STANDARD & POOR'S

RATINGSDIRECT®

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Bahamas (The Commonwealth of The)

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Table Of Contents

Bahamas (The Commonwealth of The)

Major Rating Factors

Sovereign Credit Rating
A-/Negative/A-2

Strengths:

- Track record of macroeconomic stability, bolstered by a generally prudent fiscal policy and steady monetary stance.
- Political stability and economic prosperity.
- Low public-sector external indebtedness.

Weaknesses:

- Open and narrow-based economy, whose growth depends highly on the U.S. economy and is vulnerable to adverse external developments.
- High current account deficit (CAD) and weak external liquidity.
- Constrained fiscal flexibility.

Rationale

The ratings on The Commonwealth of The Bahamas are supported by the government's track record of macroeconomic stability, bolstered by a generally prudent fiscal policy and steady monetary stance. Political stability and economic prosperity, as well as low public-sector external indebtedness, are other strengths to the rating. Standard & Poor's Ratings Services believes that The Bahamas' policy stance will remain generally disciplined, though the policy risks are increasing in light of the more severe-than-expected economic slowdown. Continuing to constrain the ratings are the country's open and narrow-based economy, with the economy's structural weaknesses especially pronounced amid the increasing contagion from the slowing U.S., the country's main investment, trade, and tourism partner. Weak external liquidity and constrained fiscal flexibility further limit the sovereign's ability to effectively withstand the growing negative impact of the U.S. recession.

The recent revision of the outlook to negative from stable reflects our concerns over the rapidly slowing economic growth in The Bahamas and its impact on the sovereign's fiscal and external accounts. More importantly, the country's inherently weak economic structure--linked to its dependence on one product (tourism accounts for more than 60% of GDP and employs more than 50% of the labor force) and one market (U.S. tourists account for 87% of the total)--exacerbates the current downturn and puts more pressure on the policy response. Unemployment in The Bahamas has increased significantly, and the banks' asset quality is deteriorating.

In light of the weaker tourism, investments, and consumer demand expected in 2008 and 2009, we have revised our real GDP growth forecast for The Bahamas for these years to 1.1% and 1%, respectively, from the previously projected 3% and 4%. The revision takes into account the weak tourism outlook, as reflected in the 3% decline in arrivals in the first seven months of 2008 and an expected 6% decline by the end of this year. In addition, a low level of hotel occupancy and the decision of major hotels to cut staff and scale down marketing initiatives attest to a negative tourism outlook in the near term. At the same time, the construction sector suffers because of scaling down and delaying of major investment projects. The government aims to boost economic growth with recently announced countercyclical policies, including a robust capital-spending program, new unemployment benefits, and relief to low-income households. These expansionary measures likely will result in fiscal deficits above the budgeted

2.2% of GDP in fiscal 2008 (ending June 30, 2009) and could lead to an increase in the government's debt.

Specifically, Standard & Poor's expects the central government deficit to hover near 3% of GDP in the next two years (2.3% of GDP on a general government level, including social security surpluses) (see table 1). As a result, the forecast is for government debt to increase to 38% of GDP by 2009 from 36% in 2007.

Fiscal stimulus will also mean that the external current account, which was high at 18% of GDP in 2007, will not contract significantly in 2008 and 2009 and should be about 15% of GDP. Combined with the declining foreign direct investments (FDIs) and a more difficult funding environment in 2008 and 2009, this will put pressure on the external reserves, which totaled US$650 million in September 2008 but are projected to decline to US$500 million by year-end 2009. Therefore, the external financing gap (defined as current account payments plus short-term debt plus medium- and long-term amortization) should remain high at about 150% of current account receipts (CARs) and usable reserves, exposing The Bahamas' significant external vulnerability.

Another increasing risk is the deteriorating asset quality of the banks. Although the share of nonperforming loans is still low at 5% of the total, it could increase substantially, as the tourism sector, major private-sector employer, and construction industry are undergoing drastic contractions.

Outlook

The negative outlook reflects the rising risk associated with a sharper and likely longer-than-expected economic contraction. The impact of the U.S. recession on the tourism and construction sectors has already led to job losses and a subsequent deterioration in the banks' asset quality. If these negative trends accelerate, significantly raising the contingent liability from the financial system and structurally impairing public finances, we likely will lower the ratings on The Bahamas. Similarly, if the government's countercyclical response leads to a sharp increase in debt, the ratings will come under negative pressures. Conversely, if the economic slowdown is mild, helped by the government's fiscal efforts and continuing investment, the resulting stabilization of fiscal and external accounts will support a revision of the outlook back to stable.

Table 1

The Bahamas--Outlook

	--Year ended Dec. 31--						
	2011f	**2010f**	**2009f**	**2008e**	**2007**	**2006**	**2005**
GDP per capita (US$)	25,383	24,338	23,498	22,795	21,783	20,986	20,145
Real GDP (% change)	2.5	2.0	1.0	1.1	2.8	4.6	3.3
Real GDP per capita (% change)	1.3	0.6	(0.4)	(0.3)	1.4	3.2	2.0
General government balance/GDP* (%)	(1.2)	(1.6)	(2.0)	(2.3)	(1.0)	(1.9)	(1.0)
Central government balance/GDP* (%)	(2.0)	(2.4)	(2.8)	(3.0)	(1.6)	(2.7)	(2.1)
General government interest/revenue* (%)	8.5	8.8	8.9	8.4	8.5	8.1	8.1
Net general government debt/GDP* (%)	23.2	23.2	22.6	21.5	20.4	20.1	20.1
Domestic credit to private sector and NFPEs/GDP (%)	96.5	91.2	88.9	87.8	88.9	85.5	78.0
Consumer Price Index (average % change)	3.0	3.0	3.5	4.5	2.9	2.3	1.2
Current account balance/GDP (%)	(8.7)	(10.3)	(13.8)	(14.9)	(18.2)	(20.4)	(10.0)
Gross financing needs/usable reserves¶ plus current account receipts (%)	137.3	141.6	146.7	151.4	146.6	146.2	124.3

Table 1

The Bahamas--Outlook (cont.)							
Narrow net external debt/current account receipts (%)	15.8	17.6	19.0	13.8	15.1	17.7	11.5
Net banking sector external debt/current account receipts (%)	18.6	19.9	20.7	17.9	18.6	22.7	19.0

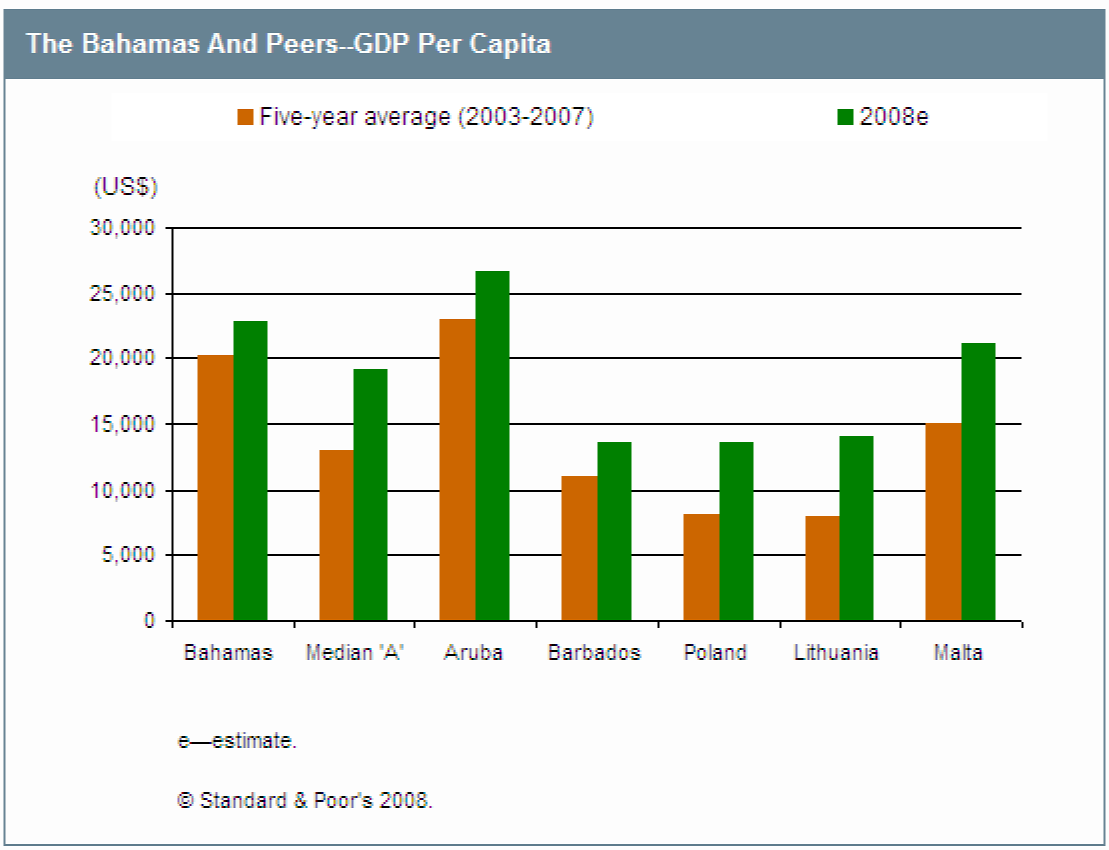
*Data on a fiscal-year basis (ending June 30). ¶Usable reserves are adjusted for 100% of the monetary base. e—estimate. f—forecast. NFPEs—nonfinancial public enterprises.

