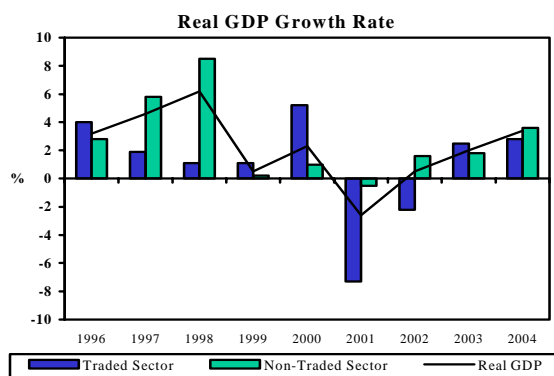


Review of the Economy for 2004

OVERVIEW

The Barbados economy, bolstered by a robust performance in tourism activity and broad-based gains in the non-traded sectors, recorded its third consecutive year of growth in 2004. Economic activity rose by an estimated 3.4%, about 2.1 percentage points higher than the average recorded since 2001 and the highest since 1998.



The economic expansion boosted retained imports by 16%, the largest increase since 1997. As a result, the current account deficit deteriorated to

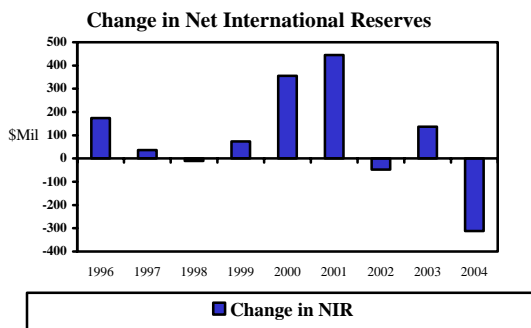
approximately 9.9% of Gross Domestic Product (GDP), compared to a deficit of 6.4% registered in 2003, and an average of 5.8% in the last five years.

Moreover, the worsening of the deficit, combined with reduced capital account inflows, led to the largest contraction in the net international reserves (NIR) since 1975. The NIR fell by approximately \$311.5 million, in contrast to an increase of \$136.9 million in 2003, when government sold its shares in a local bank to a foreign entity. Outflows under the second-tier¹ reserve

¹ The Second-Tier Reserve programme was instituted in July 2002. Under this system, certain entities are allowed to invest funds overseas with the approval of the Central Bank on the condition that such funds will be repatriated upon request. These funds will be sourced either directly from the foreign exchange market or from the Central Bank. At the end of December, total overseas investments under the programme amounted to BDS\$183.4 million.

programme (i.e. reserves which must be repatriated on request) amounted to an estimated \$99.2 million during the review period.

If the outstanding second-tier reserves are added to the NIR, the augmented figure rises to approximately \$1.37 billion, the equivalent of 27.8 weeks of imports.



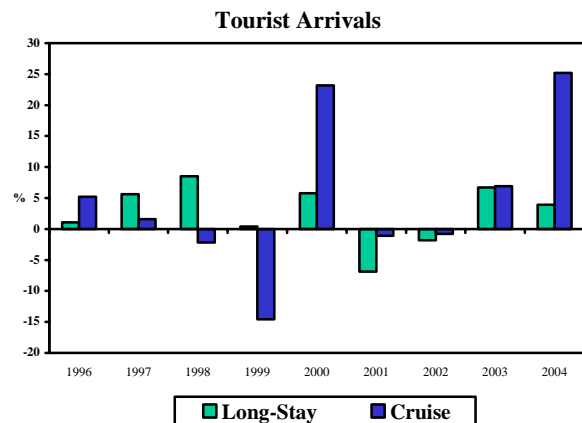
The growth in real output combined with intense competition within the banking system, spurred increases in private sector credit and consequently, commercial bank liquidity tightened significantly during the year.

After reporting a small surplus in the first half of the year, a fall-off in revenue collections resulted in government recording deficits in the last two quarters. Hence, by year-end, the deficit was estimated at \$132.5 million (2.4% of

GDP), slightly smaller than in the previous year.

