THE CENTRAL BANK OF THE BAHAMAS

Annual Report & Statement of Accounts

For the Year Ended December 31, 2003

The Central Bank of The Bahamas

MISSION STATEMENT

To foster an environment

of monetary stability

conducive to

economic development,

and to ensure a stable

and sound financial system.

Contents

Note: Throughout this Report, the sign "$" means the Bahamian dollar unless otherwise stated.

Directors & Senior Officials

At December 31, 2003

BOARD OF DIRECTORS

Julian W. Francis, CBE – Chairman

Wendy M. Craigg

Dr. Pandora Johnson

Mr. Carleton Williams, CBE

SENIOR OFFICIALS

Julian W. Francis – Governor

Wendy M. Craigg – Deputy Governor

J. Kevin Higgins – Economic Advisor

Cassandra C. Nottage – Manager, Bank Supervision

Cecile M. Sherman – Manager, Banking

Bert A. Sherman – Manager, Computer

W. Lester Bowleg – Manager, Human Resources

Rochelle A. Deleveaux – Legal Counsel

Gerard L. Horton – Manager, Exchange Control

John A. Rolle – Deputy Manager, Research

Keith T. Jones – Deputy Manager, Accounts

Selvin I. Basden – Deputy Manager Administration

Shari L. Scavella – Internal Auditor

April 26, 2004

Dear Prime Minister:

In accordance with Section 30 (1) of The Central Bank of The Bahamas Act, Chapter 321, I have the honour of forwarding to you, on behalf of the Board of Directors, the Annual Report of the Bank for the year 2003. Included with this report is the Annual Statement of Accounts of The Bank for the year.

Respectfully yours,

Julian W. Francis

Governor

The Rt. Hon. Perry G. Christie
Prime Minister and Minister of Finance
Office of the Prime Minister
Churchill Building
Rawson Square
Nassau, N.P., Bahamas

ECONOMIC AND MONETARY REVIEW

Domestic Economic Developments

After stabilizing in the aftermath of the 2001 setback to tourism, the Bahamian economy grew mildly in 2003. Amid the lackluster recovery in US households' travel expenditure, tourism gains stalled during the middle of the year, but resumed at a healthier pace in the final quarter, on account of mildly appreciated stopover pricing and continued growth in cruise arrivals. Construction output slowed as both commercial and residential investments weakened, although the outlook for 2004 is favoured by the impending start of foreign investment projects concentrated in the hotel sector. Fiscal sector developments were underscored by an enlarged deficit for the first six months of FY2003/04, explained by the combined effect of elevated expenditures, partly linked to unplanned salary increases, and reduced revenue intake from tourism and trade related sources. In the context of Central Bank's credit restraint policy and improved foreign currency inflows, the financial sector featured stronger money growth relative to credit expansion. As a consequence, the system's net foreign liabilities were reduced, and liquidity conditions were markedly more buoyant. On the prices front, domestic inflation firmed during the year, owing both to increased internal and external cost pressures. In the external sector, net invisible outflows and higher import demand extended the deficit on the current account, while a reversal in short-term flows through the banking system caused a reduction in net capital and financial receipts. The net private foreign investment component, however, was slightly increased.

More moderate credit expansion and increased net foreign currency inflows from Government's external borrowing contributed to a 45.0% boost in bank liquidity to $128.9 million during 2003—which represented 3.4% of total Bahamian dollar deposits compared with 2.4% in 2002. For 2003, the average monthly net free cash balances improved by 11.6% to $131.8 million, and the broader surplus liquid assets by 27.1% to an average $146.4 million. These trends influenced a small reduction in commercial banks' weighted average deposit rate, by 18 basis points to 3.93%; albeit, the corresponding loan rate firmed by 71 basis points to 12.04%. The

TABLE 1: Selected Indicators of Economic Activity (% Change)

	2000	2001	2002	2003
Occupied Hotel Room Nights	5.3	(3.7)	0.8	(1.6)
Total Arrivals	15.3	(0.5)	5.3	4.3
Construction Starts - Value	19.0	(8.0)	55.0	26.3 *
Construction Completions - Value	21.1	8.0	(5.9)	(15.5) *
Electricity Generation (mwh)	6.9	3.9	5.6	(1.6)
Water Consumption (gals.)	1.2	(1.4)	n/a	n/a
Retail Price Index	1.65	2.00	2.19	3.00

SOURCE: The Central Bank of The Bahamas * Ytd June weighted average interest rate spread between loans and deposits widened by 89 basis points to 8.11%. Mirroring deposit trends, the 90-day Treasury bill rate was lower by 72 basis points at 1.78%, although base rates—Commercial Banks' Prime and the Central Bank Discount Rate—remained at 6.00% and 5.75%, respectively.

Growth in the money supply (M3) firmed to 4.4% from 3.2% in 2002, placing the overall stock at $4.0 billion. However, the advance was below the 2000 pace of 9.6% but equivalent to the 2001 increase, when economic activity was more robust. Net public sector drawdowns moderated the gain in fixed deposits to 0.9% from 2.3% in 2002, while savings and demand deposits growth intensified to 7.6% and 12.7%, from a year-earlier 4.3% and 6.4%, respectively. A strong positive contribution was provided by the increased growth in the currency component to 3.4% from 0.8%, amid increased retail transactions in the private sector, alongside the 10.6% recovery in residents' foreign currency deposits.

Domestic credit expansion slowed to 1.0% from 5.6% and 9.3% in 2001 and 2002, for an outstanding total of $4,991.0 million. Developments featured a net foreign currency credit repayment of 7.8%, compared to steady growth in local currency claims of 2.5%. After advancing by 4.1% in 2002, net claims on Government contracted by 22.2%, largely related to the US$200 million external bond which financed the repayment of the $125.0 million local foreign currency facility obtained in 2002. However, credit to the public corporations rose strongly by 70.0% ($153.5 million), as domestic banks refinanced approximately $120.0 million in debt previously owed to an external multilateral agency by the Bahamas Electricity Corporation. Private sector credit growth abated to 1.0% from 4.3%, with a 12.3% contraction in the foreign currency component and a near halving in the rate of increase in Bahamian dollar claims to 2.8%. With steady mortgages growth (13.6%) contrasting with accelerated repayments of consumer credit (2.9%), net credit flows to the personal sector declined (30.5%), and was accompanied by a more sizeable net reduction on other private sector claims.

