THE CENTRAL BANK OF THE BAHAMAS

RESEARCH DEPARTMENT

RECENT BALANCE OF PAYMENTS DEVELOPMENTS IN THE BAHAMAS

by

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Introduction

The global economic situation in recent years has been marred by rising oil prices, persistent high inflation, growing interest rate differentials, sluggish economic growth, high unemployment, widening current account imbalances and increased protectionism in world trade. This gloomy scenario has resulted in large part from the second oil shock of 1979 - 1980 when oil prices rose by an average of 150%. The slowdown in economic activity was intensified by the restrictive monetary and fiscal measures taken by the authorities in the major industrial countries to fight inflation. The tight monetary policy stance adopted by the United States caused interest rates, nominal and real, to soar to unprecedented levels. This led to a widening of the differential between interest rates in the United States and the other major industrial countries which in turn caused wide fluctuations in exchange rates in favour of the U.S. dollar.

The adverse impact of these unfavourable international economic developments on the balance of payments of the non-oil developing countries, though great, has been varied from country to country. An open economy like The Bahamas, which relies heavily on imports for its economic well being and is totally dependent on oil for its energy needs, is particularly vulnerable to rising oil prices, and high inflation especially in the U.S., its major trading partner. Furthermore, owing to the close monetary and financial ties between The Bahamas and the U.S., the effects of interest rates differentials on the balance of payments is of special importance.

This paper will attempt to identify and quantify, where possible, the internal and external factors which affected the balance of payments since 1978 and the steps taken by the authorities in 1980 to relieve the pressure on the balance of payments. The paper will be organized as follows. In Section I, a brief review will be made of important balance of payments trends for the years 1975 - 1980 with particular emphasis on 1980. Section II will examine in greater detail the quarterly trends to highlight the seasonal factors that affected the balance of payments performance for the period 1978 Quarter (I) - 1981 Quarter (I). In Section III, we will attempt to quantify the impact of exogeneous influences on the balance of payments such as, rising oil prices, inflation and interest rates differentials. The discussion on interest rates spreads will be more qualitative as it is practically impossible to measure the effect of this factor. Section IV will conclude with an assessment of the short run and long run implications of a continued large spread between interest rates in the U.S. and rates in The Bahamas and its domestic and external effects.

Section I

For the purpose of this paper, the measure of balance of payments performance used is the overall balance as this is the most appropriate indicator from the point of view of short term balance of payments management. The Bahamas' balance of payments recorded a small deficit in 1980 (excluding special transactions) of $1.5 million after achieving a surplus of $15.1 million in 1979 and a cumulative surplus of $7.7 million for the years 1975 through 1978 (see Table I). The most important secular development in the balance of payments was the shift from a steady current account surplus from 1975 - 1979 to a deficit in 1980. The current account, although in surplus, began to show some signs of weakening in 1978. For 1975, the surplus amounted to $29.9 million, increasing to $66.9 million in 1976 with a moderate decline in 1977 to $59.6 million. In 1978 the surplus fell to $33.3 million with a sharp decline in 1979 to $4.9 million. There was a complete turnaround in 1980 with a deficit of $25.5 million being recorded. The most significant inflow on the current account is the income earned from tourism which showed a steady growth since 1975 with some slackening in 1980. Tourist expenditures grew at an average annual rate of 15.3% for 1976 - 1979 but slowed considerably in 1980 to 5.9%.

The deficit on the merchandise account has, however, increased pari passu with tourism receipts. The Bahamas has a somewhat unique feature in that there is an exceptionally close link between imports of merchandise (oil and non-oil) and tourist receipts, while in other countries the demand for imports and exports are determined by other factors such as domestic demand and world demand. The rapid

TABLE I SUMMARY OF BALANCE OF PAYMENTS

(In Millions of Bahamian Dollars)

	1975	1976	1977	1978	1979	1980
Current Account	29.9	66.9	59.6	33.3	4.9	-25.5
Merchandise trade (Net)	(-226.5)	(-240.2)	(-251.1)	(-318.0)	(-419.4)	(-593.6)
Receipts from Tourism	(317.5)	(368.0)	(412.4)	(494.7)	(561.7)	(595.5)
Other (Net)	(- 61.6)	(- 60.9)	(-101.7)	(-143.4)	(-137.4)	(- 27.4)
Recorded capital flows	16.6	- 3.7	50.0	- 26.3	23.7	14.4
Net Errors & Omissions	- 43.3	- 69,4	- 90.0	- 15.9	- 33.9	- 9.6
Overall balances	3.2	- 6.2	19.6	- 8.9	15.1	- 1.5
Special Transactions[1]	0.5	0.3	0.1	0.6	4.7	15.5
Changes in net official international reserves (increase = -)	- 3.7	5.9	- 19.7	8.3	- 19.8	- 14.0
Memorandum Item:						
Gross international reserves (in months of imports)	1.9	1.5	2.1	1.5	1.6	1.4

1. Includes valuation adjustments, SDR allocations, gold restitution and profits on gold sales.

increase in imports of oil and non-oil merchandise as shown in Table II, resulted also from factors other than growth in tourism. These included rising oil prices, inflation, increased domestic income and investment in import intensive areas such as tourism and construction.

