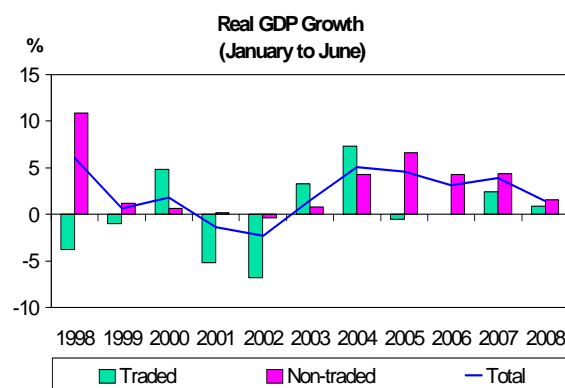


Review of the Economy

For the First Six Months of 2008

Overview

During the first six months of 2008, the pace of real economic activity in Barbados was constrained by persistently high international prices for oil and other major commodities, as well as the slowing global economy. Amid these external influences, the performance of the Barbados economy was uneven during the first half of the year. Revised first quarter growth of 2.6 % between January and March was followed by economic output, which was virtually flat in the following three months. As a result, total output growth was limited to an estimated 1.4%, an outturn significantly below the average rate of expansion of 3.6% registered during the corresponding period of the last five years.



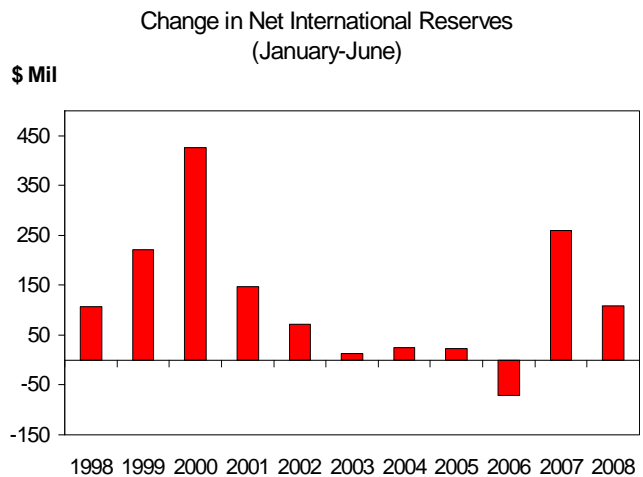
The reduction in the rate of economic expansion reflected slowdowns in both the traded and non-traded sectors. Non-traded activity grew by an estimated 1.6%, approximately 3 percentage points below the average increase in these sectors during the first half of the last five years. The estimated rise of slightly less than 1.0% in traded output, which resulted primarily from a creditable first-quarter

performance in tourism, was also significantly below the average rate of increase between 2003 and 2007.

An ever-present feature of economic activity during the six-month review period was the upward trend in domestic retail prices. In addition, the most recent labour market data for the first quarter of 2008 indicate that the unemployment rate was slightly higher than the comparable rate at the end of the first quarter of 2007.

The increase in payments for retained imports, particularly intermediate imports (mainly fuel), was substantially greater than for the corresponding period of 2007. These higher outlays on imports outweighed the modest increases in tourism receipts and domestic exports and contributed to a wider external current account deficit. However, despite recording a smaller surplus on the capital and financial account, relative to the significant first-half surplus in 2007, estimated net inflows for the period offset the deficit on the external current account, thereby leading to a rise of \$109.1 million in the

net international reserves (NIR) of the monetary authorities.

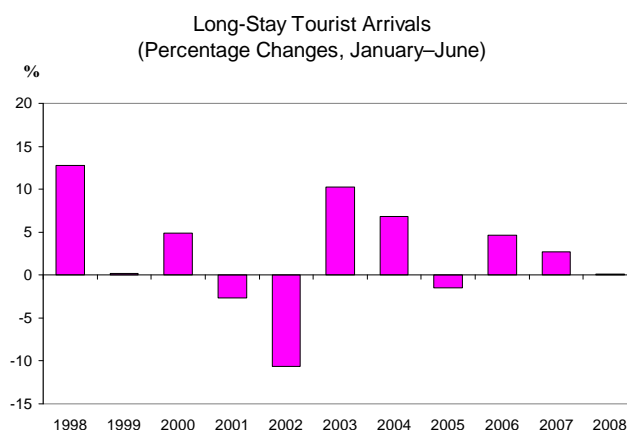


Another key development was that, with the rate of accumulation in domestic deposits at banks outpacing new bank lending, excess liquidity gradually rose over the course of the year. This surplus of funds in the banking system provided the main source of funding for the government's deficit.

