



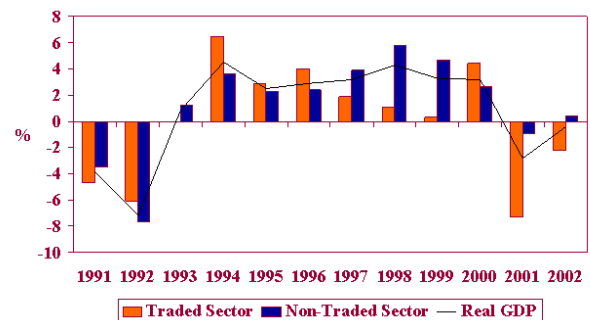
Review of the Economy for 2002

OVERVIEW

The downturn in the Barbadian economy was virtually arrested during 2002, although real economic activity dipped slightly below the level in 2001. The overall economy declined by an estimated 0.6%. A slight improvement was recorded in non-traded output and, while output in traded sector activities continued to slide, the rate of decline slowed when compared to one year earlier. The improved performance in the traded sectors was due principally to a pick up in tourism value-added in the last six months of the year. Manufacturing output remained sluggish and both sugar and non-sugar output declined. The modest rise in non-traded output was driven largely by increased output in public utilities, government services, and, to a lesser extent, transportation, storage and communications. Activity in the

wholesale and retail sub-sector was slightly lower and there were significant declines in construction and mining and quarrying. The weak economic outturn and the continued international uncertainty contributed to a slight increase in the unemployment rate at the end of September. The average

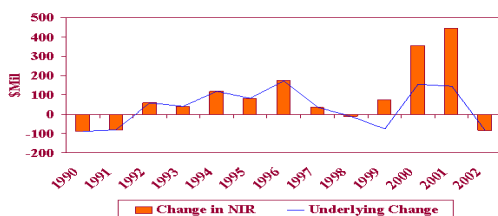
Real GDP Growth Rate



level of consumer prices remained virtually unchanged during 2002, as lower rates of inflation among Barbados' trading partners fed through to domestic prices.

The net international reserves (NIR) declined by \$83.1 million, in contrast to the underlying expansions of \$156.0 million and \$145.5 million in 2000 and 2001, respectively. The fall in the NIR reflected a worsening current account deficit and significantly lower net public and private sector capital and financial

Change in Net International Reserves



inflows. Declining earnings from domestic merchandise exports, a decrease in travel credits and a pick-up in retained imports in the last six months of 2002 were largely responsible for the weak current account balance.

Net long-term private sector capital and financial inflows were less than one half of those in 2001. Nevertheless, at the end of December 2002, the liquid assets of the Central Bank amounted to about \$1.3 billion, representing about 35.2 weeks of goods imports, or about 31.4 weeks of imports of goods and services. Despite the fall in reserves, liquidity in the banking system continued to rise

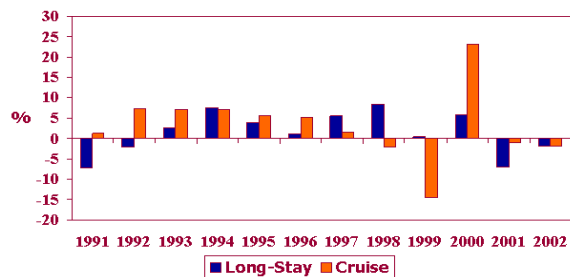
during the year under review. Indeed, the drawdown of Government funds on deposit at the Central Bank and sluggish private sector credit, among other things, drove the excess liquidity ratio up to nearly 19%. In light of this, the Central Bank continued to ease monetary policy by lowering the reserve requirements and the minimum deposit rate further, while continuing its policy of setting indicative targets for the average lending rate.

With signs of weakness persisting in the economy, Government increased its spending significantly in 2002, channelling funds to key economic sectors in order to mitigate the effects of international economic uncertainty and trade liberalisation. At the same time, Government revenue declined moderately, as the economic downturn in 2001 and fiscal reforms impinged on corporate tax revenues in particular. As a result, the fiscal deficit in 2002 was around 5.4% of GDP, up from 3.6% in 2001.