Other items in the current account showed increased net outflows during this period, specifically in 1978 and 1979 when net payments of interest, dividends and profits amounted to $114.4 million and $125.6 million respectively, compared with $75.4 million in 1977. Net outflows under interest, dividents and profits were reduced by $10.5 million in 1980 to $115.1 million. The moderation in net outflows under "other services" in 1980 was due in large measure to the substantial inflow from offshore companies' local expenses which grew from $57.1 million in 1977 to $119.3 million in 1980. While these "other items" have always shown net outflows they comprise a relatively small proportion of the current account items, hence, they have a less significant impact on the balance of payments.

The movements in the capital account have been mixed with a cumulative inflow of $23.5 million being posted for the period 1975 - 1980 (see Table III). The capital account shifted from a surplus of $16.2 million in 1975 to a deficit of $3.7 million in 1976. In 1977 recorded capital flows rebounded with a surplus of $50.0 million. However, this trend was reversed in 1978 and 1979 with net outflows of $26.3 million and $23.7 million respectively. In 1980 a surplus of $14.4 million was recorded.

The public sector accounted for a cumulative net outflow during this period of $28.6 million. These represent the amortization of long term debt from international agencies and repayment of supplier

TABLE II

(In Millions of Bahamian Dollars)

	1975	1976	1977	1978	1979	1980
Current Account	29.9	66.9	59.6	33.3	4.9	- 25.5
Non-oil Merchandise Trde	- 97.1	- 108.5	-146.0	-189.7	-242.6	-297.0
Exports (f.o.b.)	(116.2)	(149.3)	(135.9)	(146.4)	(170.5)	(200.5)
Imports (f.o.b.)	(-213.3)	(-257.8)	(-281.9)	(-336.1)	(-413.1)	(-497.5)
Net Oil Trade	-129.4	-131.7	-105.1	128.3	-176.8	-296.6
Travel (Net)	271.9	324.2	358.0	433.7	508.1	524.8
Receipts	(317.5)	(368.0)	(412.4)	(494.7)	(561.7)	(595.5)
Payments	(-45.6)	-43.8)	(-54.4)	(-61.0)	(-53.6)	(-70.7)
Local Expenses of Offshore Companies	80.4	60.2	57.1	62.0	71.3	119.3
Other Services (Net)	-80.9	- 60.8	- 86.0	-123.9	- 141.3	- 63.0
of which interest, dividends & profits (Net)	(-96.4)	(-77.1)	(-75.4)	(-144.4)	(-125.6)	-(115.1)
Transfers (Net)	-15.0	16.5	18.4	- 20.5	13.8	13.8
Private	(-14.9)	(16.5)	(18.6)	(-22.2)	-(15.8)	(-19.7)
Official	(- 0.1)	(--)	(0.7)	(1.7)	(1.2)	(6.7)

TABLE III

(In Millions of Bahamian Dollars)

	1975	1976	1977	1978	1979	1980
Capital Account	16.6	- 3.7	50.0	- 26.3	- 23.7	14.4
Private Sector (Net)	29.5	8.6	46.1	- 15.7	- 24.4	11.8
Private long term (Net)	50.9	21.3	35.7	- 16.7	3.5	7.6
Property purchase	(8.7)	(7.1)	(20.0)	(-2.3)	(8.1)	(-0.4)
Other investments	(39.8)	(6.9)	(11.4)	(1.1)	(1.5)	(4.5)
Long term loans	(2.4)	(7.3)	(4.3)	(-15.5)	(-6.1)	(3.5)
Commercial Bank and Other Financial Institutions (Net)	-21.4	-12.7	10.4	1.0	-27.9	4.2
Public Sector (Net)	-12.9	-12.3	3.9	-10.6	0.7	2.6
Public Corporations	(-7.8)	(-7.3)	(-4.5)	(-4.9)	(4.8)	(10.2)
Central Government	(-5.1)	(-5.0)	(8.4)	(-5.7)	(-7.7)	(-7.6)

credit, the majority of which were contracted prior to 1975. It should be noted, however, that while the public sector was amortizing its foreign debts throughout this period, there was a shift towards net inflows during the latter years, namely, 1979 and 1980 as new loans were contracted. In 1975, net outflows on account of the public sector amounted to $12.9 million. These stood at $12.7 million in 1976, but in 1977 owing to the floatation of general finance bonds by the Central Government, there were net inflows of $3.9 million. Net outflows in 1978 of $10.6 million were followed in 1979 and 1980 by net inflows of $0.7 million and $2.6 million respectively.