Sectoral Analysis

Over the first six months of 2008, real tourism value-added rose by approximately 2.7%, compared with an increase of 3.1% in the corresponding period of 2007, as first-quarter tourism output growth of almost 13.0% was partially outweighed by an estimated decrease of 9.8% in the second quarter. This outturn largely reflects the pattern

of growth in long-stay arrivals over the first six months of this year compared to the first six months of last year when Barbados hosted Cricket World Cup matches. In the first quarter of 2008, long stay arrivals were up 10.8%, but second-quarter arrival figures declined by 11.3%. As a result, the number of long-stay visitors declined by 0.5% for the first half, in contrast to an increase of 2.7% for the similar period in 2007. Visitor arrivals out of the UK, Canadian and European markets grew by 2.3%, 5.1% and 17.4%, buoyed by the strength of their respective currencies vis-à-vis the US dollar. In addition, persons travelling from CARICOM countries (other than Trinidad and Tobago) rose by 13.9%, a turnaround from the 25.9% decline recorded in the first six months of 2007. In contrast, arrivals from the US fell by 1.1%, partly reflecting higher travel costs out of that destination and the US economic slowdown, while those coming from Trinidad and Tobago were down by 7.3%. The cruise-ship sector recorded higher passenger arrivals of 13.0%, which was on par with the rate of expansion recorded during the first six months of 2007.



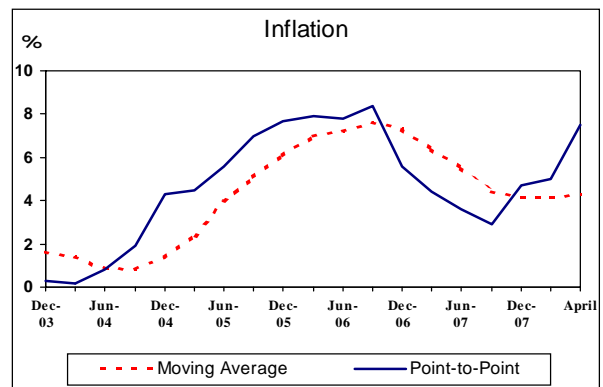
This year's sugar harvest yielded approximately 31,600 tonnes of sugar, some 2,300 tonnes less than the 2007 crop. Output in the non-sugar agriculture and fishing sector increased by 1.7%, resulting principally from higher fish catches and milk production of 6.5% and 2.1%, respectively. Manufacturing output dipped slightly, as the gains in the production of electronics and beverages and tobacco could not compensate for the fall in chemical production.

Between January and June 2008, 324 new licences were issued to international business and financial services companies, 18 more than in the equivalent period of 2007. The number of new international business companies granted licences was 264, or 56 more than in the first half of the

previous year. However, 34 fewer new licences were approved for societies with restricted liability, while two exempt insurance companies were given permission to commence operations, which was half the number during the similar period in 2007. No new offshore bank licences were issued, in contrast to the two licences granted in the comparable period of the preceding year. In addition, there were no new licences for exempt insurance management companies during the review period.

Activity in the construction sector fell by an estimated 6.7%, as several major infrastructural projects relating to Cricket World Cup 2007 were completed and there was a reduction in private residential and commercial real estate activity. The decrease in construction had a somewhat dampening effect on utilities production, with output of electricity, gas and water contracting by an estimated 1.4%. Output of the wholesale and retail trade, transportation, storage and communications, business and other services sectors grew moderately, with each industry rising by just over 3.0%.

At the end of April, the average rate of retail price inflation was 4.3%, up by 0.4 of a percentage point from the rate at the end of 2007. The point-to-point rate of inflation was much higher at 7.5%, approximately 3.6 percentage points above the comparable rate at end-April 2007. Over the review period, the major influences on domestic retail prices were the hikes in international oil, food and other commodity prices, as well as the removal of subsidies on petroleum products during the second quarter.

