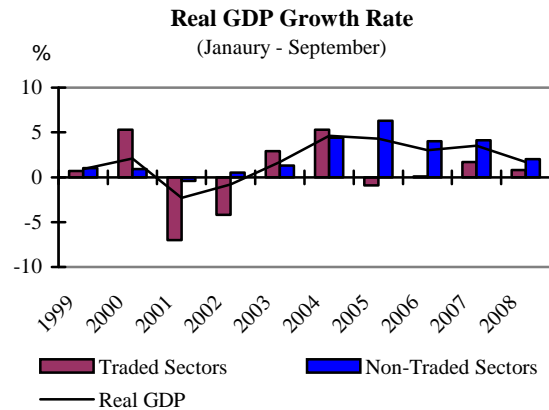


Review of the Economy for the First Nine Months of 2008

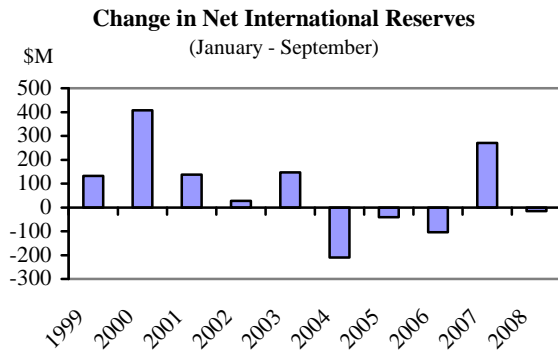
Overview

The deepening financial crisis that began in August 2007 hampered growth in global economic activity during the first nine months of 2008. This situation is evidenced by 1% expansion for advanced economies compared to 2.5% in 2007, as well as slower growth rates for major emerging markets. Ironically, this slowdown in global demand has had a somewhat stabilising effect on commodity prices, which fell by 20% between August and September, after steadily rising over the first seven months of the year.

The deceleration in the pace of global output contributed to the slowdown observed in the Barbadian economy over the January – September period of 2008, as reflected in real GDP growth of 1.7% compared to 3.5% in the same period of 2007. This outcome, which represents the slowest pace of expansion since 2003, was the result of slower growth in both the traded and non-traded sectors. As a result, unemployment also rose during the period and the situation was further compounded by rising inflation.



The higher price levels contributed to a deterioration in the external current account balance over the first nine months of 2008 compared to the corresponding period of the previous year. When coupled with significant capital outflows in the third quarter in particular, this led to a \$15.1 million decline in the net international reserves (NIR) of the monetary authorities during the period under review.



The \$129.1 million foreign reserve loss registered in the third quarter alone coincided with significant deposit withdrawals during that quarter and contributed to a slowdown in deposit accumulation for the year to date. Furthermore, when combined with a pick-up in credit growth relative to 2007, there was a moderate drain on liquidity during the quarter. Nonetheless, liquidity remained noticeably higher than at the end of 2007, boosted by a significant build-up in the first half of the year.

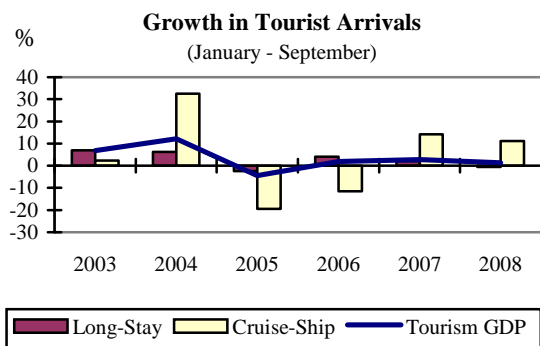
Consequently, the Central Government was able to rely on domestic sources for funding its operations, which, over the first nine months of 2008, yielded a deficit of roughly 3.4% of GDP, compared to 1.7% in 2007. This worsening of the fiscal position was driven by higher expenditure, as estimates for the period suggest a strong revenue performance.