Private sector capital flows have been far more substantial. Most inward investments have been direct as in hotels, manufacturing and retail establishments, but increasingly indirect with the advent of more joint ventures following Government's announced policy of encouraging Bahamian participation in the economy. Investments other than the purchase of Bahamian property provided net inflows of $39.8 million in 1975 which fell considerably to $6.9 million in 1976 before rising to $11.4 million in 1977. From 1978 when they stood at $1.1 million net investments grew marginally to $1.5 million in 1979 and $5.5 million in 1980. Since Government's recent moves to exercise greater control over the disposition of Bahamian property there has been a reduction in the inflow of foreign exchange from purchase of land by non-residents, and there has also been slight increase in net outflow as Bahamians repurchased Bahamian property from non-residents. In 1975, 1976 and 1977 net inflows from this source of $8.7 million, $7.1 million and $20.0 million respectively were recorded. This fell to a net outflow of $2.3 million in 1979, after a brief respite in 1979 when net inflows stood at $8.1 million, net outflows of $0.4 million were recorded in 1980.

Borrowing by Bahamians from foreign sources have provided for increasing amounts of both inflows, as loans are disbursed and outflows, as loans are repaid. These loans accounted for net inflows in 1975, 1976 and 1977 of $2.4 million, $7.3 million and $4.3 million respectively. In 1978, there was a net outflow of $15.5 million which fell to $6.1 million in 1979. The year 1980 saw a turnaround with net inflows of $3.5 million.

In The Bahamas commercial banks are allowed to make loans to residents in foreign currency. These loans have been permitted by the Central Bank in instances where borrowers have substantial foreign exchange income and are required to make frequent payments in foreign exchange, such as hotels and some large retail establishments, especially those catering to tourists. While some of these loans are facilitated by foreign currency deposits of residents held with commercial banks, the majority is funded by resources obtained from foreign branches or affiliates of commercial banks or from their non-resident depositors. Shifts in the foreign indebtedness of commercial banks have been substantial. For the review period, there were net outflows of $46.4 million as the commercial banks reduced their foreign liabilities in the wake of rising interest rates abroad. The reduction in the net foreign indebtedness of the commercial banking system, however, is also partly explained by the increase in their capitalization in Bahamian dollars where the corresponding assets are held in foreign currency. Net outflows of commercial banks and other local financial institutions were concentrated in 1975, 1976 and 1979 and amounted to \$21.4 million, \$12.7 million and \$27.9 million respectively. In 1977, 1978 and 1980, net inflows of \$10.4 million, \$0.1 million and \$4.2 million respectively were posted.

Section II

Having observed that there were signs of weakening in the balance of payments in 1978 when the current account surplus fell substantially from 1977 and the capital account moved from a strong surplus in 1977 to a deficit, it should be noted that it was primarily the higher import bill which brought about the shift despite the normal seasonal inflow of foreign exchange. The current account position in 1979, on the other hand, recorded a small surplus. It is worthy to note that for 1980 the surplus in reserves was due primarily to the shift in errors and ommissions which moved from a debit to a credit indicating a possible understatement of capital inflows. Although the deterioration in the current account in 1979 may be attributed to the increase in the import bill, there were signs of a slowdown in the growth of tourist receipts. The growth in visitor expenditures fell from 19.6% in 1978 to 13.7% in 1979. The year 1980 emerged as one in which the traditional accretion to reserves did not occur. The accretion to the foreign exchange reserves in The Bahamas is seasonal and coincides with the high tourist season in the first half of the year at which time the demand for imports is at a relatively low level as inventories built up in the last half of the year are drawndown. The Central Bank has traditionally accumulated reserves in the first half of the year with drawdowns accuring in the last half (see Table IV). This table shows net foreign exchange transactions of the Central Bank and reveals that this pattern was not as pronounced in 1980 which showed net outflows of $1.4 million, as first quarter net inflows of $4.8 were offset by second quarter outflows of $6.2 million. This compares with net inflows of $27.8 million and $12.3 million for the first half of 1978 and 1979 respectively. In the first half of 1981, a normal

TABLE IV

CENTRAL BANK'S NET FOREIGN EXCHANGE TRANSACTIONS WITH COMMERCIAL BANKS AND OTHERS

(B$ Millions)

Net Purchases/(Sale)	Commercial Banks	Others	Total
1975			
Qtr. I	7.8	(0.4)	7.4
II	7.6	1.5	6.1
III	(9.3)	(3.1)	(12.4)
IV	(3.9)	(0.3)	(4.2)
1976			
Qtr. I	10.3	(0.6)	9.7
II	2.8	1.2	4.0
III	(20.6)	(0.8)	(21.4)
IV	(7.1)	3.8	(3.3)
1977			
Qtr. I	9.9	1.9	11.8
II	5.6	5.3	10.9
III	(13.8)	10.0	3.8
IV	1.0	9.4	10.4
1978			
Qtr. I	11.3	3.8	15.1
II	13.7	(2.0)	12.7
III	(9.7)	(4.3)	(14.0)
IV	(19.8)	(8.9)	(28.7)
1979			
Qtr. I	19.8	(10.0)	9.8
II	7.4	(4.9)	2.5
III	(9.6)	(0.9)	(10.5)
IV	(22.1)	4.0	(18.1)
1980			
Qtr. I	2.8	2.0	4.8
II	(1.3)	(4.9)	(6.2)
III	(11.3)	(6.3)	(17.6)
IV	(12.2)	(1.6)	(10.6)
1981			
Qtr. I	5.0	(1.8)	3.2
II	5.4	3.1	8.5