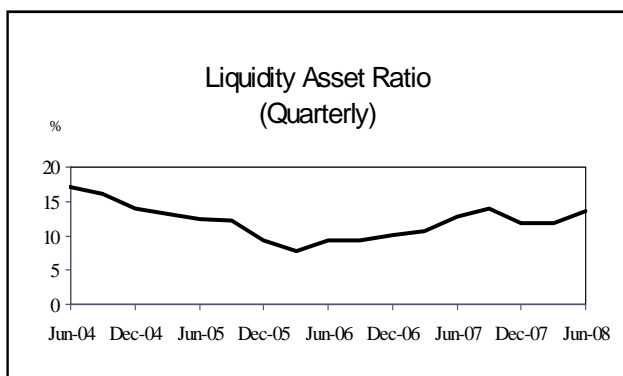


At the end of the first quarter of 2008, the unemployment rate stood at 7.9%, slightly higher than the rate at the end of the first quarter of 2007. The rate of unemployment among males decreased by 0.2 of a percentage point to 6.5%; however, female unemployment rose by 0.5 of a percentage point to 9.4%. Employment losses were recorded mainly in the manufacturing, wholesale

and retail trade and business services sectors.

Financial Sector

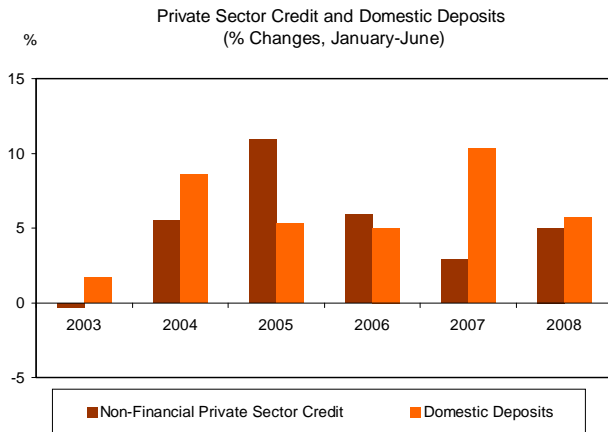
The banking system continued to experience elevated levels of excess liquidity. As at end-June, the liquid asset ratio stood at an estimated 12.7%, around 3.2 percentage points above the year-end figure. The expansion in liquidity reflected higher holdings of excess cash by commercial banks, as evidenced by the rise in the excess cash-to-deposit ratio to 5.0% from 2.2% as at the end of last year. The accumulation in excess liquidity stimulated an increased demand for short-term investments, which resulted in the downward pressure on the average discount rate on 3-month Treasury Bills. The discount rate fell by 0.7 of a percentage point to 4.16% as at end-June.



In an effort to signal the need for lower lending rates, primarily to the foreign exchange earning sectors, the Central Bank lowered the minimum deposit rate by 25 basis points to 4.50%, effective April 1, 2008. This rate cut along with the last modification in November last year brings the total reduction in the minimum deposit rate to 75 basis points. Between November 2007 and May 2008, the weighted average lending rate on all categories of commercial bank loans fell by 31 basis points to 10.38%, while the weighted average rate on total deposits has declined by 45 basis points to 4.45%.

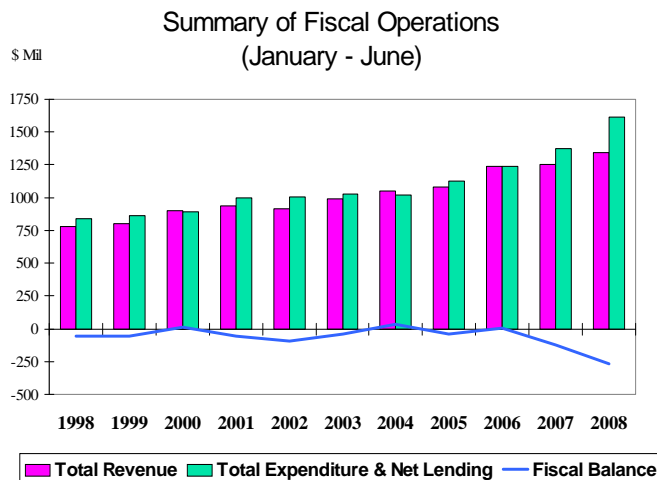
During the period under review, commercial bank credit to the non-financial private sector increased by roughly 5.0%, after growing by 2.9% in the similar period of 2007, on the strength of lending to the personal sector. Domestic deposits at commercial banks rose by 5.7% (\$421.4 million), which was considerably lower than the 10.3% expansion (\$649.8 million) reported in the first six months of 2007. The major increases in deposits were recorded for financial institutions, which augmented their deposits by \$119.1

million, while the deposit holdings of statutory bodies and central government were up by \$68.1 million and \$48.3 million, respectively.