Real Sector

The slowing global economy made its presence felt in the productive sectors of the economy. The hardest-hit sector was tourism, which suffered from the double impact of the threat of

recession in Barbados' main source markets following the financial turbulence there, and rising food and energy prices. Consequently, total long-stay arrivals are estimated to have remained flat over the first nine months of the year, despite a strong first quarter performance (10.8%). However, cruise passenger arrivals grew by 11.2% during the same period and this performance was sufficient to compensate for the lacklustre turnout in long-stay visitors. As a result, tourism value-added rose by an estimated 1.4%, half the growth rate recorded in the same period of 2007.

Data up to the end of August indicated that total visitor arrivals were roughly on par with 2007. With respect to individual markets, arrivals from the United Kingdom were marginally below the figure recorded in the previous year, reflecting economic pressures there. While counter-intuitively, visitors from the United States were only slightly higher. Visitors from Canada, on the other hand, posted a solid performance (5.6%) and this was supported by strong growth from Continental Europe (15.6%) and sustained arrivals from CARICOM (2.8%). Arrivals from the rest of the world, however, plummeted in 2008, registering a 33.8% fall-off, as this category returned to normal following the hosting of the Cricket World Cup in 2007.



A strong first quarter performance sustained the cruise ship industry for the year to date, as the growth in cruise passenger arrivals steadily declined throughout the second quarter and was relatively flat in the third quarter. This situation is linked to a reduced number of ship calls and replicates the situation that has prevailed since energy prices started to rise significantly in 2004. However, it must also be noted that some of the visitors to the Cricket World Cup in 2007 were housed in cruise ships and the absence of this phenomenon in 2008 would have had an impact on the number of cruise ship calls, especially in the second quarter.

Value-added from the sugar industry contracted by 6.9%, as the sector continued to reduce the acres of sugarcane planted in its ongoing struggle to realign itself following the removal of preferential trade arrangements. A significant increase in fish catches (36.7%), due to a good flying fish season, spurred output in the non-sugar agriculture and fishing sector, which recorded growth estimated at 3.0%, or 1.9 percentage points higher than in the corresponding period of the preceding year.

The growth in total output of the manufacturing sector in the January – September period of 2008 was sluggish, given the offsetting performances of key sub-sectors. Specifically, the production of electronics as well as beverages and tobacco was strong (up 6.9% and 5.7%, respectively), whereas the production of wooden furniture, other non-metallic mineral products and miscellaneous manufactured products continued to decrease (by 4.6%, 4.5% and 1.2%, respectively).

Although registering growth of 2.0%, less than half that averaged for the preceding four years, the combined performances of the non-traded sectors still managed to edge surpass that of the traded sectors.

The slowdown in non-traded activity stemmed primarily from declining construction activity and production of electricity, gas and water, although decelerations were noted for almost all of the other non-traded sectors. Indeed, the only sector that improved relative to 2007 was mining and quarrying, which benefited from the reactivation of onshore oil wells.

Construction activity and the production of electricity, gas and water decreased in line with the reductions in new commercial and residential real estate activity and some stalled economic activity on the West Coast as the global credit crunch put some international investors on pause. However, lower output from

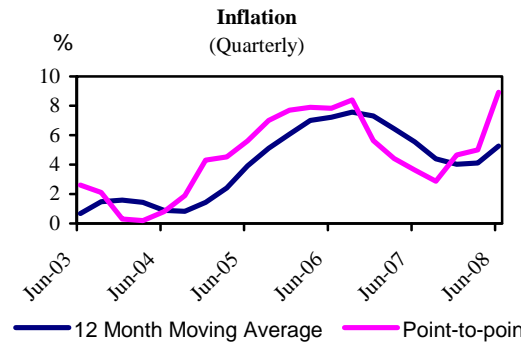
distribution, transportation, storage and communications as well as business and other services predominantly reflected general economic activity.

