

## Review of the Economy for 2003

### Overview

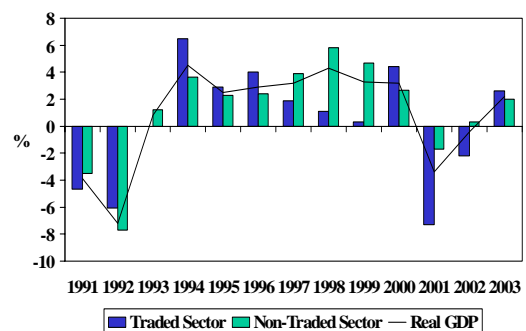
Following a modest contraction in real economic activity in 2002, the Barbados economy expanded by an estimated 2.2% in 2003, largely on the strength of tourism, and, to a lesser extent, wholesale and retail activity. Output growth of 3.2% in the last quarter of 2003 contributed significantly to this outcome. The country's net international reserves (NIR) rose by \$135.4 million but significant growth in retained imports and weak export demand were mainly responsible for an underlying decline of \$53.7 million in the NIR (after deducting divestment inflows amounting to \$189 million.). Additionally, liquidity in the banking system continued to mount on account of the drawdown of Government's divestment proceeds on deposit at the Central Bank, the expansion in the Ways

and Means Account and weak private sector credit performance. Government's fiscal position improved, as the deficit, estimated at 4.5% of GDP was about 1.2 percentage points lower than that for 2002.

### Sectoral Performance

Real tourism value-added increased by an estimated 7.7% in 2003, following nearly two years of recession in the tourism industry. The number of long-stay visitors

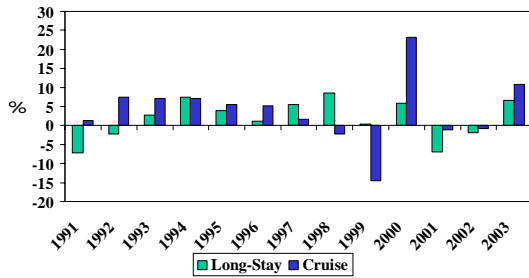
**Real GDP Growth Rate**



rose by 6.6%, in contrast to the 1.8% contraction in 2002, a recovery that can be partly attributed to the early re-launch of the “Best of Barbados” programme and an increase in seating capacity out of the major markets.

Long-stay arrivals from all of the traditional markets registered increases, with CARICOM, the United Kingdom and the U.S. in particular, recording upturns in arrivals of 8.2%, 5.1% and 4.6%, respectively.

### Tourist Arrivals

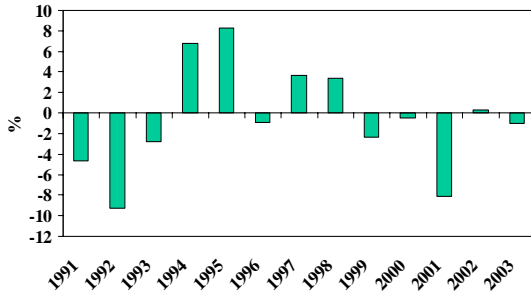


Cruise ship arrivals rose by 10.8% in 2003, largely on account of an estimated 30.0% surge in passengers in the fourth quarter when several major cruise ships made Barbados their homeport.

After contracting marginally in 2002, real value-added in the non-sugar agricultural industry grew by an estimated 2.1%. Notably, the number of fish landings grew by 9.1%, a turn-around from the 7.4% fall-off in 2002. However, milk production contracted by 3.7% continuing the downward trend exhibited for the previous two years. Sugar production contracted by 19.0% to 36,325 tonnes in 2003, compared to a 10.0% decline one year earlier. Additionally, manufacturing output fell marginally (1.0%), in contrast to a slight rise in 2002.

Construction activity is estimated to have grown by 2.9% during the review period, continuing the trend that resumed in the middle of 2002. The building of new tourism infrastructure, the refurbishment of existing properties, the Airport expansion project and commercial real estate development were the driving forces behind this performance.

### Manufacturing Growth Rate

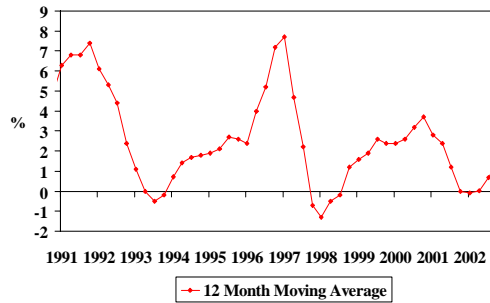


Influenced by the recovery in the tourism sector, real output within the wholesale and retail industry rose for the second consecutive year while activity in the transport, storage and communication industry strengthened by 1.3% during 2003, reflecting the surge in retained imports. Business and other services and electricity, gas and water grew by about 2.0%, while poor returns on existing oil wells resulted in a moderate decline in mining and quarrying value-added.

However, an expansion in the labour force resulted in the unemployment rate rising marginally from 10.6% at September 2002 to 10.7% at the end of the third quarter in 2003. The average number of persons employed as at September 2003 was about 1% higher than the figure at September 2002, as the pace of real economic activity increased. Most of the new jobs were

created in the general services, wholesale and retail and transport and communications industries.

