

THE BAHAMAS: 2016 ARTICLE IV
CONSULTATION—PRESS RELEASE; STAFF REPORT;
AND STATEMENT BY THE EXECUTIVE DIRECTOR
FOR THE BAHAMAS



THE BAHAMAS

July 2016

2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE BAHAMAS

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2016 Article IV consultation with The Bahamas, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 8, 2016 consideration of the staff report that concluded the Article IV consultation with The Bahamas.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 8, 2016, following discussions that ended on March 23, 2016, with the officials of The Bahamas on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 16, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for The Bahamas.

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June 10, 2016

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IMF Executive Board Concludes 2016 Article IV Consultation with The Bahamas

On June 8, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with The Bahamas.

Economic growth is estimated to have stalled in 2015, as a modest increase in air tourism arrivals was not sufficient to offset a contraction in domestic demand and weak exports of goods. Private consumption and investment were weighed down by headwinds from fiscal consolidation, as well as an end to construction and uncertainty over the opening of the Baha Mar megaresort. Inflation was moderate at 1.9 percent on average in 2015, despite a temporary increase owing to Value Added Tax (VAT) introduction in January 2015. Unemployment, after a brief dip earlier in the year, rose to 14.8 percent in November, as workers hired for the planned Baha Mar opening were later dismissed. Double-digit unemployment and the elevated share of nonperforming loans continue to constrain private credit (which fell by 1 percent year-on-year in December 2015).

Smooth VAT introduction has contributed to fiscal consolidation. VAT revenue over the first 12 months, at \$536 million (about 6 percent of GDP), has exceeded expectations. As a result, the FY2014/15 (ending in June 2015) deficit is estimated to have declined to 4.4 percent of GDP (down from revised 5.6 percent in FY2013/14). Available data for the first seven months of FY2015/16 suggest a further decline in the deficit, by about 1 percentage point, compared to the same period a year ago. The central government debt-to-GDP-ratio nevertheless reached 66.5 percent in December 2015, pointing to limited fiscal space. The current account deficit declined significantly, to 15.3 percent of GDP in 2015 (compared to 22 percent a year earlier), driven primarily by lower imports owing to the decline in oil prices and halt to Baha Mar construction. International reserves, supported in part by government external borrowing, increased to \$981

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

million at end–March 2016, equivalent to about 2.4 months of next years’ projected imports of goods and services.

Prospects are tempered by Baha Mar related uncertainties and low potential growth. Growth is expected to strengthen to about 0.5 percent this year, supported by continued growth in air tourist arrivals and moderating headwinds to private consumption and investment. Looking forward, while Baha Mar opening is expected to provide a temporary boost to growth, helping to close the still sizeable output gap, structural impediments continue to constrain potential growth. Staff estimates point to potential growth between 1 and 1.5 percent over the medium term, down from close to 3 percent at the start of the century. This outlook is subject to mainly downside risks, calling for continued fiscal consolidation to rebuild fiscal and external policy buffers and boosting investor confidence, as well as a decisive shift towards implementation of structural reforms to improve competitiveness, reduce unemployment and raise potential growth.

Executive Board Assessment²

Executive Directors noted that economic activity stalled in 2015, weighed down by weak domestic demand and goods exports. The current account deficit declined significantly but remains sizable. Going forward, the outlook remains challenging, especially with high youth unemployment and low productivity growth. Against this backdrop, Directors emphasized the importance of continued fiscal consolidation to rebuild fiscal and external buffers and structural reforms to improve competitiveness, reduce unemployment and raise potential growth. They also underscored the need to address financial sector challenges.

Directors commended the authorities for a successful VAT introduction which has contributed to fiscal consolidation. They encouraged the authorities to resist pressures to introduce exemptions and to ensure continued strong implementation. Directors called for continued consolidation to reduce the public debt to GDP ratio and ensure sustainability. On expenditures, Directors emphasized the need to contain increases in the public wage bill and to orient the budget towards growth-enhancing infrastructure spending. As regards fiscal reforms, Directors advocated moving towards a fully-fledged central revenue agency, improvements in tax administration, and a review of the efficiency of tax exemptions and concessions, including to the tourism sector. They supported the on-going reforms to modernize the public financial management system and called for extending state owned enterprise reform beyond the energy sector. Directors also emphasized the need for timely pension system reforms.

To address impediments to growth, Directors called for decisive implementation of structural reforms, including in the context of the National Development Plan. These reforms should aim at

² At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in Summings Up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

strengthening the business environment, raising human capital, reducing skill mismatches, and lowering high labor and energy costs. Directors also highlighted potential gains from efficient investment in information and communication technology, transportation, public utilities, economic diversification, and enhanced resilience to natural disasters.

Directors welcomed recent progress in financial sector reforms, including in addressing gaps in the AML/CFT regulation and implementation of the new Basel II/III regime. They encouraged the authorities to enhance their crisis management framework. Directors called for greater emphasis on risk-based financial sector supervision and regulation, given global “de-risking” trends, and strong efforts to ensure compliance and close communication across stakeholders. Directors called for renewed efforts to resolve the overhang of non-performing loans to spur credit growth.

The Bahamas: Selected Social and Economic Indicators						
	2012	2013	2014	Est. 2015	Proj. 2016	Proj. 2017
(Annual percentage changes, unless otherwise indicated)						
Real sector						
Real GDP	3.1	0.0	-0.5	-1.7	0.5	1.0
Nominal GDP	6.5	1.5	1.1	2.7	2.0	3.1
Consumer price index (annual average)	1.9	0.4	1.2	1.9	0.9	1.2
Consumer price index (end of period)	0.7	1.0	0.2	2.0	0.9	1.2
Unemployment rate (in percent)	14.4	15.8	14.6	13.4	15.6	14.9
Saving rate (percent of GDP)	10.9	10.1	9.2	12.0	14.0	14.3
Investment rate (percent of GDP)	28.8	27.7	31.2	27.2	25.4	25.0
Financial sector						
Credit to the nonfinancial public sector	14.9	23.6	4.0	7.7	5.3	6.3
Credit to the private sector	-0.3	-1.2	-2.8	-1.1	0.3	0.6
Liabilities to the private sector	-0.1	0.2	1.2	-0.3	1.7	3.8
External sector						
Exports of goods and services	10.5	-1.3	-1.4	-9.5	6.4	5.8
<i>Of which:</i> Travel receipts (gross)	7.9	-1.2	1.0	3.0	7.6	4.5
Imports of goods and services	15.6	-2.6	5.0	-17.7	-3.8	3.5
(In percent of GDP, unless otherwise indicated)						
Central government 1/						
Revenue and grants	17.8	16.0	16.9	19.5	20.8	21.9
Expenditure	23.3	22.4	22.5	23.9	23.8	24.6
Overall balance 2/	-5.5	-6.4	-5.6	-4.4	-3.0	-2.7
Primary balance	-3.2	-4.1	-3.1	-1.7	-0.1	0.2
Central government debt	48.0	55.4	60.2	64.4	65.9	67.0
External sector						
Current account balance	-17.9	-17.5	-22.0	-15.3	-11.4	-10.7
Change in net international reserves						
(Increase -)	0.9	0.8	-0.5	-0.3	-0.4	-0.1
External public debt (end of period)	17.4	19.0	23.2	23.2	23.2	22.9
Memorandum items:						
Gross international reserves						
(End of period; millions of U.S. dollars)	810	742	788	812	850	859
In months of next year's G&S imports	2.0	1.8	2.3	2.4	2.5	2.4
In percent of reserve money	90	86	80	83	85	83
GDP (in millions of Bahamian dollars)	8,399	8,522	8,618	8,854	9,035	9,319
Sources: Central Bank of The Bahamas; Department of Statistics; Ministry of Finance; UNDP Human Development Report; and Fund staff projections.						
1/ The data refer to fiscal years ending on June 30.						
2/ Reflects reclassification of capital transfers and net lending, about 1 percent of GDP, to some public entities to current transfers.						



THE BAHAMAS

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

May 16, 2016

Context. Economic activity has stalled and near-term prospects are tempered by uncertainty over opening of the Baha Mar resort. Smooth implementation of the new VAT regime has contributed to fiscal consolidation, while lower energy prices and the winding down of Baha Mar's construction have helped narrow the still sizeable current account deficit. Nevertheless, fiscal and external vulnerabilities persist and mounting structural impediments constrain potential growth.

Key policy advice

- **Safeguarding fiscal and external stability.** Continued fiscal consolidation is critical for rebuilding fiscal and external policy buffers and boosting investor confidence. Priorities include resolute implementation of the current VAT regime with few exemptions, stronger efforts to rationalize spending, far-reaching state-owned enterprise reform and structural reforms to enhance competitiveness.
- **Policies towards more jobs and stronger growth.** A decisive shift towards implementation of structural policies is needed to improve competitiveness, reduce high structural and youth unemployment and to raise potential growth. Key priorities include strengthening the business environment, raising human capital and reducing skill mismatches, and reducing costs. Growth-friendly fiscal reforms, including investing in growth-enhancing infrastructure, in the context of a credible medium-term budgetary framework would allow fiscal policy to better balance the need for continued consolidation and support for the recovery.
- **Addressing financial sector challenges.** Renewed efforts to spur credit growth by cleaning up bank balance sheets, along with advancing other financial sector reforms, can further enhance growth and help preserve financial stability. Emerging challenges from global "de-risking" trends call for further emphasis on risk-based financial sector supervision and regulation, strong implementation and efforts to ensure compliance with the AML/CFT framework and close communication across stakeholders.

Approved By
Charles Enoch
(WHD) and Rupa
Dutttagupta (SPR)

Discussions took place in Nassau and Freeport during March 10-23, 2016. The team comprised J. Turunen (Head), J. Okwuokei, S. Cerovic (all WHD) and J. Poulain (FIN). S. Lando (LEG), M. Lutz, C. Li, E. Moreno, and H. Canales (all WHD) provided assistance at headquarters. R. Young (OED) participated in the concluding meetings. The mission met with Prime Minister and Minister of Finance, Central Bank Governor, Minister of Tourism, Minister of State for Finance, and other senior government officials, and representatives of the private sector and civil society.

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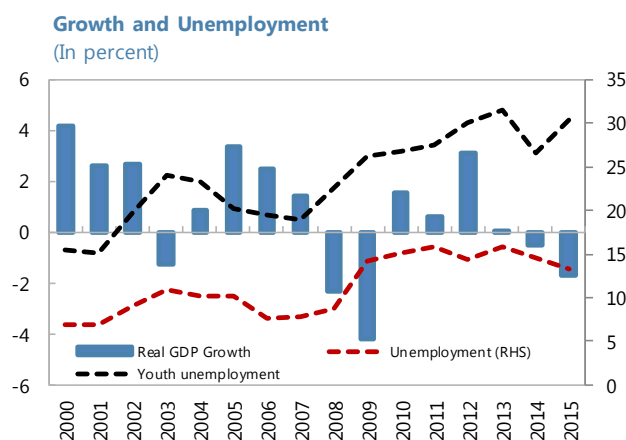
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RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

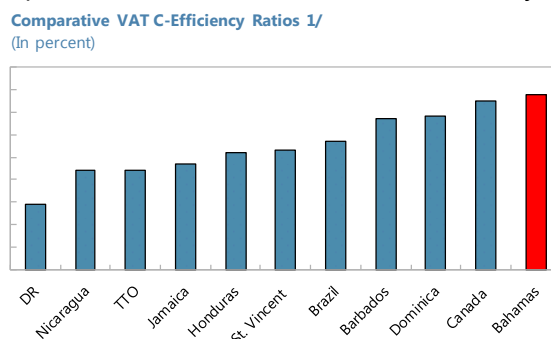
A. Recent Developments

1. **Economic activity stalled.** Preliminary estimates suggest that real GDP contracted by 1.7 percent in 2015, as a modest increase in air tourism arrivals (see Figure 1) was not sufficient to offset a contraction in domestic demand and weak goods exports. Private consumption and investment were weighed down by headwinds from fiscal consolidation, as well as an end to construction and uncertainties over the opening of the Baha Mar megaresort. Growth in 2014 was revised down to -0.5 percent, from 1 percent in the preliminary release, thus pointing to two consecutive years of falling real GDP. After repeated construction delays and legal wrangling, the main creditor (China Export-Import Bank) has taken control of the close to complete Baha Mar. Inflation was moderate at 1.9 percent on average in 2015, despite a temporary increase owing to Value Added Tax (VAT) introduction in January 2015 (see Box 1). Unemployment, after a brief dip earlier in the year, rose to 14.8 percent in November, as workers hired for the planned Baha Mar opening were later dismissed.



Sources: Department of Statistics; and Fund staff estimates.

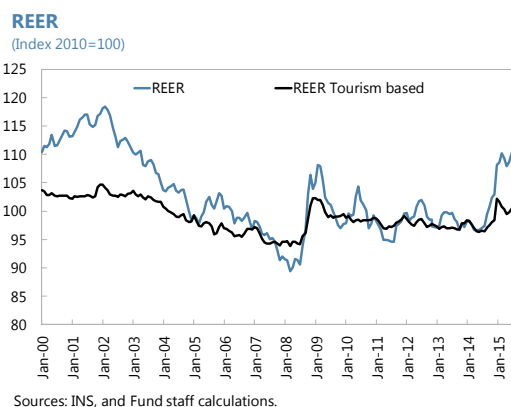
2. **VAT introduction contributing to fiscal consolidation.** Reports suggest relatively smooth implementation and an efficient VAT regime. While there are some concerns about the accuracy of the registration database, registration, filing and compliance rates appear to have been broadly comparable to regional standards. VAT revenue over the first 12 months, at \$536 million (about 6 percent of GDP), has exceeded expectations (Figure 2). As a result, the FY2014/15 (ending in June 2015) deficit is estimated to have declined to 4.4 percent of GDP (down from revised 5.6 percent in FY2013/14). Data for the first seven months of FY2015/16 point to a further decline in the deficit, by about 1 percentage point, compared to the same period a year ago. The central government debt-to-GDP-ratio nevertheless reached close to 66.5 percent in December 2015, pointing to limited fiscal space. State-owned enterprises (SOEs) continue to be a significant fiscal drag, with annual transfers from the budget amounting to about 1.4 percent of GDP in 2014/15. Damage from the October Hurricane Joaquin is estimated at \$100 million (about 1.1 percent of GDP).



Source: Fund Staff calculations.
1/ Country averages, various years. 2015 for The Bahamas

3. **Narrower, but still sizeable, current account deficit.** The current account deficit declined significantly, to 15.3 percent of GDP in 2015 (compared to 22 percent a year earlier), driven primarily by lower imports owing to the decline in oil prices and halt to Baha Mar construction (Figure 3).

International reserves, supported in part by government external borrowing, increased to \$981 million at end-March 2016, equivalent to about 2.9 months of next years' projected imports of goods and services. Reflecting a sizeable US dollar appreciation, the real effective exchange rate (REER) appreciated by 12 percent in 2015, thus weakening cost competitiveness of goods exporters. The impact on tourism competitiveness is mitigated somewhat by the large share of US tourists in total arrivals.



4. **Further contraction in private sector credit.** Double-digit unemployment, as well as tight bank lending conditions continue to constrain private credit (which fell by 1 percent year-on-year in December 2015) (Figure 4). The share of nonperforming loans (NPLs), mostly mortgages, remains elevated (at 15.2 percent of total loans in February 2016), while provisioning has been increasing. Despite stalling economic activity, available prudential indicators continue to point to a well-capitalized, liquid and profitable domestic banking system as a whole. However, the financial position of one state-owned bank, which represents around nine percent of domestic banking system assets, remains challenged with accumulated losses that continue to erode its capital base.

Financial Soundness Indicators 1/ (Domestic commercial banks)								
	2008	2009	2010	2011	2012	2013	2014	2015
Capital/risk-weighted assets 2/	23.5	26.1	25.5	25.5	26.1	31.7	31.2	30.9
Excess liquid assets 3/	28.2	53.2	46.1	48.1	49.9	53.5	53.0	55.8
Liquid assets/deposits	25.1	30.0	36.1	38.3	41.0	45.5	49.7	54.9
NPLs/total loans	6.1	9.3	11.9	12.7	13.8	15.3	15.3	14.2
Provisions/NPLs	46.0	37.1	36.6	36.6	42.7	39.0	51.2	58.5
Operating cost/average assets	3.0	2.9	3.1	3.2	3.2	3.7	4.9	3.5
Net income/average assets	3.1	2.3	2.4	2.4	1.5	1.4	-1.2	1.6
Sources: Central Bank of The Bahamas; and Fund staff calculations.								
1/ For 2015, latest available data.								
2/ Central Bank target is 17 percent.								
3/ In percent of statutory minimum requirement.								

B. Macroeconomic Outlook and Risks

5. **Prospects tempered by Baha Mar related uncertainties and low potential growth.** Real GDP is expected to stabilize, with positive growth of about ½ percent this year, supported by continued growth in air tourist arrivals and moderating headwinds to private consumption and investment. Looking forward, staff projections assume that Baha Mar opening provides a boost to growth in 2018 and 2019, helping to close the still sizeable output gap. Structural impediments continue to constrain potential growth. Staff estimates point to potential growth between 1 and 1½ percent

over the medium term, down from close to 3 percent at the start of the century (see Box 2). The still negative output gap and remaining slack in the labor market suggest that domestic inflationary pressures are likely to remain muted over the next few years. VAT revenue is expected to support further fiscal consolidation and help stabilize central government debt over the medium-term, albeit at a higher level (at about 67 percent) than previously expected. Although the current account deficit is expected to narrow further, supported by low oil prices and an expected boost to tourism receipts, it remains elevated (at about 7 percent of GDP) over the medium term. Absent further foreign borrowing, international reserves are therefore likely to increase only gradually.

Medium-Term Macroeconomic Framework											
(In percent of GDP, unless otherwise indicated)											
	2011	2012	2013	2014	2015	Staff Projections					
						2016	2017	2018	2019	2020	2021
Real GDP (in percent)	0.6	3.1	0.0	-0.5	-1.7	0.5	1.0	2.2	2.1	1.5	1.3
Inflation (average, in percent)	3.1	1.9	0.4	1.2	1.9	0.9	1.2	1.7	1.8	1.7	1.5
Overall fiscal balance 1/	-4.7	-5.5	-6.4	-5.6	-4.4	-3.0	-2.7	-2.2	-1.9	-1.5	-1.0
Central government debt 1/	45.0	48.0	55.4	60.2	64.4	65.9	67.0	66.8	66.0	65.3	64.4
External current account balance	-15.1	-17.9	-17.5	-22.0	-15.3	-11.4	-10.7	-8.9	-7.6	-7.4	-7.0
Gross international reserves (in US\$ millions)	885	810	742	788	812	850	859	909	923	958	981
In months of next year's goods & services imports	2.2	2.0	1.8	2.3	2.4	2.5	2.4	2.4	2.4	2.4	2.4
Sources: Central Bank of The Bahamas; Department of Statistics; Ministry of Finance; and Fund staff projections.											
1/ Central government only; Fiscal year data (to June).											

6. **Outlook subject to mainly downside risks.** Setbacks in fiscal consolidation and a worsening of the macroeconomic outlook owing to a slowdown in advanced economies could heighten risks to macroeconomic stability and the country's credit rating. Continued "de-risking" trends, including loss of correspondent banking relations (CBRs), could create an uncertain environment for businesses and have adverse implications for the financial services sector. Other key risks include a longer-than-expected delay in Baha Mar's opening, U.S. dollar appreciation leading to a further weakening of cost competitiveness, natural disasters, and, over the medium term, the potential emergence of Cuba as a competitor for U.S. based tourists (see Table 6). On the upside, the Baha Mar creditor (through its appointed receivers) has an opportunity to promptly complete and open the resort.

7. **Past Fund advice.** The last Article IV consultation was completed in June, 2015. The Executive Board called for (i) structural reforms to strengthen competitiveness, raise potential growth and lower unemployment; (ii) continued efforts to strengthen the fiscal position; (iii) efforts to further strengthen financial sector regulation and supervision; and (iv) policies that will address high NPLs. The authorities' policies have been broadly in line with this advice, although implementation has been gradual. The authorities are moving ahead with finalizing the National Development Plan and have taken steps towards energy sector reform (para 11). Fiscal consolidation continues, although at a more gradual pace than previously envisaged (paras 9 and 13). Authorities continue to advance financial sector reforms (para 17 and box 3). Progress in addressing NPLs has been slow (para 12).

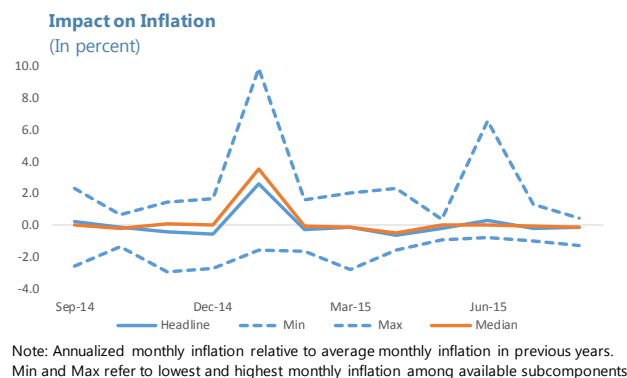
Box 1. VAT Impact

Consistent with international evidence of incomplete pass-through of tax increases to prices, VAT introduction in January 2015 likely had only a temporary and muted impact on consumer inflation, further dampened by still weak consumer demand and the concurrent decline in international oil prices.

Reform. As part of the VAT reform, the authorities have eliminated the 10 percent hotel room tax, reduced import tariffs on a number of items, as well as adjusted several domestic tax rates including rates on property taxes, business licenses, and stamp duties. Overall, estimates suggest a significant net increase in tax revenue.