On the fiscal side, provisional estimates indicate an expansion in the Government's budget deficit for the first six months of FY2003/04, to $55.8 million from $33.1 million over the same half of FY2002/03. Under pressure from a subdued economic environment, revenue collections declined by 0.6% to $446.1 million from the year-earlier 7.7% rally, as weaknesses were concentrated in customs duty collections and selected tourism services taxes. Progress was further constrained as total expenditure, including net lending, increased by 4.2% to $501.8 million, following a 0.8% decline in the previous year. The 7.5% increase in recurrent spending—attributed largely to wages—contrasted with a reduction in capital expenditure of 31.6% and in net lending to public enterprises of 6.7%. Budgetary financing included net borrowings of $17.0 million in Bahamian dollars and $68.1 million in foreign currency. Taking account of net financing activity during the second half of FY2002/03 (January to June), the Direct Charge on Government rose by $133.1 million (7.4%) to $1,939.6 million during 2003. Including the $27.8 million (6.9%) increase in government guaranteed borrowings to $429.4 million, the National Debt rose by $160.8 million (7.3%) to $2,369.0 million at end-December 2003.

In the tourism sector, stopover pricing gains and sustained—albeit moderated—growth in cruise visitors underpinned a marginal increase in expenditure for 2003. Total visitor arrivals rose by 4.3% to 4.6 million, consolidating the 5.3% improvement attained in 2002 and placing the total some 9.3% higher than in 2000. Air arrivals rebounded by 1.9% to 1.4 million, after consecutive declines in 2001 and 2002 of 3.6% and 1.8%, respectively. Growth in sea arrivals abated to 5.4% from 9.0% in 2002, for 3.2 million visitors. Only New Providence and the Family

Islands experienced visitor gains, contrasting with a downturn in traffic for Grand Bahama. While passenger growth supported expenditure gains in the cruise segment, the improvement in the more important stopover segment was based entirely on the estimated 3.7% rise in hotel room revenues, as the average nightly room rate was higher by 5.3% to $164.22 million. Total room sales however, decreased by 1.6% which, in the context of a Grand Bahama-led increase in available room nights, limited the average occupancy rate to 59.0% from 62.0% in 2002.

Consumer price inflation, measured by changes in the average Retail Price Index, advanced to 3.0% in 2003 from 2.2% in 2002. Accelerated firming was recorded on average costs for medical & health care, recreation & entertainment services and "other" aggregated goods and services. In contrast, the rise in the education component decelerated to 1.1% from 12.9% in 2002 when tuition increases were more significant. Moderated increases were also noted for furniture & household operations and food & beverages, versus a decline in average clothing & footwear costs.

Indications are that construction output decreased during the year, corresponding to valuation declines for new investments and building completions. The value of new projects started during the first half of 2003, the latest period for which data was available, fell by 3.2% to $113.1 million, with commercial starts halved to $17.3 million and residential valuations increased by 18% to $95.4 million. Completions also fell in value by 15.5% to $130.9 million, largely due to sluggish commercial activity. Forward looking indicators suggested less activity over the remainder of 2003, with construction permits falling by 15.7% in value to $214.7 million. Although support from private foreign investment was stable, less robust mortgage financing tempered both domestic residential and commercial investment activity. In particular, loan commitments for new construction and repairs to existing residential and commercial projects decreased by 31.5% to $91.4 million, mainly reflecting a slowing in housing loans approvals. A contracted level of public infrastructure works also contributed to this overall weakness.

Among other primary sector activities, available indications signal an increase in domestic fisheries output during 2003. Fisheries exports, which captured revenue more indicative of the total crawfish catch, rose by 19.3% in volume and by 8.6% in value to $108.1 million. Crawfish shipments increased by 10.2% to $105.6 million (9.7%), but fetched a lower average price per pound of 10.5% to $14.24.

In the external sector, the current account deficit widened to an estimated $426.6 million from $339.2 million in 2002. Among the main factors was the 8.0% contraction in net invisible receipts to $901.5 million, encompassing a 2.7% weakening in net travel receipts owing to a larger hike in external spending by residents relative to the inflows from tourism. Net external payments for most other foreign services also increased. Having a similar effect, the merchandise trade deficit rose by 1.2% to $1,286.6 million, with increased goods imports only partially countered by a lower oil bill. A significant offset was provided by the 22% contraction in net factor income outflows to $163.3 million, primarily due to a 33.5% fall-off in private sector profit remittances. Conversely, net transfer receipts narrowed by 8.4% to $38.8 million.

On the capital and financial account, the surplus narrowed from $380.5 million in 2002 to an estimated $207.9 million 2003. Net private investment inflows improved by 18.4%, with the 53.5% boost in net loan proceeds to $158.8 million and a two-third strengthening in net real estate sales to $84.3 million offsetting the 40.3% reduction in net portfolio investments to $60.6 million. The net increase in the public sector's external debt incorporated proceeds from the $200 million external bond which reversed the Government's position to a net inflow of $196.0

million from a repayment of $21.5 million in 2002. However, public corporations had a net repayment of $137.8 million in the total, to contrast with the year-earlier $13.5 million net increase. Given the banking system's participation in the refinancing activities and reduced foreign currency claims on the private sector, the system recorded a net short-term capital outflow of $116.7 million vis-à-vis a $183.6 million net inflow in 2002.