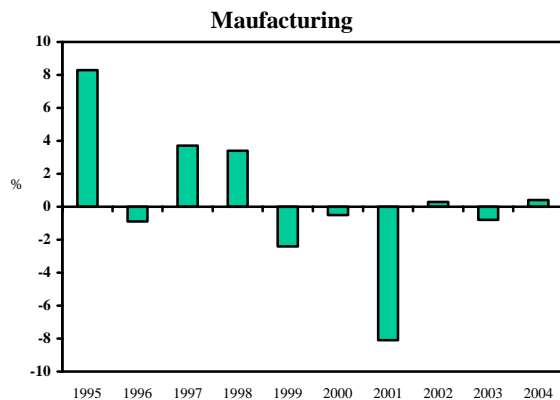
SECTORAL PERFORMANCE

Real tourism value-added expanded for the second consecutive year, growing by approximately 6.9% during the review period. Boosted by increased airline seating capacity, primarily in the winter period, long-stay arrivals moved up by 3.8%. There was broad-based growth in all of the major markets as visitor arrivals from the UK, Canada and the US rose by 5.6%, 0.8% and 0.3%, respectively, while Caricom tourist arrivals increased by 8.2%. In addition, 29.0% more cruise ship passengers visited the country during the year, reflecting gains made from the home porting of several vessels and the commencement of service by new cruise ships.



Sugar production contracted for the fourth successive year in 2004, declining by an estimated 5.4%. In addition, non-sugar agricultural production fell by approximately 7.8%, on account of decreases in milk as well as fish production of 6.2% and 23.5%, respectively, which overshadowed increases in output of chicken (5.6%) and livestock (2.4%).

Value-added in the manufacturing sector remained relatively unchanged from the previous year, as the growth in electronics and chemicals offset the contraction in food production.



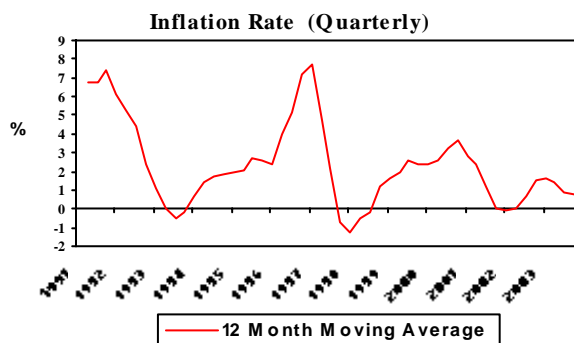
Construction output grew by a further 1.5% during 2004, following the 0.8% expansion registered in the previous period. Propelled by the strong rise in retained imports, output in the wholesale and retail sector as well as the

transportation, storage and communications grouping went up by 4.9% and 5.0%, respectively. Activity in the mining and quarrying sector also gained impetus during the year, moving upwards by 3.4%, on account of increases in both quarrying and crude oil production.

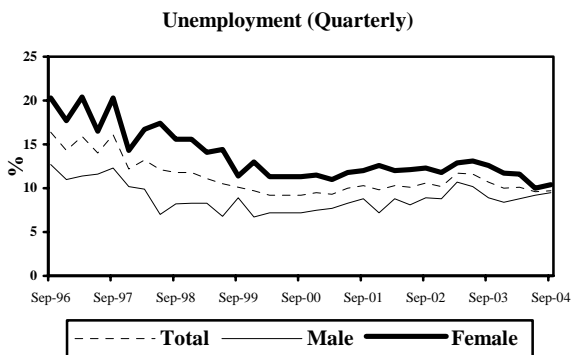
With respect to the international financial services sector, three hundred and twenty-seven new licences were issued during the first eleven months of the year, about twenty-nine more than those issued in the comparable period of 2003. Two hundred and fifty-five of the new licences were for international business companies, fifty-nine were for societies with restricted liability, nine were for exempt insurance companies and one to an exempt insurance management company. Three offshore banks were also given permission to commence operations.

At the end of September 2004, the average rate of inflation was 0.8% compared to 1.3% for the corresponding period of 2003. While food and medical and personal care costs were higher, this was partially offset by declines in

housing as well as household operations and supplies.