Temporary, muted increase in headline inflation. While the tax reform has made an important contribution to maintaining macroeconomic stability and strengthening policy credibility, it is also expected to have temporarily increased inflation and, even with low estimated fiscal multipliers, to have dampened near-term economic activity. The VAT was introduced at a time when consumer demand was already relatively depressed, with a high unemployment rate and a large negative output gap, and coincided with a large decline in global oil prices. Both factors are likely to have dampened the impact of VAT introduction on prices. Estimates based on a simple forecasting model for inflation suggest that after controlling for other inflation determinants, VAT introduction increased annual CPI inflation in 2015 by about 2 percentage points, reflecting less than complete pass-through.^{1/} The impact on inflation was also likely dampened by the simultaneous reduction in several import duties and excises.

Impact on inflation sub-components. Monthly data on the retail price index and its subcomponents (relative to the average inflation in previous years) shows a temporary spike in headline inflation in January 2015. Headline and median inflation increased by about 2½ to 3½ percentage points in January. Pass-through appears to have been immediate and near-complete for sub-components such as food, beverages, furnishings and household equipment, health, communication and recreation (accounting for about 26 percent of the consumption goods included in the retail price index). Pass-through has been incomplete for other subcomponents, including the largest subcomponent of housing, utilities and energy (more than 30 percent of the total), as well education, restaurants and hotels and miscellaneous services. For some components, such as the tourism related restaurants and hotels, this reflects compensating factors in the tax reform, such as the reduction on the hotel room tax. For others, such as transportation, lower energy prices are likely to have dampened the impact on prices. The remaining differences in pass-through across items could reflect differences in price elasticities of consumption, competition, and the impact of regulated and administered prices. There is little evidence of “inflation smoothing”, i.e. increases in inflation in the months prior to actual VAT introduction, in headline inflation.^{2/}



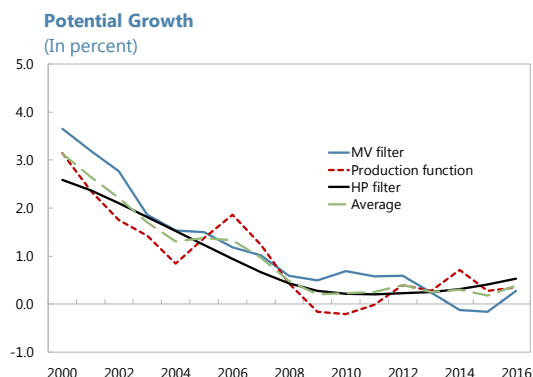
1/ The inflation forecast is based on a parsimonious model that relates headline inflation to the change in government debt and US inflation. VAT impact is approximated by the part that is not explained by underlying fundamentals.

2/ These results are broadly consistent with international evidence. For example, Benedek et al. (2015) show using European data that only about one third of VAT increases are directly passed through to consumer prices, with most of the increase taking place contemporaneously. Benedek, D, De Mooij, R, Keen, M. and Wingender, P. (2015): “Estimating VAT Pass-Through”, IMF working paper WP/15/214.

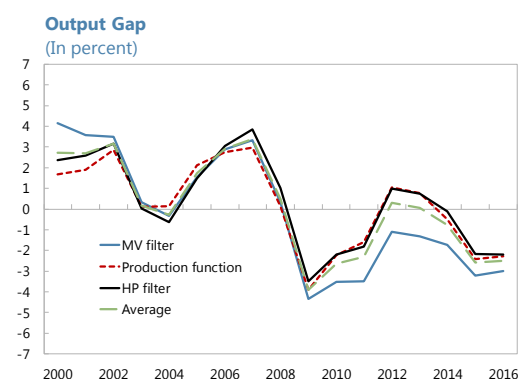
Box 2. Potential Growth

Staff analysis points to a significant decline in potential growth over the last 15 years. Furthermore, the large negative output gap is not expected to be closed before 2019. A comparison with other tourism intensive countries in the region generally shows similar trends.

Methods. Potential growth and the output gap are not observable variables and estimates are subject to significant uncertainty. We therefore use three different approaches to estimate them. First, we use the multivariate filter approach developed by Blagrove et al. (2015).^{1/} The structure of the filter relates the output gap to changes in inflation (i.e. the Philips curve) and slack in the labor market. This pragmatic approach can be easily applied to many countries, as it only requires data on three observable variables: real GDP, inflation and unemployment. Second, we estimate potential output using a conventional Cobb-Douglas production function approach with constant returns of scale. This approach also allows us to determine the different drivers of potential growth, i.e. factor accumulation (labor and capital) and total factor productivity (TFP) growth.^{2/} Finally, we benchmark our results against a simple univariate filter. Each of the three approaches have pros and cons. For example, while both the multivariate filter and production function approaches are based on economic theory, they also rely on several simplifying assumptions. In contrast, the univariate filter has no economic theory content, but is simple and widely used.



Lower potential growth and a still sizeable output gap. Although there are differences in magnitudes, all three methods suggest that potential growth has declined significantly over the last 15 years. The decline started already in the late 1990's, with potential growth hitting a low point in the immediate aftermath of the global financial crisis (GFC). Since then, potential growth has recovered modestly, with current estimates suggesting potential growth around ½ percent. Going forward, staff projections suggest a further recovery to about 1 to 1½ percent over the medium term. The results across all three methods also show a sizable negative output gap that has yet to be closed. Actual real GDP contracted by more than 6 percent in cumulative terms in 2008 and 2009, and as a result, the output gap turned sharply negative. Estimates suggest that the output gap is still negative, with an average of -2.5 percent across the three methods, and is not expected to close before 2019.



1/ See P. Blagrove, R. Garcia-Saltos, D. Laxton and F. Zhang (2015): "A Simple Multivariate Filter for Estimating Potential Output", IMF Working Paper WP/15/79.

2/ We assume a labor share of 60 percent. The capital stock series is constructed using the perpetual inventory technique, assuming a depreciation rate of 6 percent (as in N. Thacker, S. Acevedo and R. Perrelli (2012): "Caribbean Growth in an International Perspective: The Role of Tourism and Size", IMF Working Paper WP/12/235).

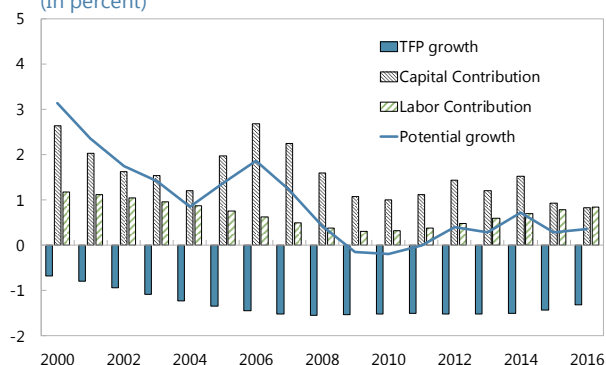
Box 2. Potential Growth (Concluded)

Decline in potential growth driven mostly by TFP. All factor inputs have contributed to the decline in potential growth. However, the deterioration in growth prospects has been driven mostly by more negative TFP growth, which has been about -1 percent of GDP on average since 2000. These results are similar to those obtained by Thacker et al. (2012), who also find that negative TFP growth has been a persistent feature in The Bahamas since the early 1980s.^{3/} Furthermore, the large positive contribution of capital has been declining over time, despite temporary effects of large investment projects (for example, Baha Mar related investments boosted the capital contribution between 2011 and 2014). The contribution of labor also declined in the early 2000s, but has been improving modestly since then, in spite of considerable slack in the labor market.

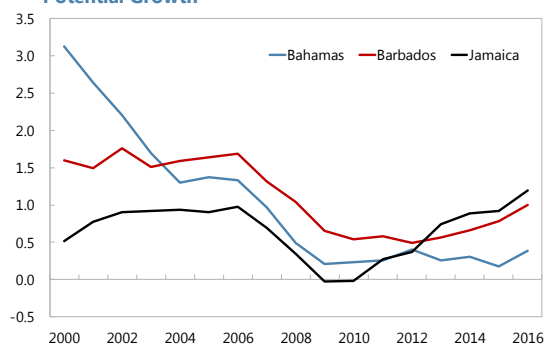
Cross country comparisons. Applying the same approaches to Barbados and Jamaica suggests that potential growth has declined also in these countries. However, the pre-crisis decline in potential growth started earlier and was larger in The Bahamas. Over the last few years, estimates suggest that potential growth has been recovering somewhat faster in Jamaica. All three countries are also still struggling to close the output gap, amid both relatively low actual and potential growth.

Drivers of Potential Growth

(In percent)



Potential Growth



Source: Fund staff estimates.

3/ TFP is measured as a residual. Thus, any measurement errors, changes in the quality of the capital and labor, as well as changes in capital utilization are attributed to TFP growth.

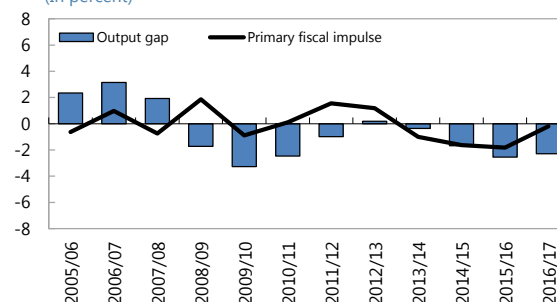
POLICY DISCUSSIONS

A. Policies Towards Stronger Growth

8. **Macroeconomic policies geared towards stability.** The nature of The Bahamas as a small, open island economy with a strong commitment to a fixed exchange regime and an extensive capital flow management (CFM) system, as well as limited policy buffers, leaves the authorities with few macroeconomic policy tools. In this context, monetary policy is constrained by the eventual increase in U.S. interest rates and fiscal policy needs to be geared primarily towards ensuring debt sustainability. Against this background, continued fiscal policy tightening centered on reducing current expenditure, while protecting necessary social spending, would be the main policy lever to respond to external shocks.

9. **Fiscal consolidation in the low growth environment.** The VAT reform has made an important contribution to maintaining macroeconomic stability and strengthening policy credibility. Authorities expect that strong VAT collection, together with reforms to enhance revenue administration raising additional revenue of up to 2½ percent of GDP, will contribute to significant consolidation in the near-term. However, with weaker than expected growth weighing on revenue collection, the authorities' plan that seeks to reduce the FY2015/16 fiscal deficit to 1.5 percent of GDP and to achieve a near balanced budget by 2017/18 appears too optimistic. Staff projections suggest a still significant, but more realistic and growth friendly pace of consolidation, with the fiscal deficit projected to narrow to 3 percent, in FY2015/16. The fiscal deficit is expected to decline further in FY2016/17, albeit at a slower pace, with debt stabilizing at around the same time. Credible reforms to ensure fiscal responsibility, including decisive steps towards a medium-term budget framework (para 15), would allow fiscal policy to better balance the need for continued consolidation and support for the recovery in the near-term.

Fiscal Impulse and Output Gap 1/
(In percent)



Sources: Central Bank of the Bahamas and Fund staff estimates.

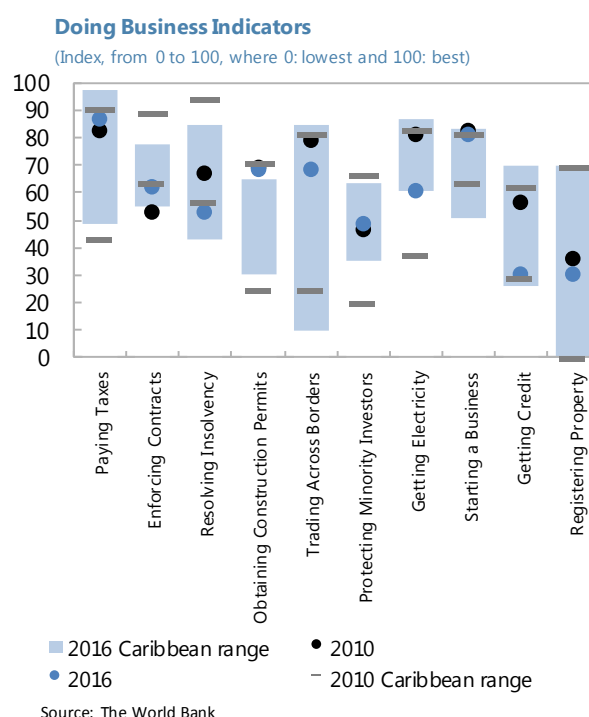
1/ Primary fiscal impulse is the change in the cyclically adjusted primary balance

10. **Investing in growth-enhancing infrastructure.** To support near-term economic activity, staff sees room for shifting spending away from current spending and towards more productive and growth-friendly infrastructure spending. Priorities include efficient investment in information and communication technology, transportation, public utilities, as well as projects that support economic diversification, increase domestic value added in the dominant tourism sector and enhance resilience to natural disasters. Using responsible public-private partnerships, where relevant, can help reduce the burden of higher investment on government finances.

11. Structural reforms to lift potential, reduce unemployment, and enhance competitiveness.

Staff estimates that negative TFP growth and smaller contributions from both capital accumulation and labor have contributed to a significant decline in potential growth since 2000 (see Box 2). Moreover, the non-accelerating rate of unemployment has been consistently increasing over the same time period (see Figure 1). Alternative indicators of competitiveness point to persistent weaknesses, such as elevated energy costs and high costs of doing business. The authorities have completed a comprehensive State of the Nation diagnostic that identifies a broad strategy for structural reforms, a first step towards completing their National Development Plan (NDP). The next steps, expected to be completed later this year, include further national dialogue and development of a comprehensive package of specific reform measures. Many structural measures, such as fundamental state-owned enterprise (SOE) reforms, will take time to bear fruit. Staff therefore argued for an urgent shift towards implementation of growth-friendly structural reforms, focusing on the following main priorities:

- *Strengthening the business environment.* Reforms to improve the ease of doing business should focus on strengthening contract enforcement and frameworks for resolving insolvencies and registering property, improving access to credit, and alleviating the administrative burden and time necessary to start a business.
- *Raising human capital and reducing skill mismatches.* Enterprise surveys suggest that the main business obstacle cited by firms is an inadequately educated workforce. Policies should aim at improving productivity through better educational outcomes, further strengthening existing apprenticeship and vocational training programs, easing restrictions on labor mobility and seeking to reverse the “brain drain” of skilled Bahamians.



- *Improving competitiveness through reducing costs.* Policies should aim at reducing energy and other utility costs and better aligning wages with productivity. Staff urged the authorities to advance state-owned enterprise (SOE) reforms, including reducing the entities' operational inefficiencies, fostering an enabling regulatory environment and aligning tariffs with costs of service delivery. Regular financial reporting and consistent monitoring are also essential to ensuring accountability. Staff welcomed recent steps towards energy sector reform. An external management company is coming on board and parliament has passed legislation for reforming the loss-making Bahamas Electricity Company, establishing an independent regulator, and refinancing legacy debts and fund capital improvements. Staff argued that reforms should be extended to other SOEs, including Bahamasair and the Water and Sewerage Corporation.

12. **Policies to revive credit growth.** Staff noted that discussions between the government and banks about placing distressed mortgage assets in special purpose vehicles (SPVs) have been protracted, owing in part to social concerns. Resolving debt overhang in a timely and socially responsible manner would help unlock resources for private sector financing, thereby supporting growth and further strengthening financial stability. In this context, the authorities should consider implementing a comprehensive framework for resolution that may include, inter alia, the establishment of a specialized agency. Work on establishing a credit bureau, which could eventually improve well-grounded access to credit, continues. Prompt finalization of this work is key, given that more time will be required to build comprehensive information regarding existing debt obligations and repayment histories.

Authorities' views

- Authorities affirmed that they remain on track to achieve their deficit target in FY2015/16, pointing to tighter spending control and seasonality in the collection of business license fees and property taxes. Authorities expect to reallocate spending items to accommodate costs related to Hurricane Joaquin, with reconstruction spanning several years. They argued that room for increasing capital spending in the near term was constrained by project execution capacity. Authorities expect to achieve further reduction of the deficit to below 1 percent next year mainly through modernization of revenue administration, stronger enforcement efforts and spending control.
- Authorities were optimistic that new investment projects coming on stream in the near term have the potential to boost growth and lower unemployment. Authorities nevertheless fully agree with the need to design and implement an ambitious growth strategy, acknowledging that weak competitiveness, low productivity and high costs of doing business are hampering growth. They see the NDP as a critical device to strengthen and diversify the economy. Finally, the authorities recognized the need for a decisive and timely resolution of NPLs. They noted that banks have been more aggressive recently in restructuring and other forms of mortgage relief and customer assistance programs. The authorities admitted that progress has been slow, but that they continue to work closely with banks on a new framework for resolution.

B. Ensuring Fiscal and External Sustainability

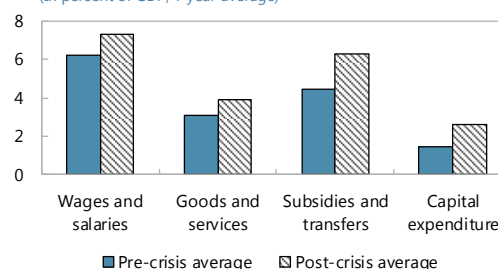
13. **Rebuilding fiscal policy buffers.** The pace of fiscal consolidation has been more gradual than previously envisaged owing to both weaker than expected growth and recent revisions in the fiscal accounts. Looking forward, and despite the more gradual pace of consolidation, the primary fiscal balance is expected to return to a surplus over the next two years. As a result, the central government debt to GDP ratio is expected to stabilize at 67 percent of GDP by FY2016/17 and begin to decline gradually thereafter (Annex I: Debt Sustainability Analysis). Fiscal vulnerabilities extend beyond the central government. SOE's debt amounted to an additional 17.4 percent of GDP in December 2015 and the unfunded pension liabilities of the public pension system, already sizeable at \$2.2 billion (about 26.2 percent of GDP), are projected to grow further in the next decades (Annex II: Pension Reform).

14. **Following smooth VAT introduction, focus on other fiscal reforms.** Further initiatives include a review of all revenue lines, and modernization of customs, property tax, vehicle fees, and immigration fee administration. The authorities recently stepped up revenue administration reform by introducing online payment of business license fees, electronic filing of customs import declaration, and merging the operations of key domestic revenue agencies as a step towards establishing a Central Revenue Agency (CRA). The government is also taking steps to introduce a National Health Insurance (NHI) scheme to be rolled out in phases, with public consultation still under way and with the cost and sources of funding yet to be determined. The authorities released a consultation paper on fiscal responsibility legislation in May 2015, which has yet to be discussed.

15. **Combination of growth-friendly reforms to help fiscal consolidation.**

- **Revenue reforms.** Staff called for standing firm against pressures to weaken the VAT's efficiency through introducing exemptions to items such as food, medical and insurance services, which could amount to an estimated $\frac{3}{4}$ percent of GDP in revenue losses. Social concerns should instead be addressed by targeted adjustments to the safety net. In addition, the authorities should comprehensively review other tax exemptions and concessions, including to the tourism sector, and consider eliminating low revenue yielding fees and duties, and further simplifying domestic taxes (such as the business license fee regime) that are not business-friendly. While VAT introduction has increased tax utilization capacity, there is substantial room to raise more revenue through non-distortionary consumption taxes to compensate for revenue losses elsewhere. Staff welcomes recent progress in improving revenue administration. Efforts should focus on moving further towards a fully-fledged CRA with well-defined institutional framework and governance structure empowered to administer most domestic taxes, thereby reducing costs, and improving efficiency and compliance. Further steps to ensure continued success in VAT implementation include more focus on program development, planning and performance monitoring based on operational data and establishing an audit program.
- **Expenditure reforms.** Fiscal consolidation has so far focused on the revenue side, while government expenditure has been drifting upwards after the GFC. Staff reiterated that rationalization of current expenditure in the context of a medium-term budget framework (see below) would help preserve the hard-won benefits of the VAT, enhance policy credibility in the low growth environment and strengthen fiscal sustainability. Such a framework should seek to contain further growth in current spending and gradually unwinding crisis related spending increases. The authorities should resist pressure to increase public wages and employment, especially in view of low labor productivity growth, while also strengthening payroll management. Furthermore, enhancing the efficiency of spending on goods and services and transfers and subsidies would generate fiscal savings. Staff urged the authorities to advance SOE reforms to reduce their drain on the budget. Finally, the authorities should begin to take

Composition of Primary Spending
(In percent of GDP, 7 year average)

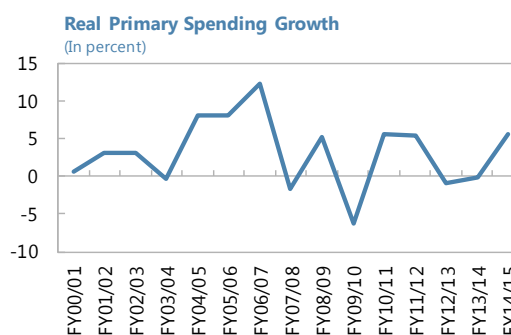


Sources: Central Bank of the Bahamas and Fund staff estimates.

measures to address risks from the pension system, through parametric reforms and over the medium-term, through the introduction of a sustainable defined contribution system.

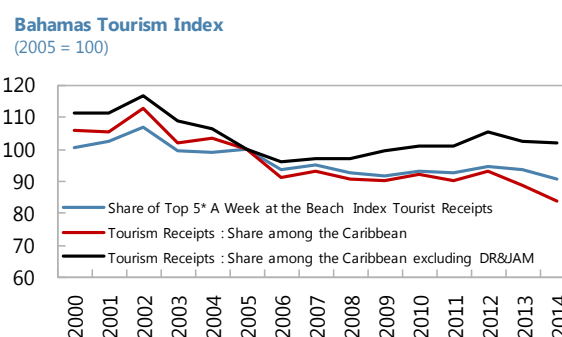
- **Medium term budget framework and public financial management (PFM) reforms.**

Weaknesses in the PFM environment, such as out-of-date accounting system and Chart of Accounts, undermine the integrity of financial reporting and spending quality. Capital budgeting is not fully integrated into the annual budget planning process. Staff emphasized that improving fiscal reporting, introducing procedural rules to support expenditure discipline and preparing a medium-term fiscal framework document, submitted to the parliament, are important immediate steps towards adopting a fiscal rule. To strengthen their commitment to fiscal responsibility, the authorities should consider further intermediate steps towards a fully-fledged framework, such as introducing a simple rule to contain volatility in spending growth.