Fiscal Operations

Indications are that the fiscal situation deteriorated further during 2003, amid persistent challenges from the sluggishness in the economy which constrained revenue performance and exacerbated by pressures stemming from salary increases in the first half of FY2003/04. Expectations are that the economy will support healthier revenue growth by the second half of the fiscal year, and hence a more favourable fiscal outcome.

2002/2003 Performance

Preliminary results for FY2002/03 indicated a widening in the overall budget deficit to $187.9 million from $170.9 million in FY2001/02 (see Table 2). Mounting pressures from recurrent spending and increased budgetary support to public enterprises coincided with less than anticipated revenue collections. Total outlays increased by 6.0% to $1,089.7 million, some $19.6 million below budgeted allocations, while total revenue, although recovered by 5.2% to $901.3 million fell short of forecasted expectations by 6.7%.

After a 9.9% reduction in FY2001/02, total tax revenue recovered by 5.5% to $815.0 million, but lagged the budgetary forecast by 7.4%. The 7.3% recovery in taxes on international trade and transactions to $528.0 million, supported by increases in customs duties and collections, still trailed anticipated receipts by 7.8%, while tourism related receipts trailed both the previous fiscal year's intake and the budget. Non-tax revenue, at $86.8 million, marginally exceeded the FY2001/02 intake, and was some 11.6% above expectations, owing mainly to gains in income from public enterprises, fines, forfeitures and administrative fees.

Recurrent outlays of $962.8 million were 0.9% above the approved allocations and represented a firmer 7.4% increase, inclusive of over-budgeted growth in salary payments (4.6%) and purchases of goods and services (16.5%). Net lending to public corporations, at $43.1 million, also exceeded the budget and the FY2001/02 outlay by 53.9% and 56.7%, respectively. A

TABLE 2: Government's Budget (B$'000)

	FY2000/01	FY2001/02	FY2002/03		FY2003/04	
	Actual	Actual	Approved Estimates	Preliminary Estimates	Approved Estimates	Preliminary[1] Estimates
Government Revenue	957,508	856,838	962,761	901,791	991,503	446,069
Government Expenditure (i+ii+iii)	975,182	1,027,771	1,109,302	1,089,702	1,114,493	501,828
i) Recurrent Expenditure	847,689	896,704	953,894	962,845	968,938	462,559
ii) Capital Expenditure	85,034	103,572	127,435	83,797	119,705	24,050
iii) Net Lending	42,459	27,495	27,973	43,065	25,850	15,219
Surplus/(Deficit)	(17,674)	(170,933)	(146,541)	(187,911)	(122,990)	(55,759)

SOURCE: Ministry of Finance
Compiled according to the IMF's Government Finance Statistics Format. [1] July - December, 2003

significant share of budgeted capital outlays was deferred (34.2%), with the $83.8 million spent consequently 19.8% lower than the previous year's outlay, as a result of a retrenched infrastructural works programme—including the New Providence Road improvement project. Budgetary financing for the fiscal year included net Bahamian dollar and foreign currency borrowings of $156.4 million and $21.5 million, respectively.

2003/2004 Budget

The Budget for FY2003/04, approved by Parliament in June, targeted a sizeable consolidation of the deficit to 2.2% of GDP, following average shortfalls in excess of 3.0% in the previous two fiscal years. Cognizant of the tentative nature of the anticipated economic recovery, the budget concentrated on further expenditure containment measures and on enhancements to the revenue administration process. Strengthening the economy's competitiveness and advancing social welfare policies that fortify labour skills capacity remained key considerations of the medium-term objective, together with an ongoing resolve to expand the availability of adequate and affordable housing.

The Budget neither introduced new taxes nor increased existing ones, but projected increased revenue—primarily from anticipated improvements in tax administration, with particular attention to combating fraud and tax evasion. Gains were also expected from an expansion in the tax base as the economy improved. Parliament approved customs import duty relief for the elderly, the handicapped, chronically ill and other socially disadvantaged groups.

Relative to the preliminary outcome for FY2002/03, revenue and grants are projected to increase by 9.0% to $991.5 million—some 3.0% above the original FY2002/03 forecast. Approved expenditure, including net lending to public corporations, was placed 2.3% higher at $1,114.5 million. When combined with the $24.0 million retroactive pay increase granted to Civil Servants in December 2003, which was not provided for in the estimates, the deficit could decrease by some $40.9 million (21.8%) to $147.0 million.

In the revenue performance, tax collections are expected to rise by 9.1% above the previous year's receipts to $889.3 million, based on gains from levies on tourism related activities, customs duties and property taxes. By contrast, non-tax receipts are set to fall short of the 2002/03 outturn by $3.0 million (3.5%) to $83.8 million, owing to reduced income from public enterprises. It is anticipated that the overall revenue outcome would be supplemented by capital revenue of $18.0 million, arising from the Government's planned sale of equity holdings in Cable Bahamas and the Bank of The Bahamas.

The combined recurrent and capital expenditure budget was $42.0 million (4.0%) in excess of the preliminary outcome for FY2002/03, while provisions for net lending to public corporations were 40.0% less at $25.9 million.

Current expenditure, at $968.9 million, exceeded the 2002/03 provisional outcome by $6.1 million (0.6%). This included a 5.2% increase in the wage bill—the largest single component (43.9%)—along with a 2.4% rise in transfer payments, which cover interest charges, subsidies and non-interest transfers. Purchases of goods and services, at 21.1% of the recurrent budget, were 0.3% below the comparative fiscal year.

Compared to preliminary estimates for FY2002/03, the capital budget rose by $35.9 million (42.9%) to $119.7 million, and foreshadowed a resumption of activity on the New Providence road improvements and other major public works and infrastructure projects, at a total planned outlay of $53.3 million. Relative to the preliminary outcome for FY2002/03, the capital development budget allocated a doubling in investments for defense ($4.0 million) and health ($12.2 million); a 48.5% increase for national security ($4.9 million) and nearly doubled expenditures for education ($20.2 million)—the second largest investment component. Outlays for anticipated airport upgrades, particularly in the Family Islands, were reflected in the 48.7% hike in provisions for transportation ($5.5 million) related investments.