Comparative Analysis

Greater political stability and stronger institutions

Political stability, widespread consensus on major economic reform, established democratic institutions, and strong judicial systems characterize The Bahamas and its closest peers: the Republic of Malta (A/Stable/A-1), Aruba (A-/Stable/A-2), and Barbados (BBB+/Stable/A-2). (Ratings are foreign currency sovereign credit ratings as of Dec. 17, 2008.) A track record of macroeconomic stability and an economy based on tourism and the financial sector have produced a high level of wealth in The Bahamas. Accordingly, The Bahamas' GDP per capita, at US$22,800 in 2008, is higher than that of the 'A' median, at US$19,000, and of most similarly rated peers' (see chart 1). At the same time, the broader human development indicators in The Bahamas are somewhat weaker than those of its peers. The Bahamas ranks 49th out of 155 countries in the 2008 United Nations Human Development Index, compared with Barbados, which comes in 31st; Czech Republic (A/Stable/A-1), 32nd; Malta, 34th; Poland (A-/Stable/A-2), 37th; and Lithuania (BBB+/Negative/A-2), 43rd.

Chart 1

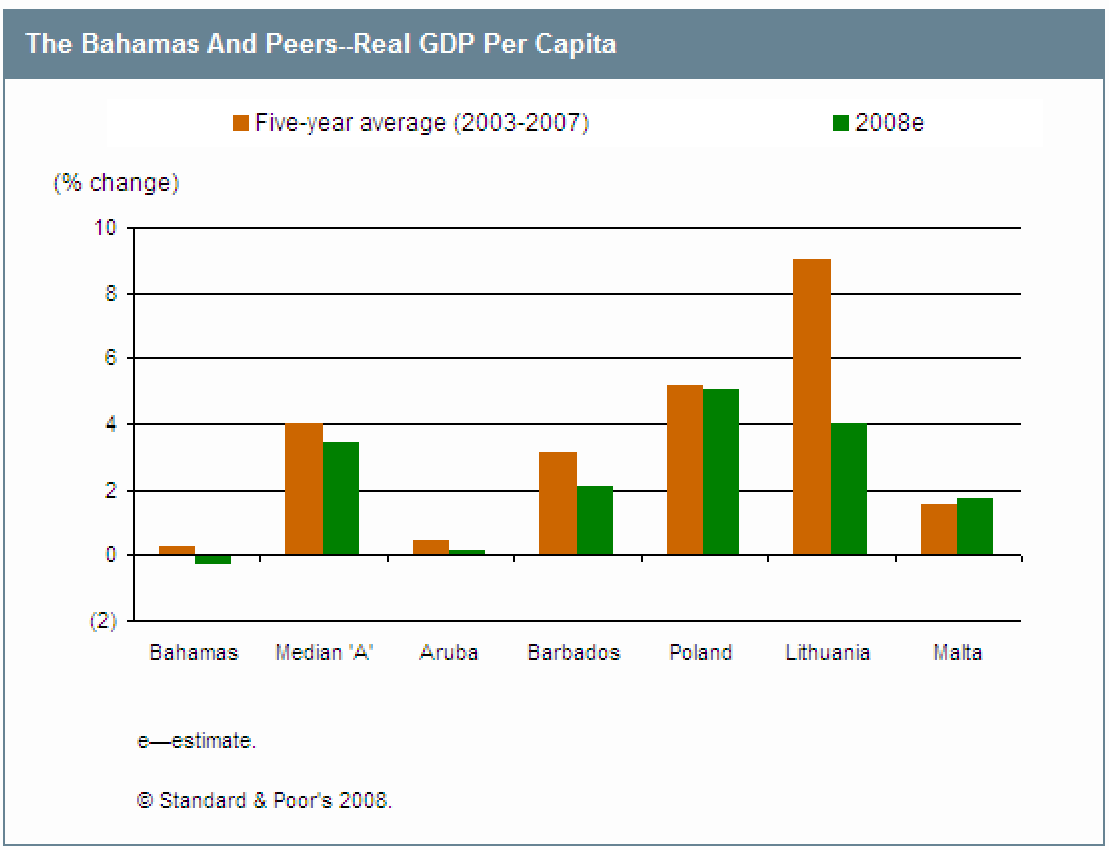


The economic structure is becoming a more pronounced credit weakness

The structure of The Bahamas' small, export-oriented economy is similar to that of its rated peers. Export exposure, with CAR standing at 49% of GDP for The Bahamas is below the ratios for Barbados (69%), Lithuania (64%), Aruba (85%), and Estonia (A/Negative/A-1) (84%). But, The Bahamas' export inflows are not diversified and reflect the economy's heavy dependence on tourism (60% of GDP and more than 50% of the labor force) and, to a lesser degree, on financial services (20% of GDP). This concentration is exacerbated by the dependence on a single market, the U.S., which is The Bahamas' main trading, tourism, and investment partner. This narrow economic base resembles that of Bermuda (AA/Stable/A-1+), where the bulk of the economy is concentrated in tourism and financial services. In contrast, the economies of Barbados, Malta, and the Baltic countries are slightly more diversified.

Reflecting its narrow base and close economic links with the U.S., the Bahamian economy grew by a mere 0.3% a year on average on a per-capita basis from 2003 to 2007, behind that of all peers and less than the 'A' median of 4% (see chart 2). The lagging performance is attributable, in part, to the negative impact of adverse weather conditions to which The Bahamas, like other Caribbean islands, is susceptible; a lackluster tourism arrival performance over the past few years; competitive pressures on the tourism industry; and slow progress on structural reform. We expect the country's economic performance to take a hard hit in 2008 and 2009 as tourist arrivals decline and construction activity slows dramatically.

Chart 2



Fiscal deficits will widen in the short term, but The Bahamas' debt burden remains smaller than most of its peers'

Despite the below-par economic growth, fiscal deficits historically have remained low (averaged 1.6% of GDP over the past five years on the general government level) (see chart 3). However, the expected countercyclical fiscal response of the government should widen the deficits in 2008 and 2009 to levels above most of the peers' (except that of Lithuania). Although the fiscal expansionary stance cannot be sustained for a long period of time and would eventually put pressure on the fixed exchange rate regime, the currently moderate general government debt levels give the Bahamian government some temporary room for fiscal maneuvering. Standing at 22% of GDP in 2008, the net general government debt in The Bahamas is close to the 'A' median and below most of its peers' (see chart 4).

Chart 3

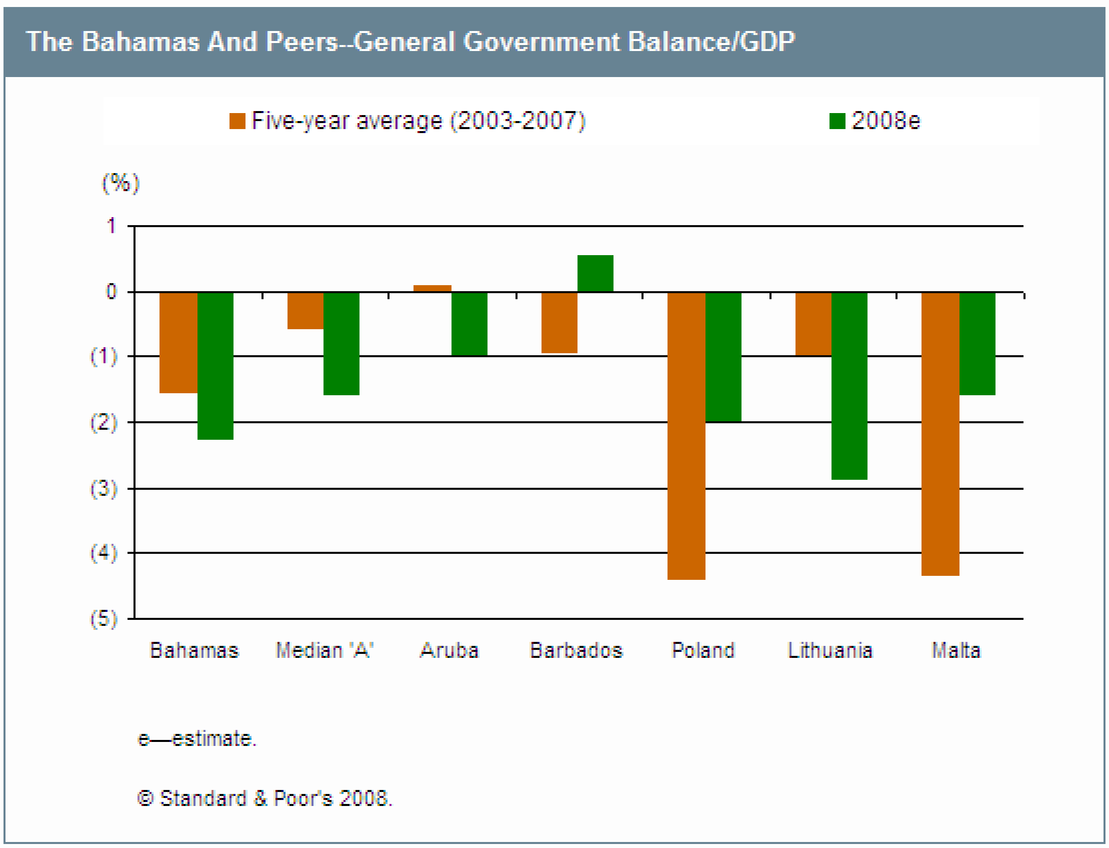
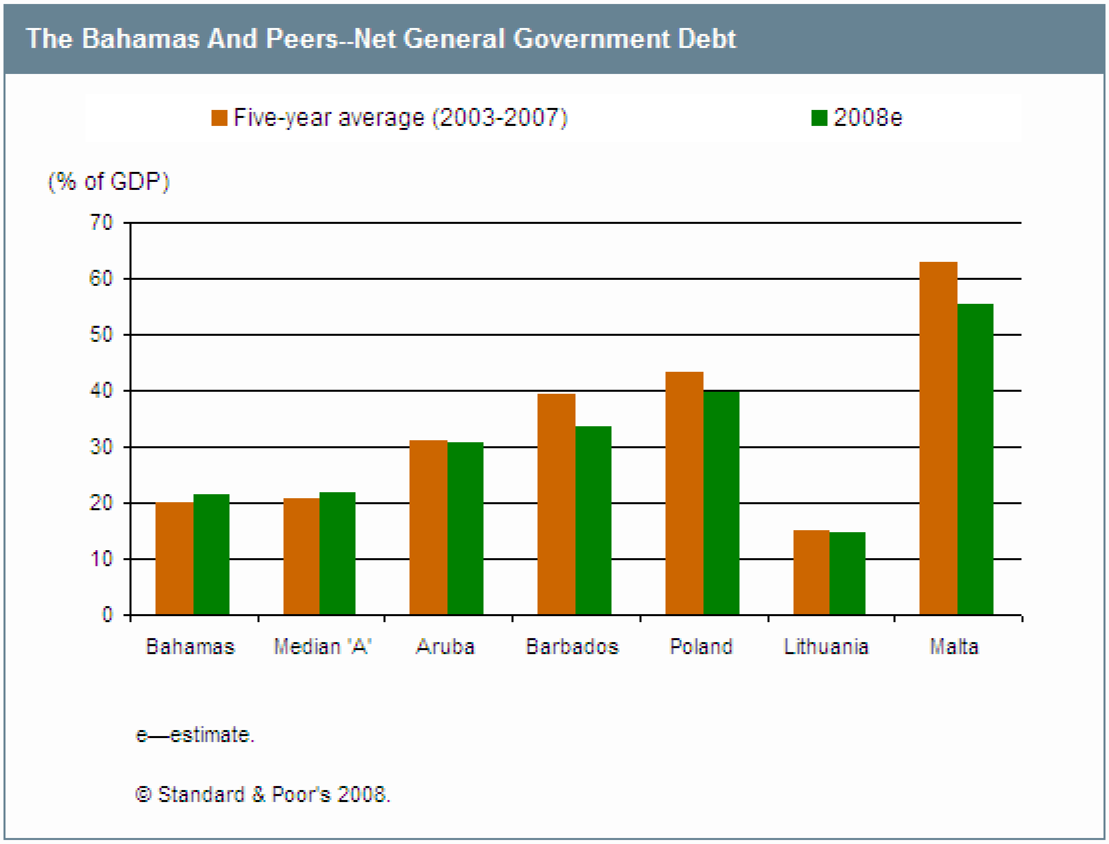


