The Barbados Economics Society

Response to the Central Bank's May 2nd Review of the First Quarter

Sentiments of the BES President Mr. Shane Lowe

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Summary

On May 2nd, 2018, Governor of the Central Bank of Barbados, Mr. Cleviston Haynes updated the country on the economy's performance during the first quarter of 2018. The general performance of the economy continued on its recent trends: fiscal contraction, weak economic growth, year-on-year declines in foreign exchange reserves and greater debt accumulation. The Government reduced its fiscal deficit to $395 million or 4.2% of GDP during 2017/2018, but this remains significantly below its initial target of a balanced budget announced during the May 30th, 2017 Financial Statement and Budgetary Proposals. Specifically, higher and new taxes along with a 28% reduction in the government's spending on capital works and infrastructure narrowed the deficit from 5.7% of GDP recorded one year earlier. Nevertheless, the Government's debt-to-GDP ratio rose to 150.5% of GDP given the need to finance the fiscal deficit mentioned earlier.

While ongoing austerity measures have succeeded in reducing the Government's financing needs and slowing the growth in demand for imported goods, it has contributed to virtually no growth in economic activity since June last year. Economic activity declined 0.7% in the first quarter compared to its performance during the same period of 2017. While the number of stay-over tourists increased by 5.8%, the persistent trend of faster growth in visitors from North America than from the generally more lucrative U.K. market reduced the average number of nights tourists spent in Barbados and limited the increase in spending to just 2.1%. The other economic sectors

The economic performance in the First Quarter of 2018 is characterized by fiscal contraction, weak economic growth, declining foreign reserves and greater debt accumulation.

Austerity measures imposed contributed to little growth in economic activity since June 2017.

increased by just 0.1%, continuing the trend observed in 2017 where the economy recorded virtually no growth during the latter half of the year: activity in distribution, construction, and finance and other services remained relatively unchanged.

Of greatest interest is developments in the Central Bank's stock of foreign exchange reserves. The stock of reserves increased by $13.6 million between December 2017 and March 2018 to $423.3 million or enough to cover 6.9 weeks of imported goods and services. This represents slower growth than the $25.8 million rise recorded over the same period one year earlier and a 40% deterioration in the stock of reserves between March 2017 and March 2018. Even though the country continues to benefit from greater earnings from tourism and demand for imports remains weak, declining inflows of foreign investment and large external debt payments continue to stifle the economy's ability to reverse the downward spiral in foreign exchange. Specifically, long-term, private financial inflows during the first quarter of this year declined for at least the 3rd consecutive year and are now 73% lower than they were in the first quarter of 2015. Similarly, the Government repaid $92 million to foreign lenders during January – March 2018 compared to just $35 million one year earlier.

BES Position

Going forward, the country's major challenges will be to eliminate the fiscal deficit and to reverse the declining trend in foreign exchange reserves. Given the large cuts to capital expenditure witnessed over the last few years; the need to boost capital works to enhance road, transportation and sewerage infrastructure; and very few sources of financing, the Government will need to cut current expenditure and/or raise tax revenues in excess of the existing $395 million to close the fiscal gap - if it intends to sustainably balance the budget and provide enough room to finance necessary infrastructure upgrades. One-off asset sales will not provide a sustainable fix to the problem.

Furthermore, given the already weak outturn recorded in typically one of the most buoyant quarters of the economic calendar, additional tax measures and/or substantial cuts to expenditure could further push the Barbadian economy back into recession unless private sector investment rebounds during the latter three quarters of the year. Renewed investor confidence and improved conditions for doing business are necessary to enable economic recovery. The Social Partnership worked well during previous downturns in the economy, and it is critical that this body be meaningfully engaged to address the challenges facing the economy.

Finally, the slow growth in foreign exchange reserves during the first quarter suggests that without substantial growth in private or public financial inflows, planned debt service payments will likely reduce the stock of foreign exchange reserves again for the 6th consecutive year. However, the planned placement of private sector foreign assets with the Central Bank and the announced sales of public assets for foreign exchange can help to stabilize the reserves in 2018, thereby mitigating further decline. However, these measures are one-off and depending on the size of the inflows, do not address future, large debt payments due during 2019 – 2022. It is therefore important that policymakers secure a cheaper and more sustainable source of foreign financing, likely for a period of 2 to 4 years, to stabilize foreign exchange reserves, to facilitate a sustainable reduction in the fiscal deficit, and to restore Barbados' International Credit rating to more credit-worthy status.