Background Information on the Removal of the Lending Restrictions

On August 9th, 2004 The Central Bank of The Bahamas lifted the restriction on domestic banks' Bahamian dollar lending that was in effect since 20th September 2001. The Central Bank indicated that in the future it would adjust its credit polices as appropriate, to achieve greater stability in the minimum levels of external reserves relative to the deposit liabilities of the banking system. Lending institutions were instructed to pay particular attention to the credit worthiness of new borrowers and in the case of personal loans, to limit the resulting debt service ratios between 40% and 45% of borrowers' income and to require direct equity contributions of at least 15% on such loans, except for those accompanied by mortgage indemnity insurance.

The Central Bank imposed lending restrictions in 2001 to prevent credit expansion from providing additional stimulus to imports, and to stem the loss of external reserves following the September 11 disruption to tourism. The resulting uncertain short-term prospects for both tourism and foreign investments also factored into this decision, as did the projected hike in the borrowing requirements of the Government, which left less room to accommodate private sector credit.

As a result of the lending restrictions, the reserves stabilized. In 2002, balances were further supported by proceeds from public sector foreign currency borrowing and a gradual seasonal recovery of tourism that was complete by the third quarter of the year. Although improved in 2003, tourism inflows were still constrained during the first six months because of uncertainties surrounding the conflict in Iraq. However, as US consumer spending improved during the second half of 2003 and gained momentum in the first half of 2004, tourism growth accelerated. This stimulus, as a result of the robust expansion of the US economy, is expected to continue in the medium term; albeit, tempered by gradually increasing interest rates as the Federal Reserve moves to fend off inflation.

The Bahamas is also attracting significant new foreign investments which should provide increased inflows over the next 18 to 24 months, and thereafter enable the tourism sector to boost its output.

The Government's borrowing requirements are still elevated, but their sequencing over the second half of 2004 and the first half of 2005 leaves some room to accommodate the private sector. Deficit financing needs are expected to subside during Fiscal Year 2005/06.

While by all accounts, the recovery in external reserves was concluded by the end of 2003, the Central Bank still noted heightened difficulties on the part of some borrowers to meet scheduled loan payments. These incidences abated during the first half of 2004. The Central Bank believes that this turnaround is linked to the strengthening economy and that the situation will improve further in the short-term.

26 AUGUST 2004