Sources: Central Bank of the Bahamas; and Fund staff estimates.

16. **Structural reforms and fiscal consolidation to address competitiveness challenges.** The authorities remain firmly committed to the exchange rate peg (US\$1=B\$1), which provides an important anchor. They are moving only gradually to reform the CFM system with recent efforts focused on easing personal business transactions and loosening limits on cross-border investments. Staff projections reflect an improvement in the current account over the medium term to around 7 percent of GDP, allowing for modest rebuilding of external buffers. Despite significant uncertainties, the external sector assessment points to an external position that is weaker than suggested by fundamentals and desirable policy settings (Annex III: External Assessment). Other indicators, such as relatively high energy costs and indicators of the business environment show The Bahamas falling further behind its peers, and the declining share of tourism among Caribbean countries that focus on a relatively expensive, higher-end tourism experience point to persistent structural weaknesses. Reserves appear broadly adequate according to standard metrics, but fall short when taking into account small island specific factors, such as exposure to external shocks and natural disasters. To maintain sustainability of the external position and improve external competitiveness, staff continues to call for structural reform (para 11) and further fiscal consolidation (paras 13, 14, and 15).



* Countries are Bahamas, KNA, Jamaica, St. Lucia, Grenada

Authorities' Views

- Authorities are committed to further fiscal consolidation to maintain macroeconomic stability and policy credibility. To mitigate the potential impact of the VAT on low-income earners, the

authorities have already raised the minimum wage and increased social spending. They continue to review social assistance benefits, and would prefer to increase them further instead of introducing exemptions that would reduce revenues and compromise the integrity of the VAT regime. Authorities are optimistic that disciplined implementation of reforms to enhance revenue administration will raise significant additional revenue. The authorities recognize the benefits of a comprehensive review of concessions, including those to the tourism sector.

- Authorities noted that efforts to introduce a medium term framework are moving in the right direction. They are taking steps to modernize their public financial management system and remain committed to gradually moving towards a more robust medium-term fiscal framework. They continue to revamp the accounting systems and to advance other budget reforms. They are open, in principle, to adopting a fiscal rule to restrain expenditure growth, but argue that they first need to create the right administrative conditions to ensure fiscal discipline. While acknowledging that SOEs remain a drain on the budget, authorities expect that ongoing initiatives to increase efficiencies and recent investments will reduce government subsidies. The authorities are committed to rolling out NHI, but are mindful of the need to avoid causing economic disruptions. They consider pension reform, including moving to a defined contribution based regime, an important objective and acknowledge the need to commence public consultation soon.
- Authorities agreed that comprehensive structural reforms and fiscal consolidation would help enhance competitiveness and build external buffers. The authorities pointed out that the current level of international reserves remain within target levels and argued that an expected improvement in tourism earnings and foreign direct investment, together with structural reforms, will facilitate stable and organic accumulation of reserves.

C. Addressing Financial Sector Challenges

17. **Building on recent progress.** Staff welcomes recent progress in financial sector reforms which address some of the priorities identified in the 2013 FSAP, including further strengthening of the regulatory and supervisory framework, reporting under the U.S. Foreign Accounts Tax Compliance Act (FATCA), and implementation of the new Basel II/III regime (see Box 3). Nevertheless, pockets of financial sector vulnerabilities remain. Authorities are encouraged to move expeditiously in strengthening their framework for crisis management and bank resolution. Despite active support in the past, further efforts are needed to put in place and implement a comprehensive plan to address financial difficulties and governance of one state owned bank.

18. **Additional scrutiny from global “de-risking” trends.** The financial system has been exposed to global “de-risking” trends as reflected in, thus far temporary, interruptions of correspondent banking relations (CBRs) in some institutions (see Box 4: Loss of CBRs). While loss of CBRs has not led to significant disruptions thus far, continued measures could have an adverse impact on the financial sector and the economy as a whole. The financial services sector is relatively large and sophisticated, reflecting the country’s status as an offshore financial center, and accounts

for more than 10 percent of GDP and 2.7 percent of total employment.^{1,2} However, global “de-risking” trends could lead to even more scrutiny, further reducing the sector’s contribution to growth and employment, and thus complicating efforts to diversify the economy.

19. **Addressing challenges from loss of CBRs.** In addition to strengthening their overall risk-based framework for regulation and supervision, the authorities have taken several steps to address risks from loss of CBRs. The central bank conducted in June 2015 a survey to gain a better view of correspondent banking activities and the impact of recent measures and plans to reissue the survey in 2016. The Caribbean Financial Action Task Force (CFATF) has recently recognized progress made in addressing the deficiencies identified in their previous report. Following the December 2015 onsite mission, an updated report and policy recommendations will be discussed at the CFATF plenary later this year. In advance of the evaluation, the central bank finalized amendments to its AML/CFT Guidelines and introduced new Wire Transfer regulations. The authorities are also actively participating in regional bodies that aim to create collective solutions to loss of CBRs. Looking forward, increased scrutiny calls for effective implementation of AML/CFT regulations and strong efforts to ensure compliance, as well as added emphasizes on the need to keep pace with evolving international standards by promptly addressing any gaps. Continued evaluation of the supervisory and regulatory framework for both banks and non-banks to proactively identify and address risks in a timely and assertive manner is critical.

Selected Financial Sector Statistics, 2010-14					
	2010	2011	2012	2013	2014
Financial intermediation (share of GDP)	11.5	12.0	11.0	10.9	10.3
Employment (percent of total employment) 1/					
Domestic	2.4	2.4	2.3	2.3	2.1
Offshore	0.8	0.7	0.7	0.7	0.6
Government revenue from the financial sector					
Percent of GDP	1.3	1.8	1.0	1.1	1.0
Percent of central government revenues	7.9	10.2	5.8	6.8	6.2
Assets (share of GDP)					
Domestic banks	119	120	114	115	113
Offshore banks	...	6,748	3,657	2,903	2,236
Licensed Mutual Funds	1,747	1,100	1,336	1,501	...
Sources: Central Bank of The Bahamas; and National Statistical Agency.					
1/ Total employment for 2010 is average of 2009 and 2011. Figures for 2012-13 are averages of within-year survey data.					

Authorities’ Views

- Authorities remain committed to further improving their regulatory and supervisory system to ensure financial stability. A state-owned bank engaged a consulting firm to develop and

¹ [The Bahamas: Financial Sector Stability Assessment](#)

² [Financial Stability Report January-June 2015](#)

implement a rehabilitation plan for the bank. The plan will be directed at strengthening risk management, enforcing collection, revising market focus and improving governance.

- The authorities recognize the challenges stemming from global “de-risking” trends, and expressed their commitment to promptly addressing them. They will continue to monitor the industry, provide assistance to banks and encourage them to take a risk-based approach, and work on any remaining regulatory gaps. The authorities will also continue to coordinate with regional counterparts to mitigate any adverse economic fallout. They also pointed to the already strong overall AML/CFT regime in place, and called for more clarity on regulatory expectations and requirements from international banks and from source jurisdictions.

Box 3. Financial Sector Regulation and Supervision: Update

2013 FSAP. The FSAP found no short-term threats to financial stability, independent and strong oversight, and strict firewalls between the domestic financial system and the offshore sector. Nonetheless, the authorities continue to further improve the regulatory and supervisory system:

- **Risk-based supervisory framework/crisis management.** The Central Bank of The Bahamas (CBB) and other regulatory authorities continue to work towards strengthening their frameworks. Following IMF technical assistance in 2015, CBB expects to issue a consultation paper that proposes a hybrid, as opposed to purely judicial, approach to bank resolution.
- **Bank stress tests.** The latest Financial Stability Report (June 2015) shows that capital adequacy ratios (CARs) are high on average, in excess of 30 percent, and the banking system is resilient to several shocks. For example, even under a scenario with a 200 percent increase in NPLs, CARs remain above the 17 percent regulatory minimum, with the exception of one bank, whose CAR was still above the trigger rate that would have mandated additional capital.
- **Basel II/III.** Implementation commenced in 2016Q1. Most foreign-owned institutions already observe Basel III. The first official reporting under the new framework occurred in January 2016 for commercial banks, and end-March for international firms. CBB analysis suggests that banks’ capital levels remain robust also under the new Basel II/III framework, although some individual institutions are “likely to be stressed” by the new requirements. Assuming full implementation of capital conservation buffer (CCB) and total eligible capital, only one bank would fall short. With respect to CCB and countercyclical capital buffer, four banks would not meet the additional requirement.
- **Credit unions.** The CBB has assumed regulatory and supervisory authority for the domestic credit union system comprising nine institutions (with assets equivalent to about 3.5 percent of the domestic banking systems’ assets). Upon adoption, credit union deposits have Deposit Insurance Corporation protection.
- **Credit Bureau.** Preparatory work continues. Necessary legislation is expected to be presented to the parliament soon with operations starting 12-16 months after legislative approval.
- **U.S. Foreign Accounts Tax Compliance Act (FATCA).** Reporting under FATCA commenced in September 2015.

Box 4. Loss of CBRs

Like other countries in the region, The Bahamas has been impacted by global “de-risking” trends that have resulted in additional scrutiny of financial institutions and, in a few cases, to temporary interruptions in correspondent banking relations (CBRs). All affected institutions have thus far been able to avoid significant disruptions in their services by proactively relying on multiple service providers, switching to alternative providers or negotiating continuation in CBRs.

Impact on financial institutions. A total of six institutions, mainly domestic commercial banks and standalone international banks, representing about 19 percent of domestic banking system assets, have recently lost CBRs. All of them either had additional CBRs; found replacements; or were able to negotiate a continuation in service (including against an additional annual fee). Canadian banks and other international banks continue to rely on their head offices and parent banks for CBRs. Money transfer business (MTB) has also been impacted. One domestic bank closed its Western Union money transfer franchise in summer 2015, while another MTB provider has been notified about a possible termination of their banking relationship. Adverse impacts on bank operations have been reflected mainly in prolonged clearance procedures and higher investment and staffing costs stemming from additional reporting requirements and scrutiny. Business segments that have been impacted include credit card payments, cash management services, investment services, clearing and settlement, international wire transfers and remittance services.

Reasons for termination. While reasons for terminations of CBRs by global banks have not always been clearly stated, they appear to be driven by stricter application of source country (mainly U.S.) regulations, and more generally, costs related to the changing regulatory environment. The general view is that the costs of AML compliance outweigh the profits generated by CBR services, making it particularly difficult for smaller local institutions with fewer international transactions to maintain their CBRs. Some terminations also appear to be driven by implementation of a risk-based approach. In particular, consistent with experiences across the region, anecdotal evidence suggests that international correspondent banks are uncomfortable providing services to domestic banks that do business with either MTBs or on-line gaming operators (so called “web-shops”), which are perceived as higher risk.^{1/}

Replacements. Replacement CBRs have been provided by other major global banks. Canadian banks present in the domestic market do not seem to be interested in taking over correspondent banking business and alternative service providers, i.e. second tier U.S. based banks, were generally not seen as credible alternatives to traditional providers.

Risks. The impact has so far been limited to those institutions that lost CBRs, with no major disruptions in service. However, continued withdrawal of services could create an uncertain environment for business, have adverse implications for the financial sector and negative effects on the economy as a whole. Risks are particularly significant for international banks and MTBs, given their reliance on the international correspondent network to maintain multicurrency payments and settlements.

- **MTBs.** While The Bahamas does not rely on remittances as a major source of foreign currency income, termination of services could lead to an increase in the cost or interruption in remittance outflows to other countries in the region. Overall remittance outflows average about 1 percent of GDP in last three years (around \$100 million), a small share of incoming remittances in recipient countries (e.g. around 2.5 percent of total in Haiti and 0.4 percent in Jamaica).

1/ In an effort to better regulate the online gaming industry, “web-shops” that fulfilled regulatory requirements were issued conditional licenses in November 2015. The Gaming Board, under the supervision of the Ministry of Tourism, has regulatory oversight of the gaming industry (including both casinos and “web shops”).

Box 4. Loss of CBRs (Concluded)

- *Domestic banking system.* While the dominance of Canadian banks, which have not been directly impacted thus far, is likely to play an important stabilizing role for the domestic banking system, additional loss of CBRs could lead to market concentration. Additional costs from maintaining CBRs are likely to be transferred to final customers, leading to higher cost of doing business and hampering access to financial services. Moreover, withdrawal of Canadian banks could cause major disruptions in financial flows and trade finance.
- *Other risks.* Further loss of CBRs or higher costs could encourage businesses to move into less regulated parts of the financial system, contributing to the growth of an informal banking system.

D. Other

20. **Data and technical assistance.** While data provision remains generally adequate for surveillance, gaps remain in both coverage and timeliness, including in national accounts, public sector accounts, and external accounts. Progress in addressing these data shortcomings has been slow. Staff continues to support the authorities' efforts, including continuing assistance with VAT implementation; adoption of International Public Sector Accounting Standards (IPSAS) on an accrual basis; strategic and medium-term budgeting, and compiling and publishing quarterly national accounts and IIP statistics.

STAFF APPRAISAL

21. **Economic activity weighed down by weak domestic demand and challenges to competitiveness.** Real GDP growth stalled in 2015 as continued growth in air tourism arrivals was not sufficient to offset weaker domestic demand, weighed down by headwinds from fiscal consolidation as well as an end to construction and uncertainties over the opening of the Baha Mar megaresort, and weaker goods exports. Looking ahead, real GDP growth is projected to increase gradually as these headwinds moderate and to receive an additional, temporary boost when Baha Mar opens.

22. **Fiscal consolidation helped by VAT introduction and progress in other revenue reforms.** Staff commends the authorities for the successful VAT introduction, which has made an important contribution to maintaining macroeconomic stability and strengthening policy credibility. Authorities should continue to resist pressures to introduce exemptions to the current broad-based and efficient VAT regime and ensure continued strong implementation. Moving further towards a fully-fledged central revenue agency and continuing modernization of customs and property tax administration can further strengthen revenues. The authorities should also review the efficiency of tax exemptions and concessions, including to the tourism sector, and consider simplifying domestic taxes that are not business-friendly.

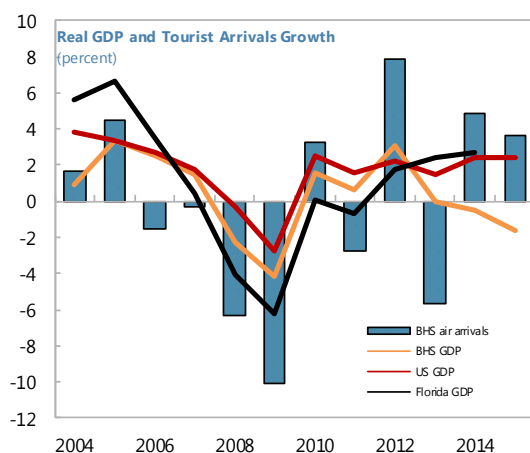
23. **Further consolidation critical for rebuilding fiscal and external policy buffers and boosting investor confidence.** In light of still rising government debt, further determined efforts focusing on spending rationalization are needed to ensure fiscal sustainability. The authorities

should contain increases in the public wage bill, extend SOE reform beyond the energy sector, and advance on-going reforms to modernize the public financial management system. A shift in composition towards growth-enhancing infrastructure spending and further intermediate steps towards a medium-term budget framework would allow fiscal policy to better balance the need for continued consolidation and support for the recovery. Finally, in the context of an ageing population, the authorities should take measures to address increasing financial burden stemming from the pension system.

24. **Mounting structural impediments call for a decisive shift towards implementation of structural policies.** Potential growth is estimated at only 1 to 1½ percent over the medium term, total factor productivity growth is negative, and both youth and structural unemployment are too high. To support near-term economic activity, staff sees room for shifting spending away from current spending and towards more productive and growth-friendly infrastructure spending. Priorities include efficient investment in information and communication technology, transportation, public utilities, as well as projects that support economic diversification, increase domestic value added in the dominant tourism sector and enhance resilience to natural disasters. Given that structural reforms will take time to bear fruit, staff urges the authorities to implement reforms to support priorities identified in the National Development Plan without delay. Reforms should aim to strengthen the business environment, raise human capital and reduce skill mismatches, and reduce high labor and energy costs. Given the exchange rate peg, improving competitiveness through structural reforms would also avoid placing an excessive burden on fiscal policy and help build still low international reserves.

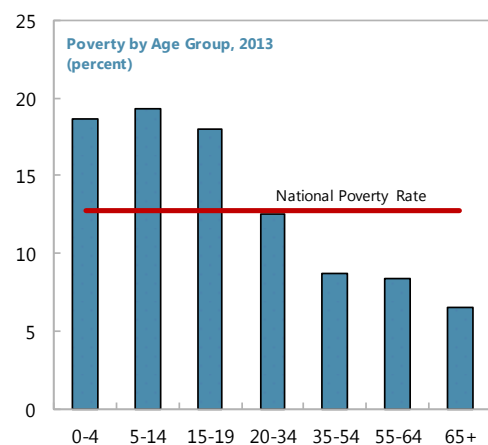
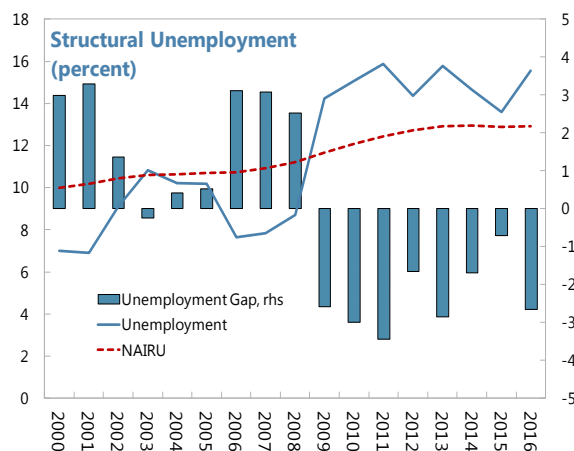
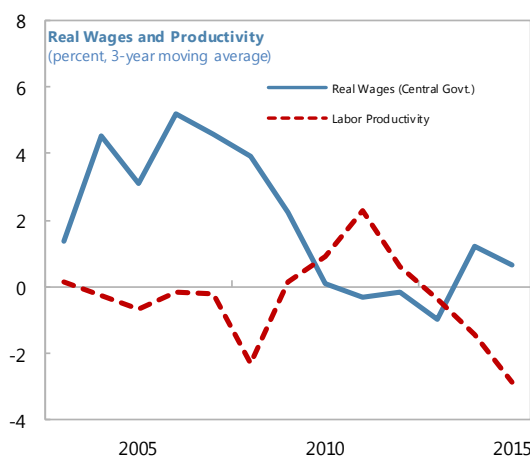
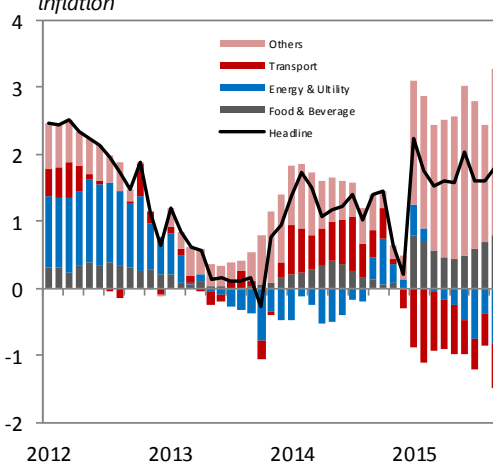
25. **Addressing financial sector challenges.** Renewed efforts to resolve the overhang of NPLs are needed to spur credit growth. Staff welcomes recent progress in financial sector reforms, including addressing gaps in the AML/CFT regulation and implementation of the new Basel II/III regime, and encourages the authorities to continue strengthening risks-based supervision and enhancing their framework for crisis management. Challenges from global “de-risking” trends call for greater emphasis on risk-based financial sector supervision and regulation, strong efforts to ensure compliance and close communication across stakeholders.