During the first nine months of 2008, 371 new licences were issued for international business companies, up from 334 in the same period of 2007. There were 75 new societies with restricted liability licensed (compared to 126 a year earlier). One new offshore banking licence was granted during the review period, compared to five new licensees in the similar period of 2007.

The slowdown in economic activity had a negative impact on employment levels, as reflected in an unemployment rate at the end of June 2008 of 8.6% compared to 6.7% at the end of December 2007 and 8.1% at the end of June 2007. The female unemployment rate rose from 9.1% in June 2007 to 9.4% in June 2008, while the male unemployment rate increased by a larger margin, from 7.1% to 7.8%, in the same period. Job losses were more concentrated in the utilities, construction and distribution sectors, whereas new jobs were created in financial and business services, transportation, storage and communications as well as tourism.

Inflation, as measured by a 12-month moving average, was 5.8% at the end of July, a decrease of 0.6 percentage points when compared to the end of July 2007. On the other hand, when

measured using the point-to-point rate, inflation was 10.2%, significantly above the 3.9% recorded in the comparable period of the previous year.



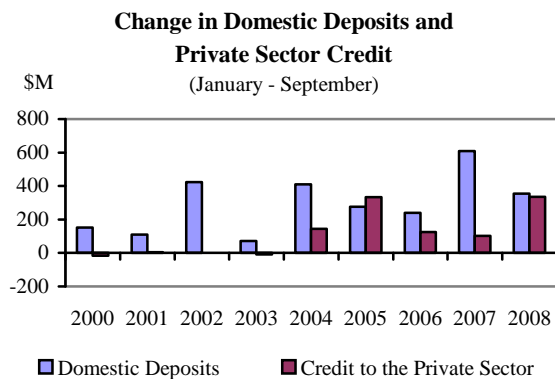
Financial Sector

Early indications are that the international financial crisis currently crippling many advanced nations has not translated into significant losses for commercial banks operating in Barbados to date. Although growth in the value of total assets of the banking system slowed relative to 2007, commercial banks continued to report steady increases in their asset base, growing by 5.3% compared to the 4.0% averaged over the corresponding periods of 2003-2006.

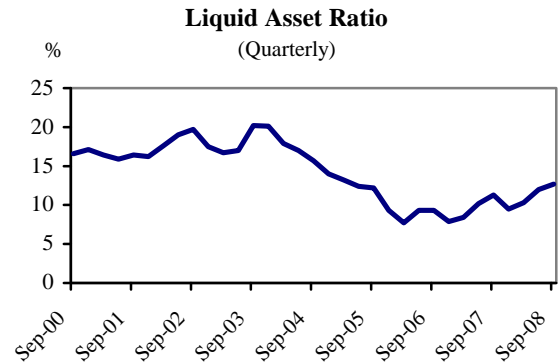
This increase stemmed from faster growth in credit to the non-financial private sector, which rose to approximately 7.4% at September 30th 2008 from 4.9% at the same point of 2007. Of particular note, oil and food distributors as well as construction firms sought additional commercial bank financing during 2008. With respect to other categories, loans to statutory bodies rose by 12.5%, credit extended to

financial institutions grew by 14.3%, while lending to central government fell by 14.6%.

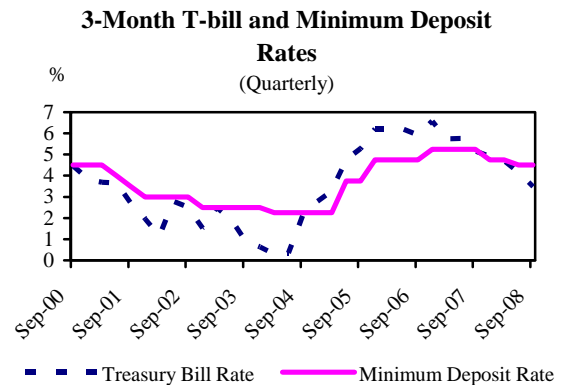
By the end of September 2008, domestic deposits were 5.7% higher than at the end of 2007, a rate that was 8.1 percentage points below that noted in the corresponding period of 2007. Although deposit accumulation has been slowing since the highs reached in 2007, it must be noted that there were net withdrawals of total deposits amounting to approximately \$232.3 million during the third quarter. These withdrawals were mainly on account of higher foreign capital outflows during that period and were reflected in a fall in total foreign currency deposits.



