# The Barbados Economics Society

*Response to the Central Bank's 2018 Mid Economic Review*

*Sentiments of the BES President, Mr. Shane Lowe*

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Issue 1

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## Response to the Central Bank's 2018 Mid Economic Review

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## Summary

On August 2nd, 2018, the Governor of the Central Bank of Barbados, Mr. Cleviston Haynes updated the country on the economy's performance during the first six months of 2018. While not surprising, key policy decisions undertaken in June 2018 have substantially altered trends in the Government's foreign exchange reserves and fiscal balance; however, economic growth remains weak and the stock of foreign exchange reserves falls short of that measured by regional and international standards.

The economy contracted by 0.6% during the first half of the year, as more tourists stayed for shorter periods and reduced tourism's contribution to overall economic activity. This persistent decline remains a general cause for concern, as despite attracting 3.4% more long-stay tourists during this period, total spending by tourists merely increased by 1.4%. Several indicators also point to a reduction in both domestic and foreign direct investment. In particular, construction output fell by 4.0% over the review period. The government spent 16% less on capital projects during April – June 2018, while despite greater spending on fuel imports, capital and intermediate imports fell by 7.3% and 4.7% respectively during the first half of the year. Private capital inflows, which capture physical investment by non-residents, fell by 10% during January – June 2018 and has continued on a steady downward trajectory since 2014.

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A major concern over the last 5 years has been the persistent decline in the country's stock of foreign exchange reserves. Reserves fell from 20 weeks of import cover at the end of 2012 to about 7 weeks of cover at the onset of the Central Bank's last report for the first quarter of the year. Since then, the government's decision to suspend interest and principal payments on foreign government debt has stabilized reserves at 7 weeks of import cover pending the completion of comprehensive debt restructuring negotiations and access to IMF and other development banks' financing. In the interim, the government has lost complete access to most private sources of financing and was therefore primarily dependent upon Central Bank of Barbados financing to fund its small deficit during the second quarter of the year. This source of funding is unsustainable. Thus, the government should match expenditures with tax revenues to eliminate the need for additional domestic borrowing in the medium-term. Even though the mini-budget presented on June 11th, 2018 aims to achieve this objective, additional expenditure cuts are necessary to reduce the 155% of GDP debt burden over time.

Consistent with weaker economic activity, the average unemployment rate increased marginally to 10% by March 2018. This coincided with a modest increase in commercial banks' ratio of non- performing loans to total loans relative to the end of 2017. Further, despite low deposit rates and falling lending rates, commercial banks' holdings of excess funds increased over the past two years on account of faster growth in domestic deposits relative to lending to the private sector. Commercial banks' profitability has therefore declined over this period, and this trend will likely continue for the foreseeable future given the Central Bank's negative projection of economic growth for 2018 and the planned restructuring of commercial banks' holdings of government securities.

Going forward, the amicable completion of debt restructuring negotiations with creditors to reduce debt service requirements whilst maintaining the viability and stability of the financial system should complement prioritized cuts in government's recurring, non-interest expenditure. If executed correctly and in conjunction with entry into an IMF programme, these measures should begin to restore investor confidence in Barbados and reverse the upward trend in the government's debt. Any subsequent rebound in economic growth will depend on a reversal of downward trends in domestic and foreign investment since austerity measures will likely keep household consumption subdued in the short-term. Access to foreign financing should also boost foreign reserve levels in the near- to medium-term and therefore provide some buffer against external shocks.