26. **It is proposed that the next Article IV consultation take place on the standard 12-month cycle.**

Figure 1. The Bahamas: Growth, Inflation, and Labor Market*US recovery supports tourism...**...but negative growth and uncertainties weigh on ratings***Bahamas: Comparative Credit Ratings**

	Moody's	Outlook/1	S&P's	Outlook/1
Trinidad and Tobago	Baa3	n	A-	n
The Bahamas	Baa2	s	BBB-	n
Suriname	Ba3	s	B+	n
Barbados	Caa1	s	B	n
Belize	Caa2	s	B-	s
Jamaica	Caa2	p	B	s

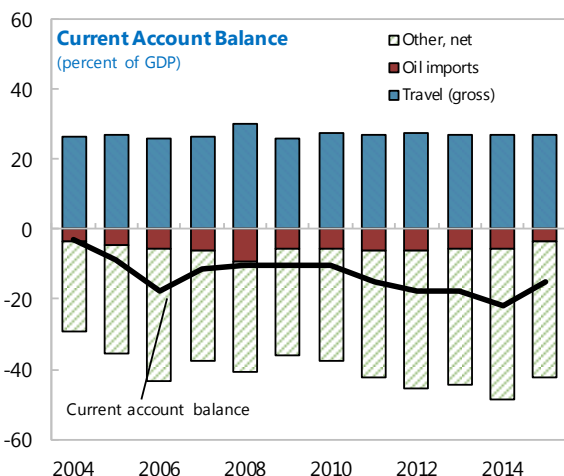
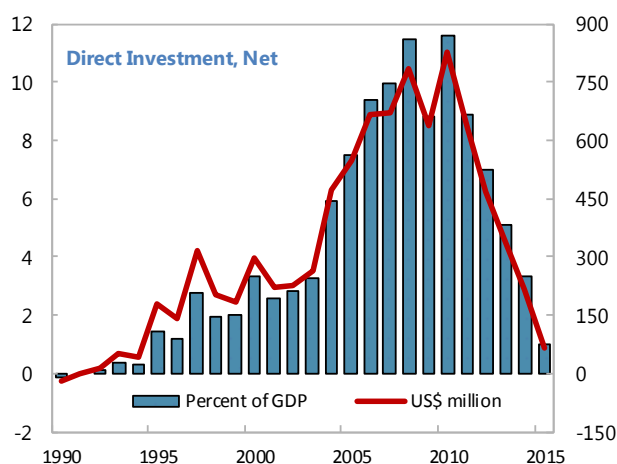
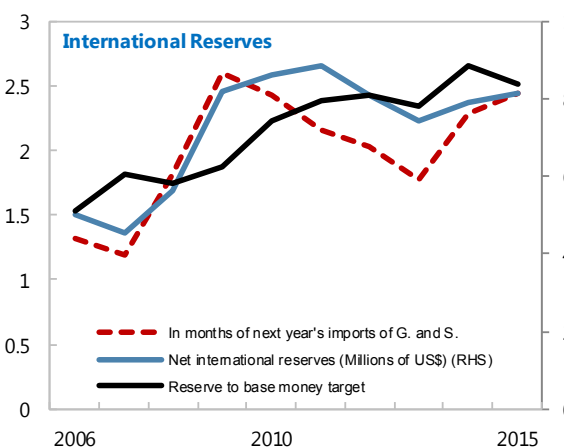
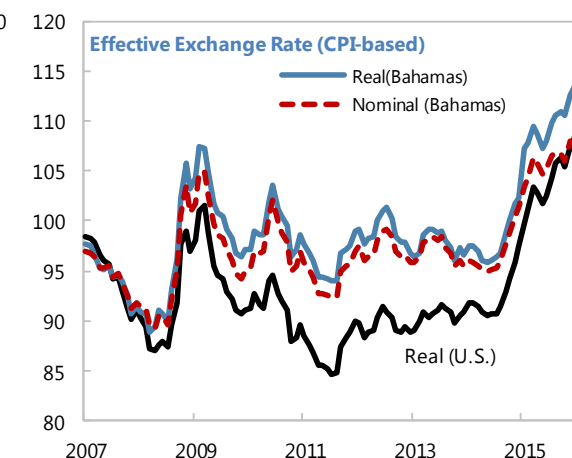
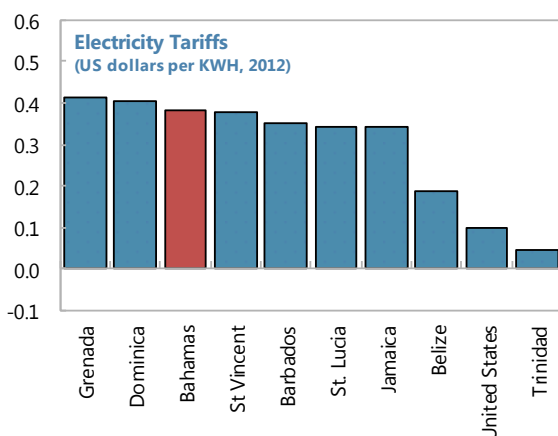
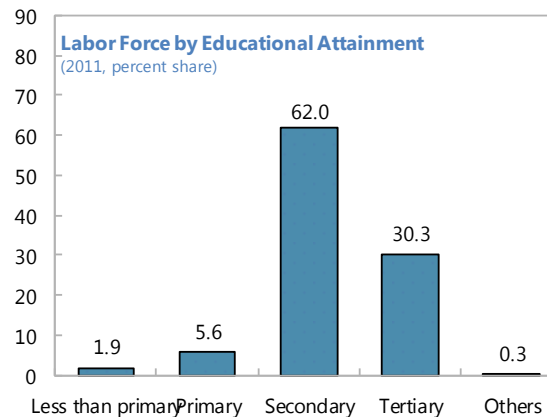
/1 s=stable, n=negative, p=positive

Poverty is prevalent among the youth...*...while structural unemployment remains high.**Public sector wages grow above productivity...**...while VAT has contributed to a temporary rise in inflation*

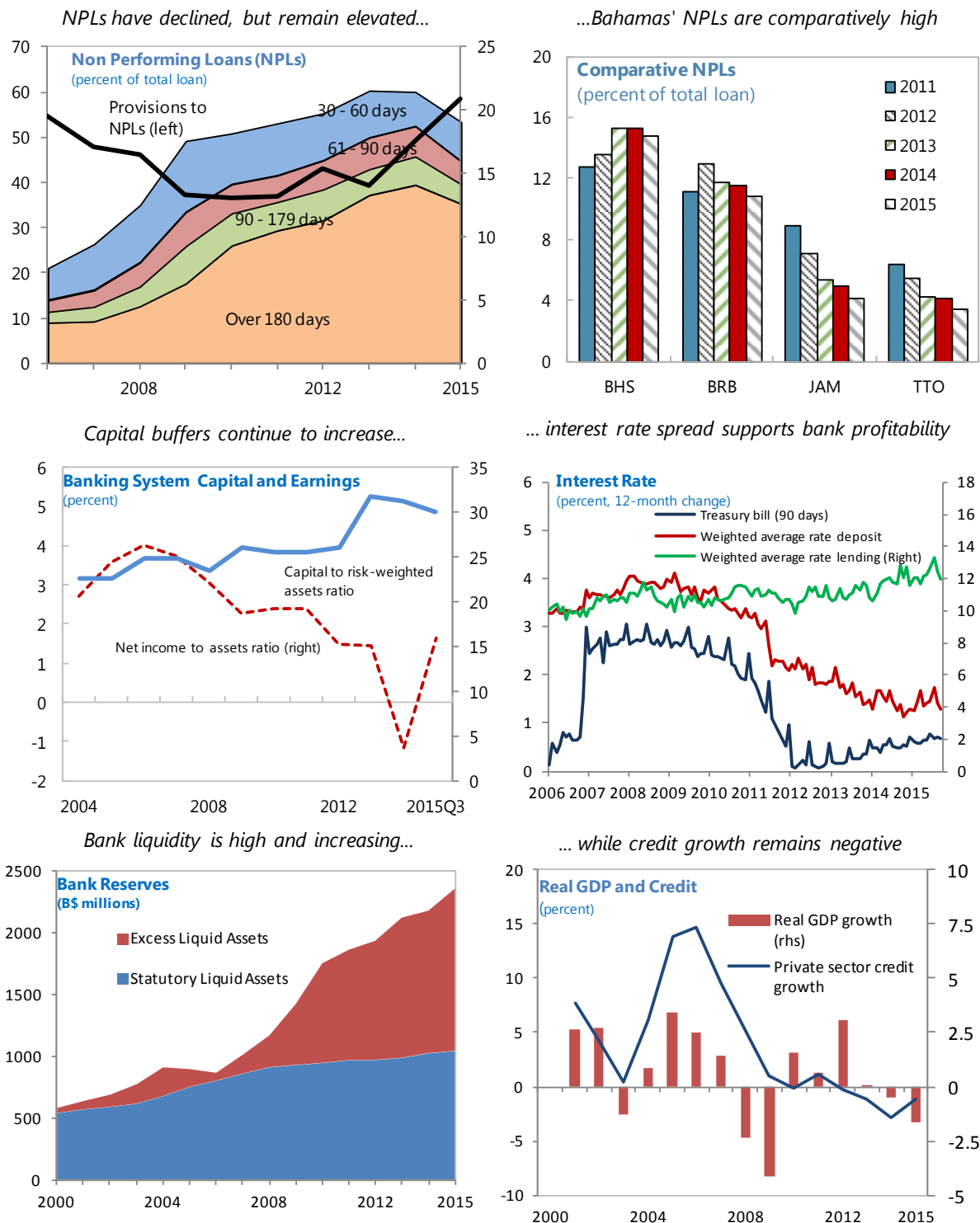
Sources: The Bahamian authorities; WEO; The Federal Reserve (St. Louis); S&P; Moody's Investor Service; and Fund staff estimates and projections.

Figure 2. The Bahamas: Fiscal Developments 1/

Sources: The Bahamian authorities; and Fund staff estimates and projections.
1/ Central government fiscal year ending June 30.

Figure 3. The Bahamas: External and Structural Competitiveness*CA deficit shrinks thanks in part to lower oil prices...**...with financing shifting away from FDI**Reserves remain uncomfortably low...**...and REER appreciation poses a challenge**Room to reduce costs, including for electricity...**...and to increase educational attainment*

Source: The Bahamian authorities; and Fund staff estimates.

Figure 4. The Bahamas: Monetary and Financial Developments

Source: The Bahamian authorities; and Fund staff estimates.

Table 1. The Bahamas: Selected Social and Economic Indicators

I. Social Indicators						
GDP (US\$ millions), 2014	8,618	Poverty rate (percent), 2013				12.8
GDP per capita (US\$), 2014	23,926	Unemployment rate (percent), November 2015				14.8
Population (thousands), 2014	360	Infant mortality rate, 2013				10.4
Life expectancy at birth (years), 2014	75.4	Human development index (rank), 2014				55
Adult literacy rate, 15 & up (percent), 2007	95.6					
II. Economic Indicators						
	2012	2013	2014	Est. 2015	Proj. 2016	Proj. 2017
(Annual percentage changes, unless otherwise indicated)						
Real sector						
Real GDP	3.1	0.0	-0.5	-1.7	0.5	1.0
Nominal GDP	6.5	1.5	1.1	2.7	2.1	3.1
Consumer price index (annual average)	1.9	0.4	1.2	1.9	0.9	1.2
Consumer price index (end of period)	0.7	1.0	0.2	2.0	0.9	1.2
Unemployment rate (in percent)	14.4	15.8	14.6	13.4	15.6	14.9
Saving rate (percent of GDP)	10.9	10.1	9.2	12.0	14.0	14.3
Investment rate (percent of GDP)	28.8	27.7	31.2	27.2	25.4	25.0
Financial sector						
Credit to the nonfinancial public sector	14.9	23.6	4.0	7.7	5.3	6.3
Credit to the private sector	-0.3	-1.2	-2.8	-1.1	0.4	0.8
Liabilities to the private sector	-0.1	0.2	1.2	-0.3	1.7	3.8
External sector						
Exports of goods and services	10.5	-1.3	-1.4	-9.5	6.4	5.8
<i>Of which:</i> Travel receipts (gross)	7.9	-1.2	1.0	3.0	7.6	4.5
Imports of goods and services	15.6	-2.6	5.0	-17.7	-3.8	3.5
(In percent of GDP, unless otherwise indicated)						
Central government 1/						
Revenue and grants	17.8	16.0	16.9	19.5	20.8	21.9
Expenditure	23.3	22.4	22.5	23.9	23.8	24.6
Overall balance 2/	-5.5	-6.4	-5.6	-4.4	-3.0	-2.7
Primary balance	-3.2	-4.1	-3.1	-1.7	-0.1	0.2
Central government debt	48.0	55.4	60.2	64.4	65.9	67.0
External sector						
Current account balance	-17.9	-17.5	-22.0	-15.3	-11.4	-10.7
Change in net international reserves						
(Increase -)	0.9	0.8	-0.5	-0.3	-0.4	-0.1
External public debt (end of period)	17.4	19.0	23.2	23.2	23.2	22.9
Memorandum items:						
Gross international reserves						
(End of period; millions of U.S. dollars)	810	742	788	812	850	859
In months of next year's G&S imports	2.0	1.8	2.3	2.4	2.5	2.4
In percent of reserve money	90	86	80	83	85	83
GDP (in millions of Bahamian dollars)	8,399	8,522	8,618	8,854	9,035	9,319
Sources: Central Bank of The Bahamas; Department of Statistics; Ministry of Finance; UNDP Human Development Report; and Fund staff projections.						
1/ The data refer to fiscal years ending on June 30.						
2/ Reflects reclassification of capital transfers and net lending, about 1 percent of GDP, to some public entities to current transfer						

Table 2. The Bahamas: Operations of the Central Government 1/
(In millions of Bahamian dollars)

	Prel.		Staff Projections					
	FY13/14	FY14/15	FY15/16	FY16/17	FY17/18	FY18/19	FY19/20	FY20/21
Revenue	1,451	1,702	1,864	2,006	2,121	2,212	2,306	2,387
Tax revenue	1,246	1,500	1,679	1,816	1,924	2,007	2,094	2,169
Taxes on international trade	595	578	510	569	609	634	656	677
Tourism taxes	170	172	137	146	152	158	164	169
Other taxes	481	532	433	477	497	522	556	584
Value added tax (VAT)		219	599	624	666	693	718	740
Other revenue	205	201	185	190	197	205	212	218
Expenditure	1,930	2,084	2,128	2,258	2,329	2,399	2,460	2,498
Expense	1,680	1,806	1,914	1,955	1,996	2,053	2,101	2,128
Current expenditure	1,680	1,806	1,914	1,955	1,996	2,053	2,101	2,128
Wages and salaries	624	640	662	679	695	723	749	772
Goods and services	308	330	322	330	333	337	349	349
Interest payments	212	233	259	266	273	280	286	288
Subsidies and transfers	536	603	671	679	695	713	718	719
Net acquisition of nonfinancial assets	250	277	215	303	333	347	359	370
Net lending (+) / borrowing (-) 2/	-479	-382	-265	-251	-208	-187	-154	-110
Net acquisition of financial assets	0	0	0	0	0	0	0	0
Net incurrence of liabilities	479	382	265	251	208	187	154	110
Domestic	51	258	212	201	166	150	123	88
Foreign	428	124	53	50	42	37	31	22

Memorandum item:

Sources: Ministry of Finance; and Fund staff estimates and projections.

1/ Fiscal year ends June 30.

2/ Reflects reclassification of capital transfers and net lending, about 1 percent of GDP, to some public entities to current transfers.

Table 2. The Bahamas: Operations of the Central Government 1/ (Concluded)
(In percent of GDP)

	FY13/14	FY14/15	Prel. Staff Projections					
			FY15/16	FY16/17	FY17/18	FY18/19	FY19/20	FY20/21
Revenue	16.9	19.5	20.8	21.9	22.3	22.3	22.5	22.6
Tax revenue	14.5	17.2	18.8	19.8	20.2	20.3	20.4	20.5
Taxes on international trade	6.9	6.6	5.7	6.2	6.4	6.4	6.4	6.4
Tourism taxes	2.0	2.0	1.5	1.6	1.6	1.6	1.6	1.6
Other taxes	5.6	6.1	4.8	5.2	5.2	5.3	5.4	5.5
Value added tax (VAT)		2.5	6.7	6.8	7.0	7.0	7.0	7.0
Other revenue	2.4	2.3	2.1	2.1	2.1	2.1	2.1	2.1
Expenditure	22.5	23.9	23.8	24.6	24.5	24.2	24.0	23.6
Expense	19.6	20.7	21.4	21.3	21.0	20.7	20.5	20.1
Current expenditure	19.6	20.7	21.4	21.3	21.0	20.7	20.5	20.1
Wages and salaries	7.3	7.3	7.4	7.4	7.3	7.3	7.3	7.3
Goods and services	3.6	3.8	3.6	3.6	3.5	3.4	3.4	3.3
Interest payments	2.5	2.7	2.9	2.9	2.9	2.8	2.8	2.7
Subsidies and transfers	6.2	6.9	7.5	7.4	7.3	7.2	7.0	6.8
Net acquisition of nonfinancial assets	2.9	3.2	2.4	3.3	3.5	3.5	3.5	3.5
Net lending (+)/borrowing (-) 2/	-5.6	-4.4	-3.0	-2.7	-2.2	-1.9	-1.5	-1.0
Net acquisition of financial assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	5.6	4.4	3.0	2.7	2.2	1.9	1.5	1.0
Domestic	0.6	2.9	2.4	2.2	1.7	1.6	1.3	0.9
Foreign	5.0	1.4	0.6	0.5	0.4	0.4	0.3	0.2
Memorandum items:								
Primary balance (In millions of B\$)	-267	-149	-6	15	66	93	132	178
In percent of GDP	-3.1	-1.7	-0.1	0.2	0.7	0.9	1.3	1.7
Central government debt (In millions of B\$)	5,158	5,629	5,893	6,145	6,353	6,540	6,694	6,804
In percent of GDP	60.2	64.4	65.9	67.0	66.8	66.0	65.3	64.4
Nominal GDP (In millions of B\$)	8,570	8,736	8,944	9,177	9,517	9,903	10,255	10,571

Sources: Ministry of Finance; and Fund staff estimates and projections.

1/ Fiscal year ends June 30.

2/ Reflects reclassification of capital transfers and net lending, about 1 percent of GDP, to some public entities to current transfers.

Table 3. The Bahamas: Outstanding Stock of Public Debt

(In percent of GDP) 1/

	2009	2010	2011	2012	2013	2014	2015
Central government debt	42.5	47.0	48.2	52.4	58.5	64.7	66.5
External	9.0	9.2	10.1	12.4	14.0	18.2	18.4
Domestic	33.5	37.8	38.1	40.0	44.5	46.5	48.1
<i>Of which: in foreign currency</i>	0.0	0.9	0.0	0.0	1.5	0.0	0.4
Public corporations' debt	12.1	13.6	14.5	16.3	16.0	17.6	17.4
External	0.8	2.4	3.1	5.0	5.0	6.1	4.9
Domestic	11.3	11.3	11.4	11.3	11.0	11.5	12.6
<i>Of which: in foreign currency</i>	5.5	5.5	5.3	5.1	4.7	4.1	5.3
Total public sector	54.6	60.7	62.7	68.7	73.2	81.4	82.3
External	9.8	11.6	13.2	17.4	19.0	23.2	23.2
Domestic	44.7	49.1	49.5	51.3	54.2	58.2	59.1
<i>Of which: in foreign currency</i>	5.5	6.4	5.3	5.1	4.8	5.2	5.3
Consolidated public sector 2/	45.3	51.8	54.0	60.0	66.4	74.6	76.6
External	9.8	11.6	13.2	17.4	19.0	24.3	23.2
Domestic 2/	35.5	40.2	40.8	42.6	47.5	50.3	53.3
<i>Of which: in foreign currency</i>	5.5	5.5	5.3	5.1	4.7	4.1	5.3

Source: Central Bank of The Bahamas.

1/ Calendar year basis.

2/ Excludes central government debt holdings by public corporations.

Table 4. The Bahamas: Balance of Payments

	Est.			Staff Projections					
	2013	2014	2015	2016	2017	2018	2019	2020	2021
(In millions of U.S. dollars)									
Current account balance	-1,494	-1,898	-1,352	-1,026	-997	-863	-765	-769	-753
Goods (trade balance)	-2,211	-2,450	-2,369	-2,235	-2,316	-2,440	-2,559	-2,675	-2,770
Domestic exports	574	549	358	388	426	457	478	496	514
Domestic imports	-2,763	-2,977	-2,707	-2,602	-2,720	-2,874	-3,014	-3,147	-3,260
Oil	-485	-481	-332	-231	-278	-317	-348	-377	-401
Capital goods	-657	-720	-674	-712	-727	-725	-731	-759	-784
Other domestic imports	-1,621	-1,776	-1,700	-1,658	-1,714	-1,832	-1,936	-2,011	-2,075
Other net exports	-22	-22	-20	-21	-22	-22	-23	-24	-25
Services	1,043	991	1,461	1,694	1,835	2,152	2,387	2,518	2,644
Travel (net)	2,022	2,097	2,140	2,318	2,428	2,688	2,965	3,130	3,285
Travel (credit)	2,285	2,308	2,378	2,559	2,675	2,945	3,233	3,408	3,572
Travel (debit)	-262	-212	-238	-241	-247	-257	-268	-278	-287
Other services	-979	-1,105	-678	-623	-593	-536	-577	-612	-641
Of which:									
Construction services (net)	-483	-645	-137	-182	-139	-42	-46	-50	-55
Offshore companies local expenditure (net)	180	201	159	189	196	205	213	222	231
Income and transfers	-326	-439	-444	-486	-516	-575	-593	-612	-627
Capital and financial account	1,425	1,944	1,376	1,065	1,006	913	779	804	775
Capital transfers	-10	-9	-19	-19	-20	-21	-21	-22	-23
Long-term public sector	138	500	76	512	49	40	34	68	-54
Commercial banks' NFA	62	-162	30	30	30	30	30	30	30
Foreign direct investment	382	251	76	213	270	282	304	331	365
Other private capital 1/	853	1,363	1,213	330	677	583	433	398	458
Overall balance	-69	46	24	38	9	50	14	35	22
Change in net international reserves (increase -)	69	-46	-24	-38	-9	-50	-14	-35	-22
(In percent of GDP)									
Current account balance	-17.5	-22.0	-15.3	-11.4	-10.7	-8.9	-7.6	-7.4	-7.0
Goods (trade balance)	-25.9	-28.4	-26.8	-24.7	-24.8	-25.1	-25.4	-25.7	-25.8
Domestic exports	6.7	6.4	4.0	4.3	4.6	4.7	4.7	4.8	4.8
Domestic imports	-32.4	-34.5	-30.6	-28.8	-29.2	-29.6	-29.9	-30.2	-30.4
Oil	-5.7	-5.6	-3.8	-2.6	-3.0	-3.3	-3.4	-3.6	-3.7
Capital goods	-7.7	-8.4	-7.6	-7.9	-7.8	-7.5	-7.2	-7.3	-7.3
Other domestic imports	-19.0	-20.6	-19.2	-18.4	-18.4	-18.9	-19.2	-19.3	-19.3
Other net exports	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Services	12.2	11.5	16.5	18.8	19.7	22.2	23.7	24.2	24.7
Travel (net)	23.7	24.3	24.2	25.7	26.1	27.7	29.4	30.0	30.6
Travel (credit)	26.8	26.8	26.9	28.3	28.7	30.3	32.0	32.7	33.3
Travel (debit)	-3.1	-2.5	-2.7	-2.7	-2.7	-2.7	-2.7	-2.7	-2.7
Other services	-11.5	-12.8	-7.7	-6.9	-6.4	-5.5	-5.7	-5.9	-6.0
Of which:									
Construction services (net)	-5.7	-7.5	-1.6	-2.0	-1.5	-0.4	-0.5	-0.5	-0.5
Income and transfers	-3.8	-5.1	-5.0	-5.4	-5.5	-5.9	-5.9	-5.9	-5.8
Capital and financial account	16.7	22.6	15.5	11.8	10.8	9.4	7.7	7.7	7.2
Capital transfers	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Long-term public sector	1.6	5.8	0.9	5.7	0.5	0.4	0.3	0.7	-0.5
Commercial banks' NFA	0.7	-1.9	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Foreign direct investment	4.5	2.9	0.9	2.4	2.9	2.9	3.0	3.2	3.4
Other private capital 1/	10.0	15.8	13.7	3.6	7.3	6.0	4.3	3.8	4.3
Overall balance	-0.8	0.5	0.3	0.4	0.1	0.5	0.1	0.3	0.2
Change in net international reserves (increase -)	0.8	-0.5	-0.3	-0.4	-0.1	-0.5	-0.1	-0.3	-0.2
Memorandum items:									
Gross international reserves (in millions of US dollars)	742	788	812	850	859	909	923	958	981
Nominal GDP (millions of U.S. dollars)	8,522	8,618	8,854	9,035	9,319	9,714	10,092	10,418	10,724
Sources: Central Bank; Department of Statistics; and Fund staff projections.									
1/ Includes errors and omissions.									