Liquidity in the banking system rose during the first nine months of 2008, as evidenced by a liquid asset ratio that was estimated at 2.0 percentage points higher than that for the end of December 2007.



The demand for liquid assets contributed to a lower average discount rate on 3-month Treasury Bills, 3.48% compared to 4.84% at the end of December 2007. Furthermore, the minimum deposit rate was lowered in April and these reductions set the stage for lower interest rates across the banking system during 2008.

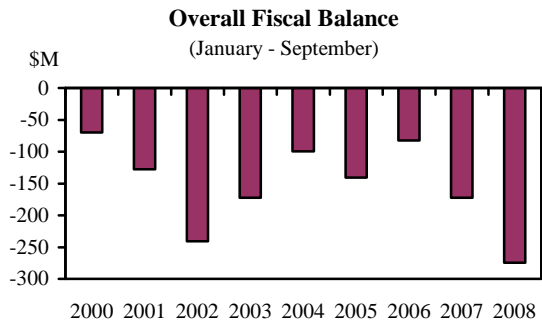


Public Sector¹

Preliminary estimates for the first nine months of the year suggested that central government operations yielded a larger fiscal deficit of 3.4% of GDP relative to 1.7% of GDP for the first nine months of the preceding year. This outcome was mainly attributed to higher current

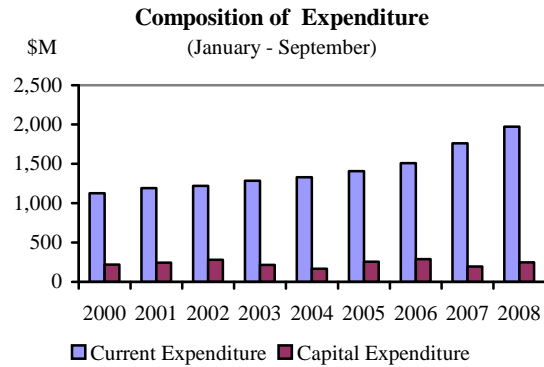
¹ Figures do not include off-budget expenditure.

expenditure, as revenue collections were higher in 2008 than in the preceding year.



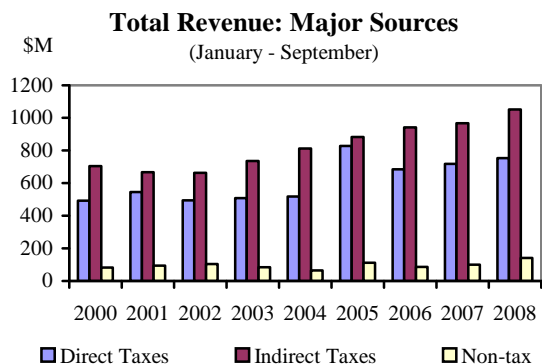
Total government expenditure during the first nine months of 2008 expanded by an estimated 11.6%, compared to the 9.0% rate of increase reported in the similar period of 2007, reflecting higher outlays on both current and capital expenditure categories. Transfers and subsidies continued to be a major expense of the central government, with additional funds being paid to the University of the West Indies, the Barbados Agricultural Development and Management Corporation and the Transport Board during the review period. Payments for goods and services and interest on outstanding debt – particularly foreign interest payments, which rose on account of prison-related payments – were also notably higher in the first three quarters of 2008. Capital expenditure increased as a result of continued road improvement projects as well as additional capital transfers to government institutions such as Caves of Barbados and the Urban Development Commission. Unlike other expenditure categories, wages and salaries declined marginally given that there were

retroactive payments made in 2007 that were not repeated in the current review period.