The $123.0 million deficit provisioned in the 2003/04 budget is expected to be financed through domestic borrowings of $173.3 million and $26.1 million in external loans, net of scheduled debt amortization of $74.0 million. This suggests a potential $125.4 million advance in the Direct Charge on Government, to exceed $1.97 billion by end-June 2004. Given the possible increase in the debt guaranteed for the public sector, the National Debt is likely to advance to beyond $2.49 billion for the same period.

First 6 Months of FY2003/04

According to provisional estimates of budgetary operations for the first six months of the fiscal year, the overall deficit widened to $55.8 million from $33.1 million over the first half of FY2002/03. Estimated revenues decreased marginally (0.6%) to $446.1 million, approximating 45.0% of budgeted expectations. Total expenditures, including net lending to public enterprises, rose by 4.2% to $501.8 million, also equivalent to 45.0% of the approved amount, with growth partly linked to unplanned salary increases, and exceeding the reduction in capital spending.

On the revenue side, tax receipts, which represented some 91.5% of total collections, fell by $4.1 million (1.0%) to $408.4 million. Soft domestic import demand and sluggish tourism activity, caused levies on international trade (mainly import duties) and selected tourism taxes (including gaming and room occupancy taxes) to contract by 0.7% and 16.8%, to $240.0 million and $10.0 million, respectively. The "other" category, which represented undisaggregated taxes, was also broadly lower at $46.5 million from $54.7 million in the previous year. A combined revenue growth of $9.4 million (9.2%) to $109.0 million was registered for "other" stamp taxes, property and departure taxes and for business and professional licenses fees

Non-tax revenue rose by 4.2% to $37.7 million, as the one-fourth increase in fines, forfeitures and administrative fees outpaced the decrease in combined income from public enterprises and other sources.

Recurrent spending rose by $32.2 million (7.5%) to $462.6 million (92.2% of the total), while capital investments were scaled back by $11.1 million (31.6%) to $24.1 million and net lending to public enterprises almost stabilized at $15.2 million. Notable under the recurrent component was the $16.5 million (8.3%) hike in the wage bill to $215.9 million, mainly reflecting the unbudgeted $100 per month pay increase honoured in December and made retroactive to July, for a $12 million impact on the total. Purchases of goods and services also advanced, by $5.7 million (7.4%) to $82.2 million. Based on an increased debt stock, interest payments rose by $6.3 million (13.0%) to $55.1 million, concentrating a larger share in foreign currency. Subsidies and non-interest transfers were higher by $3.7 million (3.5%) at $109.4 million, associated principally with increased support to quasi-autonomous agencies.

The one-third reduction in capital expenditure during the first six months of the fiscal year was explained primarily by a halving of investments for public works and infrastructure projects to $10.9 million and a one-fourth easing in investments for education to $6.0 million. By contrast, outlays for general public services were some two-thirds higher at $3.5 million.

Budgetary financing for the first half of FY2003/04 included net domestic currency borrowing of $17.0 million and a $68.1 million net increase in foreign currency debt. Bahamian dollar financing was dominated by a $75.0 million

Registered Stock issue in July, paying interest at 0.09375% to 0.375% above Prime on maturities ranging between 10 to 19 years. Foreign currency debt operations were highlighted by the flotation of the US$200.0 million 30 year bond in July, paying interest of 6.625%, and priced at 98.936% of par. Net proceeds after flotation costs, of approximately $195.0 million were mostly utilized to refinance the US$125.0 million facility obtained from domestic commercial banks in 2002.

After these transactions, the Direct Charge on Government increased by $48.0 million (2.7%) in the first six months of the fiscal period, and by $133.1 million (7.4%) to $1,939.6 million for the calendar year. Bahamian dollar claims, which accounted for 85.0% of the total, rose by $67.1 million (4.2%) to $1,647.6 million during 2003. By creditor profile, the majority of Bahamian dollar debt was held by public corporations (40.9%), followed by private and institutional investors (26.2%), domestic banks (25.9%) and the Central Bank (7.0%).

During 2003, Government's contingent liabilities grew by 6.9% to $429.4 million, mainly attributed to increased commitments guaranteed for the Education Loan Authority. Consequent on these developments, the National Debt advanced further by $160.8 million (7.3%) to $2,369.0 million at end-December 2003, following a $245.4 million (12.5%) accretion in 2002.

Foreign Currency Debt

Public sector foreign currency debt expanded by $44.2 million (8.5%) to $566.3 million at end-2003 (see Table 3), compared to a stronger advance of $119.2 million (29.6%) in 2002. Dominated by refinancing activity, total borrowing of $342.1 million occurred alongside repayments of $297.9 million. For Government, drawings of $205.0 million included proceeds from the US$200 million bond, which mainly refinanced a US$125 million foreign currency facility. The net effect was a $66.0 million (29.2%) increase in Government's component to $292.0 million, for an expanded 51.6% share of the total. The remaining $274.3 million (48.4%) was held by public corporations, which represented a decline of $21.7 million from 2002, despite some $137.1 million in drawings which largely refinanced $120.0 million of the Bahamas Electricity Corporation's multilateral debt.