Table 5. The Bahamas: Summary Accounts of the Central Bank and the Financial System

	2012	2013	2014	Est. 2015	Staff Projections	
					2016	2017
(In millions of Bahamian dollars, end of period)						
Central Bank						
Gross international reserves	810	742	788	812	850	859
Net domestic assets	89	123	193	168	147	175
Credit to nonfinancial public sector (net)	390	488	504	485	463	492
<i>Of which:</i> Central Government	395	490	521	494	494	494
Other	-301	-365	-310	-317	-317	-317
Reserve money	899	865	981	980	997	1,035
Currency held by the private sector	344	353	375	389	396	411
Liabilities with financial institutions	555	512	606	591	601	624
Financial system						
Net foreign assets	208	46	286	280	289	268
<i>Of which:</i>						
Held by commercial banks and OFIs	-602	-695	-502	-532	-561	-591
Net domestic assets	6,095	6,271	6,105	6,094	6,192	6,459
Credit to nonfinancial public sector, net	1,715	2,121	2,206	2,376	2,502	2,658
<i>Of which:</i> Central Government	1,592	1,943	2,021	2,198	2,323	2,480
Credit to private sector	6,629	6,552	6,368	6,300	6,322	6,374
Other	-2,249	-2,402	-2,469	-2,583	-2,632	-2,574
Liabilities to the private sector (broad money)	6,304	6,317	6,390	6,374	6,481	6,727
Money	1,575	1,641	1,996	2,071	2,106	2,186
Currency	217	214	233	247	251	260
Demand deposits	1,358	1,427	1,763	1,825	1,855	1,926
Quasi-money	4,729	4,676	4,394	4,303	4,375	4,541
(Change in percent of liabilities to the private sector at the beginning of the period)						
Net foreign assets	-1.1	-2.6	3.8	-0.1	0.1	-0.3
Net domestic assets	1.0	2.8	-2.6	-0.2	1.5	4.1
Credit to nonfinancial public sector	3.5	6.4	1.4	2.7	2.0	2.4
Credit to private sector	-0.3	-1.2	-2.9	-1.1	0.3	0.8
Liabilities to private sector	-0.1	0.2	1.2	-0.3	1.7	3.8
Money	2.2	1.1	5.6	1.2	0.5	1.2
Quasi-money	-2.3	-0.8	-4.5	-1.4	1.1	2.6
(Annual percentage change)						
Net domestic assets	1.1	2.9	-2.6	-0.2	1.6	4.3
Credit to nonfinancial public sector	14.9	23.6	4.0	7.7	5.3	6.3
Credit to private sector	-0.3	-1.2	-2.8	-1.1	0.4	0.8
Liabilities to private sector	-0.1	0.2	1.2	-0.3	1.7	3.8
Money	9.8	4.2	21.6	3.8	1.7	3.8
Quasi-money	-3.0	-1.1	-6.0	-2.1	1.7	3.8
Sources: Central Bank of The Bahamas; and Fund staff estimates and projections.						

Table 6. Risk Assessment Matrix 1/

Sources of Risks	Likelihood	Potential Impact	Policy Response
Further significant delay in Baha Mar opening	Medium Baha Mar opening has already been delayed several times.	Medium Delays continue to hamper growth prospects and could eventually have an adverse impact on The Bahamas' reputation as a tourism destination and business-friendly economy.	Coordinate with stakeholders to address any shortcomings that would lead to further delays. Continued fiscal consolidation and prompt implementation of structural reforms to boost investor confidence and attract FDI.
Natural disasters	Low Severe weather related disasters have been less frequent and damaging than in other Caribbean countries.	Medium Even if average disaster damage has been moderate in the past, a large hurricane could severely damage roads, housing, and tourism infrastructure.	Formulate adequate budgetary provisions for disaster mitigation. Enhance reliance through infrastructure investment. Build fiscal and external buffers.
Tighter or more volatile global financial conditions: <ul style="list-style-type: none">Further surge in the US dollar.	High Improving U.S. economic prospects versus the rest of the world leads to a further dollar surge.	Medium Could further weaken cost competitiveness, although impact is mitigated by the large share of trade with the U.S.	Continued fiscal consolidation centered on reducing current expenditure given the limited buffers available. Diversify growth drivers over the medium-term, including building a broader tourist base. Strengthen competitiveness.
Dislocation in capital flows <ul style="list-style-type: none">Reduced financial services by global/regional banks ("de-risking").	Medium Further loss of correspondent banking services significantly curtails cross-border payments, trade finance, and remittances.	Medium Continued loss of CBRs could have adverse impacts on the financial sector.	Diversify growth drivers over the medium-term. Strong implementation of AML/CFT regulations. Continue monitoring the status of CBRs and conduct periodic risk assessments.
1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (that is, which is the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding this baseline. The RAM reflects staff's views on the source of risks and overall level of concerns as of the time of preparation of this document			

Table 6. Risk Assessment Matrix (Concluded)

Sources of Risks	Likelihood	Potential Impact	Policy Response
Sharper-than-expected global growth slowdown:	Medium Weak domestic demand in key advanced and emerging market economies reduces medium term global growth.	High The tourism sector is particularly sensitive to growth in advanced economies, mostly the U.S., but also other advanced economies.	Continued fiscal consolidation centered on reducing current expenditure given the limited buffers available. Diversify growth drivers over the medium-term, including building a broader tourist base. Strengthen competitiveness.
Persistently lower energy prices	Medium Persistently low prices triggered by supply factors reversing only gradually.	Low Lower commodity prices would be favorable, reducing the value of imports and the cost of energy production.	Use as an opportunity to speed-up the reform of the energy sector.
Emergence of Cuba as a competitor	High As relations with the U.S. ease and hotels are renovated, Cuba could emerge as a competitor over the medium term.	Medium The positioning of the hotel industry as a high-end niche and efforts to develop synergies with Cuba could limit the adverse impact on The Bahamas.	Continue building a broader tourist base and developing synergies with Cuba.

Annex I. Debt Sustainability Analysis

Central government debt has increased, reflecting weaker than expected fiscal stance and continued low growth, but is expected to stabilize at 67 percent and decline gradually over the medium-term. External financing requirement remains a significant risk to the debt profile, mitigated by the projected strengthening of the current account in the medium term. Rising fiscal vulnerabilities underline the need to implement staff recommendations, including resolute implementation of fiscal consolidation and structural reforms to lift potential growth.

1. **Debt stock and gross financing requirements.** Central government debt reached 64.4 percent of GDP in FY 2014/15, up by 4.2 percentage points owing to a weaker than expected fiscal stance, continued low growth and high interest costs. Under the baseline scenario, staff projects debt to peak at 67 percent of GDP in FY2016/17, higher than projected last year, and to gradually fall to 64.4 percent over the medium term. As a result, gross financing requirement will decline from 8.4 percent of GDP in FY 2014/15 to about 3.2 percent of GDP. Ample liquidity in the domestic banking system and a captive investor base will continue to ease rollover concerns.
2. **Debt profile and vulnerabilities.** Despite continued increases in debt, its composition remains favorable. A large proportion, 72 percent of total debt, is held in local currency. Short term debt is only 12.7 percent of total debt and is denominated in local currency. The weighted average time to maturity for the government's domestic and external bonds are 9.6 and 16 years, respectively. Overall, the heat map continues to point to low to moderate risks to debt sustainability. Nevertheless, largely reflecting the still sizable current account deficit, external financing requirement, which surpasses the benchmark for emerging market comparators, remains a significant risk to the debt profile.
3. **Realism of baseline assumptions.** Staff projects real growth to average 1.6 percent over the medium term. Inflation is expected to remain low (1.6 percent), while the primary balance is projected to gradually improve from a small deficit this year to a surplus of 1.7 percent at the end of the forecast period. With respect to growth assumptions, there appears to be no systematic bias in staff's recent forecast, as projections have been close to the outcomes. Meanwhile, past projections for primary balance appear to have been relatively optimistic, while inflation has turned out better than expected. Staff does not view the historical primary balance as an appropriate comparator for the projected primary balance path mainly because debt levels have generally been low in the past, supported by stronger growth. Staff's projected primary balance path is feasible, leaving room for growth-enhancing expenditures, and is less ambitious than the path projected by the authorities.
4. **Macro-fiscal stress test.** Shocks to the baseline macro-fiscal variables could moderately worsen the debt path, and slightly raise the gross financing requirements. Real GDP growth shock remains the most significant, and could push the debt to 73.6 percent of GDP at the end of the projection period, compared with baseline projection of around 64.4 percent of GDP. Primary balance and real interest rate shocks could raise debt to around 70 percent of GDP. Exposure to real exchange rate shocks remains the least significant, with debt rising to 68 percent of GDP. Gross

financial requirements are, however, most sensitive to the real interest rate. A combined macro–fiscal shock would raise debt to 78 percent of GDP, and gross financing requirements to 6.1 percent of GDP in 2020/21.

5. **Adverse scenarios.** Staff considered two approaches that assume worse macro–fiscal outlook: (1) the constant primary balance and, (2) the historical average approaches. Under the first approach, the primary balance is assumed to, over the medium term, stay at the projected level for FY2015/16 (-0.1 percent of GDP), with the other variables, except the real effective interest rate, remaining as they are in the baseline. In this scenario, debt will rise to 73.7 percent of GDP in 2020/21. Under the second approach, real GDP growth and the primary balance are assumed to stay at 0.3 percent and -1.9 percent, respectively, from 2017 onwards. This second scenario indicates a sharp further rise of the debt burden (to 91.8 percent of GDP) over the medium term with gross financing requirements also rising to 9.3 percent of GDP. This reinforces the need for a steadfast implementation of the fiscal consolidation program to achieve a more sustainable debt path.

6. **Natural disaster shock.** A severe shock (calibrated based on the average sized–natural disaster damage) that reduces baseline real GDP growth by 2.5 percent and 1.5 percent for 2017 and 2018, respectively, and worsens the primary balance by 1.25 percent and 0.75 percent of GDP over the same period, would raise the debt level to 73.6 percent of GDP by 2021.

7. **Fiscal contingent liabilities.** The analysis has focused on the central government sector due to lack of consolidated general government and public sector data. Nonetheless, it is worth mentioning that fiscal risks emanating from public entities and the public pension system (see Annex II) are significant, and could further exacerbate the debt path if they materialize. Debt of public entities amounted to 17.6 percent of GDP in 2014/15, of which 8.2 percent of GDP are government guaranteed. The unfunded pension liabilities of the public pension system, amounts to around \$2.2 billion (about 26.2 percent of GDP), and in addition to the implicit debt of the social security system, estimated at about 50 percent of GDP in 2015, are projected to grow further in the next decades due to population aging.

8. **External debt.** Estimated at 24.2 percent of GDP in 2014/15, external public debt, (central government and public corporations) remains relatively low and is projected to stabilize at 22.3 percent over the projection horizon. The residual suggests that the private sector external debt will continue to accumulate, albeit at a declining pace. Bound test results suggest that the external public debt profile is moderately sensitive to shocks to the non-interest current account and the real exchange rate.

Figure A1.1. The Bahamas: Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

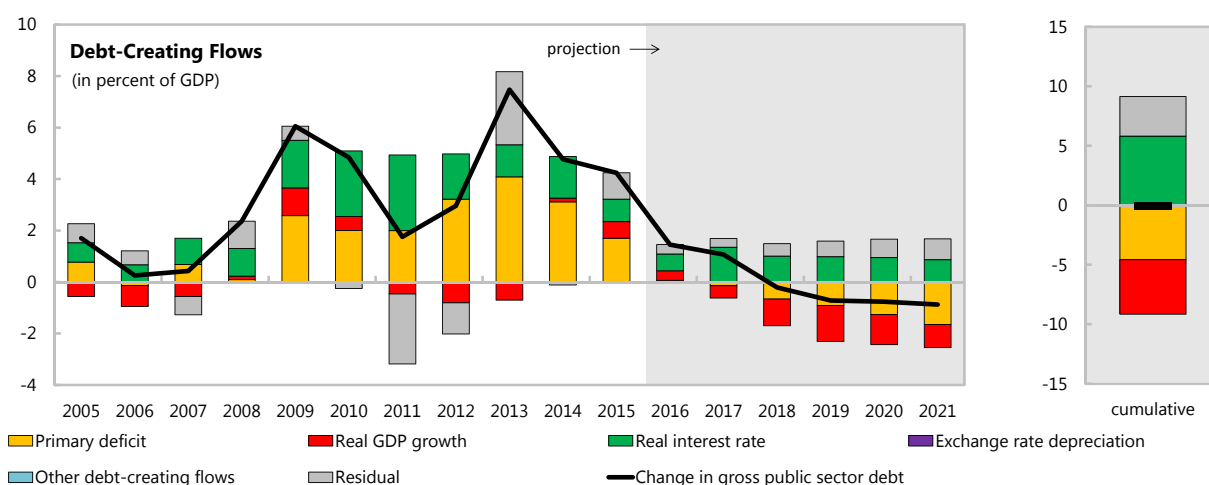
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators ^{1/}

	Actual			Projections						As of April 15, 2016
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021	
Nominal gross public debt	39.0	60.2	64.4	65.9	67.0	66.8	66.0	65.3	64.4	Sovereign Spreads Spread (bp) 2/ CDS (bp) n.a.
Public gross financing needs	5.5	9.9	8.4	4.2	6.0	4.1	3.5	3.1	3.2	
Real GDP growth (in percent)	0.7	-0.3	-1.1	-0.6	0.7	1.6	2.2	1.8	1.4	Ratings Foreign Local Moody's Baa2 Baa2 S&P's BBB- BBB- Fitch n.a. n.a.
Inflation (GDP deflator, in percent)	1.4	1.6	3.1	3.0	1.8	2.1	1.9	1.7	1.6	
Nominal GDP growth (in percent)	2.1	1.3	1.9	2.4	2.6	3.7	4.1	3.6	3.0	
Effective interest rate (in percent) ^{3/}	5.7	4.5	4.5	4.0	4.0	3.7	3.4	3.2	3.0	

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{8/}
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021		
Change in gross public sector debt	3.1	4.8	4.2	1.5	1.1	-0.2	-0.7	-0.8	-0.9	0.0	0.0
Identified debt-creating flows	3.0	4.9	3.2	1.1	0.7	-0.7	-1.3	-1.5	-1.7	-3.4	
Primary deficit	1.7	3.1	1.7	0.1	-0.1	-0.7	-0.9	-1.3	-1.7	-4.6	0.0
Primary (noninterest) revenue and grants	16.5	16.9	19.5	20.8	21.8	22.3	22.3	22.5	22.6	132.3	
Primary (noninterest) expenditure	18.2	20.0	21.2	20.9	21.7	21.6	21.4	21.2	20.9	127.7	0.0
Automatic debt dynamics ^{4/}	1.3	1.8	1.5	1.0	0.9	0.0	-0.4	-0.2	0.0	1.2	
Interest rate/growth differential ^{5/}	1.3	1.8	1.5	1.0	0.9	0.0	-0.4	-0.2	0.0	1.2	5.8
Of which: real interest rate	1.5	1.6	0.9	0.7	1.4	1.0	1.0	0.9	0.9	5.8	
Of which: real GDP growth	-0.2	0.1	0.6	0.4	-0.5	-1.0	-1.4	-1.2	-0.9	-4.6	0.0
Exchange rate depreciation ^{6/}	0.0	0.0	0.0	...	...	...	...	...	...	...
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other debt-creating flows (specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes ^{7/}	0.1	-0.1	1.0	0.4	0.3	0.5	0.6	0.7	0.8	3.3	



Source: Fund Staff Calculations.

1/ Public sector is defined as central government.

2/ Bond Spread over U.S. Bonds.

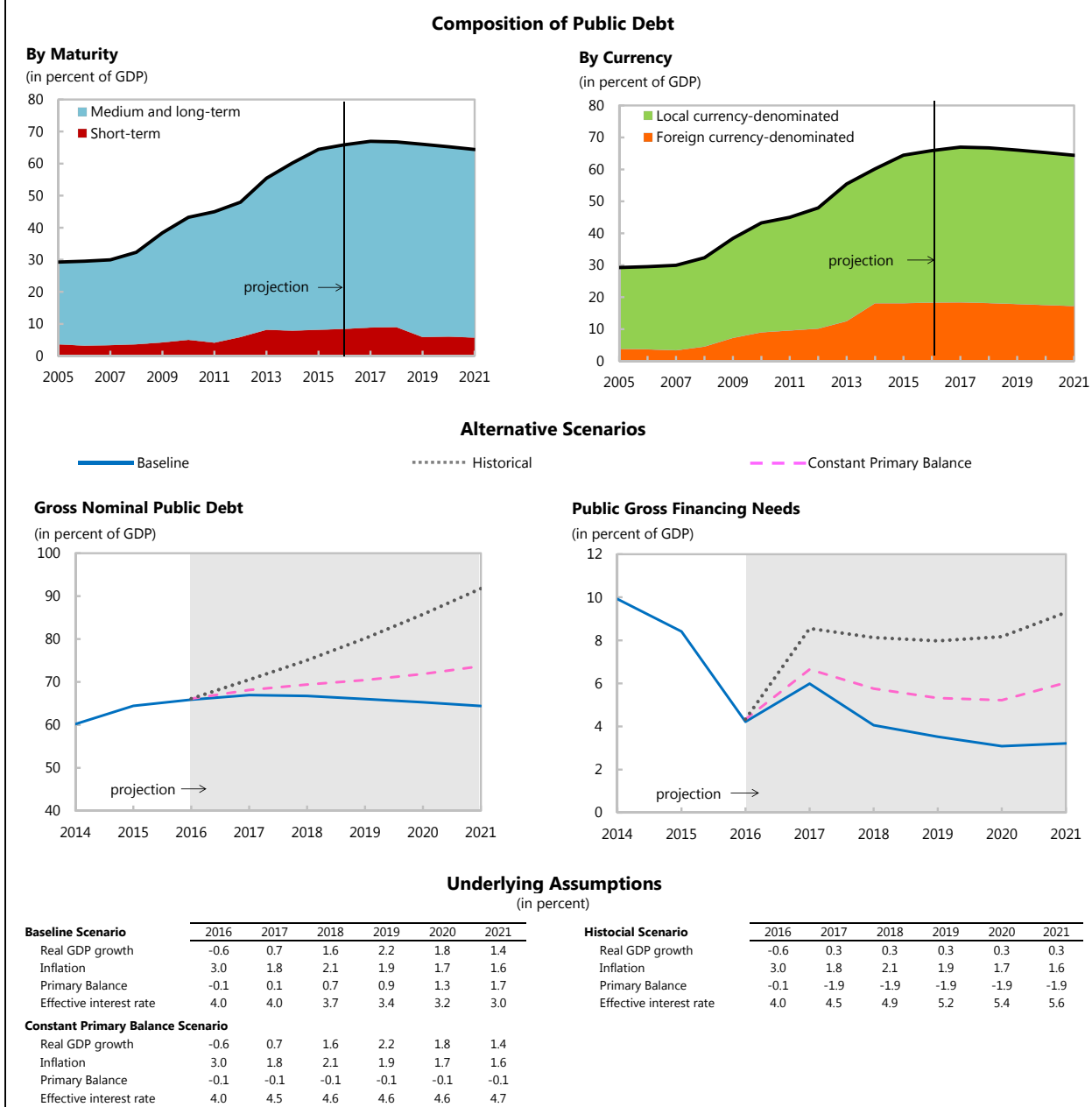
3/ Defined as interest payments divided by debt stock at the end of previous year.

4/ Derived as $[(r - p(1+g) - g + ae(1+r))/(1+g+p+gp)]$ times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).5/ The real interest rate contribution is derived from the denominator in footnote 4 as $r - \pi(1+g)$ and the real growth contribution as $-g$.6/ The exchange rate contribution is derived from the numerator in footnote 2/ as $ae(1+r)$.