Tax receipts during the review period increased by an estimated 6.0%, compared to 3.5% for the same period of 2007, predominantly owing to a substantial rise in the indirect tax take. This expansion was the result of higher collections of import duties and excise taxes – reflecting increased import values – as well as other miscellaneous taxes. Furthermore, value-added tax receipts continued to be strong in the face of higher prices for goods and services.

Early estimates suggest that direct tax receipts also performed well, despite somewhat flat collections of personal taxes and a slowdown in the collection of miscellaneous direct taxes. The main contributor to direct tax revenue was corporate taxes, which sustained its role as a major driver of government revenue, while property taxes recovered marginally from the fall-off registered in 2007.



Financing for government operations was provided primarily by domestic sources during the January-September period of 2008. The main contributors were the Central Bank, which lent approximately \$97.4 million, compared to \$104 million in the same period of the preceding year, and commercial banks, which extended more than \$140 million. With no new foreign borrowing so far for 2008, foreign financing mainly took the form of project funds.

Table 1: Percentage Change in Selected Indicators of Government Operations

	2005	2006	2007	2008
Tax Receipts	<u>5.9</u>	<u>15.3</u>	<u>3.5</u>	<u>6.0</u>
Personal	-14.0	13.3	6.7	1.2
Corporate	28.9	41.4	8.1	8.6
Property	-10.8	40.6	-33.2	-14.5
VAT	7.1	12.1	12.0	4.4
Excises	16.4	11.0	-19.8	12.3
Import Duties	5.5	-9.8	-2.2	12.2
Expenditure	<u>11.1</u>	<u>8.0</u>	<u>9.0</u>	<u>11.6</u>
Wages & Salaries	4.4	6.8	13.6	-0.3
Goods & Services	17.8	-3.2	29.1	36.5
Interest Payments	5.4	11.9	10.3	20.9
Transfers & Subsidies	3.9	9.6	18.1	11.0
Capital Expenditure	52.4	12.4	-32.3	10.5

Source: Central Bank of Barbados

External Sector

During the January-to-September months of 2008, the external current account deficit is estimated to have worsened from \$312.8 million to an estimated \$552.8 million, as a result of a significant increase in the value of imported goods.

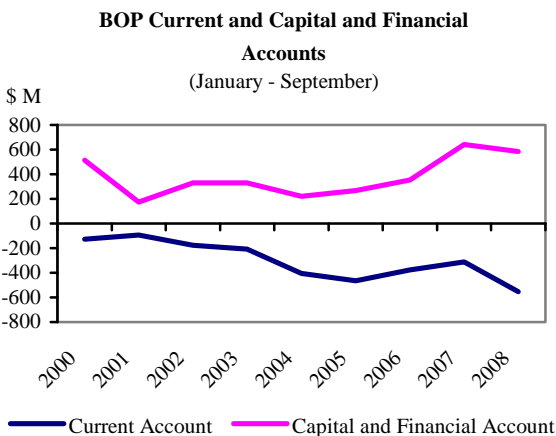
Retained imports rose by an estimated 17.5% over the first nine months of 2008, in contrast to 5.7% in the equivalent period of the prior year. Since import volumes remained fairly stable relative to 2007, the main factor contributing to this expansion was high fuel and commodity prices. This phenomenon was especially evident in the value of intermediate goods imported during the first eight months of the year, which rose by a substantial 43.1%, reflecting an 113.8% jump in fuel imports. Consumer goods, on the other hand, increased by a more moderate 3.5% despite a 14.8% rise in the value of food and beverages imports, while capital goods declined by 4.9%, as machinery imports fell by 4.2%.