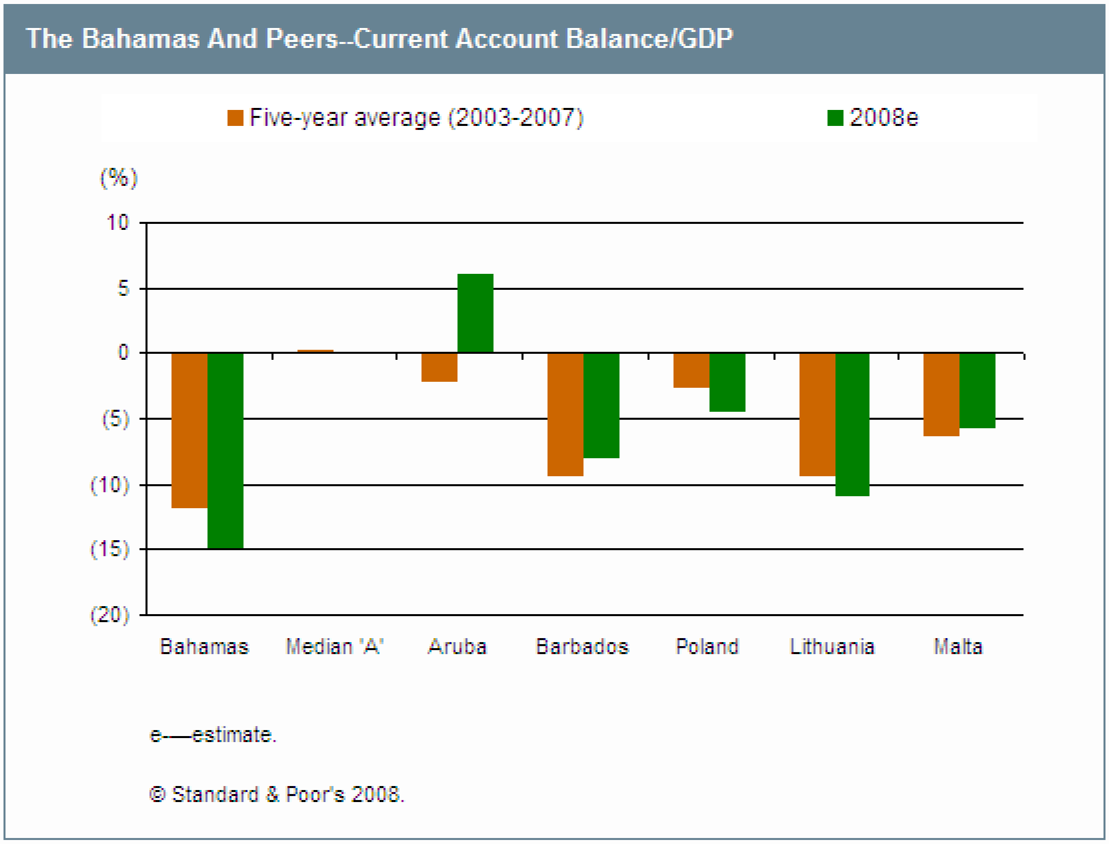
Chart 4



Despite low deficits, fiscal flexibility is limited because of the heavy dependence on taxes on international transactions (60% of revenue) and because of a general consensus opposing the introduction of direct taxation. Bermuda faces similar challenges. On the other hand, Barbados favorably distinguished itself from many Caribbean countries by introducing a value added tax (VAT).

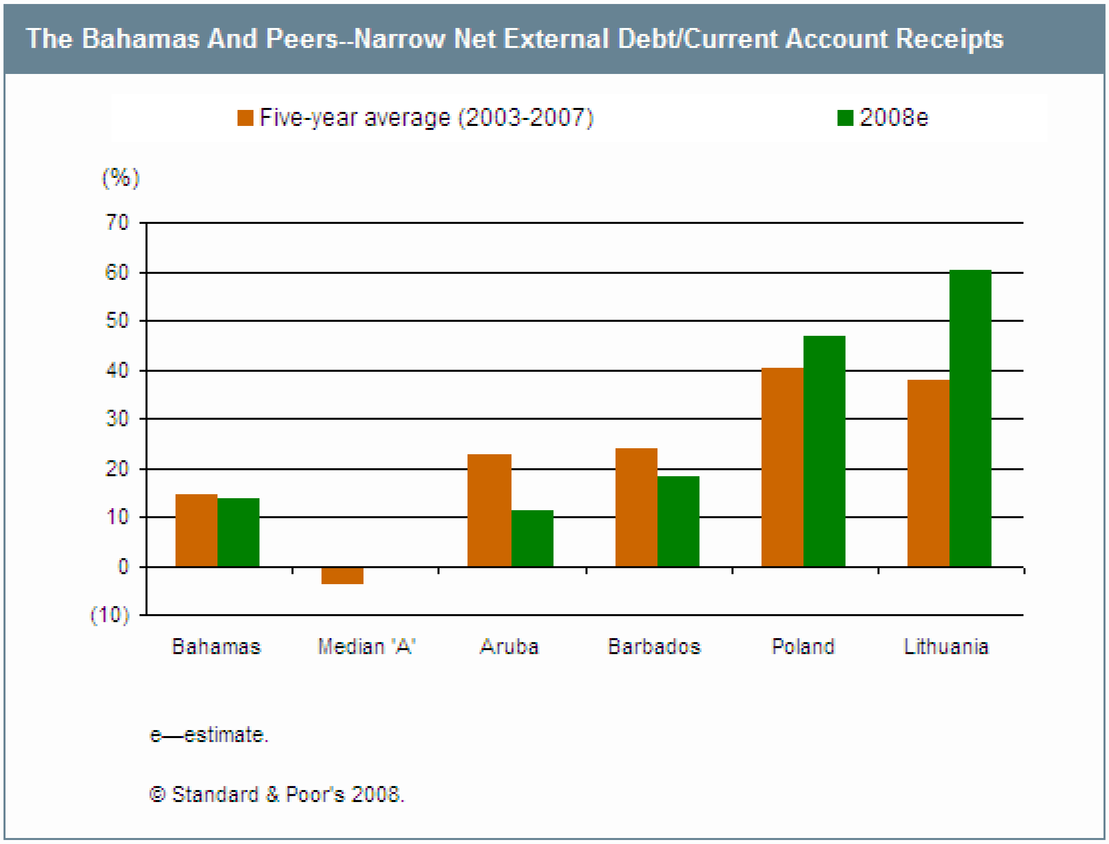
Reflecting its small size, openness, and the capital-intensive nature of its main industry, tourism, the Bahamian economy depends heavily on imports. Rising oil prices in the past few years, investment-related capital imports, and less-than-robust tourism led to the gradual widening of the CAD to an average of 12% of GDP per year from 2003 to 2007, above all peers' and a balanced position for the 'A' median. Even with lower oil prices and slowing import needs, the Bahamas' CAD at 15% of GDP in 2008 stands higher than all of its peers' (see chart 5).

Chart 5



Despite the high CADs, the deficit financing historically has been covered by large FDIs (expected to continue to cover about 50% of CAD going forward) and positive large errors and omissions. As a result, the country's external balance sheet has not changed over the past years (narrow net external debt hovered around 14% of CAR) and is expected to stay at about the same level in the near term. This is better than all the peers', except for the rapidly improving net external position of Aruba.