7/ For projections, this line includes exchange rate changes during the projection period.

8/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

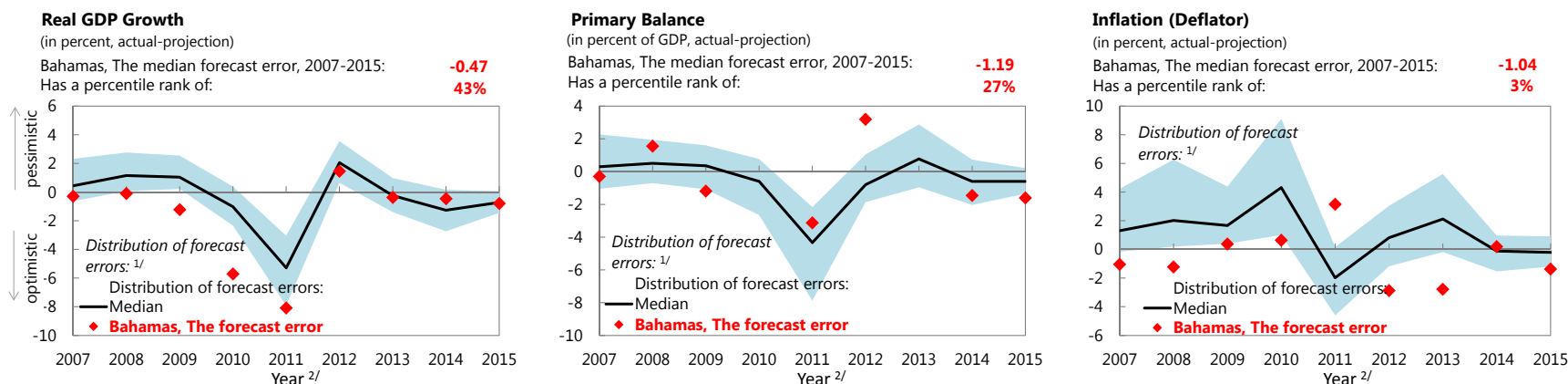
Figure A1.2. The Bahamas: Public DSA - Composition of Public Debt and Alternative Scenarios



Source: Fund Staff calculations.

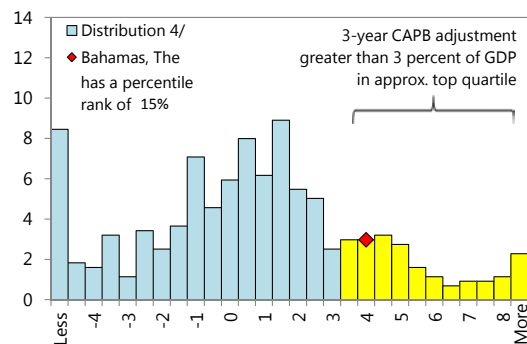
Figure A1.3. The Bahamas: Public DSA - Realism of Baseline Assumptions

Forecast Track Record, versus all countries

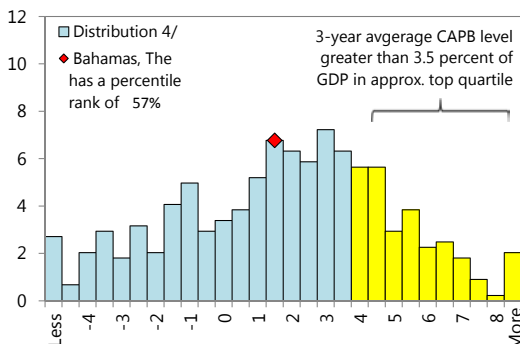


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB) (Percent of GDP)

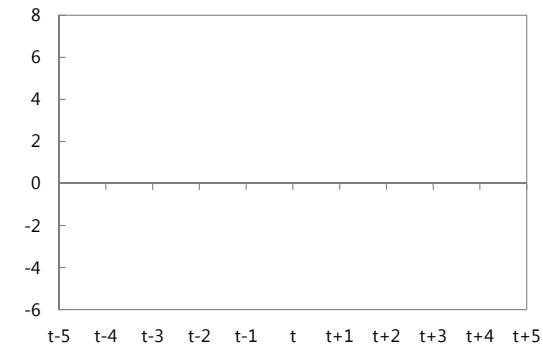


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB) (Percent of GDP)



Boom-Bust Analysis^{3/}

Real GDP growth (in percent)



Source: Fund Staff calculations.

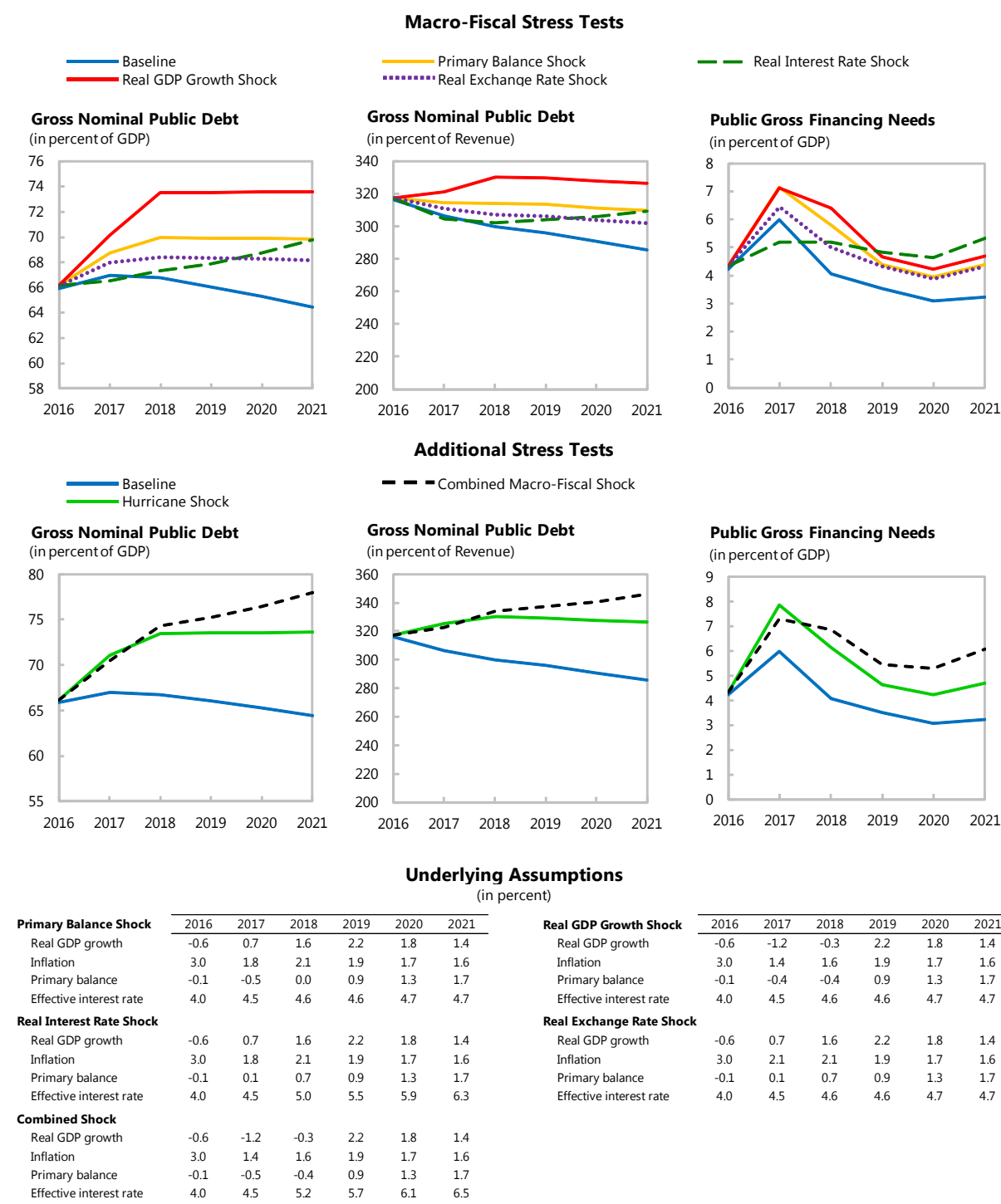
1/ Plotted distribution includes all countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Bahamas, The.

4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure A1.4. The Bahamas: Public DSA - Stress Tests



Source: Fund staff calculations.

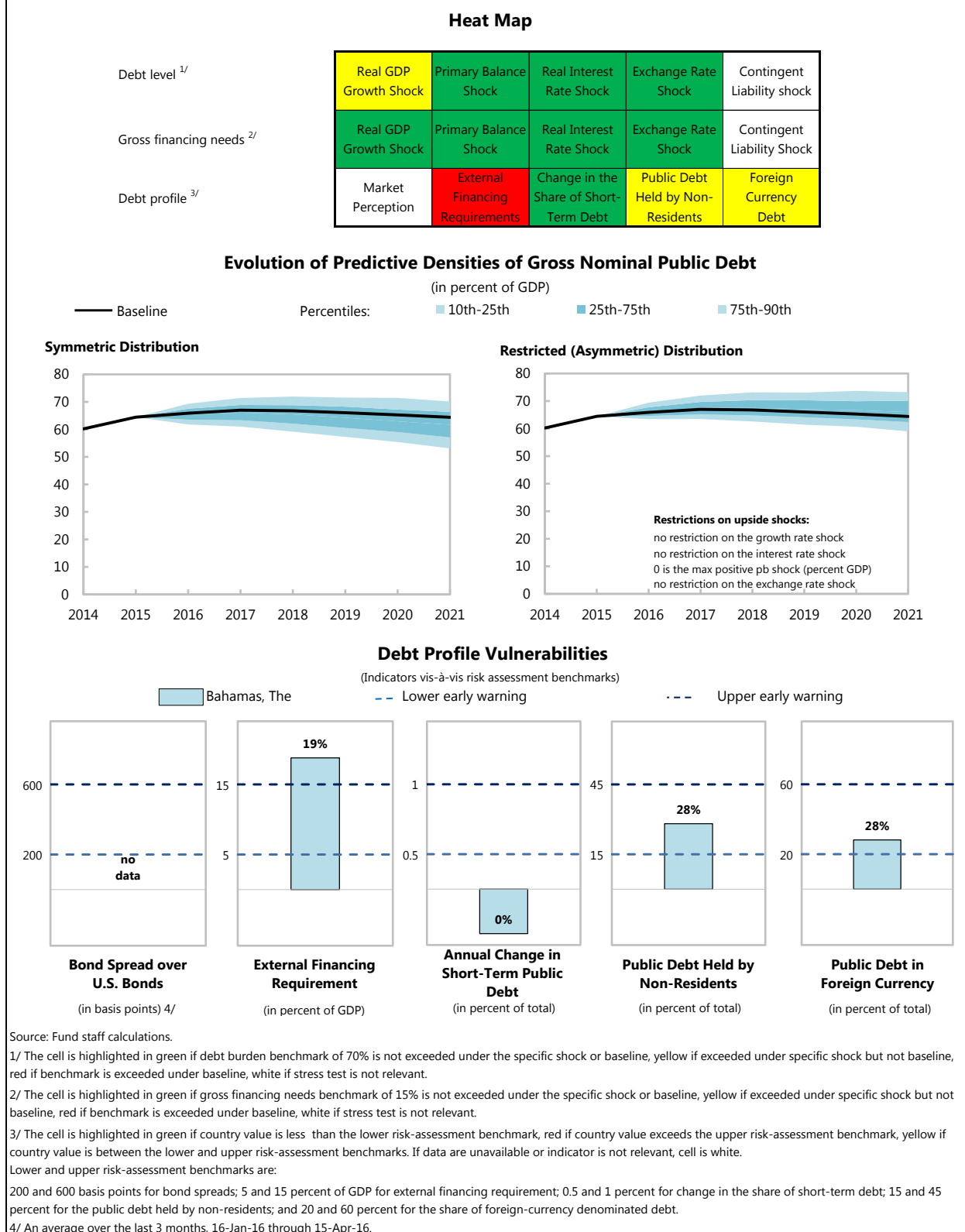
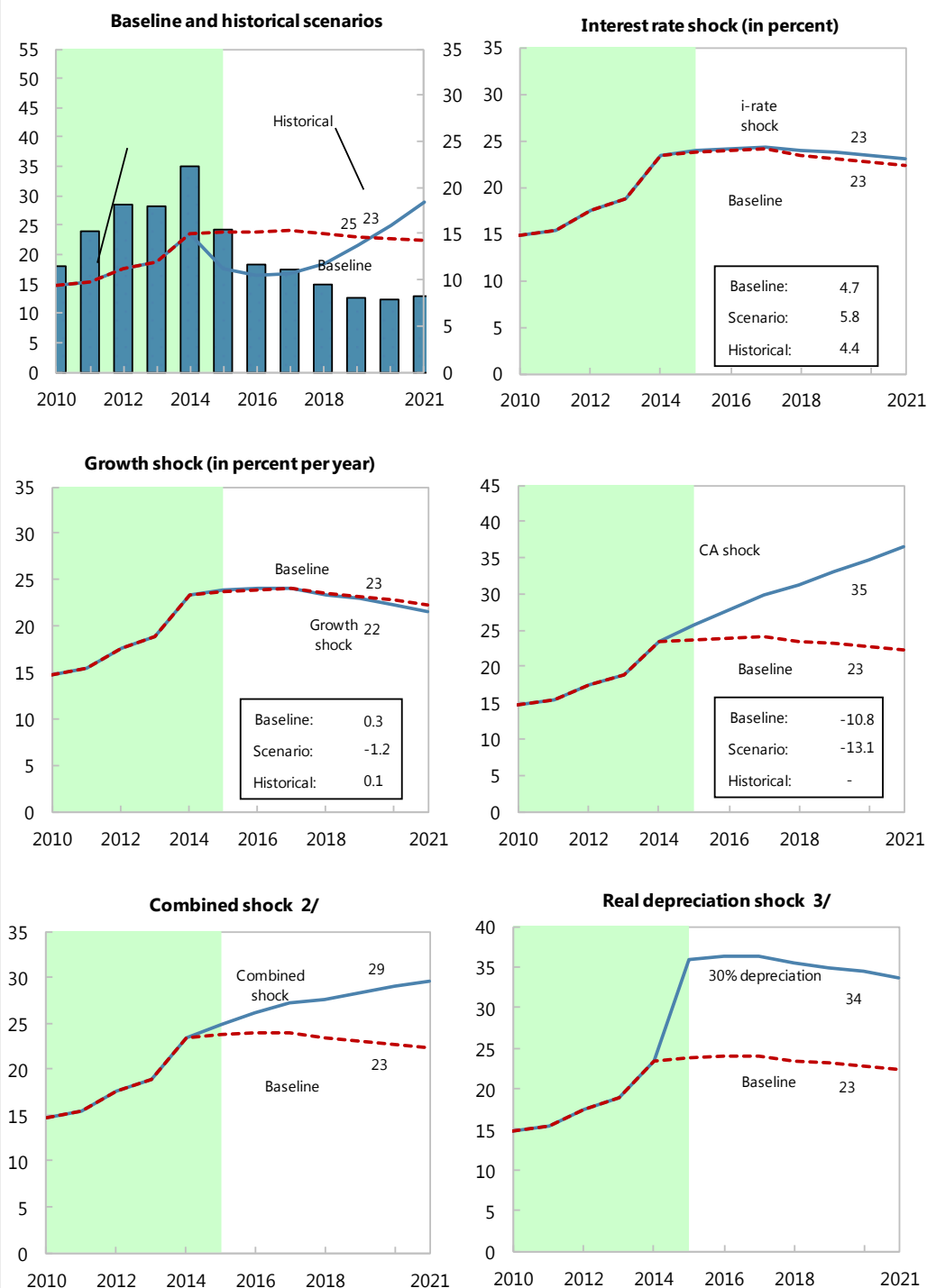
Figure A1.5. The Bahamas: Public DSA Risk Assessment

Figure A1.6. The Bahamas: External Debt Sustainability: Bound Tests 1/
(External debt, in percent of GDP)



Sources: International Monetary Fund, Country desk data, and Fund staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

3/ One-time real depreciation of 30 percent occurs in 2010.

Table A1.1. The Bahamas: External Debt Sustainability Framework, 2011-2021
(In percent of GDP, unless otherwise indicated)

	Actual											Debt-stabilizing non-interest current account 6/ -2.9
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	
Baseline: External debt	15.4	17.5	18.8	23.4	23.7	23.9	24.0	23.4	23.1	22.7	22.3	
Change in external debt	0.7	2.1	1.3	4.6	0.3	0.2	0.1	-0.6	-0.3	-0.4	-0.5	
Identified external debt-creating flows (4+8+9)	7.0	10.9	13.0	19.1	14.0	9.1	7.8	5.7	4.3	4.1	3.5	
Current account deficit, excluding interest payments	14.5	17.1	16.6	21.0	14.0	10.1	9.5	7.7	6.5	6.3	6.0	
Deficit in balance of goods and services	11.8	14.9	13.7	16.9	10.3	6.0	5.2	3.0	1.7	1.5	1.2	
Exports	42.2	43.8	42.6	41.5	36.6	38.1	39.1	41.0	42.9	43.7	44.4	
Imports	54.0	58.6	56.3	58.4	46.8	44.1	44.3	44.0	44.6	45.2	45.6	
Net non-debt creating capital inflows (negative)	-8.2	-6.1	-4.3	-2.7	-0.6	-2.1	-2.7	-2.7	-2.8	-3.0	-3.2	
Automatic debt dynamics 1/	0.6	-0.1	0.6	0.8	0.6	1.2	1.0	0.7	0.6	0.7	0.7	
Contribution from nominal interest rate	0.6	0.8	0.9	1.0	1.2	1.3	1.2	1.2	1.1	1.1	1.0	
Contribution from real GDP growth	-0.1	-0.4	0.0	0.1	0.4	-0.1	-0.2	-0.5	-0.5	-0.3	-0.3	
Contribution from price and exchange rate changes 2/	0.1	-0.5	-0.3	-0.3	-1.0	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	-6.3	-8.8	-11.7	-14.5	-13.7	-8.9	-7.7	-6.3	-4.6	-4.4	-4.0	
External debt-to-exports ratio (in percent)	36.6	40.1	44.2	56.4	64.9	62.8	61.4	57.1	53.9	52.1	50.2	
Gross external financing need (in billions of US dollars) 4/	1.2	1.5	1.5	1.9	1.4	1.1	1.0	0.9	0.8	0.8	0.9	
in percent of GDP	15.3	18.1	18.0	22.2	15.5	11.6	11.2	9.4	8.1	7.9	8.3	
Scenario with key variables at their historical averages 5/						16.5	16.8	18.4	21.5	25.0	28.9	-6.1
Key Macroeconomic Assumptions Underlying Baseline						<u>10-Year Historical Average</u>	<u>10-Year Standard Deviation</u>					
Real GDP growth (in percent)	0.6	3.1	0.0	-0.5	-1.7	0.1	2.3	0.5	1.0	2.2	2.1	1.3
GDP deflator in US dollars (change in percent)	-0.9	3.3	1.5	1.7	4.5	1.4	1.8	1.6	2.1	2.0	1.7	1.6
Nominal external interest rate (in percent)	4.1	5.6	5.2	5.5	5.3	4.4	1.0	5.5	5.2	5.0	4.9	4.6
Growth of exports (US dollar terms, in percent)	3.6	10.5	-1.3	-1.4	-9.5	1.2	11.2	6.4	5.8	9.3	8.6	5.1
Growth of imports (US dollar terms, in percent)	12.9	15.6	-2.6	5.0	-17.7	2.3	13.1	-3.8	3.5	3.6	5.3	4.6
Current account balance, excluding interest payments	-14.5	-17.1	-16.6	-21.0	-14.0	-14.2	3.9	-10.1	-9.5	-7.7	-6.5	-6.0
Net non-debt creating capital inflows	8.2	6.1	4.3	2.7	0.6	6.9	3.4	2.1	2.7	2.7	2.8	3.0
1/ Derived as $[r - g - r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate. e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt. 2/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator). 3/ For projection, line includes the impact of price and exchange rate changes. 4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period. 5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP. 6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.												

Annex II. The Public Pension System—A Case for Reform

The Bahamas public pension system consists predominantly of partially funded and unfunded defined benefit schemes. Pension obligations, already sizable, are expected to rise in the next two decades due to population aging. Absent reform, the pension system will pose an increasing financial burden.

A. Government Pension Scheme

1. **Scheme.** The government's non-contributory scheme provides retirement pensions from age 65 to eligible public officers—mainly direct government employees, the police and the defense force—with at least 5 years of service (Table 1). Pension benefits vary. For officers in the general public service, with tenure of 30 years, the retirement pension is 1/60 of pensionable earnings each year, up to a maximum of 40 years.

2. **Costs and liabilities.** Government pensioners (15 percent of the public work force) receive pension payments from the budget that, on average, stood at 1 percent of GDP and 7.3 percent of tax revenue per year in 1994–2014. The accrued pension liabilities totaled B\$1.5 billion in 2012¹ (17.9 percent of GDP). Pension payments and liabilities are projected to reach B\$230million (1.5 percent of GDP) and B\$3.7 billion (24 percent of GDP), respectively by 2030.

B. Public Entities Pension Scheme

3. **Schemes.** Most public entities have non-contributory schemes, separate from that of the government and the National Insurance Scheme (NIS). The benefit structure and eligibility requirements are different across entities, perhaps reflecting negotiation with unions, the absence of national pension regulation and limited government oversight. The schemes provide benefits to retirees from age 60, at 2 percent of their pensionable earnings, up to a maximum of 40 years. A few entities, however, have introduced defined contribution pension especially for new employees.