Sectoral Performance

The tourism decline in 2001 continued into the first half of 2002, with real activity contracting by 10%, on average. A rebound in the latter half of the year, during which activity increased by an estimated 6.0% and 9.3% respectively in the third and fourth quarters, was

Tourist Arrivals (% Changes)



insufficient to prevent an overall fall of 2.8% for 2002, following the downturn of 5.9% one year ago.

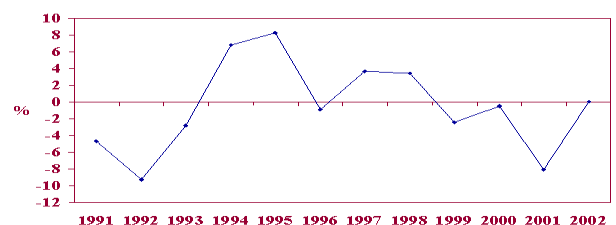
Long-stay arrivals fell by around 1.8% compared to 6.9% in 2001. The only traditional markets to record positive growth were the US and the Caribbean, all the other declined. Arrivals out of the USA were higher by 15.7%, the most impressive performance since the 1980s, primarily due to the success of the “Best of Barbados” promotion and the addition of US Airways to the existing airlift capacity out of North America. With respect to the United

Kingdom (UK), Canada and Germany, the number of visitors decreased by 11.6%, 12.7% and 6.6%, respectively. Arrivals from the UK, the mainstay of the tourism industry, fell mainly on account of the withdrawal of a number of charters and increased competition.

Barbados attracted an additional 21.3% visitors from Trinidad and Tobago and arrivals from other CARICOM destinations were up by 5.3%, the result of intensified promotion of the Crop-Over festival in other Caribbean countries and the hosting of two major regional sporting events. Cruise ship arrivals, despite an improvement in the third quarter, were down by 0.8% due to fewer cruise ship calls to Barbados.

The outturn in the agricultural sector continued to be poor during 2002. The sugar crop yielded only 44,818.7 tonnes, 10% below the previous year’s total, as drought conditions and protracted wage negotiations adversely affected the crop. Consequently, Barbados was unable to satisfy its

Manufacturing (% Changes)



contractual obligation of supplying 54,000 tonnes of raw sugar to the European Union. The shortfall in the quota was met by other countries in the African, Caribbean and Pacific grouping. Non-sugar agriculture declined for the second consecutive year, on this occasion by 3.2%, due to reduced levels of milk production and fish landings.

The manufacturing sector benefited, in part, from the continuation of the “*Buy-Local*” initiative and the imposition of a 60% tariff on specific items and, as a result, real activity was almost flat, in contrast to the steep decline of 8.1% in 2001. Those sub-sectors, such as food processing and other manufacturing products, which cater largely to domestic consumers, registered gains, while the more export-oriented sectors like beverages, electronics and chemicals continued to struggle in the face of intense competition from external producers.

Although construction activities improved during the last six months of the review year, as a number of new public sector projects came on stream, this was insufficient to prevent a decline

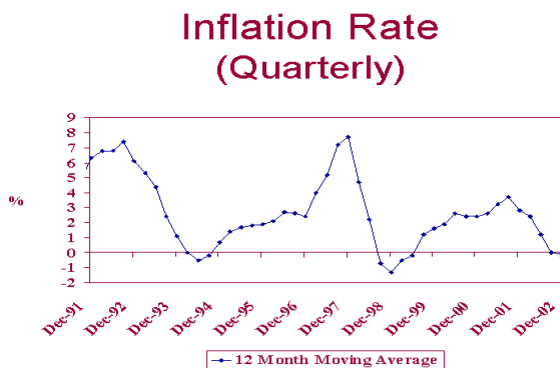
of 3.1% for 2002, after the decrease of 3.9% one year earlier. A reduction in residential building activity was the main reason for this outcome.

