

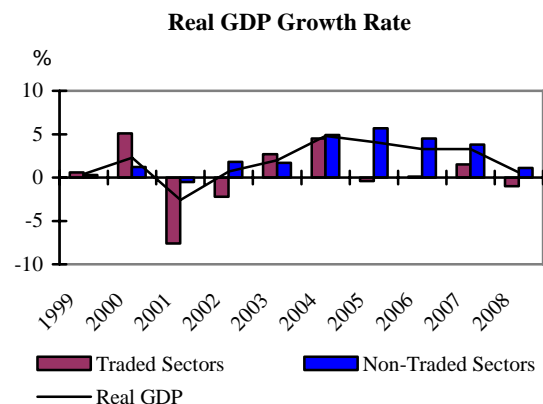
## Review of the Economy for 2008

### Overview

The economic slowdown triggered by a deepening of the U.S financial crisis, spread to other advanced economies, including Barbados' main trading partners, and contributed to a slowing in the pace of Barbados' economic expansion in 2008.

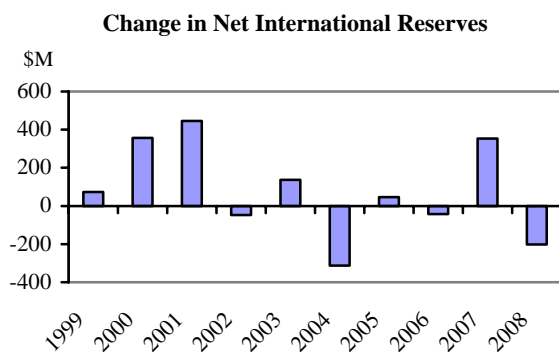
Real output growth in the Barbadian economy increased by an estimated 0.7%, substantially lower than the 3.3% expansions registered in 2007 and 2006, respectively. This was the first year since 2002 that gross domestic product (GDP) rose by less than one percent. However, as was the case in the last five years, growth was led by the non-traded sectors, which expanded by only 1.2%, just enough to overshadow a decrease of 1.0% in the traded sectors.

Both sectors were negatively affected by a reduction in tourism output and an increase in input costs during 2008. Consequently, between January and October, the rate of inflation increased relative to the same period in 2007, while the unemployment rate at the end of September rose further from the rate observed during the first nine months of 2007.



Rising oil prices during the first half of the year inflated the value of fuel imports, which

when combined with the lower travel receipts, gave rise to a wider external current account deficit. Moreover, capital outflows were higher than in 2007 and therefore, there was a smaller surplus on the capital and financial account. Since this surplus was not sufficient to finance the external current account deficit, the net international reserves (NIR) of the monetary authorities contracted by \$202 million.



Domestic deposits grew at a slower pace than in 2007, reflecting the slowdown in economic activity and an increase in payments for fuel imports. Since credit grew at a much quicker rate than in the previous year, the level of excess liquidity in the banking system fell from the highs observed during the first nine months to a level slightly above that registered a year earlier. Government's operations resulted in a fiscal deficit estimated at 4.5% of GDP, up from 1.9% of GDP in 2007, owing principally to substantially higher expenditure.

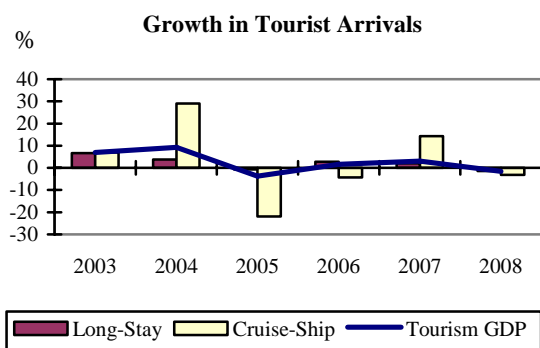
## Real Sector

In the productive sectors, tourism was most affected by the slowdown in global economic activity. Tourism value-added is estimated to have fallen by 1.7%, after an increase of 3.1% in 2007, when Barbados hosted some matches in the Cricket World Cup (CWC). This outcome was primarily attributed to declines in both the long-stay and cruise segments, which were reflected in an overall decrease of 12.0% in value-added during the second quarter followed by modest decreases during the remainder of the year.