pattern was evident with net inflows at a reduced level of $11.7 million. This indicates an underlying pressure on the balance of payments. This pressure is explained in part by the much reduced current account surplus in the first half of 1980 - $36.9 million, compared with $53.5 million and $46.4 million in the first half of 1978 and 1979 respectively. In 1978 and 1979, oil imports for the first half of each year accounted for outflows of $58.1 million and $74.7 million respectively. For the same period in 1980, the oil import bill increased by 113.6% over 1979 to $159.6 million. Non-oil merchandise was also much higher in the first half of 1980 than in the same periods in 1978 and 1979. Non-oil merchandise imports at $220.5 million grew by 23.6% from the $178.4 million registered for the first half of 1979, and is much higher than the $152.7 million imported for the same period in 1978. While there is normally growth in the import bill in line with the growth in tourism, in 1980 the growth in receipts from tourism over the previous year amounted to only $35.5 million compared with the growth in all merchandise of $127.0 million. In fact, from 1978 to 1980 tourist receipts grew by 20% while oil imports soared by 132% and non-oil imports by 47.9%. Even when allowance is made for a $55.9 million growth in oil imported for bunkering of foreign ships and aircraft, the growth in imports over the growth in tourism expenditures for this period amounts to $35.6 million.

An analysis of the current account positions for the first quarters does not indicate a favourable outlook for 1981. The current account showed a surplus of only $10.4 million, compared with $50.1 million in 1980, $43.4 million in 1979 and $39.4 million in 1978. Again the high level of imports, $68.8 million as against $45.4 million in the first quarter of 1980 is the primary source of pressure. It should be noted that oil import payments at $63.5 million were down from the $72.0 million recorded in the first quarter of 1980. However, this decline was entirely in foreign bunkers as imports for domestic consumption increased over the first quarter of 1980 by $1.4 million (5.5%) to $26.9 million. Note should also be taken of the decline in tourist receipts which stood at $163.8 million or 8.3% lower than a year earlier. In addition, net outward factor payments were higher at $41.1 million, compared with $27.9 million a year ago.

While most of the adverse developments in the balance of payments since 1978 were concentrated in the current account, it is noteworthy that the capital account while suffering from reduced inflows overall at least appeared to have leveled off especially in the areas of property purchase and commercial banks' foreign indebtedness. First quarter 1981 saw a surplus on capital account of $14.2 million compared with deficits of $17.1 million and $20.0 million for the same periods in 1979 and 1980 respectively. Property purchases by foreigners accounted for a net inflow of $1.1 million in the first quarter of 1981 as against an outflow of $10.2 million in the first quarter of 1980 and a net inflow of $2.3 million in the first quarter 1979. The banking sector increased its net foreign indebtedness by $13.3 million compared with a reduction in this position of $11.7 million and $7.6 million in the corresponding periods in 1979 and 1980. The more important factors contributing to the pressure on the balance of payments will be discussed in the next section.

TABLE V

QUARTERLY BALANCE OF PAYMENTS 1978 - 1981

	1978				1979				1980				1981
	Qtr.I	Qtr.II	Qtr.III	Qtr.IV	Qtr.I	Qtr.II	Qtr.III	Qtr.IV	Qtr.I	Qtr.II	Qtr.III	Qtr.IV	Qtr.I
CURRENT ACCOUNT	39.4	14.1	10.3	-30.5	43.4	3.0	- 4 2	-37.3	50.1	-13.2	- 7.9	- 55.2	10.4
Non oil Merchandise Trade	-35.0	-57.8	-33.6	-63.3	-47.2	-51.6	-54.2	-89.6	-45.4	-72.3	- 68.1	-111.2	-68.8
Exports (f.o.b.)	(32.7)	(27.2)	(40.1)	(46.4)	(36.8)	(42.8)	(43.1)	(47.8)	(54.0)	(48.8)	(53.0)	(44.7)	(41.6)
Imports (f. o. b.)	(-67.7)	(-85.0)	(-73.7)	(-109.7)	(-84.0)	(-94.4)	(-97.3)	(-137.4)	(-99.4)	(-121.1)	(-121.1)	(-155.9)	(-110.4)
Net Oil Trade	-24.8	-33.3	-34.3	-35.9	-33.7	-41.0	-44.0	-58.1	-72.0	-87.6	-68.4	- 68.6	- 63.5
Travel (Net)	123.5	109.3	94.8	106.2	143.7	115.3	112.7	136.4	160.2	121.9	124.2	118.5	145.4
Receipts	(140.5)	(121.1)	(115.3)	(117.9)	(155.2)	(126.4)	(131.3)	(148.8)	(178.6)	(138.5)	(144.8)	(133.6)	(163.8)
Payments	(-17.0)	(-11.8)	(-20.5)	(-11.7)	(-11.5)	(-11.1)	(-18.6)	(-12.4)	(-18.4)	(-16.6)	(-20.6)	(-15.5)	(-18.4)
Local Expenses of Offshore Companies	14.1	15.9	16.4	15.6	16.3	15.8	16.5	22.7	32.2	35.7	24.3	27.1	43.5
Other Services (Net)	-32.3	-15.8	-26.8	-49.2	-35.2	-30.9	-30.6	-44.6	-15.5	- 8.1	-16.2	-23.7	-42.4
of which interest, dividends & Profits (Net)	(-25.0)	(-21.8)	(-22.5)	(-55.1)	(-31.7)	(-28.5)	(-26.7)	(-38.7)	(-27.9)	(-31.7)	(-26.3)	(-31.0)	(-41.1)
Transfers (Net)	- 6.1	- 4.2	- 6.2	- 3.9	- 0.5	- 4.6	- 4.1	- 4.1	- 9.4	- 2.8	- 3.7	- 2.7	- 3.8
Private	(- 6.2)	(- 4.1)	(- 6.6)	(- 5.3)	(- 0.8)	(- 5.6)	(- 4.8)	(- 4.6)	(- 9.7)	(-3.2)	(- 3.9)	(- 3.9)	(- 3.8)
Official	(-0.1)	(-0.1)	(-0.4)	(-1.2)	(-0.3)	(-1.0)	(- 0.2)	(- 0.5)	(-0.3)	(-0.4)	(-0.2)	(-5.6)	(-)