### Inflation Rate (Quarterly)

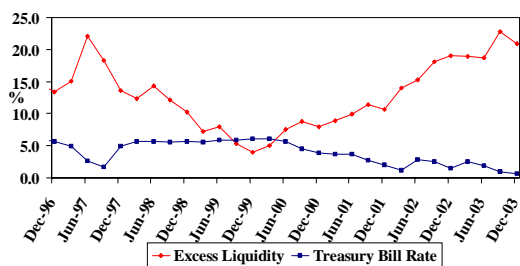


The rate of inflation at the end of October was 1.65%, in contrast to 2002 when the average price level remained basically unchanged. Increases in the prices of food, fuel and light, and medical and personal care were the primary reasons for this outcome.

Liquidity in the banking system continued to accumulate with the excess liquidity ratio reaching 20.9% at the end of December 2003, some 3.1 percentage points higher than at the end of the previous year. During 2003 the Central Bank discontinued its policy of setting the weighted average indicative lending rate to commercial banks. Nevertheless the Bank remained committed to the goals of cutting the cost of lending to

the productive sector to reinforce the current economic recovery.

**Selected Indicators  
(Quarterly)**



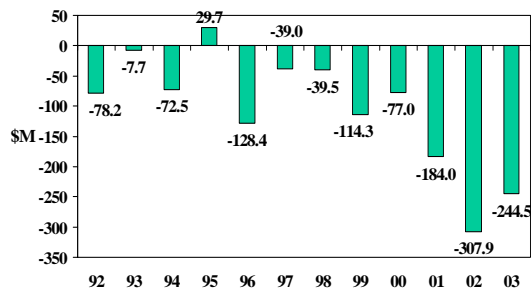
As a result of public and, to a lesser extent, private investments in the latter half of the year, domestic deposits rose by 10.3% or \$443.9 million, almost the same as the increase in 2002. All major categories of economic agents registered growth in their deposits. The deposits of central government expanded by \$41.0 million, facilitated in large part by the receipt of the divestment proceeds, while increased deposit holdings of \$214.2 million and \$44.1 million were recorded for private individuals and business firms, respectively. Deposits of financial institutions rose by \$96.8 million, primarily as a result of an increase in deposits by the National Insurance Scheme (NIS).

Credit to the non-financial private sector was up marginally by only \$16.8 million (0.6%) in 2003, following a \$86.6 million

expansion in 2002 when foreign loans were transferred to the books of a domestic financial entity. Personal sector borrowing rose by \$59.9 million for the year, driven largely by a sharp expansion in the last quarter. Credit extended to tourism-related establishments and statutory bodies increased by \$49.3 million (14.7%) and \$60.6 million (38.3%), respectively. However, loans to the distributive industry recorded a decline of \$15.3 million, as firms in the industry relied increasingly on trade credits to finance their operations.

The fiscal deficit for calendar year 2003 was estimated at \$244.5 million, approximately \$63.4 million lower than the deficit for 2002. Total tax revenue grew by 6.7% on account of increased corporate tax collections, import duties and Value Added Tax (VAT) receipts. However, personal income tax collections fell moderately because of a cut in the basic income tax rate from 25.0% to 22.5%.

### Overall Fiscal Balance

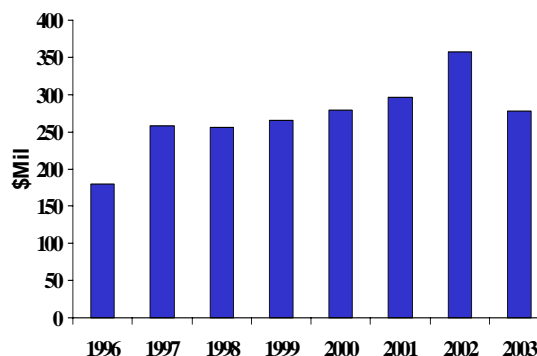


Modest growth of approximately 1.3% was recorded in the central government's total expenditure over the review period, compared to a 4.9% rise in 2002. Propelled by double-digit increases in transfers and subsidies and domestic interest payments, current expenditure expanded by 5.6% (or \$92.8 million). The substantial growth in transfers and subsidies was largely attributed to the new status of the Queen Elizabeth Hospital (QEH) as a statutory board, which resulted in a reclassification of outlays on wages and salaries and goods and services in that institution as transfers and subsidies. There were also significant disbursements to the Transport Board, the Barbados Tourism Authority and the University of the West Indies. Both wages and salaries and goods and services contracted because of the reclassification of outlays on the QEH.

The upswing in interest outlays was due to higher interest payments on domestic debt.

During 2003, Government's on-budget capital expenditure fell by 20.8%, in contrast to a rise of 18.4% in the previous year, as some key Government projects were concluded. Off-budget capital expenditure on the Hilton Hotel and the Grantley Adams International Airport were estimated at \$90.6 million in 2003.