Wholesale and retail activity fell by 2.0% during the first six months of 2002 but benefited from the gains of tourism in the six months that followed to record a decrease of approximately 1.0% at year-end, compared to a contraction of 3.8% in 2001. Mining and quarrying output was 3.6% lower, due to reduced oil production. However, government services, transportation, storage and communication, business and other services, as well as electricity, gas and water, all recorded modest growth.

Despite an uncertain global environment, the international business sector registered an expansion in the number of entities that were granted licences to operate during 2002. Newly licensed international business companies totalled 197, or 5.3% more than in 2001. In addition, six new licences were issued to exempt insurance companies, compared to two in 2001 while three permits were granted to exempt management

companies, compared to only one in the previous year. Fifteen societies with restricted liability were given permission to operate during 2002, compared to eighteen in 2001, while the number of licences issued to offshore banks amounted to three, two less than in 2001.

At the end of October 2002, the average rate of inflation was estimated at zero percent, compared to 3.7% in October 2001. Increases were recorded for food, alcoholic beverages and tobacco, housing and medical and personal care, while the categories that declined were fuel and light, household operations and supplies, clothing and footwear.



Given the depressed level of economic activity during the past two years, unemployment edged upward during 2002. The average rate of

unemployment for the nine months ending in September 2002 was estimated at 10.3%, compared to 9.9% for the same period in 2001. The male unemployment rate rose by 0.7 of a percentage point to 8.7%, whereas the rate for females grew from 11.9% to 12.2%. Job losses occurred in the construction, transport, storage and communications, quarrying and general services sectors as well as in the sugar and manufacturing industries. These offset the gains in other agriculture and fishing, insurance, finance and business services, as well as the wholesale and retail sub-sector.

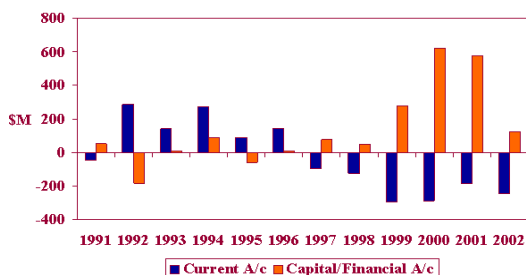
The decline in the NIR, the first since 1998, was brought about partly by a record fourth quarter decline of \$110.9 million. The current account deficit widened to \$246.3 million (4.9% of GDP) compared to \$187.7 million (3.7% of GDP) during 2001. Domestic exports contracted by about 6.6%, almost on par with that of the previous year, as all major categories registered declines. Sugar exports were 14.4% lower, while electronic components, chemicals and food and beverages fell by 22.5%, 5.1% and 5.6%, respectively.

Net foreign receipts from services declined by 5.1% during 2002, compared with a fall of 2.7% in 2001. Although travel credits improved during the last six months of the year, this was insufficient to offset the fall recorded during the first half of 2002. Overall, travel credits contracted by an estimated 3.0% for the year. At the same time, retained imports, which had been falling during the first half of 2002, rebounded in the six months that followed, limiting the overall decline to 1.9%, compared to 8.2% in 2001. Imports of capital goods imports were 4.0% higher, in contrast to a decrease of 8.0% one year earlier, while the decline in purchases of intermediate goods slowed to 2.7% from 12.5% in 2001. Outlays on consumer goods remained virtually unchanged compared to a decrease of 4.4% in 2001.

The capital and financial account surplus was estimated at \$123.6 million, slightly below one-quarter of the surplus of 2001. Net long-term public sector inflows amounted to only \$11.0 million, significantly below the inflows of the previous year when Government borrowed \$300 million on the international capital market. Net long-term private sector inflows of \$108.6 million were less than one half of the figure for 2001.