Domestic exports grew by an estimated 9.0% over the first nine months of 2008, compared to marginal growth in the same period of 2007. Leading export categories up to the end of August 2008 included electrical components, other food and beverages² and chemicals, up 13.2%, 19.9% and 12.4%, respectively. Travel

² Other food and beverages in this report includes all food and beverages except sugar, rum and molasses.

credits also performed reasonably well, despite a marginal decline in long-stay tourist arrivals, as a result of the higher prices. Sugar receipts, on the other hand, fell relative to 2007; however, it must be noted that the decline in sugar receipts was smaller than the decline in production due to favourable exchange rate movements with respect to the euro.

Preliminary estimates suggest a lower surplus on the external capital and financial account over the first three quarters of 2008 when compared to the corresponding period of the previous year. Higher capital outflows overall led to lower net inflows for the year to date. Notable outflows included debt service payments, repatriation of profits and large tourism-related outflows.



Outlook

While the current turbulence in the world financial markets has not had any significant impact on the Barbados domestic banking system, as the major industrial economies either slow or go into recession the result could be a slowdown in the growth of the Barbados

economy going forward. Specifically, recession in the UK and some European economies would impact adversely on tourism prospects and investment inflows. In light of this, the Barbadian economy is forecasted to grow by between 1.0% and 2.0% in 2008, as the effects of the global financial crisis and relatively high commodity prices continue to negatively impact the productive sectors. Furthermore, it is anticipated that the effects of the global turmoil will continue to be felt in the short-to-medium term. As such, in 2009, it would probably be difficult to attain even the growth rate that was obtained in 2008.

Tourism, in particular, is expected to exhibit lacklustre growth in 2009 when there is an increased probability of flat growth in Barbados' largest source markets. So far for 2008 hotels are already reporting lower occupancy rates and advanced bookings for 2009 are weaker than in previous years. Expansion in those sectors that receive spin-off benefits from tourism activity, such as wholesale and retail trade and agriculture, is therefore expected to be constrained. With economic activity slowing, business and other services as well as transportation, storage and communications are also likely to be impacted. Construction activity, on the other hand, is forecasted to improve as a result of new public and private sector projects slated to commence in 2009.

Based on these expectations, the average rate of unemployment is expected to continue its gradual rise, but is likely to still remain relatively low. Inflation is also forecasted to increase, reaching approximately 8.0% by the end of the year as a result of lags in the pass through effect of lower oil prices. In 2009, however, with international fuel and commodity prices declining, there should be some tapering off of domestic inflation rates.

In line with the forecasted deceleration in economic growth, the rate of deposit accumulation is also expected to slow. In addition, deposit growth could be further hampered by lower net capital inflows, as 2009 is expected to be similar to 2008 with respect to the volume of foreign capital flows. With deposit growth forecasted to slow to the point where it is likely to lag that of credit, relatively tighter liquidity conditions should prevail. This forecast assumes that while there may be a slight increase in the level of provisioning for bad debts, there should be no serious deterioration in the loan portfolio of commercial banks.

The performance of the offshore sector will be impacted more in the last quarter of the year, so that a relatively good outturn in terms of new registrations for 2008 may still be recorded for the year as a whole on the strength of the first nine months. Given the shortage of credit currently dominating international financial markets, the government would be positioned to

source most of its funding domestically. The total amount sought in 2008 is expected to surpass that of 2007, as revenue collections are likely to be weaker – in line with slower economic growth and lower inflation – as well as higher expenditure, especially for public sector construction projects.

The external current account is forecasted to continue to deteriorate as the price of imported goods is expected to still be high in the medium term. This deterioration is further underpinned by the expectation of lower travel credits on account of lower tourist arrivals and the uncertainty surrounding the reaction of domestic exporters in light of higher prices of raw materials.

It is anticipated that the capital and financial account should post a smaller surplus, both in 2008 and 2009, and as a result it is unlikely to fully compensate for the expected increase in the external current account deficit. As a result, the NIR of the monetary authorities is expected to decline over the next 9 to 12 months.

Events are unfolding rapidly on the international scene and while projections are always tentative there is greater than usual uncertainty in the 2009 projections at this time.

October 28, 2008