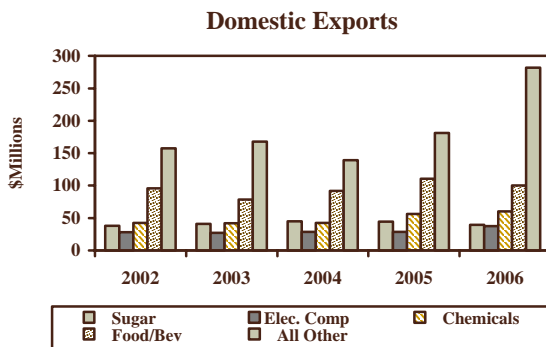
Retained Imports



Merchandise exports climbed by 23.3%, the third consecutive year of growth and the largest expansion since 1996. Exports of electronic components jumped 31.3%, mainly because of higher sales of resistors to the United States market. Receipts from the sale of chemicals advanced by 7.3%, as the price of chemicals increased in response to a rise in the prices of the raw materials used to produce the chemicals. In addition, exports of orthopaedic products and cement resulted in an estimated 55.5% (\$100 million) growth in miscellaneous exports. However, revenue from sugar exports dropped by 11.5%, while earnings from food and beverages declined by 9.3%, on account of a reduction in the

sales of rum and miscellaneous beverages.

Net receipts from the export of services rose by an estimated 5.3%, the fourth straight year of expansion, and principally because of the performance of tourism, which led to a 9.3% increase in travel receipts.

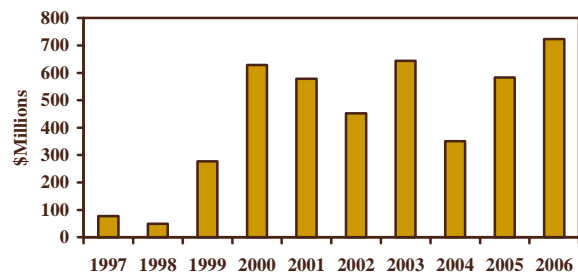


Boosted primarily by a significant pick up in net private capital inflows, and, to a lesser extent, government's external borrowing, the capital and financial account for 2006 registered an estimated surplus of \$717.4 million, roughly \$134.1 million more than that of 2005 and the largest surplus on record.

Net private sector inflows amounted to \$293.8 million on account of higher

proceeds for real estate projects and lower amortisation payments by the private sector. Additionally, net long-term public capital inflows totalled \$113.2 million, supported by the proceeds from a US\$65 million reopening of a 2035 bond on the international capital market.

**Capital and Financial Account**



### Outlook for 2007

In 2007, economic activity is expected to grow between 4% and 4.5% on the strength of improved performances in traded sector activity and continued buoyant growth in the non-traded sectors. Traded sector output is forecasted to pick-up at a faster pace than it did in 2006, mainly on account of an expected robust performance in the tourism industry. Indeed, the staging of the CWC 2007,

together with the strength of the pound sterling and a recovery of cruise tourism, augurs well for the industry. In addition, an upturn in the non-sugar agriculture and fishing industries is expected. Wholesale and retail, along with transport, storage and communications and business and other services, are projected to drive growth in the non-traded sectors, on account of the increased activity associated with tourism and CWC 2007. Employment levels should remain relatively high, while the inflation rate should be lower than that of 2006 as the recent slide in oil prices is likely to continue. Even if geopolitical tensions and supply constraints halt the current downward movement in oil prices, it is not expected that oil prices would return to the high levels experienced in 2006.

With the continued expansions in the non-traded sectors and in tourism, retained imports are predicted to show strong growth in 2007. Moreover, the removal of

the cess, which is expected to take place in the first half of 2007, would also be a contributing factor to the growth of imports. However, travel credits are forecasted to rise at a rate exceeding that of 2006, occasioned by a better outturn for tourism. Thus, the external current account deficit is projected to improve beyond 2006's level. Consequently, the NIR should show a marginal decline as capital and financial inflows are likely to continue.

Relatively high wages settlements payable in 2007 could lead to faster growth in government expenditure. However, there has been a recent upturn in Government revenue from VAT and corporation tax. Moreover, Government capital expenditure should slow considerably as many projects related to the activities surrounding CWC 2007 are concluded. Thus, a favourable on-budget fiscal performance is likely in 2007.

The monetary policy measures implemented by the Central Bank at the end of 2006 are likely to constrain the growth of commercial bank credit in 2007. However, the expansion in loans could still outpace the accumulation in domestic deposits. Consequently, liquidity in the banking system is expected to remain relatively tight.

**30 January 2007**