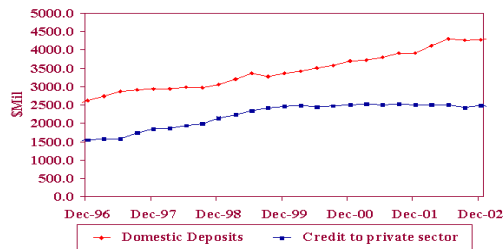
Liquidity remained high during 2002 with the excess liquidity ratio reaching 19.0% at the end of December, marginally up from 18.1% at end-September, but significantly higher than the 10.7% recorded at end-December 2001. In an effort to revive economic activity, the Central Bank eased monetary policy by reducing the reserve requirement of commercial banks to 16% of deposit liabilities and lowering the minimum deposit rate to 2.5% by year-end. In addition, to reduce borrowing cost to the business sector, commercial banks were required to reduce the loan rate on selected loans by one-half of a

BOP Current and Capital/Financial Account



percentage point to 8% by the end of 2002.

Commercial Banks' Domestic Deposits and Credit to the Private Sector (Quarterly)



Burgeoning liquidity and the resulting competitive bidding for the available supply of treasury bills drove down the treasury bill rate to a historic low of 1.51% at the end of the year, compared with 1.97% one year earlier.

The weakness of domestic demand was reflected in a contraction in credit to the non-financial private sector. Effective credit to the non-financial private sector fell by \$16.3 million, a reversal of the growth of \$8.4 million in 2001. With the exception of the distributive sector, which registered growth of \$47.7 million, all of the other major sectors slowed.

Domestic deposits grew by around \$354.3 million (9.1%) in 2002, compared to an expansion of \$224.4 million in 2001, boosted primarily by

Government's drawdown of some of its special deposits at the Central Bank as well as the deposits of those individuals who sold their shares in Life of Barbados Ltd. to the Barbados Mutual Life Assurance Society. These transactions were reflected in the growth of deposits of financial institutions and private individuals.

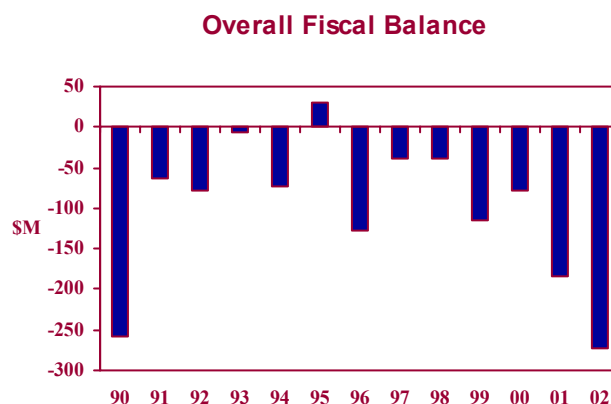
Government's fiscal deficit was estimated at \$273.4 million (5.4% of GDP), compared to \$184.0 million (3.6% of GDP) in 2001. This deficit was the highest since the 7.5% of GDP in 1990. Total revenue declined by 1.4% in contrast to growth of 1.2% in 2001, mainly due to a decrease in direct taxes. Direct taxes fell by 8.4% as a result of reduced collections from corporation and property taxes. The 20.8% decline in corporation taxes was partly due to reduced profitability of some businesses, while the decrease in property taxes (7.6%) contrasted with an expansion of 19.7% one year earlier when the early issuance of property tax bills facilitated the timely collection of revenues. Only receipts from personal taxes showed any improvement, rising by 3.7% compared to 2.4% in 2001.

Indirect taxes advanced by only 0.3% (after declining by 3.2% in 2001) on the strength of import duties - up by 21.7% - and value-added tax (VAT), which was 1.8% higher. The expansion in import duties was attributed to the impact of the 60% tariff on certain categories of imports during 2001. On the contrary, excise taxes fell by 18% mainly as a result of reduced motor car imports. Non-tax revenue and grants were lower by \$2.8 million.