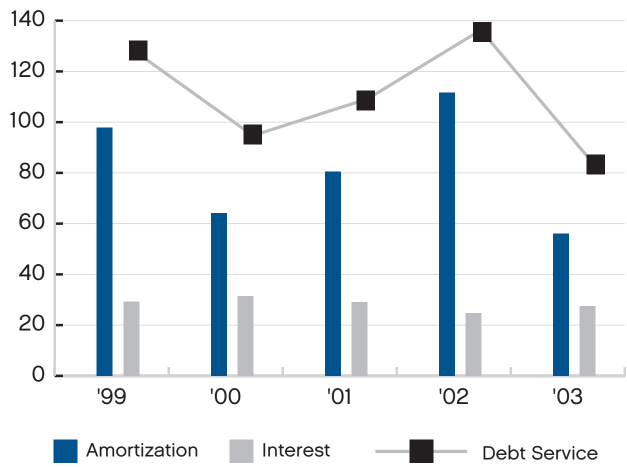
TABLE 3: Public Sector Foreign Currency Debt (B$'000)

	2000p	2001p	2002p	2003p
A. EXTERNAL DEBT	**347.3**	**325.9**	**290.8**	**349.1**
i) Government	110.2	117.5	96.0	292.0
ii) Public Corporations	237.1	208.4	194.8	57.1
Of Which Gov't Guaranteed	219.1	192	180.7	44.5
B. INTERNAL FOREIGN CURRENCY DEBT	**77.9**	**77.0**	**231.4**	**214.3**
i) Government	20.8	36.4	130.0	0
ii) Public Corporations	57.1	40.6	101.4	214.3
Of Which Gov't Guaranteed	0	0	36.2	165.7
C. TOTAL FOREIGN CURRENCY DEBT	**425.2**	**402.9**	**522.2**	**563.4**
D. DEBT SERVICE RATIO	**3.8**	**4.8**	**5.6**	**3.5**

SOURCE: Treasury Accounts, Treasury Statistical Summary Printouts and Public Corporations' Quarterly Reports

Refinancing activities resulted in significant shifts in the creditor profile. Domestic banks still held the largest share of the foreign currency debt, at 41.6% vis-à-vis 49.8% at end-2002. The share held by private institutional investors rose to 39.7% from 4.8%, while the proportion held by multilateral institutions was lowered to 18.8%. With the 30-year US bond issue, the average term to maturity for the debt lengthened by approximately 7 years to 17 years, with over 95% of the liabilities denominated in US dollars.

Foreign Currency Debt Service (B$ Millions)



Total debt service was $189.3 million higher at $325.8 million, inclusive of the 11.5% increase in interest payments to $27.6 million. Adjusted debt servicing, net of $80.6 million in refinancing, as a percentage of estimated exports of goods and non-factor services decreased to 3.5% from 5.6% in 2002. The Government's adjusted foreign currency debt service to total revenue normalized at 3%, relative to an elevated 8.3% in 2002 when a $25.0 million development bond matured.

Real Sector

Tourism

After rebounding during 2002, tourism sector output firmed mildly in 2003, with further pricing gains in the stopover market augmented by steady growth in cruise visitors. The performance was buoyed by strengthened results in the fourth quarter, after some comparative weakening during the second and third quarters, with overall gains in New Providence and the Family Islands offsetting an expenditure decline for Grand Bahama. However, the pace of industry growth remained constrained by demand weakness in the US household sector, where labour market conditions remained soft despite notable progress in economic growth. The outlook for The Bahamas' tourism performance is expected to improve in 2004 as more favourable conditions take hold among US households by the second half of 2004, and amid the persistent weakness in the US dollar.

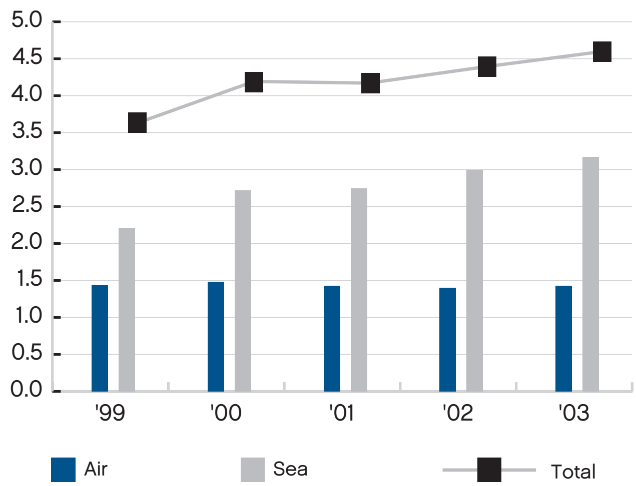
Tourist arrivals to The Bahamas rose by 4.3% to 4.6 million in 2003, extending the 2002 increase of 5.3% and surpassing the 2000 mark by 9.3% (see Table 4). After consecutive declines in the previous two years, air traffic rebounded by 1.9% to 1.4 million, which remained some 3.5% below 2000. Sea arrivals, which encompass cruise visitors, continued to dominate the mix, but with gains abated from 9.0% in 2002 to 5.4% for 3.2 million passengers.

TABLE 4: Visitor Arrivals

Period	Air Arrivals	% Change	Sea Arrivals	% Change	Total	% Change	Occupied Room Nights	% Change
1999	1,438,887	10.3	2,209,404	8.2	3,648,291	9.0	2,088,389	13.0
2000	1,481,545	3.0	2,722,286	23.2	4,203,831	15.2	2,199,358	5.3
2001	1,428,124	-3.6	2,754,547	1.2	4,182,671	-0.5	2,117,729	-3.7
2002	1,402,894	1.8	3,003,077	9.0	4,405,971	5.3	2,134,962	0.8
2003	1,428,973	1.9	3,165,069	5.4	4,594,042	4.3	2,100,975	-1.6

SOURCE: The Bahamas Ministry of Tourism

Tourism (Millions)



Among the major island destinations, healthier arrival trends for New Providence and the Family Islands contrasted with a decline for Grand Bahama. Following contractions in both the air and sea components of a combined 4.7% in 2002, arrivals to New Providence rose by 2.0% (see Table 5). For the Family Islands, arrivals strengthened further by 11.9%, based on recovered air traffic of 14.4% and sea visitor growth of 11.5%. Reversing the 0.3% increase in 2002, total visitors to Grand Bahama fell by 0.8%, as the 2.6% downturn in air traffic outweighed the incremental 0.9% growth in sea arrivals.