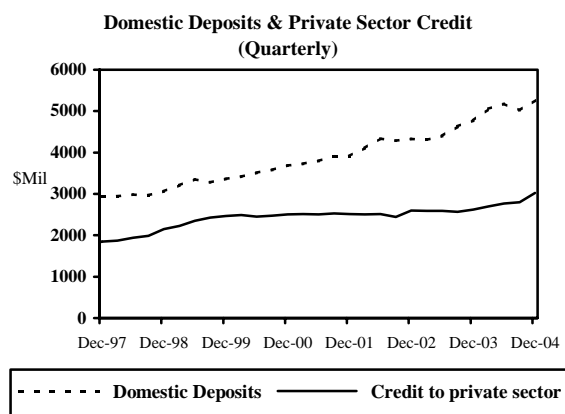
Supported by increased economic activity, the average rate of unemployment fell by 1.4 percentage points to 9.9% at the end of September. Unemployment among males decreased by 0.7 percentage points to 9.2%, while female unemployment contracted by 2.2 percentage points to 10.7%. The main employment gains were recorded in general services, construction, finance, insurance and business services.



Liquidity in the banking system contracted during 2004, reflecting a

marked deterioration in the level of cash reserves held by the commercial banks with the Central Bank. The liquid assets ratio² declined by 5.8 percentage points to 14.3%, in contrast to a rise of 2.6 percentage points registered in 2003.

Domestic deposits expanded by \$406.6 million, following growth of \$441.3 million in the previous year. The major increases were recorded in the accounts of private individuals, business firms and statutory bodies, which rose by \$248.9 million, \$243.9 million and \$20.0 million, respectively³. In contrast, declines were registered in the deposits of financial institutions (\$44.9 million) and government (\$46.8 million).



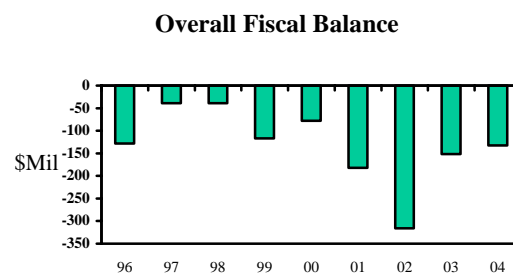
² The liquid assets ratio is defined as the ratio of the commercial banks' cash and treasury bill holdings to their total assets.

³ Information for the individual deposit and credit categories pertains to the first eleven months of the year.

Credit to the non-financial private sector surged by \$313.3 million, a significant increase over the \$23.4 million expansion registered in 2003. The most notable gain was seen in the personal lending category (\$155.7 million), as the demand for residential mortgages intensified in line with the reduction in mortgage rates. Additionally, lending to the distribution and construction sectors rose by approximately \$58.4 million and \$38.3 million, respectively. However, declines of \$23.9 million and \$8.6 million, respectively, were recorded in credit to the tourism and agricultural industries. Additionally, credit to financial institutions was \$44.0 million higher, while statutory bodies borrowed an additional \$49.8 million, during the review period.

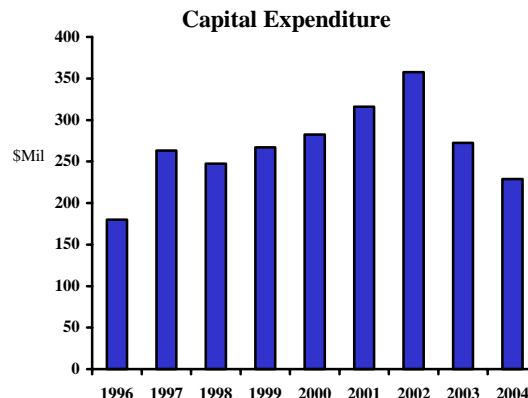
The fiscal deficit declined to \$132.5 million in 2004, approximately \$19.3 million below the previous year's level. Total revenue grew for the second consecutive year, rising on this occasion by 2.7%. Indirect taxes expanded by 8.6%, buoyed by higher value added tax (VAT) receipts, excise taxes and import duties, which registered increases of 9.5%, 14.6% and 14.8%, respectively. In

contrast, direct taxes contracted by 1.7% on account of reductions in both personal and corporate tax receipts. The fall in personal taxes was due in part to the lowering of the tax rate on the first \$24,200 of taxable income by 2.5 percentage points to 20%. Moreover, personal allowances were also increased from \$15,000 to \$17,500. The contraction in corporate tax receipts was attributed primarily to the downward revision in the corporate tax rate by 1.5 percentage points to 33%.