Total expenditure was 4.2% higher during 2002, compared to an increase of 7.9% in 2001. Outlays on recurrent items grew by 2.1%, following growth of 7.3% one year earlier. Wages and salaries increased by 3.8% as a result of the wage settlement and back pay, while expenditure on goods and services rose by 8.0%, compared to 9% in 2001. Transfers and subsidies were higher by 1.9%. On the contrary, interest outlays contracted by 5.6% on account of lower interest rates.

Government's counter cyclical policy was reflected in an acceleration in its capital works programme. Capital expenditure surged by 20.8% during

2002 in comparison to 5.9% in 2001. This increase was the largest since the 42.9% rise in 1997. The main factors



responsible for this growth were the on-going work on Edutech and the South Coast Sewerage Project and upgrades at the air and seaports.

Financing for public sector operations came primarily from domestic sources. Government's net deposits at the Central Bank fell by \$322.1 million, in contrast to 2001, when Government increased its net deposits at the Central Bank by \$310.5 million. Commercial banks, the National Insurance Scheme and private non-banks held additional securities amounting to \$173.6 million, \$109.2 million and \$16.9 million, respectively. Net foreign financing rose by \$43.4 million, as project funds totalling \$105.4 million were offset by

foreign amortisation payments of \$62.0 million.

OUTLOOK FOR 2003

The Barbadian economy is projected to grow by between 1.5% and 2.5% during 2003, largely on the assumption that the robust growth in the tourism sector observed during the latter half of 2002 would continue into 2003.

Current projections point to a 5.0% increase in real tourism value-added for 2003, which would mark the first such increase since 2000. In this regard, building on the momentum created by the “Best of Barbados” initiative is paramount, as is the sustained recovery of the economies of our major source markets. However, optimism must be tempered by caution, as the very real prospect of a US war on Iraq poses significant downside risks to tourism and the overall economy. Should this war scenario materialise, value added in tourism is likely to fall by approximately 3% and overall output could register a decline between 1.0% and 2.5%,

depending on the timing and duration of the conflict.

Tourism aside, sugar production and manufacturing are also expected to have a positive impact on growth. The anticipated rise in manufacturing output reflects the assumption that the effects of the “Buy Local” campaign, the 60% tariff on selected imports and the WTO special safeguard mechanism will persist into the coming year. However, the projected upturn in sugar output, attributed to greater rainfall in 2002, is coming after steep declines in 2001 and 2002, and actual output in the sector will therefore remain below historical levels.

Non-sugar agriculture is projected to contract, although the decline should not be as steep as in 2002. Broad based growth should occur in the non-traded sectors with all activities showing upward movement. The greatest contribution to this improvement is expected to come from the construction and wholesale and retail sectors, both of which should benefit from increased traded-sector activity, and the pick up in tourism in particular. In line with the predicted expansion in economic

activity, the average rate of unemployment is likely to fall somewhat during 2003. Inflation is also expected to record a modest rise, and in the absence of war, the change in prices should actually be below trend. However, in the event of war, oil prices could rise above \$30 a barrel, which would inevitably spill over into domestic prices, pushing up inflation by as much as 3% higher than anticipated.

The NIR may contract during 2003, as the improvement in the current account, boosted by rising travel credits, may be more than offset by a slowdown in capital and financial inflows. However, the import reserve cover should remain high at around 32 weeks of imports. Domestic liquidity is likely to remain high, although some decrease should occur in the excess liquidity ratio with the anticipated pick-up in credit demand. In addition, the Bank is scheduled to remove the ceiling on the weighted average lending rate during March 2003, in keeping with the process of gradual liberalisation. The fiscal deficit is projected to improve to approximately 4% of GDP, as the resumption of economic activity should lead to a

higher intake from indirect taxes. However direct taxes should be lower than in 2002 with the implementation of fiscal reforms, which will result in downward revisions to the rates of personal and corporation taxes, while no significant expansion in Government's capital works programme is anticipated.

However, in the context of war, the deficit could be higher than anticipated, unless steps are taken to reduce Government expenditure further.

January 30, 2003