4. **Costs and liabilities.** Key entities are estimated to spend a combined B\$12 million annually, representing partial, advanced funding of accruing pensions. Their combined pension shortfall—unfunded component of future pensions²—amounted to B\$0.7billion (8.3 percent of GDP). Pension cost, reportedly a drain on most entities' cash flow, also impacts their viability, due to limited resources left for productive capital spending. Entities such as the Water and Sewerage Corporation (WSC), Bahamasair, and Bahamas Electricity Corporation (BEC) continue to record financial losses as a result of their public service mandates, operational inefficiencies and inadequate regulatory framework. Reflecting aged facilities and generous employment policies, their operating cost are noted to be particularly high while tariffs remain low, necessitating continued budget support, which amounted to B\$116.8 million (1.4 percent of GDP) in FY2014/15. Moreover, the pace of public

¹ In independent assessment by a consultant hired by the government.

² Defined as accumulated pension assets less accrued pension liabilities to current employees and retirees.

entities reform is lagging, and could hamper efforts towards alleviating infrastructure bottlenecks, enhancing medium term growth and stemming their drag on public finances.

Public Sector Employees Pension Benefits		
	Government	Public Entities 1/
Retirement pension	1/60 of pensionable earnings from age 65 per year, up to maximum of 40 years, for officers in the general public service with over 30 years of service	2 percent of pensionable earnings from age 60 per year, up to maximum of 40 years
Pensionable earnings	Earnings in final year of service	Final year of service, average earnings in the last 2, 3, or 5 years of service
Employee contribution	None	None, 3-5 percent contribution plus voluntary contribution
Early retirement	After 30 years of service, or reaching age 55 and having completed 5 years of service	After 30 years of service, or reaching age 50, or 55
Leaving service	Cash benefits of 4 percent of final salary per year after 10 years of service	Cash benefits of 4 percent of final salary after 10 years of service, cash benefits of 4 percent of average earnings after 10 years of service
Death in service	Final year salary at death	Depends on the extent to which monthly retirement pension has been made.
Cost of Living Adjustment	None	None, 2-5 percent maximum
Source: Ministry of Finance.		
1/ Benefits vary across entities		

C. The National Insurance Scheme Pension

5. **Scheme.** The National Insurance Scheme (NIS), the backbone of social protection, offers a contributory, partially funded, pay-as-you go (PAYG) old-age pension, covering 70 percent of the labor force, and financed by payroll taxes paid by employers and employees.

6. **Costs, liabilities and funding.** Old-age pension benefits stood at 2 percent of GDP in 2013 (three-quarters of total benefits), for pensioners, equivalent to 23.4 percent of the employed workforce. Cash surplus generated since inception has helped to build reserves, about 20 percent of GDP in 2014, invested in domestic assets, which could cover about 7.6 years of benefit payments without additional revenue (Table 2).³ Compared with Caribbean peers, excluding Jamaica, The Bahamas NIS appears to lag behind in contribution rate, asset accumulation and administration cost. However,

Bahamas NIS: Selected Demographic and Performance Indicators 1/
(In percent, unless stated otherwise)

	Bahamas	Barbados	Jamaica	St. Lucia	St. Kitts
Contribution rate	9.8	18.0	5.0	10	10.0
Premium gap	-10.0	0.0	-6.5	-6.7	-5.6
Reserves					
<i>GDP ratio</i>	20.0	43.7	4.4	46.1	59.1
<i>benefits expenditure ratio</i>	7.6	8.2	5.1	30.7	24.4
Pensionable age (in years)					
<i>Mandatory</i>	65	66.5	63	65	62
<i>Early retirement</i>	60	62	...	60	...
Life expectancy (in years)					
<i>At birth</i>	76	78	75	74	76
<i>At age 60</i>	21	23	22	21	19
Administrative Cost					
<i>Contribution ratio</i>	24.6	5.2	8.1	11.4	17.5
<i>GDP ratio</i>	0.7	0.3	0.1	0.3	0.6

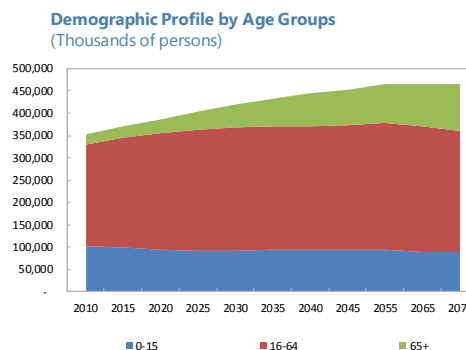
Sources: National Authorities; Social Security Programs Throughout the World; WHO; and Fund Staff Calculations.

1 / Latest available, or stated otherwise

³ Nassar, K., Okwuokei, J., Li, M., Robinson T., and Thomas, S. (2016): "National Insurance Scheme Reforms in the Caribbean", Forthcoming IMF working paper.

as a result of low growth, high unemployment, relatively low contribution rate, and compliance issues, the income from contributions (2.7 percent of GDP) can no longer finance total expenditure (3.3 percent of GDP). Beyond 2033, the scheme is projected to run operational deficits as it matures.

7. **Changing demographics will further increase pension outlays.** Demographic trends are unfavorable, and point to further increases in pension liabilities. Fertility rate (2 percent in 2010) will stabilize at 2.2 percent in 2030, below replacement levels. Combined with high and rising life expectancy, projected to reach 79 percent in 2030, old-age dependency ratio⁴ would increase four-fold from 9.4 percent in 2010 to 38 percent in 2075. Thus, under the current benefit rules, pension liabilities would become fiscally unsustainable in the next two decades, as a significant number of employees retire.⁵



8. **High administrative costs.** At the same time, as highlighted by the 2011 actuarial report, the NIS administrative costs are high, equivalent to about one-quarter of contributions in 2013, mostly reflecting increasing staff size, its relatively large role, operational inefficiencies, and the difficulties of rendering social services in the archipelago.⁶

D. Options for Reform

9. **Pension reform is inevitable.** Staff analysis indicates that a parametric reform that raises the contribution rate by 1 percent, freezes pension benefits for two years, and raises the retirement rate from 65 to 67 years, if implemented together, will nearly wipe out the NIS implicit debt, estimated at 49 percent in 2015, and put the pension scheme on a sound financial footing.⁷ Table 3 provides a menu of policy recommendations for the different pension schemes. The authorities should begin to take steps to implement policies that would contain increases in pension costs, and over the medium, gradually phase in more far-reaching reforms.

⁴ Defined as elderly population (Age 65+) divided by working age population (Ages 16-64).

⁵ The average age of direct government employees was 43 in 2013.

⁶ The NIS has 579 employees in up to 20 locations across The Bahamas, and performs numerous functions, including registration, collection of contributions, and the administration of various benefits. It will begin registration of beneficiaries under the soon-to-be launched government's National Health Insurance.

⁷ Nassar, K., Okwuokei, J., Li, M., Robinson T., and Thomas, S. (2016): "National Insurance Scheme Reforms in the Caribbean", Forthcoming IMF working paper.

Table A2.1. The Bahamas: Options for Reform

	Central Government	Public Entities	National Insurance Scheme
A. Parametric Reforms	<ul style="list-style-type: none"> Extend the retirement age from 65 to 67 percent. Cap salary increases that are pensionable. Freeze pension benefits in nominal terms for a number of years. Adjust the benefit structure, eligibility rules and replacement rates. Index benefits to the CPI to avoid discretionary upward adjustment in benefits. 	<ul style="list-style-type: none"> Gradually extend the retirement age from 60 to 67 percent. Cap salary increases that are pensionable. Increase the contribution rate as applicable. Freeze pension benefits in nominal terms for a number of years. Adjust the benefit structure, eligibility rules and replacement rates. Modify indexation provisions, or index to the CPI. 	<ul style="list-style-type: none"> Extend the retirement age from 65 to 67 percent. Increase the contribution rate. Freeze pension benefits in nominal terms for a number of years. Adjust the benefit structure, eligibility rules and replacement rates.
B. Structural Reforms	<ul style="list-style-type: none"> Introduce a defined contribution system starting with new employees. Gradually shift to a fully funded defined contribution system. 	<ul style="list-style-type: none"> Introduce a defined contribution benefit system starting with new employees. Gradually shift to a fully funded defined contribution system. 	<ul style="list-style-type: none"> Introduce a defined contribution starting with new entrants. Gradually shift to a fully funded defined contribution system.
C. Other Measures	<ul style="list-style-type: none"> Continue fiscal consolidation. Implement policies to alter the demographic profile. Introduce national pension legislation. 	<ul style="list-style-type: none"> Reform loss-making entities. Strengthen oversight of public entities, including through regular financial reporting. 	<ul style="list-style-type: none"> Streamline the role of NIS Reduce administrative cost. Expand the coverage, including to the self employed. Enforce stronger penalties for non compliance with contribution payment Diversify investment portfolio.

Annex III. External Sector Assessment

The Bahamas external accounts are characterized by persistent current account deficits that are mostly financed by FDI and other private inflows, and in recent years, by public borrowing. While the estimates point to significant uncertainty in assessing the external position, overall, they suggest that the external position is weaker than suggested by fundamentals and desirable policy settings. While the CFM regime in place substantially reduces risks, the country would benefit from additional reserves accumulation, given its exposure to external shocks and natural disasters, and increased reliance on more volatile non-FDI capital flows in recent years. With the well-established currency peg, efforts to improve competitiveness through structural reforms, accompanied by fiscal consolidation are needed to address these vulnerabilities.

A. Exchange Rate Assessment

1. **Model-based estimates.** Model-based estimates point to an external position that is weaker than suggested by fundamentals and desirable policy settings. Uncertainty across the estimates is substantial, as reflected in the range of estimates from 10.7 to 31.3 percent.

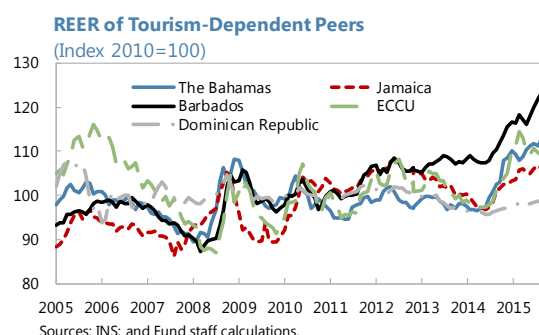
2. **EBA-lite results.** Both the EBA-lite CA and REER approaches point to an overvalued REER in 2015 (see Table).¹ The EBA-lite REER regression approach, which has a better fit than the CA regression approach, suggests that the real rate is 10.7 percent stronger than the level consistent with fundamentals and desired policies. The assessment using the CA regression approach is based on an adjusted CA deficit to account for country-specific circumstances and additional temporary factors. Specifically, the 2015 CA deficit is driven in part by sizeable, but one-off, imports related to construction of the Baha Mar resort (which was halted in the first half of the year) and a significant share of other imports that are funded by stable FDI related inflows. Adjusting for these factors, as well as potential tourism revenue from Baha Mar opening (together estimated at around 7.1 percent of GDP) reduces the estimated cyclically adjusted CA deficit to 8.2 percent of GDP. The CA approach norm is estimated at -1.2 percent of GDP, therefore pointing to a sizeable REER gap of 31.3 percent. In this context, the limitations of the approach are also reflected in a persistently poor fit of the panel CA estimation for small, tourism-based countries such as The Bahamas. In addition, the reliability of the assessment is affected by data shortcomings (such as very large net errors and omissions in last three years, and in particular in 2015).

	Exchange Rate Assessment		
	EBA-lite methodology		MB Approach
	CA Approach Adjusted	REER Approach	
Actual CA	-8.2%		-7.0%
Cyclically adjusted CA	-8.5%		
CA norm	-1.2%		-2.0%
Cyclically adjusted CA norm	-1.5%		
CA gap	-7.0%		-5.0%
o/w Policy gap	-0.6%		
REER gap	31.3%	10.7%	16.6%

¹ The external sustainability approach is not used owing to lack of official net international investment position data. The EBA-lite CA approach uses an estimate of the NFA position derived from incomplete data available in updated and extended version of the Lane and Milesi-Ferretti (2007) dataset: "External Wealth of Nations". Given the small elasticity for NFA in the CA regression results are not sensitive to alternative estimates.

3. **Macroeconomic Balance (MB) approach.** Given the large range of estimates from the EBA-lite methods and apparent methodological weaknesses (in particular as regards the use of the CA regression approach), we also employ an additional regression based MB approach to assess external sustainability. As opposed to the EBA-lite CA regression approach, the MB approach appropriately accounts for the fact that the CA deficit is expected to narrow significantly over the medium term, reflecting both low oil prices and higher tourism revenue generated by Baha Mar opening, therefore pointing to less REER misalignment (see Table). Analysis using this approach suggests that the CA deficit is about 5 percentage points larger than the norm, implying a REER gap of 16.6 percent.

4. **REER has been appreciating.** The REER has been appreciating since end 2014, at an increased pace starting in March 2015, in line with the appreciation of the US dollar relative to other currencies (see Figure). The pace of REER appreciation over the last year was comparable to several other Caribbean countries (notable Barbados and the ECCU), but noticeably faster than in countries with more flexible exchange rate arrangements (Jamaica and the Dominican Republic). The current level of the REER is around 11 percent higher than the long-term average. The REER appreciation poses risks to the country's competitiveness and already weak external position. However, risks to tourism competitiveness are mitigated somewhat by the large share of US tourists in total arrivals. To illustrate, the REER based on tourism weights only has been more stable in recent years and has also appreciated much less over the past year.



5. **Other indicators.** Estimates of the “Week at the Beach” index indicate that the nominal costs of an average one week beach holiday in The Bahamas are already among the highest in the world.² Although the country remains an attractive high end tourism destination, its share in the Caribbean tourism market that focuses on more exclusive tourism experience has been declining. The World Bank’s Doing Business Index places The Bahamas well behind the regional average, at 106th place among 148 countries. While the country marginally improved its rating since last year, the overall position has significantly deteriorated over last seven years, further increasing the economy’s distance to frontiers and best performers. A closer look at Doing Business sub-indicators suggests that The Bahamas performs particularly poorly in registering property, getting credit, starting a business, and protecting minority investors.

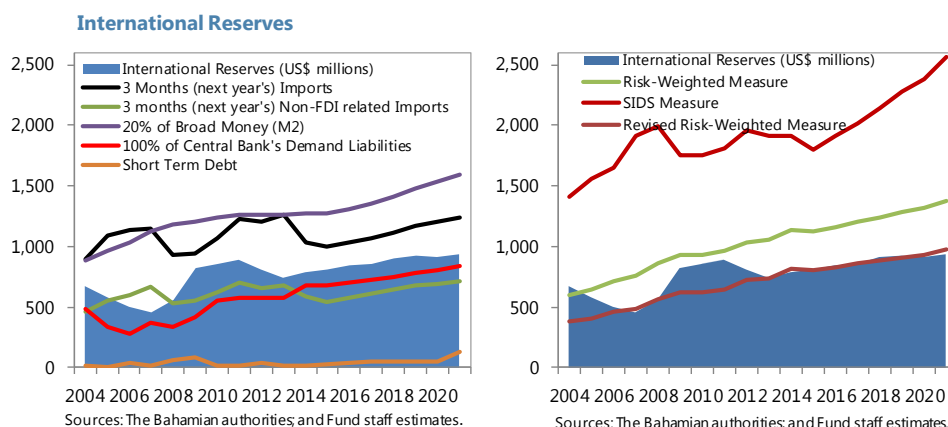
B. Reserve Adequacy

6. **Overall assessment.** Reserves appear to be adequate according to several metrics, but low when taking into account small island specific factors, such as exposure to external shocks and natural disasters. Strengthening external accounts through structural reforms that will improve

² N. Laframboise, N. Mwase, J. Park, and Y. Zhou (2014): “Revisiting Tourism Flows to the Caribbean: What is Driving Arrivals”, IMF Working Paper 14/228.

business climate and competitiveness, together with continued fiscal consolidation, should therefore be a priority.

7. **Reserve adequacy metrics.** International reserves stood at US\$981 million at end-March 2015 and are below traditional international benchmarks of 3 months of next year's goods and services imports and 20 percent of broad money. However, adjusting for FDI-related imports, reserves are more than 3 months of imports. They are also well above 100 percent of short term debt. The Fund's standard risk-weighted measure, which attempts to measure the benefit of reserves in avoiding crises and in reducing their severity, requires coverage against medium and long-term external liabilities, in addition to coverage of short-term debt and broad money. The results indicate that current reserves are at around 72 percent of the suggested level. However, the existence of capital controls both on residents, and certain types on nonresident outflows, continues to be an important mitigating factor.³ Accounting for these country-specific factors, the revised risk-weighted measure shows that reserves appear to be adequate. Still, the country has been increasing its reliance on private capital inflows other than stable FDI inflows, and on sovereign bond issuance, suggesting increasing risks from shifts in investor sentiment. The framework proposed by Mwase (2012) further takes into account specifics of small island states and their exposure to natural disasters.⁴ In the case of The Bahamas, this measure (SIDS) indicates that reserves are only at 45 percent of the recommended level.



³ With the exception of 2009, when they briefly fell to zero, net portfolio investment and other private capital flows have always been positive, thus supporting reserves. All outward capital transfers require Exchange Control approval, and outflows on resident-owned capital are restricted. In principle, inward investment in shares and other securities by nonresident is unrestricted. However, the Central Bank approval is required for the sale and issuance of capital and money market instruments on nonresidents locally.

⁴ Mwase, N. (2012): "How Much Should I Hold? Reserve Adequacy in Emerging Markets and Small Islands", IMF Working Paper 12/205



THE BAHAMAS

May 16, 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION— INFORMATIONAL ANNEX

Prepared By Western Hemisphere Department
(In consultation with other departments)

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FUND RELATIONS

(As of March 31, 2016)

Membership Status: Joined August 21, 1973; Article VIII

General Resources Account:

	SDR Millions	Percent of Quota
Quota	182.40	100.00
Fund holdings of currency	163.12	89.43
Reserve position in the Fund	19.29	10.57

SDR Department:

	SDR Millions	Percent of Quota
Net cumulative allocation	124.41	100.00
Holdings	54.15	43.50

Outstanding Purchases and Loans: None

Latest Financial Arrangements: None

Projected Payments to the Fund:

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2016	2017	2018	2019	2020
Principal					
Charges/					
Interest	0.03	0.04	0.04	0.04	0.04
Total	0.03	0.04	0.04	0.04	0.04

Exchange Rate Arrangement

The Bahamas has a conventional fixed peg arrangement, with the Bahamian dollar pegged to the U.S. dollar at B\$1 per US\$1. The Bahamas has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions. There have been no changes in exchange restrictions since the last Article IV consultation.

Assessment of Data Adequacy for Surveillance:

Data provision is broadly adequate for surveillance. In particular, all critical macroeconomic data, including comprehensive central government finance statistics, are regularly published in the Central Bank of the Bahamas' *"Monthly Economic and Financial Developments"* and *"Quarterly Statistical Digest"*. However, the authorities have yet to develop the institutional capacity for the compilation of international investment position (IIP) statistics and general government accounts data. Also, The Bahamas has still not started compiling balance of payments statistics consistent with the *Balance of Payments Manual 6*. Staff continues to support the authorities' efforts towards addressing data gaps, including continuing technical assistance to compile and publish quarterly national accounts and IIP statistics.

Last Article IV Consultation

The Bahamas is on a 12-month consultation cycle. The last Article IV consultation was concluded by the Executive Board on June 8, 2015 (IMF Country Report No. 15/75).

Technical Assistance		
Department	Dates	Purpose
CARTAC	January 2011	CPI Revision
CARTAC	April 2011	Revenue Mod./Forecasting
CARTAC	May 2011	PFM Reform Action Plan
STA	October 2011	Government Finance Statistics
LEG	February 2012	Central Bank of The Bahamas Act
MCM	February/March 2012	Public Debt Management
STA	June 2012	Quarterly National Accounts
LEG	July 2012	Payment System Laws
STA	Jan 2013	Government Finance Statistics
MCM	February 2013	Financial Stability Reporting
FAD	April 2013	Tax Reforms for Increased Buoyancy
CARTAC	April 2013	Draft VAT Bill
MCM	May 2013	Basel II Implementation
CARTAC	May/September 2013	Central Revenue Agency
CARTAC	July 2013	Support for Customs and Excise Department's Preparation of VAT
FAD	January/February 2014	Revenue Administration
FAD	March 2014	Tax Administration Readiness to Successfully Launch and Administer VAT
FAD	March 2014	Goods and Services Tax
FAD	March 2014	VAT Revenue Projection

Technical Assistance (Concluded)		
FAD	April 2014	Revenue Impact of Implementing VAT
MCM	March 2014	Financial Crisis Management Planning
MCM	April 2014	Debt Management
CARTAC	June 2014	Price Statistics
CARTAC	August 2014	Balance of Payment and International Investment Position
FAD	September/October 2014	Revenue Administration
FAD	October 2014	Preparation To Launch a Value Added Tax
CARTAC	November 2014	Quarterly National Accounts
CARTAC	December 2014	Price Statistics
CARTAC	December 2014	Risk-Based Supervision of the Securities Market
LEG	March 2015	Strengthening The Legal Framework for Bank Resolution and Crisis Management
CARTAC	August/September 2015	Quarterly National Accounts
FAD	February/March 2016	Assessment of VAT Launch and Administration

Resident Representative: None

FINANCIAL RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of March, 2016)

Country Strategy with The Bahamas 2013–2017

The current Country Strategy supports the Government of The Bahamas (GoBH) efforts to ensure macroeconomic sustainability, social stability and employment, while focusing on resilience to mitigate the negative impact of natural disasters and climate change. The Bank is:

(i) supporting the implementation of fiscal and debt sustainability reforms with an impact on public finances and public financial management; (ii) assisting with fostering social cohesion, with an emphasis on preventing crime and violence and strengthening the criminal justice system; (iii) assisting with modernizing the electricity sector and diversification of the energy matrix; (iv) facilitating diversification of both the economy and trading partners by enhancing areas of comparative advantage and removing constraints to private sector activity; and (v) building resilience to natural disasters through improved coastal zone management, incorporating disaster risk reduction and climate change adaptation measures in development planning, control and

monitoring. The support is focused on the following priority areas: (1) Public Finances and Management; (2) Citizen Security and Justice; (3) Energy; (4) Private Sector Development; and (5) Coastal Risk Management and Climate Change Adaptation. Interventions will contribute to stemming the erosion of per capita incomes by protecting public investment and promoting growth. Efforts are made to generate non-sovereign guaranteed (NSG) lending that is closely aligned to the development and diversification of the private sector, as well as direct financing for alternative energy and energy efficiency. In addition, the IDB aims to support interventions in sectors where additional financial and non-financial resources may be leveraged.