Preliminary data<sup>1</sup> for 2008 suggest that long-stay arrivals fell by approximately 2.0% during 2008, in contrast to an average increase of 2.9% over the previous five years. Visitors from both the United Kingdom (U.K) and the United States (U.S) were down by 2.3%, owing mainly to reduced airlift capacity from the U.K market and a decrease in disposable incomes. From non-traditional markets, long-stay arrivals declined by 28.1%, reversing the growth that occurred in 2007 because of the

<sup>1</sup> Official data from the Barbados Statistical Service (BSS) is up to October 2008. Data for the November and December months are calculated using estimates from the BTA.

CWC. In spite of a 7.9% decrease in arrivals from Trinidad and Tobago, overall CARICOM arrivals were flat, while arrivals from Canada - the third largest source market - increased by 6.6% compared to 13.2% in 2007. In addition, there was an expansion of 12.2% in arrivals from Continental Europe.



The cruise industry registered an increase of 15.4% in total passenger arrivals for the first half of 2008. However, owing to strong contractions in the last two quarters, total cruise arrivals declined by 0.1%, for the year as a whole, following an expansion of 14.3% in 2007. The downturn reflected increased competition from the Mediterranean region and the effects of an ongoing legal battle between Puerto Rico (the main hub for Barbados) and a major cruise line. Consequently, cruise ship calls fell by 14.3% after an increase of 9.7% during the same period of 2007.

During 2008, sugar production declined by 6.9%, primarily because of a late start to the harvest. However, value-added from non-

sugar agriculture increased by 3.7%, as a 36.2% expansion in fish catches more than compensated for reductions of 3% and 0.1% in milk and chicken production, respectively, as well as a 5.7% contraction in other meats<sup>2</sup>.

Manufacturing output contracted by a marginal 0.4%, following a decrease of 2.9% in 2007 and an increase of 1.1% in 2006. A reduction of 1.3% in miscellaneous manufacturers coupled with downturns in chemicals (5.2%), non-metallic mineral products (1.1%) and furniture production (4.3%) outweighed improvements in other key sub-sectors. Food production was up by 1.6%, whereas output of beverages and electronics rose by 7% and 3.5%, respectively.

Growth in the non-traded sectors was constrained by the decline in tourism activity and higher commodity prices. Following a further slowdown in road works and tourism-related projects, the construction sector registered an estimated decline of 3.1% in 2008, while there was a 1.4% reduction in the production of electricity, gas and water. Additionally, slower growth was recorded for wholesale and retail (0.7%), transport storage and communications (2.7%) and business and other services (2.4%) sectors.

<sup>2</sup> Other meats include: pork, mutton, veal, beef, turkey and eggs.

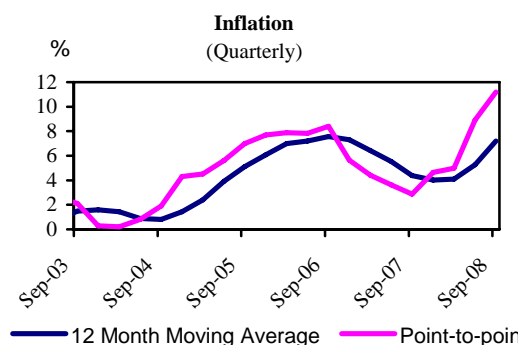
The biggest improvement was in mining and quarrying, which grew by an estimated 2.5% owing to the reactivation of onshore oil wells.

In the international business and financial services sector, preliminary data as at the end of September 2008 indicated that 371 new licences were issued for international business companies, approximately 37 more than in the same period of 2007. Seventy-five new societies with restricted liability were licensed, compared to 126 a year earlier. One new offshore banking licence was granted during the period, compared to five new licensees in the similar period of 2007.