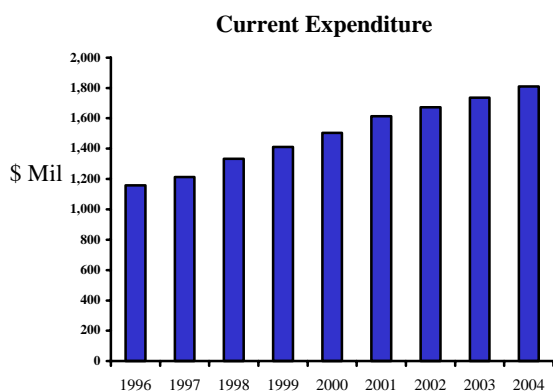


Total government expenditure was 1.6% higher than in 2003, moving to approximately \$2.04 billion, as growth in current expenditure outstripped declines in on-budget capital expenditure. Current expenditure rose by 4.3%, reflecting mainly expansions in transfers and subsidies (8.6%), wages and salaries (2.1%) and goods and services (2.8%). Interest payments remained relatively unchanged because the rise in external interest outlays was countered

by lower domestic interest payments. Government's on-budget capital expenditure contracted for the second consecutive year in 2004, falling on this occasion by 16%. The outcome was mainly due to the completion of several major projects during the year, as well as the reclassification of the expenditures for the Queen Elizabeth Hospital as transfers and subsidies in the first quarter of 2004.



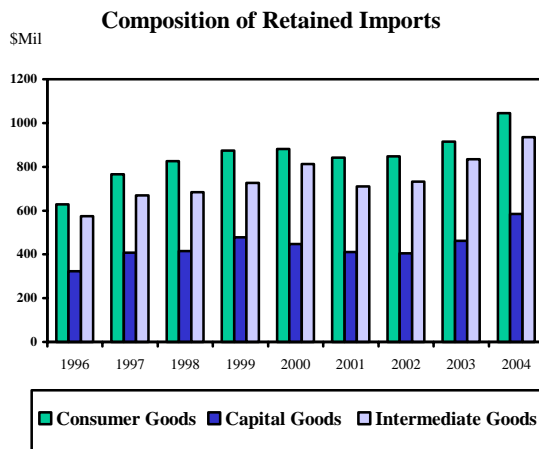
Domestic entities were the main sources of financing for the fiscal deficit during the year. In particular, commercial banks and private non-banks provided funding totalling \$143.0 million and \$111.1 million, respectively, while the National Insurance Scheme held an additional \$4.5 million in government securities. However, government's net deposits at the Central Bank rose by \$30.0 million and net foreign financing contracted by an estimated \$3.8 million as amortisation payments of \$81.8 million overshadowed project fund inflows.



Provisional estimates indicate that during 2004 off-budget capital expenditure totalled \$63 million. The expenditures were mainly for public sector enterprises, including: the Enterprise Growth Fund Ltd. (\$16 million), the Grantley Adams International Airport (\$12.0 million) and the Barbados National Oil Terminal Co. Ltd (\$10.2 million).

The external current account deficit deteriorated to approximately \$555.5 million, the highest level ever recorded. This was attributed to a sharp expansion in retained imports, which surged by 16% (\$353.6 million), reflecting growth in all of the major sub-categories.

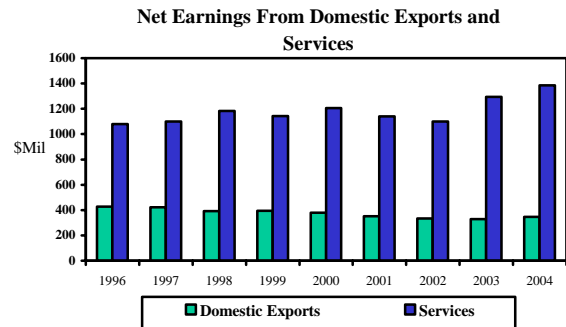
Imports of consumer goods increased by 14.1%, as a result of higher imports of motorcars as well as food and beverages. A pick up in outlays for fuel as well as construction materials was principally responsible for the 12.0% growth in intermediate goods. Increased machinery expenditure drove the 26.6% rise in imports of capital goods.