Other areas for future dialogue. In addition to the priority areas identified above, the Bank is supporting diagnostic and analytical work in the following dialogue areas: (a) Education: The provision of quality education services: (i) via strengthening capacity at the secondary education level to improve the transition from school to work, including potential areas for PPPs, and (ii) for special needs children and youth at all levels of the educational system and with an emphasis on the transition from school to work; (b) Food Security: Analyzing options to increase domestic food production and consumption of local goods, given the country's heavy dependence on food imports; (c) Transport: An analysis of (i) the impact and opportunities from the completion of the Panama Canal, (ii) greater connectivity: how inter-island mobility could be made more efficient across the 28 inhabited islands; (iii) enhancing trade links with the rest of the Caribbean and Latin America; and (d) Informal Immigration.

Active Loans as of March 31, 2016

(In millions of U.S. dollars)

Project	Name	Approval Date	Approved	Disbursed	Available
BH-L1027	Air Transport Reform Program (PBL)	Dec 14, 2011	47.5	15.0	32.5
BH-L1027	Air Transport Reform Program (TC Loan)	Dec 14, 2011	2.5	2.4	0.1
BH-L1028	WSC Support Program—New Providence Water Supply and Sanitation Systems Upgrade	Nov 16, 2011	81.0	56.2	24.8
BH-L1016	Trade Sector Support Program	Jul 18, 2012	16.5	4.2	12.3
BH-L1029	New Providence Transport Program Supplementary Financing II	Sep 04, 2012	65.0	59.5	5.5
BH-L1030	Social Safety Net Reform Program	Jul 18, 2012	7.5	1.6	5.9
BH-L1033	Citizen Security and Justice Program	Jul 7, 2015	20.0	0.0	20.0
BH-L1035	Performance Monitoring and Public Financial Management Reform	Nov 19, 2014	33.0	0.0	33.0
Total			273.0	138.9	134.1

Net Flow of IADB Convertible Currencies

(In millions of U.S. dollars)

**Net Flow of IADB Convertible Currencies
(US\$ million)**

	2010	2011	2012	2013	2014	2015	2016 (P)
a. Loan Disbursements	32.8	57	61.9	49.4	30.4	11.0	17.2
...PBL disbursements	0	15	0	0	0	0	0
b. Repayments principal	8.6	9.4	11.7	14.1	14.2	16.6	16.5
c. Net Loan Flow (a-b)	24.2	47.6	50.2	35.3	16.2	-5.6	0.7
d. Subscriptions & Contributions	0.3	0.3	0.9	1	0.8	0.0	0.5
e. Interests & Charges	5.6	5.7	6.4	6.8	6.8	6.6	6.9
f. Net Cash Flow (c-d-e)	18.3	41.6	42.9	27.5	8.7	-12.2	-6.7
(p) Projected.							

FINANCIAL RELATIONS WITH THE CARIBBEAN DEVELOPMENT BANK

(As of April, 2016)

Country Strategy with The Bahamas 2013–2017

The overriding aim of the CDB's current Strategy for The Bahamas is to support the country's advancement as a progressively stable and vibrant economy, as well as an increasingly safe society with enhanced opportunities for productive employment and improved living standards. An indicative programme of assistance was proposed to help the country achieve faster, more inclusive and environmentally sustainable development, buttressed by macroeconomic stability and citizen security. The Country Strategy responds to The Bahamas' development priorities and is aligned with the Bank's strategic objectives of fostering inclusive social development and promoting broad-based economic growth, as well as environmental sustainability. The Bank is supporting six development priorities: (i) improved access to, and quality of climate-resilient social and economic infrastructure; (ii) enhanced access to quality, and demand-driven post-secondary and tertiary education; (iii) increased social inclusion and citizen security; (iv) strengthened productive and managerial capacities of micro, small and medium-sized enterprises; (v) improved public finances and planning; and (vi) strengthened resilience to climate change and improved disaster risk management (DRM). A number of projects, along with associated technical assistance, are being taken forward to address these priorities.

Other areas for future dialogue: The Bank has already conducted a mid-term review of the existing strategy, with a view to shaping the rest of the strategy period, and thinking about the next, which is due to start in 2018. Discussions are likely to focus on consolidating the work of the existing strategy, with particular focus on the development needs in the Family Islands.

Loans as of April 14, 2016 (In millions of U.S. dollars)					
Project	Name	Approval Date	Approved	Disbursed	Available
Active Loans					
9/OR-BHA	Family Islands Transport Sector Enhancement Project	Mar 11, 2010	10.1	6.3	3.8
10-OR/BHA	College of The Bahamas Transformation Project	Mar 13, 2014	16.2	0	16.2
Active Loans 2			26.3	6.3	20.0
Pending Loans					
	Technical and Vocational Institute Enhancement Project	Dec 11, 2014	4.7	0	4.7
	Water Supply Improvement Project	Dec 10, 2015	28.3	0	28.3
Pending Loans 2			33.0	0	33.0
Total Loans 4			59.3	6.3	53.0

Net Flow of CDB Convertible Currencies (In millions of U.S. dollars)							
	2009	2010	2011	2012	2013	2014	2015
a. Loan Disbursements	0	0	0.06	5.06	0.72	1.15	0.11
...PBL disbursements	0	0	0	0	0	0	0
b. Repayments principal	0.68	0.90	0.90	0.69	0.48	0.80	0.02
c. Net Loan Flow (a-b)	-0.68	-0.90	-0.85	4.37	0.24	0.35	0.08
d. Subscriptions & Contributions	1.47	1.47	3.36	3.36	3.36	3.36	3.36
e. Interests & Charges	0.16	0.15	0.17	0.19	0.28	0.89	0.39
f. Net Cash Flow (c-d-e)	-2.31	-2.52	-4.39	0.82	-3.40	-3.90	-3.67

STATISTICAL ISSUES

Statistical data are broadly adequate for surveillance purposes, but some weaknesses remain in both coverage and timeliness, partly reflecting capacity constraints. The central bank produces annual, quarterly, and monthly reports on macroeconomic developments, and monetary and fiscal data, and is the main source of economic information. The operations of public

corporations are not compiled into a consolidated set of public sector accounts, although their debt is included in the public debt data. Thus, a presentation of the general government accounts, including revenue, expenditure, and overall balance is not available.

In March 2015, the Department of Statistics (DoS) updated the CPI methodology with technical assistance from CARTAC. Using the results of the 2013 Household Expenditure Survey, it revised the CPI weights to 2013 from 2006 and changed the base period to November 2014 from February 2010. The coverage was expanded to include new local and foreign items reflecting current expenditures by households. New sample outlets were also introduced to reflect those that are frequently visited by Households.

The DoS continues to develop the Export-Import Price Indices (XMPIS) to meet international standards. CARTAC missions have assisted in compiling the XMPIS, including Tourism Services Price Index (TSPI) on quarterly basis. New XMPIS for goods and major services have been developed, while procedures for systematic re-sampling and re-weighting were modified in order to keep the market basket representative of what is being measured. The DoS is also receiving technical assistance from CARTAC to produce quarterly GDP estimates, and they are expecting to start publishing quarterly data in October 2016. The Bahamas does not prepare data covering the economy-wide external debt position, nor an international investment position (IIP), although they have stated their intention to do so. In August 2014, a CARTAC mission advised the authorities on the requirements for transitioning to Balance of Payments Manual 6 (BPM6) and disseminating statistics on the IIP. The mission noted that most of the conversion from BPM5 to BPM6 is straightforward and some of the data required, such as reserve assets and public sector debt, are already available. However, the authorities will need to collect new data on the nonbank private sector. Capacity constraints at the Central Bank have led to little progress in this project. The authorities plan to start publishing BPM6 statistics in September 2016 and IIP statistics in March 2017.

The Inter-American Development Bank (IDB), with the technical support of the United States Census Bureau (USCB), has promoted the development of a methodology called “Tool for Assessing Statistical Capacity” (TASC). This is a self-assessment instrument, the general purpose of which is measuring and evaluating the statistical capacity of a country’s National Statistical System (NSS), and more specifically, the operational capacity of its National Statistical Office (NSO), to produce and disseminate basic statistics drawn from censuses, surveys and administrative records. There was a mission to The Bahamas to meet with the Department of Statistics and other agencies that produce statistics to apply the TASC in late November, 2013. As part of the statistical component of the IDB’s Public Financial Management reform program (PFM) with the government, the TASC assessment will be applied again to assess how things have evolved since 2013.

The Bahamas began participating in the General Data Dissemination System (GDDS) in 2003. Its metadata were posted on the Fund’s Dissemination Standards Bulletin Board on February 14, 2003.

The Bahamas: Table of Common Indicators Required for Surveillance
(As of April 20, 2016)

	Date of Latest Observation (mm/yy)	Date Received	Frequency of Data⁷	Frequency of Reporting⁷	Frequency of Publication⁷
Exchange Rates	Fixed				
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	3/16	04/16	M	M	M
Reserve/Base Money	2/16	04/16	M	M	M
Broad Money	2/16	04/16	M	M	M
Central Bank Balance Sheet	2/16	04/16	M	M	M
Consolidated Balance Sheet of the Banking System	12/15	04/16	M	M	Q
Interest Rates ²	3/16	04/16	M	M	M
Consumer Price Index	12/15	03/18	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ —General Government ⁴	NA	NA	NA	NA	NA
Revenue, Expenditure, Balance and Composition of Financing ³ —Central Government	12/15	02/16	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	12/15	02/16	Q	Q	Q
External Current Account Balance	12/15	4/16	Q	Q	Q
Exports and Imports of Goods and Services	12/15	4/16	Q	Q	Q
GDP/GNP	2014	03/15	A	A	A
Gross External Debt	12/15	02/16	Q	Q	Q
International Investment Position ⁶	NA	NA	NA	NA	NA

¹ Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

² Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³ Foreign, domestic bank, and domestic nonbank financing.

⁴ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

⁵ Including currency and maturity composition.

⁶ Includes external gross financial asset and liability positions vis-à-vis nonresidents.

⁷ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

Statement by the Staff Representative on The Bahamas
June 8, 2016

1. **This statement provides new information that has become available since the issuance of the staff report (SM/16/110).** The additional information does not change the thrust of the staff appraisal.
2. **Budget communication.** Prime Minister Christie presented the 2016/17 fiscal year budget to Parliament on May 25. For the current 2015/16 fiscal year (ending this June), the government expects the fiscal deficit at B\$150 million, broadly consistent with the earlier budget projection (at B\$141 million, about 1.5 percent of GDP). Compared to the budget projection, the somewhat larger deficit reflects lower revenue (despite strong VAT performance), higher current spending (including additional tourism concession payments), and lower capital spending. The government's fiscal deficit estimate remains lower than staff's expectation primarily owing to more optimistic revenue projections and lower than budgeted capital expenditure.
3. **The 2016/17 budget.** The budget proposes further deficit reduction next year (to \$100million, or about 1.1 percent of GDP) that is expected to arrest the recent increase in public debt. At this pace, the authorities' project the central government debt-to-GDP ratio to fall below 60 percent by 2018/19. The budget proposes "relief to consumers and businesses" through reductions in customs duties and tax concessions, as well as continued measures to modernize tax administration. The budget communication also outlines several new policy initiatives, including a training program for the unemployed; a mortgage relief program; and support for the loss-making Bank of The Bahamas, in line with the priorities identified in the staff report. As a part of the budget communication, the government also announced a framework agreement to finance and complete construction of the Baha Mar resort.

**Statement by Michael McGrath, Alternate Executive Director for The Bahamas
and Rebekah Young, Senior Advisor
June 8, 2016**

The Bahamian authorities continue to value greatly the policy dialogue with the Fund. They welcome the thorough assessment of the country's economic situation and financial system made by the Article IV mission and broadly agree with this assessment. The report outlines a sensible set of policy options, for the most part in line with initiatives already in train or envisioned by our authorities.

The Outlook

Economic conditions in The Bahamas remain subdued. Preliminary estimates for 2015 suggest a contraction of 1.7 percent of GDP. The modest growth in tourism was offset by a contraction in domestic demand and weak goods exports, fueled by headwinds from fiscal consolidation, introduction of the VAT, and the wind-up of construction activities related to the Baha Mar.

Growth is expected to pick up modestly in 2016 by around 0.5 percent of GDP, driven by modest growth in the tourism sector and foreign investment related to the construction sector. Economic activity thereafter is projected to strengthen further in 2017 to an annual rate of 1 percent in real terms.

A number of new investment projects coming on stream in the near term have the potential to boost growth, lower unemployment, and enhance competitiveness. Notably, our authorities are confident that the Baha Mar resort, which is 97 percent complete, will open shortly. This new, high-end resort is expected to add 2,200 rooms to the country's stock of over 14,000. Additionally, a relatively strong level of foreign investment projects in both New Providence and across the archipelago should sustain aggregate demand in the short run, boost the tourism productive capacity, and lead to a much-needed increase in economic activity and employment creation once these projects come fully on stream.

As growth solidifies, the unemployment rate should gradually decline from its current level of 14.8 percent (November). By itself, the Baha Mar project should employ at steady state more than 5,000 employees. This is expected to reduce significantly the unemployment rate, increase disposable income, and support domestic demand.

While our authorities broadly agree with the medium-term outlook and risk profile, they are cautiously optimistic on the upside potential. For example, while our authorities acknowledge that a further surge in the U.S. dollar could weaken cost competitiveness of The Bahamas, the country stands to gain from increased trade and tourism with the U.S., provided the surge is underpinned by improving U.S. economic prospects. Cuba is not perceived as a significant competitor in the medium term, particularly given The Bahamas' high-end target market, rather it could yield synergies through enhanced collaboration in the region. Our

authorities also view persistently low oil prices as an upside risk as it would reduce the value of imports and could help smooth the transition of the energy sector reforms.

Ensuring Fiscal Sustainability

The Bahamian authorities recognize the importance of responsible fiscal policy to maintaining macroeconomic stability and policy credibility. They reaffirm their commitment to firmly staying the course with their Medium-Term Fiscal Consolidation Plan, including through continued fiscal consolidation to place public debt on a declining path and rebuild buffers. They are on target to meet their 2015/16 fiscal deficit target of 1.5 percent, with a further reduction in 2016/17 to 1.1 percent, as announced in the recent the 2016/17 Budget Communication on May 25th. They expect to eliminate the deficit and to achieve a small balance by 2018/19. The central government debt to GDP ratio is expected to stabilize at 67 percent of GDP by 2016/17 and begin to decline thereafter to about 59 percent in 2018/19. This will be achieved by continued restraint of public expenditures, enhanced revenue administration, and securing new sources of revenue, as well as continued efforts to stimulate overall economic growth.

Our authorities have demonstrated credible progress towards consolidation. The successful introduction of the VAT in 2015 was a significant achievement and will contribute to the long-term macroeconomic stability of the country. Revenue collection exceeded expectations and, taken together with other reforms, should raise additional revenues of 2.5 percent of GDP, bringing the total revenue yield to a respectable 22.5 percent of GDP this year. Our authorities are intent on protecting the integrity and efficiency of the VAT regime by resisting pressures to introduce distortionary exemptions. They view targeted social spending as a more effective means to assist low-income populations, and have already raised minimum wage and increased social spending to this end.

Our authorities are continuing with revenue administration reforms that will yield significant additional revenue. These include a number of targeted reforms, for example to customs, business license and real property taxes, as well as modernization measures, including the successful introduction of electronic filing of customs import declarations and online payment of customs duties. These measures lower the cost and increase the ease of doing business, while providing stronger controls over the collection of government revenue. The modernization of the property tax management system is expected to be concluded over the course of upcoming fiscal year. This a significant advance under the mandate of the centralized revenue administration (Department of Inland Revenue). Our authorities are also taking steps to modernize their public financial management system, including through revamped accounting systems and other budget reforms.

Our authorities recognize the importance of expenditure reforms in fiscal consolidation. In the recent Budget Communication, they project at least a 1 percent of GDP reduction in recurrent expenditures per year beyond the coming fiscal year. They recognize this will take discipline. For example, they will accommodate for fiscal costs related to Hurricane Joaquin through spending reallocation, amounting to \$100 million (1.1 percent of GDP) over several years. They also recognize the need to be mindful of fiscal constraints in rolling out the

National Health Insurance, and they will soon commence public consultation on pension reform, including on options to move to a defined contribution-based regime.

Maintaining External Sector Sustainability

Inflation has been tempered at 1.9 percent in 2015. While the introduction of the VAT resulted in some temporary upward pressure, this has been moderated by low oil prices. This is allowing monetary policy to remain supportive while maintaining the fixed exchange rate which has been instrumental in reducing uncertainty for foreign investors and providing a credible nominal anchor.

The current account deficit has come down modestly to 7 percent of GDP. The level of reserves has increased to US\$980.5 million at the end of March, up significantly by about \$172 million since December 2015. These levels remain adequate when measured in terms of non-FDI imports and other standard metrics, and are expected to improve through growth in tourism earnings and foreign direct investment, together with reforms that will facilitate stable and organic accumulation of reserves.

Strengthening Financial Sector Resilience

The Bahamian banking system remains well capitalized, profitable, and liquid. Our authorities have made steady progress in implementing financial sector reforms identified in the 2013 FSAP, including further strengthening of the regulatory and supervisory framework, reporting under the U.S. Foreign Accounts Tax Compliance Act (FATCA), and implementation of the new Basel II/III regime. A consulting firm has also been engaged by a state-owned bank to develop and implement a rehabilitation plan, which should improve governance, revise its market focus, strengthen its risk management, and enforce collection.

Our authorities recognize the need for decisive and timely resolution of non-performing loans (NPLs). They note that banks have been more aggressive in writing off and provisioning for bad debts, as well as proactively implementing policies to provide relief or restructuring options to distressed customers. Our authorities are also working with banks to develop a new framework for mortgage relief that will impact significantly more homeowners than the previous program without unduly burdening the budget or rewarding poor lending practices. They expect to release details of this new Mortgage Relief Programme during the forthcoming budget debates, through which an estimated 1,000 delinquent borrowers are expected to initially qualify. Our authorities remain committed to addressing any remaining gaps that will ensure financial stability.

De-Risking

Our authorities recognize the challenges stemming from global de-risking trends, which are affecting a number of countries in the region, including The Bahamas. While affected institutions have been able to avoid significant disruptions, our authorities are committed to proactively addressing any concerns. They continue to monitor the industry, provide assistance to banks, and are encouraging them to take a risk-based approach and to work on

any remaining regulatory gaps. Our authorities will also continue to coordinate with regional counterparts to mitigate any adverse economic fallout. With a strong overall AML/CFT regime in place, our authorities are seeking greater clarity on regulatory expectations and requirements from international banks and from source jurisdictions. They are strongly committed to promptly addressing gaps or concerns as they may arise.

Fostering Growth and Competitiveness

The Bahamian authorities are very mindful of the need to boost potential growth, enhance productivity and bolster competitiveness. They afford high priority to the finalization of the National Development Plan (NDP), which will help accelerate economic, institutional, and social development over the medium and long term. The April ‘State of the Nation Report’ was an important milestone in the first phase of the NDP, providing an in-depth diagnostic of The Bahamian economy and society. While extensive, non-partisan consultations on the NDP have taken considerable time, this inclusive approach will be critical to gaining consensus for implementation. A first draft of the NDP is expected to be released in the coming months for further consultation.

Our authorities recognize the importance of improving the business environment to strengthen competitiveness, including through reliable and affordable energy costs. This would also help facilitate economic diversification. To this end, important steps have been taken, including the introduction of legislation to reform the Bahamas Electricity Corporation (BEC). Its management has recently been outsourced to a private sector company, PowerSecure International (US), with a mandate to operate on a fully commercial basis, which should bring down costs and resolve power supply problems to the benefit of tourism and other sectors. It should also end uncertainties that have prevented long-term investment needed to expand generation capacity, improve the distribution network, and reduce the cost of power.

The authorities strongly agree with the need for continuous improvement of efficiency and transparency of operations of other state-owned enterprises (SOEs), not only to minimize the budget implications but to lower costs and improve services to customers. They expect to achieve significant milestones in introducing competition in the cellular market in the coming weeks. At the same time, they note the challenges associated with providing uniform and affordable services to all islands in the archipelago, given the high cost and low scope for economies of scale.

Our authorities remain committed to raising human capital through educational and vocational reforms to lower unemployment and raise potential growth. Legislation has recently been finalized for the establishment of the University of The Bahamas. This will complement other recent secondary educational reforms, including strengthened standards for school graduates and the introduction of STAR Academy targeting vulnerable children. Significant efforts are underway to also strengthen work force training including through the establishment of the National Training Agency. The government announced on May 25th, an additional \$22 million to complement last year’s \$20 million in support of an apprenticeship program in partnership with the private sector under which employers will be incentivized,

through a wage subsidy, to employ young persons in positions that will afford them the opportunity to acquire basic job skills.