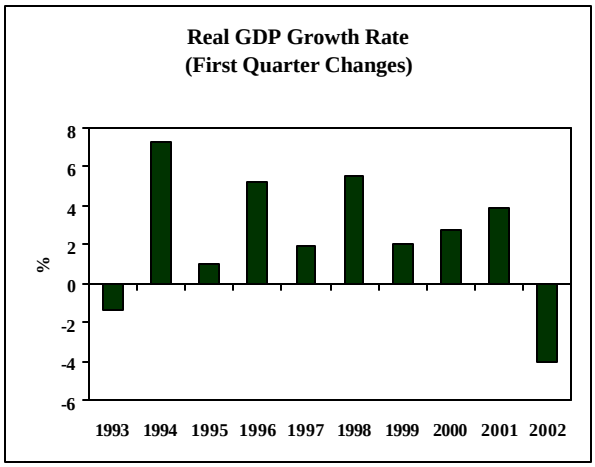
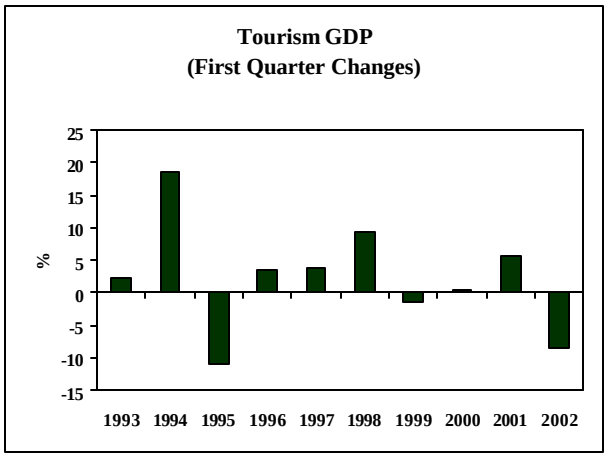
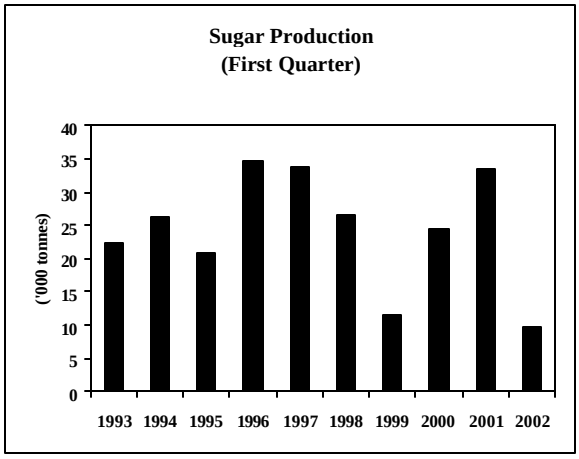
REVIEW OF THE ECONOMY FOR THE FIRST QUARTER OF 2002

During the first three months of 2002, the Barbados economy contracted by an estimated 4.0%, in contrast with a modest increase of 0.7% during the first quarter of 2001 and an average expansion of 2.9% over the corresponding period 1993 to 2000. It was the first time since 1993 that a decrease in real economic activity had occurred between January and March. Activity in the traded sectors declined by 12.9%. There were significant declines in tourism and sugar output, and this, together with substantially reduced capital inflows, moderated the accumulation in the net international reserves. Real activity in tourism fell by an estimated 8.4%, in contrast to a rise of 4.9% during the first three months of last year, the result of significant declines in both long-stay and cruise ship arrivals. While there was a welcome return to growth in the U.S. market which rose by 6.8%, long-stay arrivals fell by 8.5%, mainly due to decreases in the U.K. and Canadian markets.





Arrivals out of the UK declined by 11.1%, those from Canada contracted by 15.9%, while those from Continental Europe fell by 10.4%. Cruise ship arrivals declined by 7.6%, in contrast to increases of 23.9% and 43.4% in the corresponding periods of the previous two years. This was the result of a reduced number of cruise-ship calls.