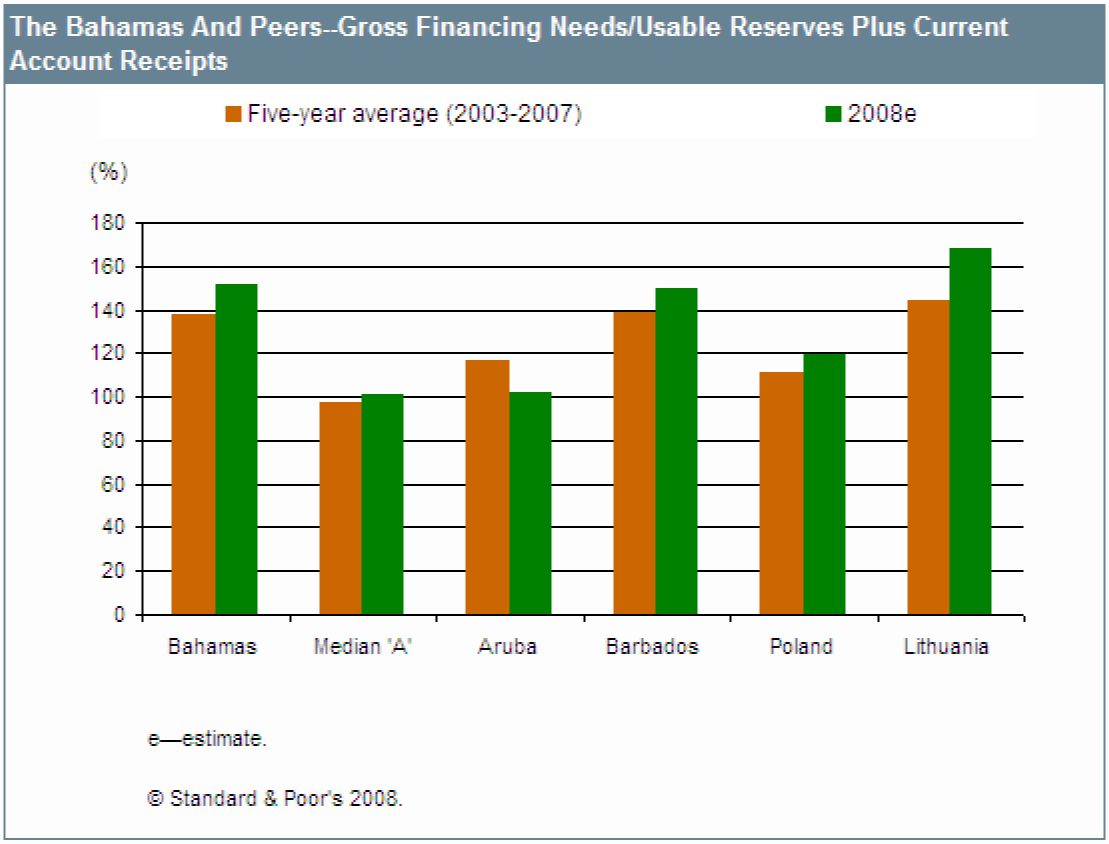
Chart 6



Weak external liquidity remains high but stable, similar to peers'

As a result of the high CAD and substantial external liabilities of the banking sector, The Bahamas' liquidity ratio is weak, a feature common to many of its peers. Gross financing needs are estimated to have averaged 140% of CAR in the past five years and are expected to increase to 151% in 2008 (see chart 7). This is similar to Barbados' results and less than those of Aruba and Poland, but better than externally vulnerable Lithuania's.

Chart 7



Political Environment

- The government faces a difficult policymaking environment as it balances social pressures and economic discipline.
- Structural reforms remain delayed.
- Renewed pressures targeting the tax heavens are coming from the Organization for Economic Cooperation and Development (OECD).

The Free National Movement (FNM) party, which won the general elections in May 2007, faces a challenging task of leading the country through the current turbulent economic times. Fortunately, it is not the first test for Prime Minister Hubert Ingraham, who led the government through the 2001 U.S. slowdown during his previous term in office in 1992-2002. However, the current economic downturn is more severe and prolonged, necessitating a timely and disciplined policy response, which may be hard to balance with the party's election promises. So far, the prime minister has announced a number of measures (such as new unemployment benefits, increased social transfers, temporary tax relief for the electricity company to improve distribution of electricity, and encouragement of banks to work out the debt repayment solutions with the debtors in arrears) to stabilize the rapidly slowing economy and support the social safety net. Given the uncertain magnitude of further economic deterioration, it remains to be seen to what extent the government chooses to accommodate the social needs and bolster the economic growth at the expense of the fiscal accounts. Standard & Poor's believes that the long-standing fiscal prudence will prevail, albeit a widening of the fiscal deficits and an increase in the debt levels seem unavoidable.

The FNM party won the elections on the mandate of increased transparency, with the party's Trust Agenda focusing on the accountability and transparency issues, strengthening institutional framework, and promoting better governance. On the back of these promises, the government initiated a widespread review of the public contracts upon assuming the office in mid-2007. Addressing other social issues, such as tackling the rising crime, fostering small and medium entrepreneurship, upgrading the tourism-related infrastructure, and improving education will be more difficult and protracted, especially in light of the slowing economy. Crime is on the rise, with a 14% increase in major crimes in the first ten months of 2008. The biggest increase has been recorded in the area of property crimes, which was up 18%, versus the 6% decrease in crimes against persons. Improving the investment climate is also essential, as the World Bank's Ease of Doing Business index for The Bahamas deteriorated to 55 from 51 (from 1 to 181, with 1 being the best) during the past year. The particular weaknesses were seen in the areas of dealing with construction permits, registering property, and enforcing contracts.

On the domestic front, the government makes all efforts to push ahead with the long-postponed privatization of Bahamas Telecommunications Co. The government is now open to sell a majority holding, rather than the originally proposed 49% stake. However, the negotiations with the prospective investor, BlueWater Communications Holding, are currently delayed because of legal disputes and difficult negotiations with the labor unions.

In the international arena, The Bahamas maintains good relations with the U.S., Canada, and Europe. Establishing legislation against drugs and money laundering was an important policy step. Although The Bahamas is a member of the Caribbean Community, the country decided not to participate in the Caribbean Single Market and Economy (CSME). The Bahamian population is most concerned about the CSME's provision for free movement of labor (given the vast difference between the average wages in The Bahamas and other Caribbean countries) and the lack of trade benefit from such a union for The Bahamas. The country trades mostly with the U.S., while the trade of CSME participants is more regionally oriented. The Bahamas also continues to oppose any free-trade agreements (FTAs), including the Economic Partnership Agreement (EPA) with the EU. Given the challenging international environment, there is no incentive to take risk in the liberalization of capital controls at this time. Finally, renewed pressures may be coming from the OECD. Although The Bahamas successfully cleared its name in 2002 after being put on the OECD blacklist in 2000, the European authorities are reviewing the tax heavens.

Economic Prospects

- Growth is slowing rapidly, reflecting the close link of the narrow-based Bahamian economy to the U.S.
- The status of the investment projects is mixed: large ones are stalled/progressing slower than expected, while smaller projects move ahead.
- A larger tourism dip (compared with the expected 6% decline in arrivals in 2008) is expected in 2009.

The Bahamian economy is narrowly based, with tourism accounting for 60% of GDP, 62% of CAR, and employing more than 50% of the labor force. Over the years, tourism has benefited from the country's proximity to the U.S., the strong brand name of the Atlantis resort, the country's dominant position as a cruise line destination, and a strong inflow of tourism investments. However, all of these factors recently have turned against the country, exposing The Bahamas' high vulnerability resulting from its dependence on one product (tourism) and one market (the U.S. accounts for 87% of total tourism).

Following real GDP growth of 4.5% in 2006 (see table 2), the growth momentum has been interrupted by the election and then by the protracted period of contracts review by the FNM government after it came to power. The review of $80 million worth of contracts and eventual cancellation of a $23 million public contract for straw market negatively affected investors' sentiments and brought substantial disruption to the contractors' activity. The situation has since normalized, but the important economic growth momentum has been lost. Real GDP grew by 2.8% in 2007 (1.4% in per capita terms) (see chart 8). The 2008 growth prospects are constrained because of slowing domestic activity and the negative impact of external events--the U.S. slowdown and hurricanes. The effects of the U.S. slowdown are being felt across all sectors of the Bahamian economy, but especially in tourism, construction, and retail. At the same time, the damage from the two major storms that hit The Bahamas in late August to early September resulted in a further drop in economic activity. Category 4 Hurricane Ike passed over the island of Inagua (population 1,000) in September, causing widespread damage to most buildings and infrastructure. In addition, the Morton Salt evaporation facility, which employs more than one-half of the working population of the island, was badly damaged and is currently closed. The hurricane also led to tourist arrival disruptions, costing the Bahamian hotel industry approximately US$900,000 in revenue. Similarly, the tropical Storm Hanna resulted in losses of about US$760,000 in cruise and stop-over tourist cancellations. Overall, Standard & Poor's estimates the real GDP growth at 1.1% (down from an earlier projection of 3% and less than the government's recent estimate of 2%). We expect economic performance to remain depressed in 2009, with real GDP growth forecasted at 1% next year.