TABLE VI

QUARTERLY BALANCE OF PAYMENTS 1978 - 1981

	1 9 7 8				1 9 7 9				1 9 8 0				1 9 8
	Qtr.I	Qtr.II	Qtr.III	Qtr.IV	Qtr.I	Qtr.II	Qtr.III	Qtr.IV	Qtr.I	Qtr.II	Qtr.III	Qtr.IV	Qtr.I
CAPITAL ACCOUNT	1.5	5.3	- 5.2	- 27.9	- 17.1	- 18.4	4.4	- 29.4	- 20.0	9.1	16.6	8.4	14.2
Private Sector	5.3	7.7	- 2.9	- 25.8	- 16.1	- 15.5	3.4	- 27.2	- 16.7	10.8	19.7	- 2.0	18.1
Private long term (Net)	1.6	- 2.0	- 4.0	- 12.3	- 4.4	9.5	7.8	- 9.4	- 9.1	7.1	14.8	- 5.2	4.8
Property purchase	(4.3)	(2.7)	(0.7)	(-10.0)	(2.3)	(5.3)	(7.1)	(-6.6)	(-10.2)	(-0.6)	(10.4)	(-)	(1.1)
Other Investments	(1.6)	(-2.2)	(-2.0)	(-3.5)	(-)	(0.3)	1.4	(-0.2)	(-0.3)	(0.9)	(7.0)	(-3.1)	(3.9)
Long term loans	(-4.5)	(-2.5)	(-2.7)	(-5.8)	(-6.7)	(3.9)	(-0.7)	(-2.6)	(1.4)	(6.8)	(-2.6)	2.1)	(-0.2)
Commercial Banks and Other Financial Institutions (Net)	3.7	9.7	1.1	- 13.5	-11.7	6.0	- 4.4	- 17.8	- 7.6	3.7	4.9	3.2	13.3)
Public Sector (Net)	- 3.8	- 2.4	- 2.3	- 2.1	- 1.0	2.9	1.0	- 2.2	- 3.3	- 1.7	- 3.1	10.4	- 3.9
Public Corporations	(- 2.1)	(- 1.3)	(- 0.8)	(-0.7)	(1.1)	(4.0)	(3.1)	(0.2)	(-1.1)	(- 0.6)	(- 0.5)	(12.4)	(- 1.6)
Central Government	(- 1.7)	(- 1.1)	(- 1.5)	(-1.4)	(- 2.1)	(-1.1)	(-2.1)	(-2.4	(-2.2)	(- 1.1)	(- 2.3)	(- 2.0)	(- 2.3)

Section III

Rising import prices for oil and non-oil merchandise have accounted in large part for the pressure on the balance of payments in recent years. Oil prices have risen sharply since 1978 as shown in Tables VII and VIII.