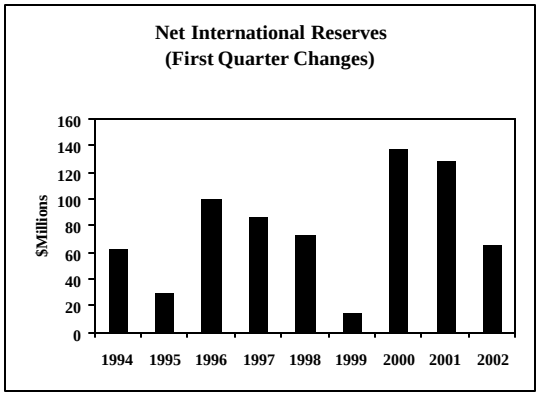
Sugar production contracted by some 66.5%, owing largely to the late start to the sugar harvest. Non–sugar agriculture fell by 0.9%, as decreases in fish landings and milk production more than offset the rise in chicken production. The rate of decline in manufacturing output of 0.9% was considerably slower when compared with the 8.8% fall in the corresponding quarter of 2001. This was mainly the result of a 5.2% increase in processed foods and 0.4% increase in garment production. Also, there were declines in output of electronic components of 17%, beverages and tobacco, 6.9%, other non-metallic mineral products, 4.4% and wooden furniture by 1.2%.

In the non-traded sectors, the production of electricity, gas and water rose only 0.3%, compared to 4.8% last year. Real construction output rose by only 0.4%, compared to 1.8% in 2001. The decline in real tourism activity and the slower growth in construction constrained output in ancillary services such as transportation, communications, business and other services and wholesale and retail trade.

The average rate of unemployment for 2001 was 9.9%, an increase of 0.7 of a percentage point over the rate for the year 2000. The unemployment rate for males stood at 8.0%, 0.7 of a percentage point higher than one year earlier, while the rate for females reached 11.9%, about half of a percentage point above the figure for 2000. Most job losses were in the manufacturing, tourism and general services sectors.

Inflation abated slightly during the period. At the end of the first three months of 2002, the average rate of inflation was estimated at 2.5%, compared to 2.6% during the corresponding period of 2001.

The net international reserves rose by $65.1 million during the quarter, slightly more than one-half of the growth recorded during



the corresponding period of last year, but virtually on par with the increase of 1994. This slowdown was reflected in both the external current and capital and financial accounts. The external current account surplus of around $47 million was approximately $23 million lower than for the January to March period in 2001. Retained imports contracted by 10% during the quarter, while travel credits declined by 6.4% and domestic exports decreased by 25.6% or $24.3 million.

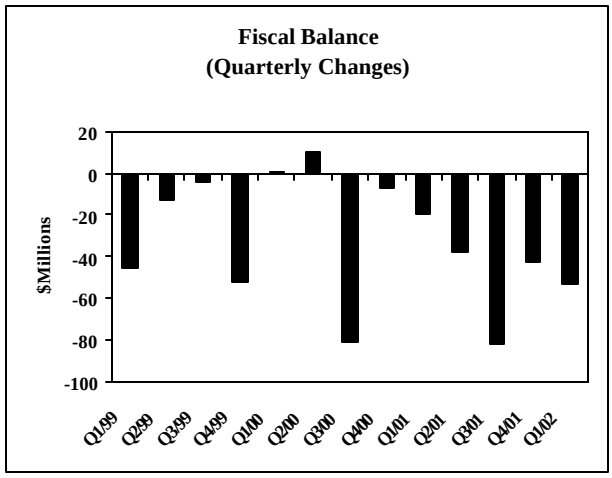
The capital and financial account, estimated at $40.5 million, was $39.6 million below the total for the first three months of 2001. This was due to lower net long-term private sector inflows and net long-term capital outflows from the public sector. At the end of the review period, the liquid assets of the monetary authorities represented 40 weeks of import cover compared to 25.5 weeks at the end of March last year.