The unemployment rate at the end of the third quarter was 8.4% compared to 7.4% reported at the end of September 2007. The female unemployment rate was unchanged at 8.9%, while the rate of unemployment for males increased by 1.2 percentage points to 6.6%. The reduction in employment was mainly attributed to scaled-down labour demand in the utilities, construction and distribution sectors.

Faster growth in international commodity prices and an upswing in domestic fuel charges in April raised the rate of inflation for the first ten months of 2008. According to the 12-month moving average measure

of inflation, prices at the end of October increased by 7.6%, or 3.5 percentage points more than in the corresponding period of 2007. On a point-to-point basis, prices increased by 9.4% following a rise of 4.6% in October of the previous year. The increase in cost of living was driven by higher prices for food, fuel and light, housing as well as household operations and supplies.



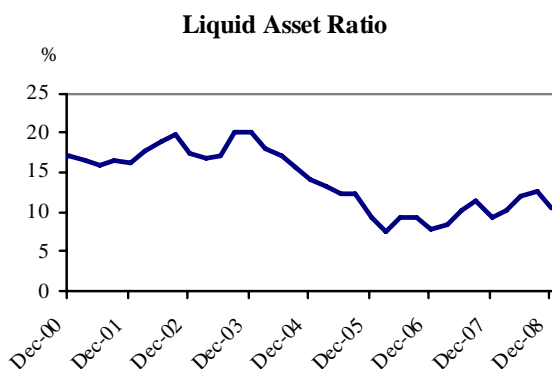
### Financial Sector

In spite of the increased uncertainty surrounding the global financial crisis and a rise in the level of non-performing loans in 2008, most indicators of the banking system continued to suggest that commercial banks operating in Barbados performed fairly well.

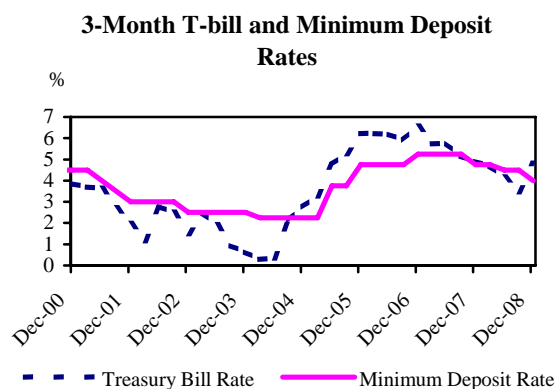
In 2008, credit to the non-financial private sector expanded by 11.8% compared to 5.1% in 2007. Personal sector loans, which were underpinned by continued growth in new mortgages, increased by 7.8% (\$190.2 million), while loans to the distribution sector rose by 3.6% (\$14.4 million). Credit extended to statutory bodies and financial

institutions advanced by 12.7% (\$50.3 million) and 29.4% (\$66.7 million), respectively. In contrast, loans to central government fell by 8.7% (\$13.7 million).

Domestic deposits grew by 6% during the first half of 2008. However, in line with the deceleration in economic activity, growth in deposits had slowed to 3.5% during the entire year from 16.2% in 2007. As a consequence, excess liquidity fell below the high levels observed during the first nine months and, at the end of October 2008, the liquid asset ratio decreased to 10.4%, slightly above the 9.5% reported at the end of the corresponding period of 2007.

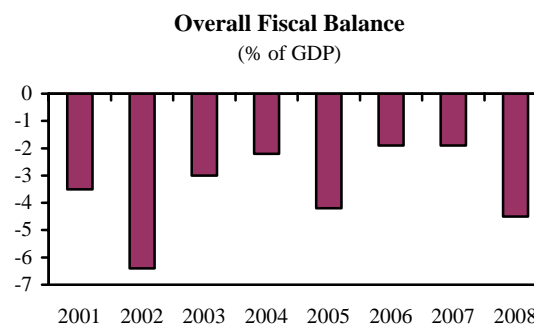


The interest rate on 3-month Treasury Bills fell marginally to 4.81% from the 4.84% recorded at the end of December 2007. Moreover, owing to a continuation of the Central Bank's monetary easing in 2008, the minimum deposit rate was reduced to 4%, 0.75 of a percentage point lower than the rate at the end of December 2007.