Expenditure indicators suggest that industry earnings rose only marginally during 2003, with receipts from an increased number of cruise traffic supported by hotel sector pricing gains. Growth in estimated hotel room revenues slackened to 3.7% from 6.6% in 2002, with the 5.3% increase in the average nightly room rate to $164.22, offsetting a 1.6% reduction in total room nights sold. As the latter occurred alongside a 3.0% rise in total room nights available for sale, the average hotel occupancy rate also softened to 59.0% from 62.0% in 2002.

On a destination basis, New Providence's room revenue gains narrowed to 4.6% from 7.9% in 2002, with inroads from the smaller appreciation in the average nightly room rate of 5.6% to $188.11 partly offset by slightly reduced room sales of 1.0%. In Grand Bahama, room revenues registered a marginal downturn of 0.4%, as reduced room sales of 3.4% outweighed the 3.2% rise in the average nightly room rate to $84.05. However, Grand Bahama experienced a 9.9% boost in room inventory from renovated properties returned to use, causing the average occupancy rate to retreat to 48.0% from 55.0% in 2002. For the third consecutive year, Family Island room revenues declined, although moderated at 2.9% from 7.8% in 2002. While average room rate and occupancy levels were unchanged, at $160.36 per night and 35% respectively, both capacity and room sales fell by approximately 2.9%.

The outlook for tourism is expected to strengthen throughout 2004, particularly in the stopover segment, as the United States' expansion deepens and embraces the labour markets. The weak US dollar also continues to make vacations in The Bahamas a cheaper alternative to Europe and Asia, although travel safety concerns, while

TABLE 5: Growth in Tourist Arrivals (% Change)

PORTS OF ENTRY	2000	2001	2002	2003	2003 Market Share
Nassau/Paradise Island	17.6	1.0	(4.7)	2.0	57.4
Grand Bahama	1.1	(6.3)	0.3	(0.8)	13.7
Rest of Family Islands	21.6	(0.5)	41.2	11.9	28.9
TOTAL	15.3	(0.5)	5.2	4.3	100.0

SOURCE: The Bahamas Ministry of Tourism

steadily dissipating, still persist. The outlook is for healthy stopover visitor gains in the Family Islands, concentrated in Exuma, owing to the presence of the upscale 183 rooms Four Seasons Resort, which opened in November 2003, and supported by the re-opened Club Med property at San Salvador which was closed since 2001. Planned improvements to several major airports in the Family Islands and New Providence should complement the favourable outlook. Foreign investments aimed at adding more upscale rooms capacity to the hotel sector within most of the major islands, including New Providence and Grand Bahama, underscore increasing confidence in the medium term outlook for the tourism sector. Among these are the start of work on the $600 million Phase III expansion of the Atlantis Resort on Paradise Island, a $140 million development on Abaco and another $240 million project earmarked for Exuma.

Construction

Available indicators suggest that construction output weakened during 2002. Although increased, support from foreign investment expenditures still significantly lagged the highs of the 1998-2000 period, and were overshadowed by abated domestic mortgage flows and contributions from public infrastructural works. Activity is expected to strengthen in 2004, as significant new foreign investment projects commence in the hotel sector.

Based on latest available data for the first six months of the year, the number of building starts rose by 3.1% to 666, with the estimated value 3.2% lower at $113.1 million (see Table 6). Housing starts advanced in number by 5.0% to 609 and in value by 18.0% to $95.4 million, while commercial activity dipped in number by 14.1% and was halved in value to $17.3 million. Public sector projects started remained at two, with estimated value reduced to $0.4 million from $1.6 million in 2002.

TABLE 6: Construction, All Bahamas (B$'000)

	1999	2000	2001	2002	YTD - June 2002	YTD - June 2003
Building Permits						
Number	3,206	3,208	3,053	3,016	1,572	1,448
Value	646,539	536,586	752,030	529,448	254,736	214,731
Building Starts						
Number	1,065	1,064	1,010	1,324	646	666
Value	162,496	193,443	177,907	275,753	116,757	113,058
of which:						
i) Residential						
Number	976	976	933	1,180	580	609
Value	133,450	162,679	144,713	170,732	80,854	95,421
ii) Commercial						
Number	89	87	71	140	64	55
Value	29,046	30,549	30,358	100,406	34,313	17,274
iii) Public						
Number	-	1	6	4	2	2
Value	-	215	2,836	4,614	1,590	363
Building Completions						
Number	1,250	1,519	1,706	1,602	763	779
Value	247,682	299,982	323,957	304,752	154,889	130,909

SOURCE: Department of Statistics, Quarterly Bulletin of Construction Statistics

Building completions rose by 2.1% to 779 units, but were depreciated in value by 15.5% to $130.9 million. With commercial activity concentrated on smaller projects, the 10.4% increase in the number of units completed to 85, corresponded to a 47.8% decline in associated value to $21.3 million. Similarly, the number of residential completions rose by 0.9% to 691, but valuation declined by 17.9% to $93.6 million.

Building permits issued during the first half of 2003, which partly underpinned investments during the second half of the year, fell by 7.9% in number to 1,448, and by 15.7% in value to $214.7 million. Commercial permit valuations contracted by more than half to $39.0 million, limiting the overall growth in housing permits to 2.2% at $172.1 million.

Annual mortgage lending data, as reported by domestic banks, insurance companies and the Bahamas Mortgage Corporation, indicate a weakening in the financing support for domestic construction activity. The value of mortgage commitments for new construction and repairs to existing structures fell by almost one third to $91.5 million, with commercial commitments reduced by more than half to $20.4 million and the residential component, by 17.2% to $71.0 million. Mortgage loan disbursements advanced by 7.1% to $301.3 million and, while mainly for residential approvals, contained important equity loans amounts. As regard financing cost, indications are that industry wide average interest rates on residential and commercial mortgages were unchanged at 9.0% and 9.6%, respectively.