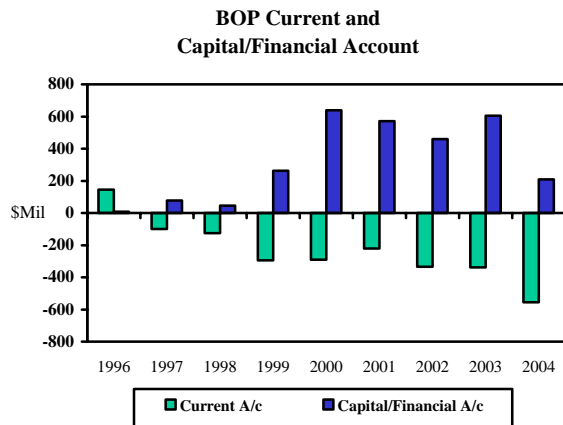
Domestic exports rose by approximately 5.1% during the year, in contrast to an average decline of 3.3% recorded over the last five years. In spite of lower output, the value of sugar exports grew by 9.5% as the sector benefited from the continued appreciation of the euro against the US dollar during the review period. Exports of food and beverages expanded by 17.1%, owing to higher rum sales, while exports of electronic

components and chemicals went up for the first time since 1999, increasing by 5.4% and 1.1%, respectively. In contrast, the value of miscellaneous exports fell by 1.8%.

Net receipts from services rose by approximately 7.1% as the continued improvement in tourist arrivals led to an 8.8% boost in travel credits, following the 15.2% growth recorded in the previous year.



The surplus on the capital and financial account declined to approximately \$209.4 million, compared to \$604.2 million in 2003. The contraction reflected lower receipts from private sector investment activities and a strengthening in overseas investment under the second-tier reserve programme.



OUTLOOK FOR 2005

The economy is expected to continue on its current upward growth path in 2005. Output is forecasted to expand by between 3.0% and 3.5%, buttressed by sustained improvements in both the traded and non-traded sectors.

However, the year 2005 will present additional challenges for the Barbados economy, particularly as the country seeks to fulfil its liberalisation obligations under the Caricom Single Market and Economy (CSME). Further liberalisation of the capital account would permit domestic entities to make alternative investment opportunities within the region. In addition, sectors such as manufacturing and agriculture will continue to face fierce competition from regional and international producers. A

major challenge, therefore, will be to effectively manage these expected outcomes so as to minimise the impact on the balance payments.

The NIR may contract further during the year as the rise in disposable incomes, expected from the reduction in the personal tax rate, the increase in personal allowances and negotiated salary increases, may heighten import demand.

Value-added in tourism is anticipated to rise by about 4.5%, as gains are projected to be partly generated from the reopening of the Hilton Hotel during the year. Another critical factor will be the likely continued depreciation of the US dollar against the pound and euro, which should lower the cost in euros of vacations in Barbados by Europeans. Sugar production is expected to be higher than the previous year's level. However, the uncharacteristically high rainfall, experienced during the fourth quarter of 2004 and January of this year, will most likely impact negatively on harvesting and factory operations and may result in lower output than is currently being projected.

In the non-traded sectors, construction activity should pick up further in 2005, driven by the availability of relatively low mortgage rates, new housing projects and the activity associated with the country's preparations for the Cricket World Cup in 2007. It is anticipated that the sustained liberalisation of the telecommunications market, will boost activity in the transportation, storage and communications sector.

Output in the wholesale and retail as well as the business and other services sectors is forecasted to expand, on account of growth in the tourism sector and expected further increases in disposable incomes.

Retail price inflation is projected to be between 1.5% and 2% on account of slightly higher food prices. Additionally, the expected expansion in economic activity should keep the unemployment rate below 10%.

The fiscal deficit of the Central Government is likely to remain at around 2.4% of GDP during the year, as the increase in tax revenue is projected to offset the growth in expenditure.

Revenue gains are expected to be driven by higher indirect tax receipts, which should offset the slight contraction in direct tax revenue. Capital expenditure is forecasted to rise, due in part to the implementation of Government's World Cup 2007 plans.

With the expansion in economic activity and the reduction in both personal and corporate tax rates, domestic deposits are projected to increase further during the year. However, it is anticipated that the high demand for mortgage loans will lead to continued credit expansion in 2005; consequently, the liquidity situation is likely to tighten further over the year.

The expectation of further increases in international interest rates would require an upward adjustment in domestic interest rates. The challenge will therefore be to target interest rate levels, which will simultaneously encourage borrowing for productive activities and attract capital inflows.

January 28, 2004