TABLE VII

NET OIL IMPORTS

	1978	1979	1980
Value (B$ Millions)	54.75	93.81	126.26
Volume (Millions of Barrels)	3.48	4.00	3.67
Average Price (B$ per Barrel)	15.73	23.45	34.41

TABLE VIII

ANNUAL % CHANGE IN PRICES AND VOLUME OF OIL

		1978	1979	1980
Propane	V	5.2	14.9	7.8
	P	-17.1	23.9	36.4
Motor-gasoline	V	12.8	11.0	- 4.2
	P	2.0	55.6	37.9
Aviation Gasoline	V	35.5	-	- 2.4
	P	5.7	52.0	61.1
Kerosene (Jet Fuel)	V	10.2	4.9	30.2
	P	1.9	70.9	48.5
Bunker "C"	V	63.0	20.4	-19.1
	P	-16.2	53.0	38.3
Gas Oil	V	5.9	12.9	6.0
	P	3.2	55.6	38.3
Lubricants & Other	V	266.0	6.1	2.9
	P	-38.3	14.7	29.8

V=Volume
P=Price/bbl
Source: Oil company reports

The impact of rising oil prices on the balance of payments since 1977 may be estimated by expressing the value of oil imports in 1977 prices. In the absence of an import price index to deflate non-oil imports, the most appropriate deflator that may be used is the index of finished consumer goods in the wholesale price index for the United States, from which over 70% of the country's non-oil imports originate. Table IX provides crude estimates of the impact of rising oil and non-oil import prices on the balance of payments since 1977.

TABLE IX

(B$ Millions)

	1978	1979	1980
Oil Imports: Domestic Consumption	54.7	93.8	126.3
Oil Imports in 1977 prices ($16.11/BBL)	56.0	64.5	59.1
Increase due to price	-1.5	29.3	67.2
Non-oil imports	336.1	413.1	497.5
Non-oil imports in 1977 prices	312.1	345.3	367.2
Increase due to price	24.0	69.8	130.3

With the rise in the price of imports, larger amounts of foreign exchange are needed to meet the cost of a fixed quantity of goods. Even fewer imports would still lead to increased outflows of foreign exchange since the demand for imports is inelastic. This higher import bill will be passed on in the form of higher cost to tourists for goods and services. This price mechanism, aside from operating with a lagged effect will cause serious disruptions to those areas which are relatively price elastic. Higher prices for touristic goods and services will have an adverse impact on the balance of payments owing to a loss of competitiveness to other destinations which are able to avoid or absorb rising import prices. The Bahamas must ensure, therefore, that it maintains its competitive edge in this all important area.

The level of real income in the home countries or prospective visitors is another exogenous factor which affects The Bahamas balance of payments. Table X provides data on tourism volume (thousands of days), tourist expenditures and the growth in real incomes in the United States which accounts for some 75% of the total stopover visitors.

TABLE X

	1975	1976	1977	1978	1979	1980
Total number of visitors ('000)	1324.3	1344.5	1244.2	1532.8	1605.6	1758.9
Total visitor expenditure (B$ Mns)	317.5	368.0	412.4	494.7	561.7	595.5
Number of stopover visitors ('000)	903	940	891	1083	1129	1181
Stopover visitor expenditure (B$ mns)	298.5	351.4	394.8	472.2	536.9	563.7
Total visitor days ('000)	6228	6310	6721	8192	8592	9141
% Change in total visitor expenditure	- 3.3	15.9	12.1	20.0	13.5	6.0
% Change in Stopover visitor expenditure	- 3.9	17.7	12.4	19.6	13.7	5.0
% Change in visitor days	- 3.9	1.3	6.5	21.9	4.9	6.4
% Change in U.S.A. Real G.N.P.	- 1.1	5.4	5.5	4.8	3.2	- 0.1

Source: I.F.S. and Bahamas Ministry of Tourism.

An increase in real incomes should lead, a priori, to an increase in demand for tourist services on the assumption that people will have more money available for travel. Conversely, when incomes decline it is expected that this will have an adverse impact on travel, hence on the level of tourist expenditure.

From Table X it may be seen that the Bahamas experienced negative growth in its tourism sector in 1975 with total visitor days off by 3.9% and total expenditure off by 3.3%. This decline coincided with the 1.1% decline in real G.N.P. in the United States. With the recovery in the growth of real incomes in the United States, the tourist sector in The Bahamas picked up significantly with annual growth in total visitor expenditure of 15.9%, 12.1% and 20.0% from 1976 to 1978 respectively. The robust growth in visitor expenditure in 1978 may be explained by the increase in visitors from destinations other than the United States. Total visitor expenditure growth slowed to 13.5% in 1979 reflecting a slowdown in the growth of real G.N.P. in the United States to 3.2%. The growth in tourist expenditure in 1980 was sharply reduced to 6.0% as the U.S. economy declined by 0.1%. The outlook for 1981 continues to be overshadowed by forecasts of economic recession in the major industrial countries. Also the depreciation of the European currencies against the dollar is expected to adversely affect tourist traffic from the European market.

The unfavourable effects of these external influences on the balance of payments was undoubtedly compounded by the growing interest rate differential between domestic interest rates and interest rates abroad. Table XI shows the shift in the mix of outstanding bank credit from foreign currency to Bahamian dollars in the wake of the widening interest rate spread. This shift became evident in the second half of 1978.