Fisheries

Stronger export data suggested a healthy increase in fisheries output during 2003. Despite less favourable pricing, increased volumes supported a 8.6% rise in fisheries export earnings to $108.1 million in 2003. Crawfish shipments, which constituted 93.5% of volume and 97.7% of value, fetched receipts of 10.2% to $105.6 million, supported by a 23.1% boost in weight to 7.4 million pounds. The average price per pound, however, fell by 10.4% to $14.24. Meanwhile, export proceeds from conch, scale fish and other products fell by 31.7% to $2.5 million.

Prices

Inflation, as measured by changes in the average Retail Price Index, firmed to 3.0% from 2.2% in 2002 (see Table 7). This mainly reflected accelerated price increases for recreation & entertainment services (9.8%), medical care & health (9.8%), furniture & household operations (3.85%), transport & communication (1.82%) housing (0.74%) costs, as well as “other” non-disaggregated goods and services (12.04%). Conversely, the increase in average education costs abated sharply to 1.1% from the 12.9%

TABLE 7: Average Annual Percentage Changes in Retail Price Index, New Providence

Group	Weight	2000	2001	2002	2003
Food & Beverage	138.3	1.63	2.14	1.97	0.53
Clothing & Footwear	58.9	0.68	0.53	0.49	(0.06)
Housing	328.2	0.22	0.16	0.07	0.74
Furniture & Household Operation	88.7	2.02	2.60	4.91	3.85
Medical Care & Health	44.1	2.37	1.70	1.20	9.80
Transportation & Communication	148.4	2.30	1.63	0.13	1.82
Recreation, Entertainment & Services	48.7	(0.93)	3.52	2.48	9.81
Education	53.1	11.87	7.70	12.89	1.08
Other Goods & Services	91.6	(0.37)	5.52	2.06	12.04
ALL ITEMS	1,000.0	1.65	2.00	2.19	3.00

SOURCE: Department of Statistics

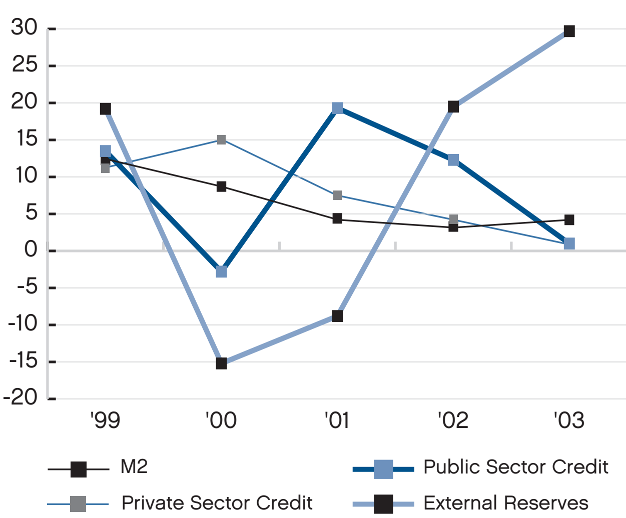
tuition fee led hike during 2002; was tempered for food & beverages (0.5%), and slightly decreased clothing & footwear costs (0.1%).

Money, Credit and Interest Rates

Monetary developments in 2003 featured an improvement in liquidity conditions amid the continuation of the Central Bank's credit restraint policy, which evoked slower domestic credit expansion, and supported by stronger private sector foreign currency inflows and net proceeds from public sector foreign currency borrowing. The latter also influenced a reduction in the financial system's net foreign liabilities. In this context, the weighted average deposit rate softened, but with a more sizeable firming in the average lending rate, the loan-deposit interest rate spread widened compared to 2002. Bank performance indicators suggest a reduction in profitability during 2003, mainly because of the moderation in credit growth.

Monetary policy was restrictive throughout 2003, as the Central Bank retained the credit ceiling imposed on the banks since September 20, 2001 in a continued bid to stem the downward pressure on external reserves in the context of the relatively soft economic growth performance (see article in Box I).

Monetary Developments (% Change)



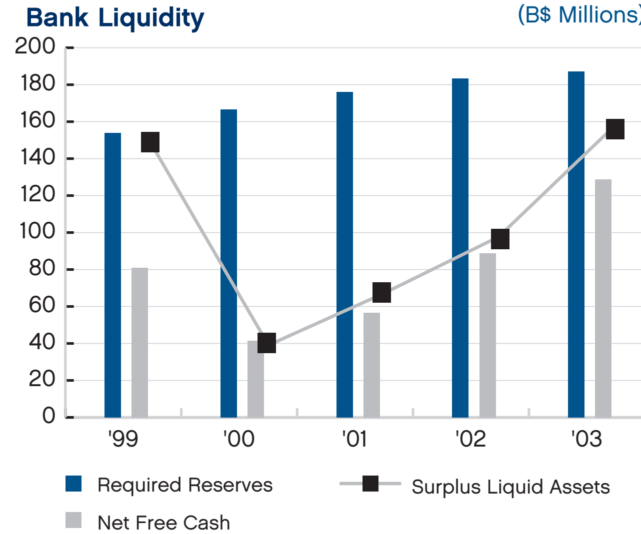
Liquidity

Average monthly liquidity, as measured by banks' free cash balances, improved by 11.6% to $131.8 million during 2003. The year-end position was also elevated by 45.0% to $128.9 million, representing a larger 3.4% of Bahamian dollar deposit liabilities compared to 2.4% the previous year. Similarly, average monthly surplus liquid assets rose by 27.1% to $146.4 million, corresponding to an expanded 24.4% of the statutory minimum from 19.5% in 2002. Free cash balances and surplus liquid assets peaked in August, at $164.8 million and $183.9 million respectively—corresponding with the seasonal high for net private sector foreign currency inflows and the timing of net receipts from the Government's bond issue in the same month. Both measures subsided over the remainder of the year, in line with the accommodation of seasonally elevated domestic credit demand.