Government operations during the first three months of 2002 gave rise to an overall deficit estimated at $53.4 million, some $34 million above the deficit of the corresponding quarter of last year. Total revenue fell by 1.7% while the total expenditure rose by 4.5%. Direct tax receipts were lower by 2.8%, in contrast to an expansion of 13.3% one year ago. With the slowdown in economic activity, corporation tax receipts fell by 6.7%, a reversal of the 7% rise in 2001. However, personal tax receipts increased by 3.5%, some 1.8 percentage points below the growth recorded last year and property tax receipts rose by 1.8%.

Consequent upon the decline in economic activity, indirect tax collections decreased by 2.1%. Excise taxes fell by 21%, after recording a marginal increase last year while import duties fell by 6.7% as a result of reduced import demand. However, the intake from value added taxes (VAT) rose by 2.1% during the review period, while an increase of $2.9 million was recorded for non-tax revenue and grants.

Government's current expenditure expanded by 2% during the first quarter of 2002. This represented higher outlays of 15.9% for interest payments, 3.1% for goods and services and 1% for wages and salaries. The sharp rise in interest payments was primarily due to higher foreign interest outlays, as a result of the rising stock of foreign debt. However, transfers and subsidies, which rose by 47% in the first quarter of 2001, fell by 2.7% during the review period.

Spending on capital works was about 13.4% ($16.5 million) higher when compared to the first quarter of last year. The capital projects undertaken primarily by Government during the three-month period

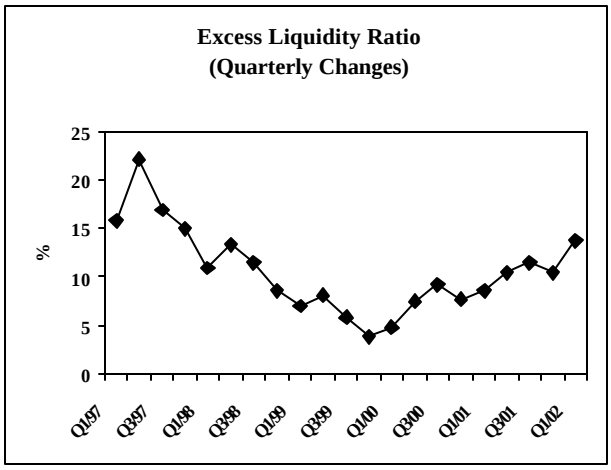


were the South Coast Sewerage Project, the expansions of the air and seaports, road repairs and refurbishments to schools to enable their participation in the EDUTECH 2000 programme.

The deficit for the quarter was financed primarily from domestic sources. Net domestic financing amounted to $53.0 million. Commercial banks and the National Insurance Scheme invested additional $62.7 million and $29.8 million, respectively in Government securities. However, Government increased its deposits at the Central Bank by $48.1 million. Net foreign financing for Government was estimated at only $0.4 million, as project inflows of $20 million were partly offset by foreign amortisation payments by Central Government totaling $19.6 million.

At the end of the fiscal year ending March 2002, the fiscal deficit was estimated at $215.2 million or 4.1% of GDP. Total revenue rose only marginally by 0.3% to $1737.4 million while total expenditure increased by 6.7% to $1952.6 million.

The excess liquidity ratio reached 13.7% of deposits at the end of March 2002, compared with 10.4% at the end of 2001. Deposits of financial institutions rose 12.2% and private individuals 2.9%, while deposits



of business firms fell 3.7%. Credit to the private sector was flat during the first three months of 2002 and loans to the tourism and distributive sectors fell by 0.7% and 1.2%, respectively. Marginal increases were, however, recorded in credit to the personal, construction, manufacturing and agricultural sectors. As a result of the accumulation in excess liquidity, the treasury bill rate continued to decline, reaching 1.16% at the end of the first quarter, compared with 1.97% at end-December 2001.