Table 2

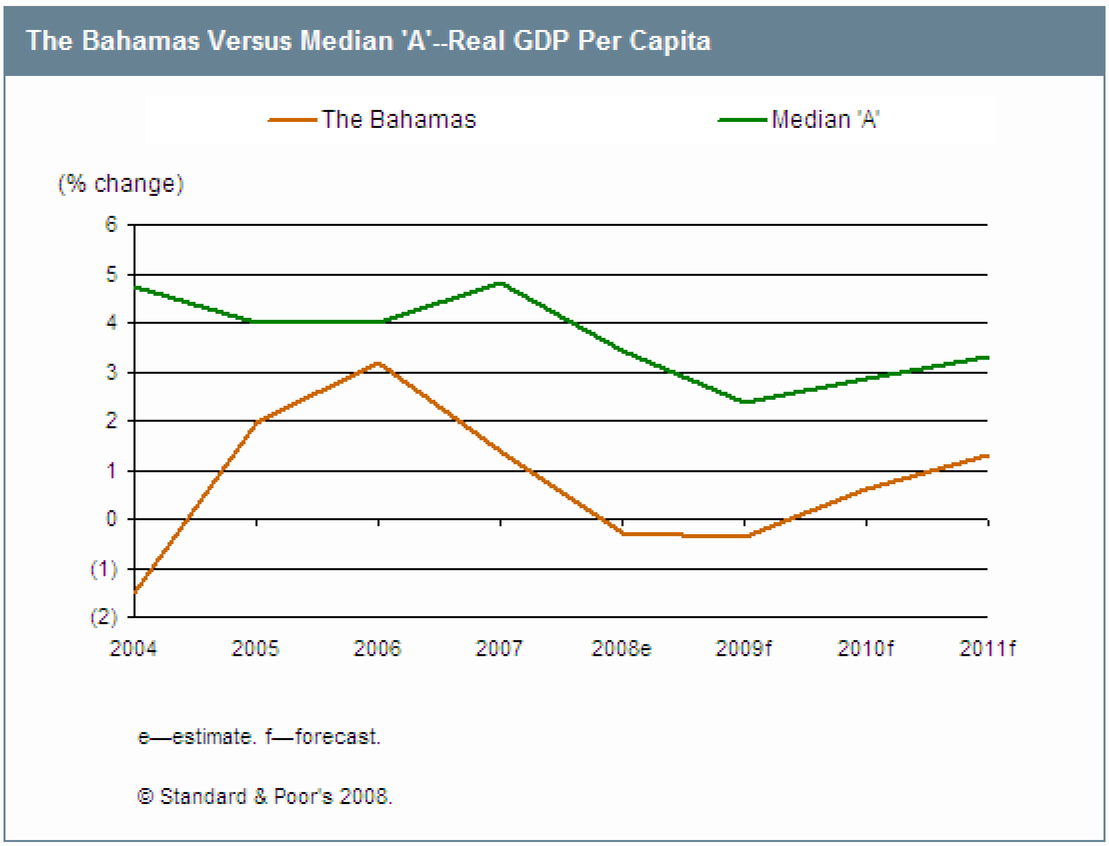
The Bahamas--Economic And Monetary Indicators

	--Year ended Dec. 31--							
	2011f	**2010f**	**2009f**	**2008e**	**2007**	**2006**	**2005**	**2004**
GDP per capita (US$)	25,383	24,338	23,498	22,795	21,783	20,986	20,145	18,920
Real GDP (% change)	2.5	2.0	1.0	1.1	2.8	4.6	3.3	(0.2)
Real GDP per capita (% change)	1.3	0.6	(0.4)	(0.3)	1.4	3.2	2.0	(1.5)
Consumer prices (average % change)	3.0	3.0	3.5	4.5	2.9	2.3	1.2	1.9
Domestic credit to private sector and NFPEs (% of GDP)	96.5	91.2	88.9	87.8	88.9	85.5	78.0	74.8
Domestic credit to private sector and NFPEs (% change)	11.6	7.7	5.8	4.8	9.4	15.8	12.5	5.1
Financial sector contingent liability (% of GDP)	19.3	18.2	17.8	17.6	17.8	17.1	15.6	15.0
Memo: GDP (bil. B$)	8.9	8.4	8.0	7.7	7.2	6.9	6.5	6.0

e—estimate. f—forecast. NFPEs—nonfinancial public enterprises.

The Bahamas' tourism outlook for 2009 is bleak. The industry was experiencing difficulties even before the full effects of the international economic crisis began to take hold. Reconstruction and unavailability of rooms in 2005 (Royal Oasis) and 2006-2007 (Bahamar), the tightening of the U.S. passport requirement, and a slowing U.S. economy are the main reasons for the below-average performance in the tourism sector. In fact, stay-over arrivals declined each year since 2005. During the first seven months of 2008, total visitor arrivals fell by 3.2%, including a 5.9% decrease in sea visitors and a 2.2% increase in stayovers. Overall, we expect visitor arrivals to decline by 6% by the end of this year. Besides the plummeting demand from the U.S., the loss of scheduled flights to The Bahamas during the high season of October 2008-March 2009 as well as a drastic reduction in marketing efforts from the major hotels will impair tourism in 2009. The hotels are drastically reducing their staffs and cutting employees' workweeks. For instance, Atlantis, the largest employer in the country outside the government, is laying off approximately 800 employees, or 10% of the resort's workforce. Bahamar, a stalled US$2.6 billion project, is also reducing staff, as the prospects for reopening the project are becoming ever more distant. The cuts are the result of the lower occupancy rates (Atlantis used to boast more than 85% occupancy and has now revised its forecast to 64%) and poor advanced booking (Atlantis is forecasting that it is 50% behind on bookings for the first three months of 2009). Despite the bleak outlook, the government marketing efforts to promote The Bahamas continue and the appointment of a well-respected new minister of tourism with expertise in international tourism is encouraging.

Chart 8



The slowing investment activity in the country is taking an equally hard toll on the construction sector. This is a reflection of a substantial slowdown/halt in several large foreign tourism projects (see the section "Status Of Major Tourism Projects In The Bahamas" at the end of the article) as a result of constricted credit and capital flows as well as the slowdown in the construction of second homes and real-estate presales to finance tourism investments. As a result, unemployment is now a most serious concern. With many contractors and tourism workers losing their jobs, the unemployment rate is rising rapidly and could reach 13% in 2009, up from 7.6% in 2006. The government plans to address the unemployment problem through increased capital spending aimed at creating new jobs and new unemployment benefits.

Fiscal Flexibility

- Fiscal deficit is projected to be higher than budgeted, but debt levels remain moderate and debt service is low.
- Fiscal borrowing requirement is low and domestic markets provide most of the financing, a significant advantage in the current environment.
- Financial sector's contingent liability is low now, but it may grow if the asset quality of banks deteriorates rapidly.

The Bahamas' prudent fiscal policy has been one of the key factors underlying its macroeconomic stability. General government deficits averaged 1.1% of GDP in the past ten years (slightly better than the average deficit of 1.4% of GDP for the 'A' median during the same time), including a social security surplus of 0.9% of GDP. Fiscal deficit stood at 1.6% of GDP in fiscal 2007 (fiscal year ended June 30, 2008) on a central government level and 1% of GDP on the general government level, including the social security surplus of 0.7% of GDP (see table 3).

Table 3

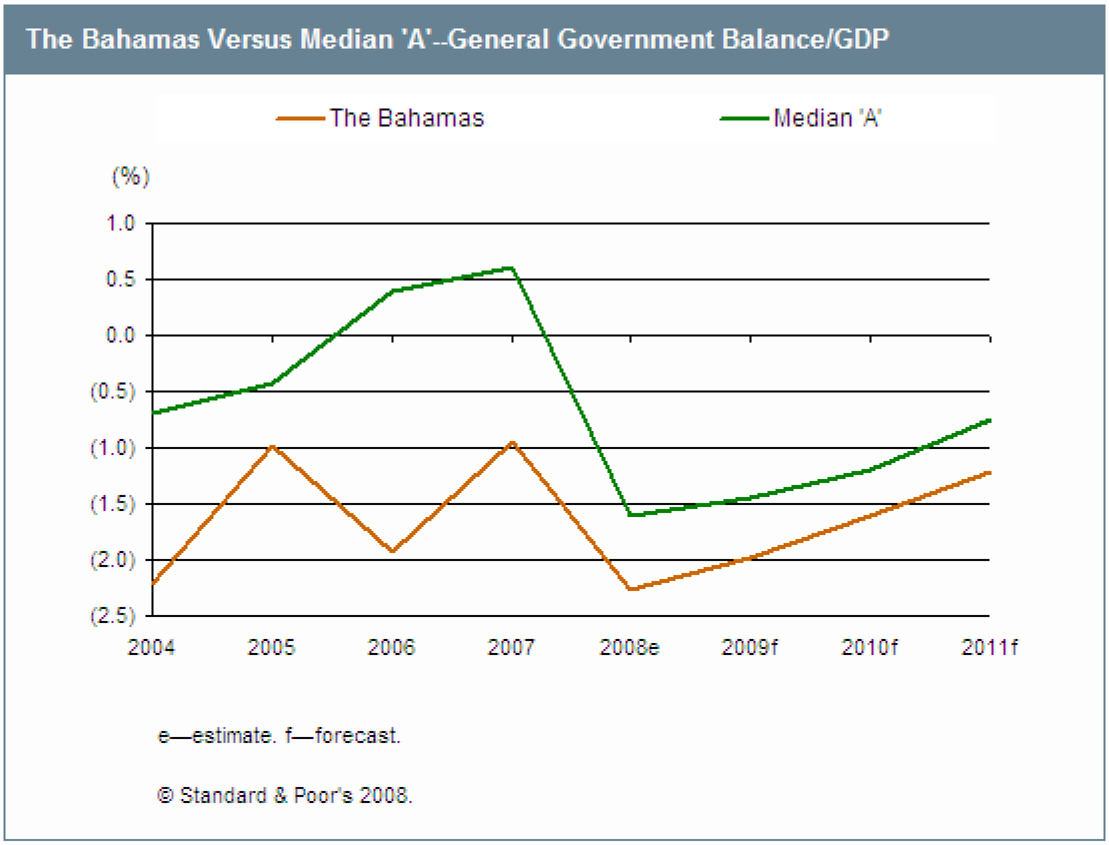
The Bahamas--Fiscal Indicators

				--Year ended June 30--				
	2011f	**2010f**	**2009f**	**2008f**	**2007e**	**2006**	**2005**	**2004**
(as a % of nominal GDP)								
General government revenue	24.3	23.8	23.2	23.2	23.0	23.0	22.3	20.5
General government expenditure	25.5	25.4	25.2	25.5	24.0	24.9	23.3	22.7
General government balance*	(1.2)	(1.6)	(2.0)	(2.3)	(1.0)	(1.9)	(1.0)	(2.2)
Central government revenue	21.0	20.4	19.8	19.8	19.5	19.5	18.8	17.2
Central government expenditure	23.0	22.8	22.6	22.8	21.2	22.1	20.8	20.2
Central government balance	(2.0)	(2.4)	(2.8)	(3.0)	(1.6)	(2.7)	(2.1)	(2.9)
General government primary balance	0.9	0.5	0.1	(0.3)	1.0	(0.1)	0.8	(0.3)
Gross general government debt	39.3	38.8	37.7	36.5	36.4	34.7	34.3	34.8
Net general government debt	23.2	23.2	22.6	21.5	20.4	20.1	20.1	19.3
(as a % of general government revenue)								
General government balance	(5.0)	(6.8)	(8.5)	(9.8)	(4.1)	(8.4)	(4.4)	(10.9)
General government interest expense	8.5	8.8	8.9	8.4	8.5	8.1	8.1	9.5

*Includes central government and social security balances. e—estimate. f—forecast.