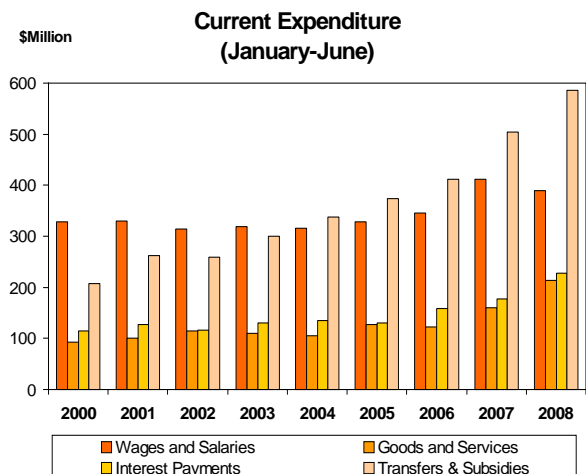


Fiscal Sector

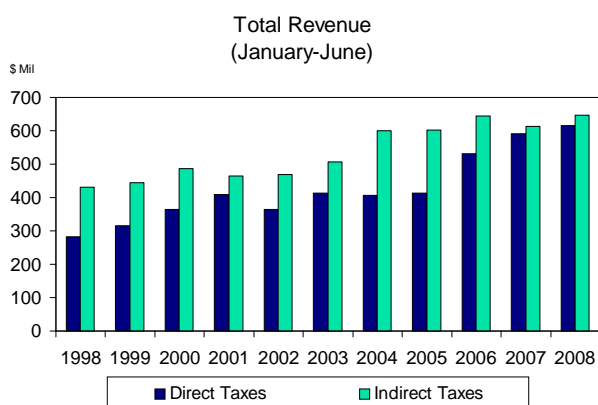
Preliminary estimates for the first six months of 2008 indicate that the central government recorded a larger fiscal deficit of \$294.3 million, compared with a deficit of \$142.9 million in 2007.



Total expenditure rose by almost 17.0% to \$1628.6 million, spurred by higher current and capital expenditure. Current expenditure grew by an estimated 14.5% or \$181.8 million between January and June of this year, mainly because of higher transfers and subsidies of \$84.3 million to the University of the West Indies, the Barbados Agricultural Development and Management Corporation and the Transport Board. In addition, spending on goods and services jumped by 41.5%, as some items of capital expenditure were reclassified and shifted to this category. Despite this reclassification, capital expenditure still increased by \$53.1 million, as work continued on the rehabilitation of the road network, including the expansion of the ABC Highway.



Total tax revenue grew by around 5.0%, buoyed by increases in both direct and indirect tax receipts. The rise in indirect tax revenues stemmed predominantly from higher collections of excise taxes (up 10.9%), import duties (up 12.8%), both reflecting the strong growth in the imports of intermediate goods, and value-added tax (VAT) receipts (up 1.9%). The intake of direct taxes rose by about 4.8%, as the 9.4% expansion in corporate tax receipts eclipsed lower property taxes (9.8%) and personal taxes (1.3%)



External Sector

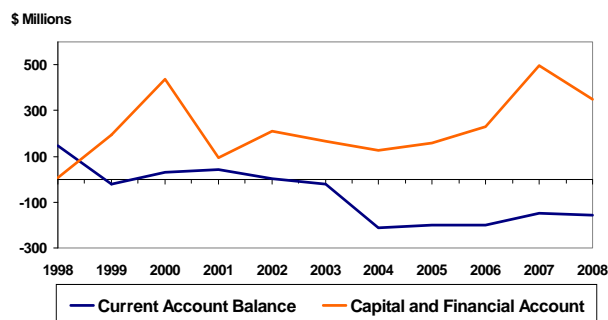
The external current account deficit was estimated at \$164.5 million, about \$16.5 million above the deficit registered in the first half of 2007. Spending on retained imports went up an estimated 10.5%, mainly attributable to an almost doubling

of the value of payments for intermediate imports, which were up by almost 36% or \$194.7 million, because of higher fuel prices. In contrast, imports of capital goods contracted by \$47.0 million, on account of declines in the imports of miscellaneous machinery and transport equipment.