In an effort to lower the cost of credit and to stimulate economic growth, the Bank relaxed its monetary policy stance during the month of March this year. Effective March 15, 2002, the Central Bank reduced the securities requirement for commercial banks by one percentage point to 18%.

OUTLOOK FOR THE REMAINDER OF 2002

Current projections suggest that the Barbados economy is lightly to register a marginal decline of up to 1% in 2002 unless the outturn for tourism is stronger than anticipated. Much will depend on the performance of the US economy, which is expected to recover by the second half of this year. Of the traded sector activities, only non-sugar agriculture and manufacturing are likely to register any growth. Real value-added in tourism is projected to contract, but the decline should not be as sharp as in 2001, while a further decrease in sugar production is anticipated. Uncertainty in the international business and financial services sector should ease with the recent removal of Barbados from the list of countries categorised by the Organisation for Economic Cooperation and Development (OECD) as exhibiting harmful tax practices. Non-traded activities are expected to expand marginally during 2002, and this will be led mainly by improvements in electricity, gas and water, mining and quarrying, business and other services and transportation, storage and communications. Activity in the wholesale and retail sector, the biggest non-traded sector, is likely to remain depressed

given the decline in tourism output. Construction activity should be sustained by Government-initiated as well as private sector residential projects. However, overall performance of construction for the year will depend on the speed at which some of the key projects, such as the Hilton Hotel and the Pierhead projects are brought on stream. Inflation should be in the range of 3% to 3.5%, and no gains in employment are anticipated.

As a consequence of the slowdown in net long-term capital and financial inflows, the net international reserves are projected to decline by between $30 million and $50 million during 2002. However the current account deficit should improve since the expected fall in goods purchased from abroad should be higher than the decline in travel receipts and domestic exports.

The deficit for fiscal year 2002/2003 should exceed that of the previous year as a result of lower direct tax intake (particularly personal and corporation taxes) and rising capital outlays. This deficit is expected to be financed both from domestic and foreign sources. Government is likely to reduce its deposits at the Central Bank, while commercial banks and the National Insurance Scheme are expected to purchase additional Government securities. Project inflows will be the major component of foreign finance. The build-up in liquidity is expected to decline during the remainder of the year 2002, with an anticipated increase in credit demand. Consequently, some pickup in the treasury bill rate should occur.

In summary, though the first quarter decline in 2002 is largely the result of a timing difference due to the lateness of the sugar crop, this does not wholly account for the decline. Given that the Barbadian economy recorded a decline in 2001, we can conclude that there is a definite sluggishness in the economy which we need to address. It is important that we ensure that this recession is short lived. Tourism and financial services are our more dynamic sectors. Though the March outturn for tourism was an improvement on January and February, it is hoped that this will be a continuing trend. In the financial services sector, now that Barbados has been removed from the OECD list there should be added momentum in the sector.

Generally, however, in the prevailing environment, given that our costs of operations are already high, it is important

that wage demands, including government workers' wage demands be controlled. It is difficult to reverse wage increases once they are already granted. Barbadians are therefore urged to exercise good judgment and agree to wage settlements which are in the best interests of the country. It is better to take preventative action so as not to worsen our competitiveness than to have to take corrective action. Global competitive forces can impact on our ability to compete both at home and abroad. It is important that our competitive position is not allowed to worsen.

Barbados' economic fundamentals, however, remain good. The fiscal deficit is manageable, inflation remains low, unemployment is relatively low and our foreign exchange reserves are at their highest levels ever. Reserves amount to the equivalent of 40 weeks of imports. This gives us an opportunity to continue our programme of gradual exchange control liberalization. In addition, we are proposing to enlist the assistance of institutional investors to help us to build a second tier of foreign exchange reserves. The response so far has been very positive it could make a great difference to our ability to implement a programme of financial liberalization.

April 30, 2002