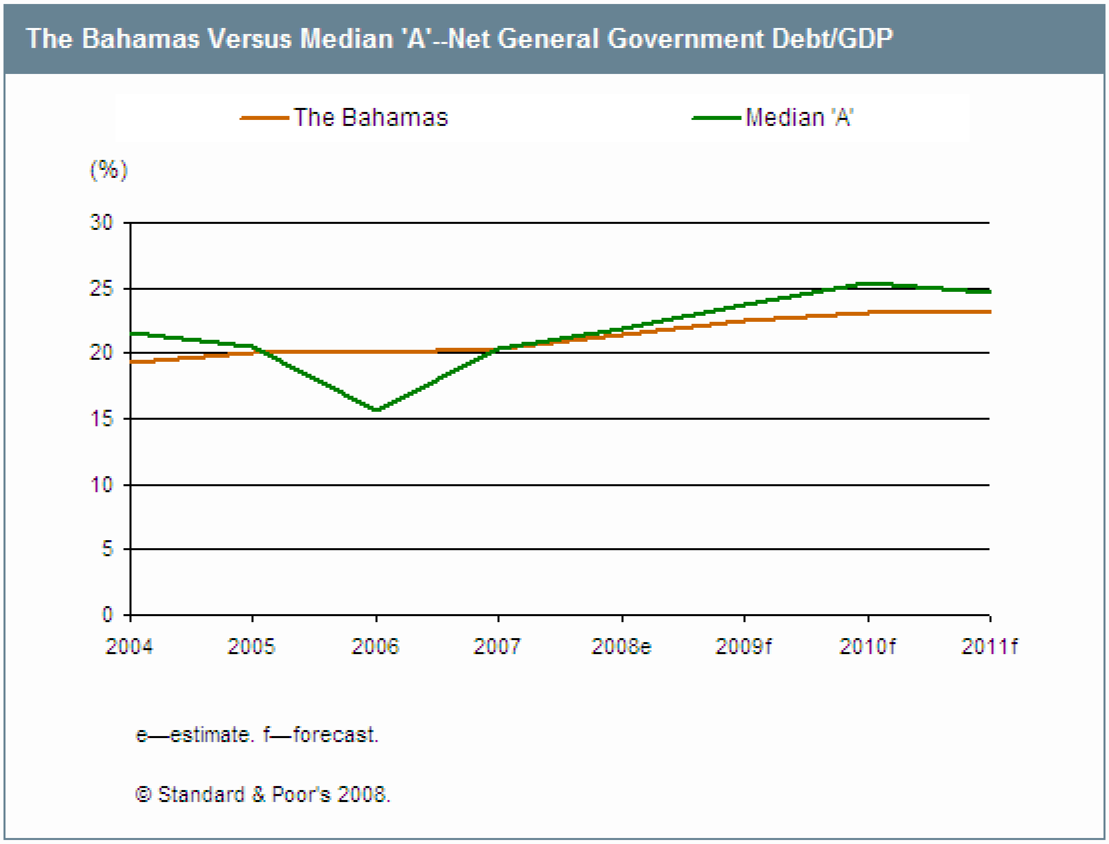
The 2008 budget envisages the widening of the deficit to 2.2% of GDP as the government aims to alleviate the social impact of the slowing economy and to boost growth. Specifically, recognizing the rapidly increasing unemployment rate, the government has introduced new unemployment benefits (funded by the National Insurance Board) and has increased social subsidies to low-income households. In addition, it provided a two-year tax holiday from 10% customs duty and 7% stamp duty on fuel imports to the electricity company and enlarged its capital investment program, partly to compensate for slowing private investment projects. With GDP data recently revised upward, the government feels that its fiscal "space" has widened as all fiscal ratios (debt and deficit as a percent of GDP) have declined as a result of this revision. Nevertheless, the fiscal discipline remains important and the government focuses on improving tax collection (appointing new revenues officers throughout Family Islands) and has limited the transfers to the loss-making enterprises. Nevertheless, these measures are unlikely to offset the increasing negative impact of the slowing economy on fiscal accounts. Revenues were already 10% below budgeted targets in the first two months of fiscal 2008. In addition, fiscal spending likely will exceed the budgeted targets. Overall, Standard & Poor's forecasts the Bahamian government's 2008 fiscal budget at 3% of GDP on a central government level and 2.3% on a general government level (see chart 9).

Chart 9



Deficit financing (borrowing requirement is forecasted at 3.8% of GDP in fiscal 2008) comes predominantly from domestic sources. The structure of the debt remains favorable, with domestic debt accounting for about 90% of the total. Domestic issuance enjoys good terms, with more than 40% of domestic debt maturing in 10-25 years. General government debt stood at 36% of GDP in 2007 (20% on a net basis) (see chart 10) and is expected to rise slightly to 39% of GDP by 2009 (23% on a net basis). Interest expenditure is about 8% of general government revenue.

Chart 10



We estimate public corporations' debt at 9.6% of GDP as of year-end 2008, of which direct government guarantees to public enterprises account for 5.6% of GDP. The contingent liability of the financial sector is estimated at 18% of GDP, which could increase if asset quality deteriorates further.

Monetary Policy

- Credit growth is subsiding and banks are increasing provisions to deal with an anticipated deterioration in asset quality as unemployment rises significantly.
- There have been some changes in the offshore books of the domestic banks, but these have not affected the banks' domestic operations, and the banks' local funding sources remain stable.

Monetary policy is circumscribed by the 1973 decision to set the Bahamian dollar at parity with the U.S. dollar. The exchange-rate peg is supported by a moderate level of external reserves and by prudent fiscal policies. Although inflation historically has been low (averaging 2% in the past ten years), global conditions led to the acceleration of inflation in 2008. Still, estimated at 4.5% in 2008, the Consumer Price Index (CPI) in The Bahamas is significantly lower than that of its Caribbean peers. Part of the explanation is the outdated CPI basket, with an inadequately low share of fuel, and the other part is the tax structure.

The Central Bank's monetary policy instruments are limited, with credit ceilings and capital controls being used the most to influence money supply. Currently, there are no direct credit controls on domestic banks' lending. The most recent controls were in place during 2001-2004. Following the abolition of credit restrictions in 2004, consumer lending intensified, especially in the mortgage sector, reflecting pent-up demand. Consumer lending increased by 12% in 2005, 16% in 2006, and 9% in 2007. This trend is reversing in 2008 (credit growth is expected at 5%) as banks are taking a more cautious approach to lending and focusing on preserving asset quality. There has been an increase in the level of arrears over 31 days, which as of Sept. 30, 2008, stood at 10.4% of total loans, compared with 9.3% at year-end 2007 and 8.6% in September 2007. The biggest increase was seen in the consumer loans, while the arrears on residential mortgages, although high at 10.5%, rose more slowly. Nonperforming loans (payments overdue by 90 days and more) rose to 5.1% from 4.9% in December 2006. The smaller increase in nonaccruals indicates that the consumers so far tend to cure their arrears within the first three months. Provisions to arrears increased to 24.7%. Banks work on delinquency management techniques to help their clients, an initiative similar to the one instituted in 2001.

The Bahamas' financial sector continues to play a significant role in the local economy, with an estimated 15%-20% contribution to the country's GDP and about 5,000 people employed in the industry. 245 banks and trusts are licensed to operate from or within The Bahamas. More than three-fourths have a physical presence in the jurisdiction, and the remaining ones--mainly G-8 branches--operate under managed arrangements approved by the Central Bank. Out of nine licensed commercial banks, three are domestic (one is partially owned by the government), and the other six are subsidiaries of foreign banks. Bahamian banks are the principal channels for allocating resident and nonresident investment because they are allowed to conduct both onshore and offshore operations. As a result, the accumulation of nonresident deposits on the books of the domestic banks has been quite substantial, reaching 41% of the banks' external liabilities and standing at 5x the country's GDP and 6.9x the banks' resident deposits. This huge exposure is counterbalanced somewhat by prudent management practices and historically good loan portfolio quality, as well as by the soundness and stability (until recently) of the depositor base (mostly Canadian and European). Nevertheless, the nonresident deposit shrunk by 13% in the first half of 2008, reflecting global conditions.

So far, the global financial fallout has had only a minimal impact on the banking sector in The Bahamas, both domestic and offshore. Although some of the banks' head offices were significantly affected, the amount of excess liquid assets in the financial system remains adequate, standing at Bahamian dollar (B$) 337 million in September 2008, compared with B$135 million a year ago, a result of the shrinking credit growth. Similarly, the foreign exchange reserves stood at US$650 million in September 2008, up from US$454 million at year-end 2007. The reserves are likely to decrease following the holiday period, and more external pressures are expected to emerge in 2009. As a result, the central bank likely will be wary of liberalizing the capital accounts, as it had planned.