TABLE XI

LOANS AND ADVANCES OF COMMERCIAL BANKS TO THE PRIVATE SECTOR

	Total	In Foreign Currency	In Bahamian Dollars	Proportion of Foreign Currency Loans	Interes Rate Spread
	(In millions of Bahamian $)			---(In per cent)---	
1976 - IV	259.7	90.8	168.9	35.0	4.2
1977 - IV	282.1	100.1	182.0	35.5	2.4
1978 - I	277.4	97.0	180.4	35.0	2.2
II	298.1	110.2	187.9	37.0	1.7
III	302.3	108.0	194.3	35.7	0.8
IV	306.1	101.1	205.0	33.0	-1.6
1979 - I	301.1	94.2	206.9	31.3	-1.4
II	309.8	89.2	220.6	28.8	-1.6
III	323.7	87.4	236.3	27.0	-2.7
IV	343.3	79.7	263.7	23.2	-5.7
1980 - I	349.9	77.2	272.7	22.1	-6.1
II	360.1	73.3	286.8	20.4	-0.2
III	367.2	72.2	298.1	19.7	-1.1
IV	395.1	76.2	318.9	19.3	-6.1
1981 - I	389.1	65.4	323.6	16.8	-5.3

1. Spread calculated using the local prime lending rate and the three-month Eurodollar rate.

By the end of 1979, Bahamian dollar credit had grown by 28% while foreign currency credit declined by 20%. During this same period, the interest rate spread between the local prime rate and the 3-month Eurodollar rate moved from a positive 2.2% to a negative 5.7%. During 1980, the spread fluctuated from a high of 6.1% to a low of 0.2%. During this period foreign currency loans remained fairly constant. Bahamian dollar credit expanded by 20% while Bahamian dollar credit increased by 1.5% in the first quarter of 1981 and foreign currency credit declined by 14.2% as the interest rate spread widened by 5.3%. This rapid expansion in Bahamian dollar credit was directly reflected in an increased demand for imports while the repayment of foreign currency credit had a negative impact on reserves.

The impact of the widening differential between foreign interest rates and Bahamian dollar rates on the financial assets of the private sector, although difficult to measure, was discernable from the deceleration in the growth of commercial banks' Bahamian dollar liabilities in the second half of 1979. Table XII gives an indication of the impact of the interest rate differential on the asset side using as representative rates that paid on local 3 month Bahamian dollar fixed deposits and the U.S. Treasury Bill rate. The table also shows changes in the Bahamian dollar deposit liabilities of commercial banks.

TABLE XII

BAHAMIAN DOLLAR DEPOSIT LIABILITIES OF COMMERCIAL BANKS

		Total	Demand	Savings	Fixed	3-Month Fixed Deposit	U.S. Treasury Bills	Spread
1976	IV	214.5	55.5	48.8	110.2	6.52	4.68	1.84
1977	IV	235.6	64.2	54.6	116.8	5.69	5.47	0.22
1978	I	243.1	69.0	58.8	115.3	5.48	6.41	-0.93
	II	249.3	69.5	63.2	116.6	5.71	6.48	-0.77
	III	257.2	73.9	65.5	117.8	4.95	7.32	-2.37
	IV	267.0	77.2	66.5	123.3	5.06	8.68	-3.62
1979	I	278.0	87.0	74.3	116.7	5.10	9.36	-4.26
	II	294.6	95.5	80.0	119.1	4.87	9.38	-4.51
	III	311.6	99.8	80.6	131.2	4.83	9.63	-4.80
	IV	319.1	102.0	83.0	134.1	4.64	11.80	-7.16
1980	I	341.9	106.9	89.0	146.0	6.64	13.46	-6.82
	II	339.9	99.8	93.4	146.7	6.91	10.05	-3.14
	III	358.5	98.5	94.2	165.8	7.03	9.24	-2.33
	IV	367.9	99.6	94.6	173.7	7.74	13.71	-5.97
1981	I	372.4	104.5	99.4	168.5	7.90	14.37	-6.47

The rate moved in favour of U.S. bills with a spread of 0.93% in the first quarter of 1978 to 7.16% in the last quarter of 1979.

Commercial banks' Bahamian dollar liabilities rose by 5% in the first half of 1979 compared with 11% and 8% in the first and second half of 1978 respectively. It should also be borne in mind that a significant portion of the growth in these deposits particularly fixed deposits resulted from the mobilization of the National Insurance Board's surplus funds, the exclusion of which would be reflected in a marked slowdown in deposit growth.

The differential in interest rates in favour of Bahamian dollar liabilities and foreign assets prompted the authorities in February 1980 to raise the prime rate to 11% from 9%. Other lending and deposit rates also moved up. However, while this move did provide for an easing of the tight liquidity position of the commercial banks, the respite was only temporary as interest rates in the United States continued to soar. Although local rates on 3-month fixed deposits moved up in 1980, the interest rate spread in favour of assets such as the U.S. Treasury Bills, though reduced from the 7.16% recorded in the last quarter of 1979, was still sufficiently large (averaging 4.57% in 1980) to be attractive. Short term capital movements normally tend to move in line with a growing interest rate differential and the movements in commercial banks' net foreign indebtedness as shown in Table III provides some evidence of this as the banks reduced their dependence on foreign funds for domestic asset creation.