### Public Sector<sup>3</sup>

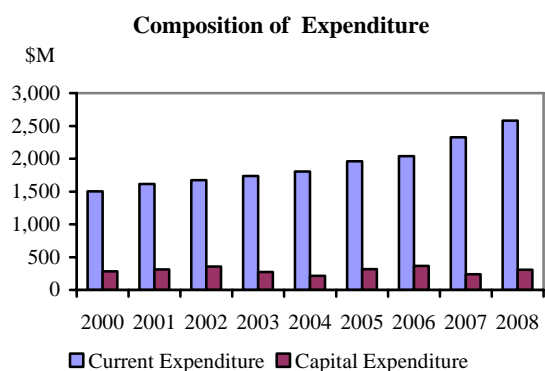
Preliminary estimates of the operations of central government revealed a fiscal deficit of 4.5% of GDP compared to 1.9% of GDP for 2007. The larger deficit was attributed to expansions in both current and capital expenditure, which could not be matched by an increase in government's revenue.



Total government expenditure expanded by an estimated 12.8%, reflecting growth in current and capital expenditure to the tune of 11.4% and 31.5%, respectively. A major portion of the increase in current expenditure was attributable to transfers and subsidies, with increased

<sup>3</sup> Figures do not include off-budget expenditure.

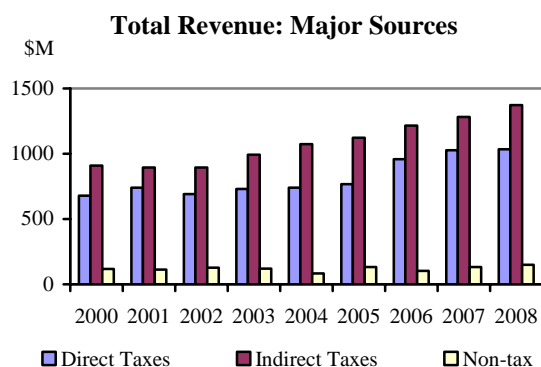
disbursements to the University of the West Indies, the Barbados Agricultural Development and Management Corporation and the Transport Board. With regards to capital expenditure there were increased capital transfers to government institutions such as Caves of Barbados and the Urban Development Commission.



Government's tax receipts were 4.6% above the level in the previous year, principally due to a rise in indirect tax collections. The increase was driven by increased revenue from the value-added tax (VAT) and import duties, which were boosted by higher prices for both domestic and imported goods. Excise taxes also yielded more revenue, owing to increased taxes on alcoholic beverages and manufactured tobacco.

Direct tax receipts rose by approximately 1.1%, or roughly 6.6 percentage points below the growth in 2007. The collections from personal and miscellaneous direct taxes marginally outweighed reductions in corporate and property tax receipts, which

fell in response to lower profits from the international business sector and the revision of the property transfer tax rate from 7.5% to 2.5% in April 2007, respectively.



Government financed its deficit using mainly domestic resources. The Central Bank provided \$136.1 million, while commercial banks and the National Insurance Scheme lent \$100.6 million and \$266.6 million, respectively. Moreover, there was financing from non-bank financial institutions amounting to \$175.1 million. Foreign borrowing was not pursued in 2008 and, foreign financing was therefore mainly in the form of previously contracted project funds.

### External Sector

The deficit on the external current account is estimated to have widened by \$376.6 million to an estimated \$730.3 million in 2008, following a significant increase in the value of imported goods and sluggish growth in travel receipts.

Retained imports rose by an estimated 13.0%, substantially above the 4.1% reported one year earlier. Higher fuel and commodity prices were mainly responsible for this expansion. As a result of the sharp increases in oil prices witnessed in the first half of the year, expenditure on intermediate goods imports surged by 28.5%. Outflows for imports of consumer goods increased by a more moderate 4.7%, despite a 14.7% rise in the value of food and beverages imports. Spending on capital goods declined by 2.6% on account of an estimated 2% fall in machinery imports.