The Bahamas is considered one of the top 10 offshore centers because of its favorable tax regime, adherence to international standards of practice, strong supervision and regulation, and good pool of financial professionals. The country strives to further improve its regulatory framework. The most recent regulatory improvements include the amendments to the Central Bank's two primary acts--the Central Bank of The Bahamas (Amendment) Act and the Banks and Trust Companies Regulation (Amendment) Act --to allow for the sharing of information with other domestic regulatory authorities. Other proposals included legislative changes to the existing Banks and Trust Companies Regulation Act of 2000. These changes include bringing the supervision of nonbank money transmission businesses under the authority of the Central Bank, clearly defining the rights and duties of the auditors of licensees in reporting significant information to the Inspector of Banks and Trust Companies, and modifying the documentary requirements for applicants, specifically as they relate to net worth and character references requirements. Overall, these measures combined with many others implemented since 2000 (when The Bahamas was put on the OECD blacklist, from which it was removed two years later), constitute important steps toward better regulation and supervision. This should prove important as the OECD prepares another round of review of tax heavens as it advances its anti-offshore financial centre agenda.

External Finances

- CAD should be shrinking, as lower oil prices and decreasing capital imports improve the trade deficit. However, tourism receipts will slip as well.
- The country's external balance sheet remains relatively stable, as FDI and large errors and omissions finance most of the CAD.

We expect the CAD to come down to 15% of GDP in 2008 from 18% in 2007 (see chart 11 and table 4) as lower FDI and slowing consumer demand, accompanied by lower oil prices, shrink the trade deficit and construction- and transportation-related service outflows. The CAD traditionally has been financed in large part by FDI (averaging 68% of CAD in the past five years). The official FDI inflows are likely to decline in the near future as larger investors scale down their projects or delay massive financial disbursements, but the smaller projects continue to support the FDI levels so far. Therefore, the coverage of CAD by FDI is expected to remain at more than 50%. The projected inflow of FDI in 2008 reflects a decline in property purchases by nonresidents, while tourism-related investments continue to show growth, at 16% in the first nine months of 2008 over the corresponding period in the previous year. With public-sector external debt generally stable (except the $100 million issuance in 2008), the rest of the CAD financing is provided by the private sector (mostly in the form of FDI), or it takes the form of errors and omissions in the balance of payments account. The presence of persistently large positive errors and omissions substantially complicates the analysis of the current account financing and the external balance sheet of the country overall. Errors and omissions stood at 24% of CAD in 2007 (and were as high as 85% of CAD in 2004). Standard & Poor's estimates that errors and omissions most likely represent the underreported FDI or tourism inflows and thus qualitatively diminish liquidity risks as seen from the officially large external current account position.

Chart 11

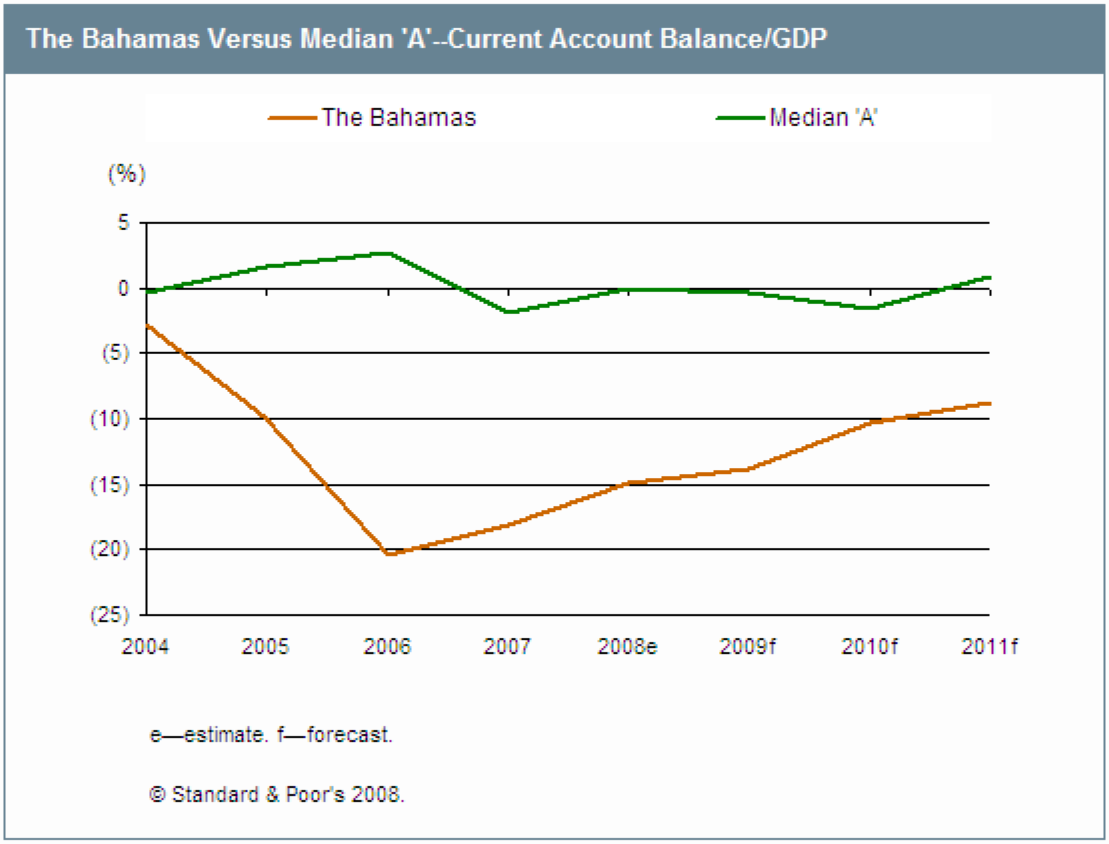


Table 4

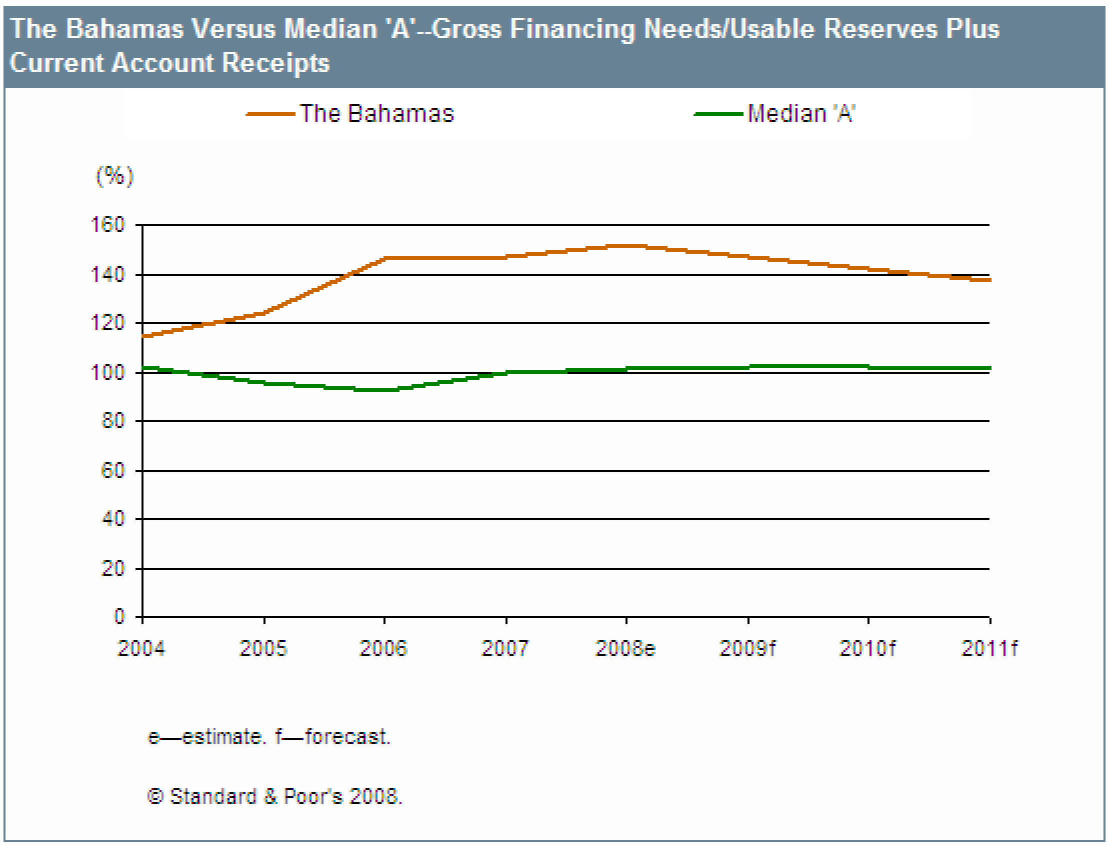
The Bahamas--External Indicators

	--Year ended Dec. 31--							
	2011f	**2010f**	**2009f**	**2008e**	**2007**	**2006**	**2005**	**2004**
(as a % of nominal GDP)								
Current account receipts	51.4	50.8	48.1	48.9	49.7	48.4	49.4	50.8
Trade balance	(20.3)	(21.4)	(24.3)	(26.7)	(29.8)	(30.0)	(27.1)	(22.4)
Current account balance	(8.7)	(10.3)	(13.8)	(14.9)	(18.2)	(20.4)	(10.0)	(2.8)
Net federal direct investments	9.0	7.8	7.4	8.0	9.9	10.3	8.3	7.3
(as a % of current account receipts, unless noted otherwise)								
Current account balance	(17.0)	(20.2)	(28.6)	(30.5)	(36.6)	(42.2)	(20.2)	(5.6)
Narrow net external debt	15.8	17.6	19.0	13.8	15.1	17.7	11.5	7.9
Gross public sector external debt	28.5	30.0	31.9	29.3	27.7	32.7	29.5	29.6
Net banking sector external debt	18.6	19.9	20.7	17.9	18.6	22.7	19.0	18.4
Usable reserves*/current account payments (months)	(0.7)	(0.7)	(0.4)	(0.6)	(0.2)	(0.0)	0.1	(0.0)
Gross financing needs/current account receipts plus usable reserves* (%)	137.3	141.6	146.7	151.4	146.6	146.2	124.3	114.7
Memo: Current account receipts (mil. US$)	4,570	4,275	3,860	3,750	3,593	3,325	3,214	3,066

*Usable reserves are adjusted for 100% of the monetary base. e—estimate. f—forecast.