Section IV

In considering policy tools available to the authorities for easing balance of payments pressure it has to be kept in mind that The Bahamas cannot avail itself of exchange controls on current account payments or exchange rate adjustments by virtue of the fact that it is an Article VIII member of the International Monetary Fund, and it has opted for a fixed exchange rate system with parity to the United States dollar since trade with the United States accounts for some 75% of its total trade. This leaves essentially two methods of adjustment, namely, interest rate variations and domestic absorption restraints. It was mentioned earlier that in February 1980 the prime rate was raised by 2 percentage points; at this time the Central Bank asked commercial banks to reduce loans to customers for carrying large inventories. The Central Bank also halted Exchange Control approvals for prepayments of foreign currency debt. While the raising of the local prime rate by 2 percentage points in February 1980 was designed to ease the balance of payments pressure on the premise that the interest rate differential was an important initiating factor, the upward adjustment was not large enough to have the desired effect of narrowing the differential owing to the continued upward movement of foreign rates. The policy option of increasing domestic interest rates poses certain internal problems which must be carefully weighed against the advantages derived from achieving balance in international payments and a healthy foreign reserves position. The choice of an appropriate level and structure of interest rates raises certain social and political questions. In developing countries one of the implicit assumptions of economic policy seems to be the desirability of financing long term development programmes with low interest rates. However, the notion that low, stable rates are normal is becoming increasingly inappropriate in such countries where relative prices including interest rates must necessarily reflect the scarcity of factors and goods.

An increase in domestic interest rates should mobilize domestic savings and increase the supply of loanable funds which would stimulate production in the long run and direct idle resources in more productive, efficient areas. Higher interest rates will also combat the problem of under-utilization of capital because it forces existing and newly acquired capital goods to be used more efficiently. The favourable short run effects of high domestic interest rates would be reflected in a steady growth in international reserves as the excessive demand for credit and for imports of consumption goods ease and as savers increase investment in local assets.

However, an increase in domestic interest rates does raise certain problems for the domestic economy. Sectors which are credit - sensitive such as agriculture, low cost housing, small hotel operations and other small business will be adversely affected. The concern is that economic growth will be hampered as investment falls, unemployment rises and inflation increases. Furthermore, there has been little or no empirical evidence in developing countries to support the proposition that high domestic interest rates will attract an inflow of capital. In developing countries like The Bahamas, political stability appears to be the most important factor in attracting short term or long term capital inflows. There is also the concern that high interest rates will be built into the cost structure and fuel inflation and thereby further erode the real return on financial assets.

The social implications of high interest rates must also be considered. In the short run the lower level of consumption that will result from increasing interest rates may raise social discontent as consumers are forced to not only reduce their consumption level but also bear the burden of higher prices passed on to them by businesses. A further argument against higher domestic interest rates is that it will increase the cost of Government borrowing, the level of which is considerably higher in developing countries. However, one may argue that it may not be feasible or desirable to allow the Government to enjoy low rates of interest when capital is scarce as this promotes wasteful investment and tends in the long run to promote inequality in income distribution.

Since at present The Bahamas has no other significant source of foreign exchange earnings besides tourism and because an increase in tourism leads to an increase in demand for imports, it is the trade account which must bear the brunt of adjustment. The production of domestic goods such as food grains, fruits, vegetables, poultry, meat,beverages, etc. to service the tourist industry and meet domestic demand would result in a substantial saving of foreign exchange. In this vein, efforts are being made to stimulate agricultural production, food processing and canning, garment manufacture, light engineering and metal and plastic fabrication. These efforts include the development of agricultural services such as the provision of freezing, storage and handling facilities and the dissemination of marketing information. The Development Bank and the Development Corporation have been established with a view to providing finance and initiative for the development of commercial and industrial ventures. The objectives of these actions are the achievement of self-sufficiency in food production by increasing the rate of growth of domestic agricultural output. The aim also to develop and expand the industrial base of the economy.

As regards interest rates, it is no coincidence that the pressure on the balance of payments occurred in a period of rising interest rates internationally. However, interest rates have not been the sole cause of this deterioration, hence an increase in interest rates may not be a panacea. The appropriate overall policy should be based on a delicate balancing of rates realistic enough to stimulate savings but not so high as to hinder investment in productive areas. It is the policy of the Central Bank to ensure the availability of reasonably priced commercial credit and to discourage consumptive uses of credit. In this regard, it is the view of the Central Bank that it is not prudent to increase local interest rates, as the disadvantages to internal equilibrium would not warrant the gains to external equilibrium especially as the Bank is not clearly able to identify the impact of interest rates.

Although it is expected that the current account will come under pressure in 1981 owing to cyclical fluctuations in the United States economy and large capital imports associated with the anticipated rise in domestic investment, the situation is not intractable. In fact, recent moves clarifying and revising the proposed legislation on the disposition of land to foreigners, and the restraint of Government expenditures should offset to some degree other unfavourable impacts on the balance of payments.