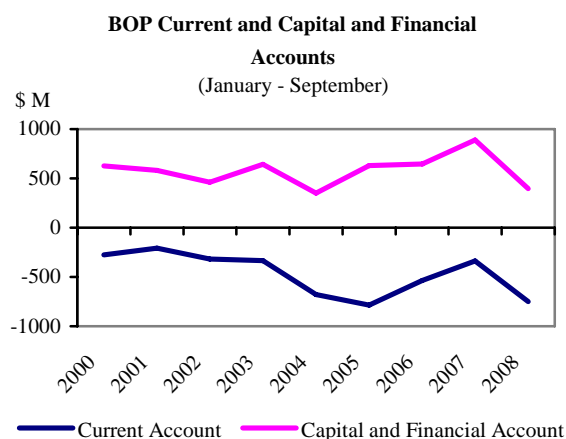
Domestic exports grew by an estimated 4.2%, following growth of 5.1% in 2007. Sales of electrical components as well as other food and beverages<sup>4</sup> rose by 11.8%, whereas, exports of margarine and similar products expanded by 30.5%. Additionally, exports of other manufacturers increased by 8.9%.

As a consequence of the decline in tourism, travel credits grew by only 1.3%, compared to the 13.5% increase registered in 2007. In contrast, sugar receipts fell by 2.7% after growing by 3.7% in 2007.

The surplus on the capital and financial account was \$378.6 million, compared to an

<sup>4</sup> Other food and beverages in this report includes all food and beverages except sugar, rum and molasses.

average surplus of \$765.8 million estimated for 2006 and 2007. The reduction in net inflows was driven by additional debt service payments, repatriation of profits and large tourism-related outflows.



## Outlook

With recession deepening in the U.S and U.K and most economic indicators pointing to a further deterioration in world economic activity, there is a greater likelihood that the Barbados economy will decline in 2009. The most recent economic outlook produced by the International Monetary Fund (IMF) projects that GDP per capita in advanced economies should decline by around 0.1%, while unemployment rates in these economies are anticipated to increase on average from 5.7% in 2008 to about 6.8% in 2009. Based on these projections and lessons from past fluctuations in domestic output arising from changes in the international environment, and based on our assessment of the likely performance of the

Barbadian economy, total output in the Barbadian economy is projected to decline by between zero and 2% in 2009.

The greatest drain on total output, as in the case of 2008, is expected to originate from a contraction in tourism activity, which is anticipated to be at least double the figure recorded in 2008. As a consequence, the spin-off effects on the non-traded sectors are likely to worsen.

In particular, output growth from wholesale and retail activity, business and other services as well as transport, storage and communications, is expected to fall for the first time since 2002. Furthermore, value-added in the construction sector is forecast to register a further decline in 2009.

These performances should place greater upward pressure on the unemployment rate. In contrast, inflationary pressures are expected to ease somewhat, mainly due to the reductions in domestic fuel prices witnessed during the latter half of 2008 and further decreases in commodity prices projected for 2009. The twelve-month moving average rate of inflation is forecast to be in the range 4% to 5% in 2009.

In line with the deterioration in economic activity, domestic deposits are forecast to slow further from the level recorded at the

end of 2008. Similarly, credit expansion should not be as buoyant, principally because of the increasingly uncertain economic climate. As a result, there should be some tightening of liquidity in the banking system.

Government should still be able to finance its operations using mainly domestic resources but there will be some need for foreign borrowing to support the counter-cyclical policies to be introduced during the year.

In terms of the balance of payments, the forecasts suggest some narrowing of the current account deficit, as a reduction in import prices (particularly oil prices) is expected to compensate for slower growth in travel receipts and a weak expansion in domestic exports during 2009. In addition, boosted by an increase in foreign financing and higher private capital inflows, the capital account surplus is anticipated to be higher than in 2008. Consequently, the NIR is expected to contract by less than the amount recorded in 2008.

**January 30, 2009**