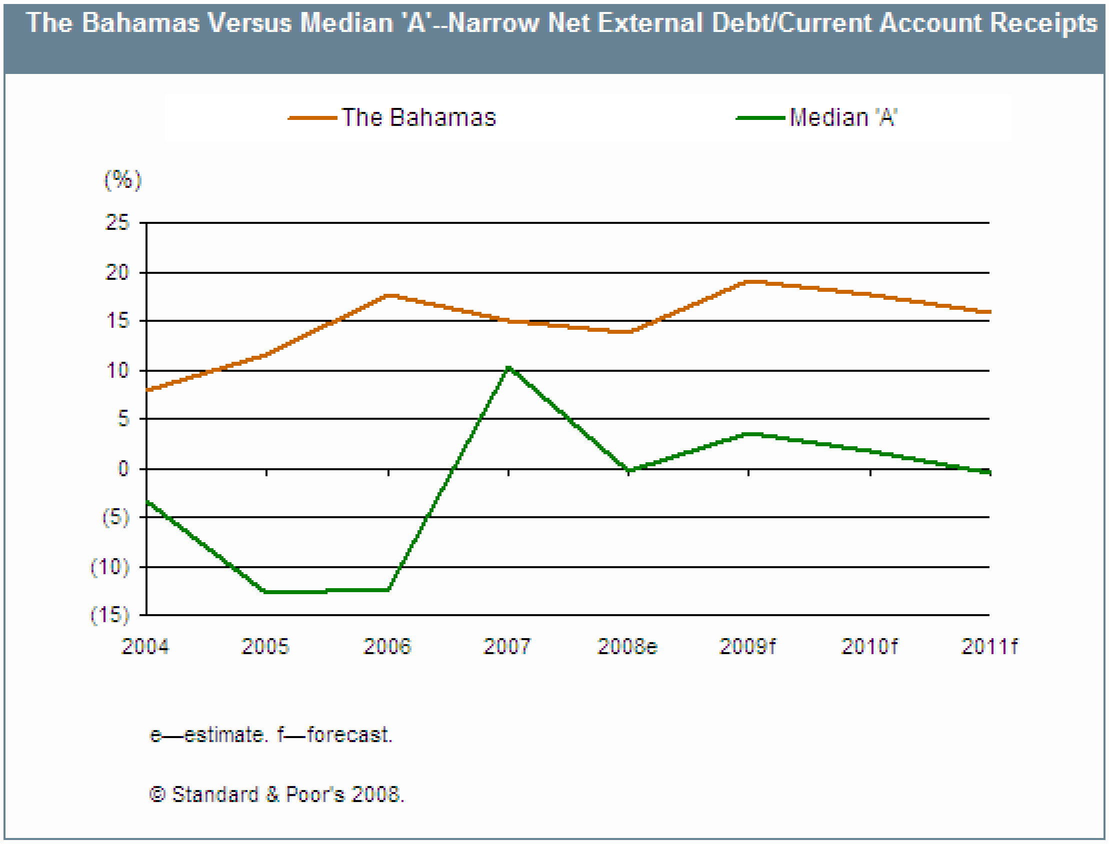
International reserves increased substantially in 2008, benefiting from the proceeds of public-sector borrowing as well as from a one-off inflow of US$40 million in stamp duty from the sale of an oil storage facility. With some drawdown expected in the last two months of the year, the reserves likely will close out the year at about US$580 million, but likely will decline to US$500 million in 2009. The liquidity ratio remains high but stable. Assuming the mostly short-term nature of the banks' external liabilities, the financing requirement in 2008 should amount to 151% of usable reserves (adjusted for 100% of the monetary base) (see chart 12).

Chart 12



The public sector's external debt service is low, estimated at 4% of CAR. Two international bonds (in the total amount of US$300 million) mature in 2033 and 2038 and constitute 70% of public-sector external debt. Narrow net external debt is estimated at 14% of CAR in 2008, rising to 19% in 2009 (see chart 13). The banking sector is a net external debtor, with liabilities at 18% of CAR on a net basis in 2008.

Chart 13



Status Of Major Tourism Projects In The Bahamas

Prior to the financial crisis in the U.S., the government of The Bahamas expected more than 50 projects to begin in the country, worth more than US$10 billion, which would have drastically changed the economy in the next five to seven years. However, the global economic crisis dented these plans. Below is an update on the major projects in The Bahamas.

Ginn sur Mer

The project, a mega resort in Grand Bahama, was valued at the time of signing at US$4.9 billion. The plan called for 2,000 acres of land, 1,400 home sites, 4,500 condo-hotel suites, two golf courses, a grand canal with water taxis and gondolas, a 55,000-square foot casino, two water theme parks, a 500-slip yacht marina, a private airport, and other facilities. The project was expected to take 10 years. The main idea behind the project is to alleviate the marina congestion in Florida by bringing yachts to Grand Bahama (only 40 minutes away). In 2007, Ginn raised in excess of US$300 million in lot sales, raised the land 10 feet above sea level, dredged for the creation of four to five miles of canals, staked out the golf course, purchased Old Bahama Bay, and, with money for residential infrastructure held in escrow and somewhat protected from creditors, is still tracking favorably despite Ginn's credit woes. The project is still in the stage of the infrastructural work. Vertical buildout was not planned in the first four to five years. Infrastructure and the marina are expected to be completed in the next 18 months to three years. Construction of the cabanas is projected to begin in July 2009. Ginn is expecting to host its first golf tournament on its property in June 2009.

Baha Mar

The mega project on Cable Beach in New Providence is valued at US$2.6 billion. The initial project included the renovation of the three existing Cable Beach properties and the construction of a new tourist zone around Cable Beach, including building a 100,000 square-foot casino (the largest in the Caribbean) and a new West Bay Village complex to house offices, restaurants, nightclubs, and shops. Two hotels have been renovated, and the company is refurbishing the third one. So far, US$500 million has been spent, but the total size of the project is likely to be scaled down to US$1.2 billion. A big setback occurred in spring 2008 when a strategic gaming partner, Harrah's, pulled out of the deal. The Bahamar project has been stagnant since then and the company is now looking for a new partner and new financing. The project currently employs 2,500 people but is reducing its staff. The Bahamian investor leading this project remains fully committed to it.

Cotton Bay development and Cay development

The Cotton Bay Development is valued at US$400 million and is located in Eluthera. The Rum Cay development is valued at US$700 million and is located in Rum Cay. Both projects are stalled.

Although the future and speed of activity of the largest scale projects (Ginn sur Mer and Bahamar) are uncertain, smaller projects are moving ahead. In general, The Bahamas is trying to shift from large scale to smaller scale, boutique developments and eco-sensitive types of tourism.

Baker's Bay Golf And Ocean Club

Baker's Bay is the current model of the eco-resort. The full project includes the construction of 300 homes, costing anywhere from US$10 million to US$20 million.

I-Group

This project is a US$1.8 billion joint-venture development in Mayaguana. Work is on track and continuing. The development covers some 10,000 acres and includes an airport, utilities, marina village, residential lots, private villas and condos, a boutique resort, and nature preserves.

PGA village

PGA Golf Club The Bahamas (the First PGA golf course outside the U.S.) is a 36-hole facility, a PGA Learning Center, and a PGA Historical Center in Cat Island. The development is moving ahead.

Ritz Carlton Rose Island development

The project, valued at US$700 million, is in development. No slowdown has occurred, despite Lehman Brothers' involvement (the bank was the lender of record for this project and was the 50% equity stake holder in the Ritz Carlton hotel and in a residential real estate project on Rose Island).

Albany project

Despite controversy regarding the project location in Nassau's most important freshwater lens, the US$1.4 billion project, encompassing 565 acres of land and 350 estate-type homes goes ahead. (It will include million-dollar homes, a canal, two golf courses, and a marina.) In addition, the project includes a club house, an Ernie Els-designed championship golf course, and a 100-room condominium complex. Also, 370 acres of land will be made available for the government to build low-cost homes for Bahamians.

South Ocean Development Co.

This is a US$1 billion mixed-use resort project located on 385 acres of the southwestern coast on New Providence Island in Nassau. The exclusive development will encompass a large upscale casino hotel, an intimate five+ star boutique hotel, a lifestyle hotel brand, a mega yacht marina, a spa, retail outlets, a world-class tennis center, and residential components. The Blue Shark Golf Club, a 7,200 yard, 18-hole championship course, recently redesigned by Greg Norman, is scheduled to open in late 2008/early 2009.

Other projects

- Freeport Container: US$300 million expansion.
- International airport: US$400 million expansion started.
- Ross University addition: construction of a US$2 million building (to serve about 250 students) for the U.S.-based medical school, to be opened in January 2009.

Ratings Detail (As Of December 17, 2008)*	
Bahamas (The Commonwealth of The)	
Sovereign Credit Rating	A-/Negative/A-2
Senior Unsecured (2 Issues)	A-
Sovereign Credit Ratings History	
24-Nov-2008	A-/Negative/A-2
28-Jan-2008	A-/Stable/A-2
01-Aug-2007	A-/Positive/A-2
Default History	
None since 1975	
Population	340,000 as of 2008
Per Capita GDP	US$22,800
Current Government	
Prime Minister Hubert A. Ingraham, head of the ruling Free National Movement	
Election Schedule	
House of Assembly Most recent: May 2007 Next: by May 2012	

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.