Domestic exports rose by an estimated 2.9% or \$7.7 million, in contrast to a decline of 3.5% or \$9.1 million in the comparable period of 2007. Despite the lower production of raw sugar, export receipts from sugar were higher by roughly 6.0 and amounted to \$38.9 million. In addition, exports of electronic components and other manufactures increased by \$1.5 million and \$6.9 million, respectively.

However, mirroring the decline in the level of production, exports of chemicals fell 2.6% or \$0.8 million. Net receipts from services grew by 13.2%, principally the effect of a 10.3% increase in travel credits.

**BOP Current and Capital Account Balances
(January - June)**



The capital and financial account registered a surplus of \$349.7 million during the first half of 2008, approximately \$146.0 million less than the surplus reported in the same period of 2007. Net long-term public outflows totalled \$20.1 million, the result of higher amortisation payments of central government. Private sector net long-term inflows were estimated at about \$149.2 million, compared with \$221.8 million in 2007, as significant outflows for tourism-related loans to the private sector were recorded. Short-term inflows amounted to \$34.9 million, about \$33.6 million below the figure recorded in 2007, when there was a \$34.1 million bridging loan to the Grantley Adams International Airport.

Outlook for the Remainder of 2008

The outlook depends largely on the unfolding of key developments in the international economy, most importantly the degree of movement in international oil, food and commodity prices and extent of slowdown in Barbados' main trading partner economies. Barring no exacerbation of these downside risks, the current outlook is for real output growth in the range of 1.5% to 2.0%.

Notwithstanding an expectation of a continued decline in construction activity to pre-CWC levels, the non-traded sectors are still likely to remain the main sources of growth, although anticipated to expand at a reduced pace. In addition, although both long-stay and cruise arrivals are expected to moderate somewhat in light of the slowdown in the global economy and persistently high fuel and travel costs, tourism is anticipated to be the engine of the expansion in traded activity.

The projected dampening effect on real economic activity could lead to some unemployment, but the rate is expected to remain in single digits. Furthermore, the average rate of retail price inflation

is expected to be moderately higher than originally forecasted.

The external current account deficit is anticipated to be around 8.0% of nominal GDP by the end of 2008, approximately one percentage point above the ratio registered one year ago. This is principally because despite higher projected travel credits, payments for retained imports are expected to remain inflated by continued high food and fuel prices. In particular, imports of capital goods are anticipated to rise, in view of the construction of the Ash Handling System at Spring Garden and the new Electric Generation Station at Trents, St. Lucy.

The capital and financial account balance is not likely to be as strong as in 2007. Net long-term inflows for the private sector are likely to be weaker and sizeable outflows relating to loan payments and real estate are expected to continue during the latter half of the year. However, these developments are not projected to seriously impinge on reserve growth, as the NIR of the monetary authorities is forecasted to rise.

Commercial bank credit is likely to increase further during the remainder of 2008, as lending rates are expected to gradually fall in the coming months, thereby lowering borrowing costs and providing an incentive to borrow. However, the growth in domestic deposits is likely to decelerate, in view of the lower rates of return on deposits and weaker forecasted net long-term private capital inflows. These developments are not expected to reduce significantly the level of liquidity in the financial sector.

With regard to the fiscal accounts, increases in both current and capital expenditure are forecasted. In particular, capital expenditure should pick up as a result of the continuing ABC expansion project and the increase in outlays to government institutions for capital projects. Revenue generated from import duties and excise taxes is likely to rise, given the forecasted expansion in retained imports. In addition, the removal of the petroleum subsidies is likely to lead to a pick-up in VAT receipts, which in turn may aid in containing the fiscal deficit in 2008.

July 25, 2008