### Capital Expenditure

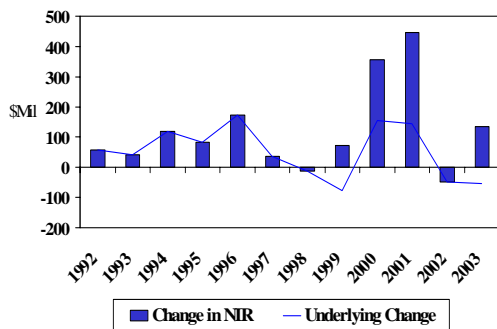


The fiscal deficit was financed mainly from foreign sources, predominantly in the form of project funds and government's divestment of BNB shares. The drawdown of Government's deposits with the Central Bank of Barbados and the NIS were the primary sources of domestic funding.

A substantial pick-up in retained imports and flagging domestic exports resulted in a current account deficit of \$420.8 million, approximately 7.8% of nominal GDP, compared with 6.6% of GDP in 2002. In

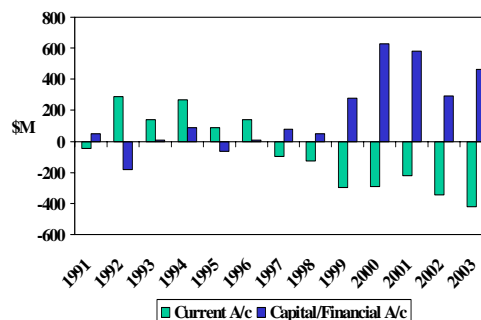
line with rising economic activity, retained imports were up by about 10.7%, compared to only 1.1% in 2002. Imports of capital and intermediate goods increased by 14.1% and 12.2%, respectively, while outlays on consumer goods rose by approximately 8.0%. The growth in capital goods was due to higher imports of machinery while the upturn in intermediate goods mainly reflected the higher cost of fuel as well as a rise in construction and chemical imports.

### Change in Net International Reserves



Domestic exports declined by 1.9% as an increase in sugar receipts (mainly from exchange rate gains) and expansions in the sale of miscellaneous products were more than offset by declines in all other categories. Travel credits rose by 6.0%, the first annual increase since 2000, with the upswing in tourism activity.

### BOP Current and Capital/Financial Account



The capital and financial account recorded a surplus of \$463.9 million in 2003, compared to a \$294.5 million surplus in 2002. The expansion was due, in part, to net long-term public capital inflows of approximately \$141.7 million, resulting mainly from the divestment of shares in BNB. Additionally, private capital inflows almost doubled compared to the intake in 2002 as a result of one company's sale of its shares in an overseas entity to foreign investors and higher inflows for real estate.

### Outlook for 2004

The Barbados economy is well poised to benefit from the expected improvement in the global economy. Economic activity is forecasted to expand by between 3% and 3.5% in 2004, on the strength of increased growth in tourism, construction and

wholesale and retail activity. The outlook for both land-based and cruise tourism is expected to be promising. A considerable increase in airlift capacity from major cities in the US, UK, Canada and Europe is projected for the current winter season in order to satisfy the demand for special events, especially the upcoming West Indies/England Cricket Test. In addition, the home porting of cruise vessels during this period is anticipated to provide an additional boost to overall tourist activity. The expected expansion in tourism is likely to spur further activity in other ancillary services, mainly in the distributive, utilities, and business and other services industries.

Sugar production is forecasted to be moderately above the level attained in 2002, and output in the non-sugar agricultural and fishing sector is projected to expand in line with domestic demand. Our sugar quota of 54,000 tonnes reduced by the EU to 35,000 tonnes should be achievable. The outlook for manufacturing, with the exception of a few areas, is likely to continue to be sluggish.

During the year, the ongoing liberalisation of the telecommunications market will gain momentum, as the new companies granted

licences in 2003 are expected to become fully operational. As a result, there should be some easing of telecommunications costs, particularly cellular communications to households and business firms, as there is already ample evidence that demand is growing in this market segment.

Retail price inflation is anticipated to be about 2.0% by year-end due to possible increases in food prices. Also the level of employment should increase in the tourism, distributive and telecommunications industries, with the projected expansion in economic activity and the coming on stream of the new cellular phone providers.

With higher projected earnings from tourism and slower import growth, the external current account is expected to contract somewhat. This should facilitate a moderate build-up in the NIR.

An improved fiscal position is anticipated as a result of higher tax revenue due to increased economic activity and continued moderation in outlays on Government's capital works programme.

The banking system should remain highly liquid, as greater levels of disposable

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income should produce further growth in domestic deposits. In addition, a modest expansion in private sector credit is likely, on account of rising consumer confidence and greater economic activity.

Barbados is entering a much more uncertain, yet promising, period, than ever before. Critical issues that inform our medium term outlook are maintaining the momentum to operationalise the single market and economy, and in this context, the Bank will continue its programme of gradual financial liberalisation. The recent four percentage points reduction in the securities requirements of commercial banks signals the continuation of this policy. Monetary policy will also focus on reducing the cost of credit, as credit demand by the productive sectors remain low. It will also be important that greater emphasis be placed on improving productivity and enhancing competitiveness in all industries. Since interest costs are an important component of overall costs, any programme aimed at improving competitiveness will need to keep these costs under review.