Foreign Exchange

Increased public sector external borrowing and private sector inflows from tourism underpinned a hike in the volume of the Central Bank's net foreign exchange transactions during 2003. Total foreign currency sales rose by 43.1% to $787.1 million, with approximately 15.9% representing the debt refinancing flows associated with the external bond issue. Purchases were higher by 50.6% at $884.2 million, with almost

Bank Liquidity (B$ Millions)



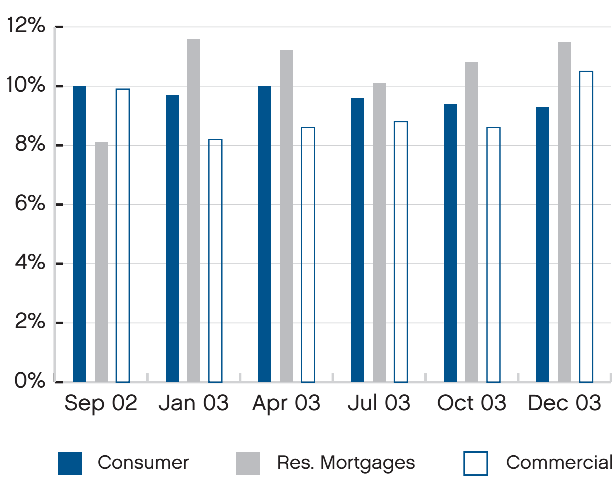
BOX I :
Monetary Policy During 2003

The Monetary Policy Committee (MPC) was established by the incumbent Governor in 1980, to promote efficiency and transparency in the formulation and conduct of monetary policy, and to ensure a well-organized decision-making process. The MPC also formulates recommendations for the Government on fiscal and Exchange Control matters, and reviews supervisory issues as they impact the domestic financial system. The MPC is chaired by the Governor and its membership includes the Deputy Governor, Economic Adviser and several department heads. While the Governor is ultimately responsible for the policies promulgated by the Bank, the Committee formally assists this process, and credibility is ensured by the consensus nature of decisions, acted upon by the Governor.

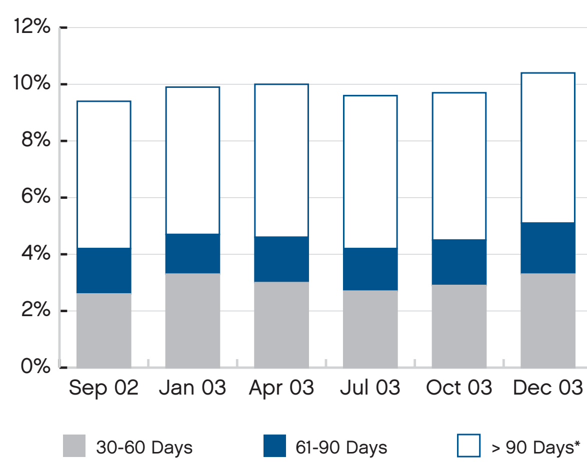
During 2003, the MPC continued to monitor trends in domestic credit, external reserves and liquidity, having particular regard to the ceiling imposed on financial institutions' Bahamian dollar loans and advances, since September 2001, to limit downward pressures on the external reserves. The MPC monitored conditions in the foreign exchange sectors of the economy, the state of public sector finances and the asset quality (loan performance) of domestic banks, to determine when it would be appropriate to remove or lessen the restrictions. The Committee concluded that the economy was not sufficiently strengthened during 2003 to warrant policy changes, notwithstanding improved outcomes for external reserves and bank liquidity, which both benefited from the existence of the controls. To ensure greater transparency and public understanding of how the policy framework operated, the Governor and senior officials of the Bank made a number of presentations during the year on the continuing rationale for the controls.

As part of the Bank's increased surveillance activities, the Committed started monitoring asset quality of domestic banks in the first quarter of 2003, to assess how economic conditions were affecting borrowers' ability to service their loans. The quarterly surveys indicate that over the period September 2002 - December 2003, the percentage of non-government guaranteed private sector loans in arrears firmed to 10.4% from 9.4% of Bank's total Bahamian dollar loans. This was after some slight easing in the arrears rate during the middle of 2003. The arrears rate on consumer balances declined since September 2002, partly in response to more aggressive loan write-offs, but firmed for residential mortgages and commercial loans.

B$ Loan Arrears as a % of Total Loans



Age of B$ Loan Arrears as % of Total Loans



Given the link between non-performing loans and economic conditions, the Central Bank also began to scrutinize financial institutions' provisioning policies, to ensure that adequate reserves were being appropriated for both general and specific loan losses. As a result, the Bank expects to see a gradual increase in average provisioning levels relative to non-performing loans over the next few years. To detect when the economic recovery would begin to have a positive impact on asset quality, the Bank focused more closely on the age distribution of arrears, particularly more recently distressed balances in the 30 – 60 day range and arrears of 90 days and over.

Given questions as to whether the restrictions on bank lending had caused any shift in domestic credit demand to the insurance sector, the MPC also commissioned a survey on lending trends and conditions in this sector. The results, which did not confirm this, indicate that the insurance companies experienced slowed assets growth during 2000-2002, and therefore also a reduced rate of credit expansion. The sector's arrears rate on mortgages and other loans had also increased.

Other important focuses of the MPC during 2003 were on developing recommendations for the Government on the introduction of a market based mechanism for the issuance of domestic bonds and on fine tuning administrative procedures for Exchange Control. Going forward, the Committee expects to make more enhancements to its policy formulation framework and to increase its intelligence gathering capabilities on the real sector of the economy.

half of the growth linked to the proceeds from the bond transaction. The resultant net foreign currency purchase widened to $97.1 million from $37.3 million (see Table 8).

On a seasonal basis, total purchases during the first half of the year at $375.7 million, lagged the previous year's $381.0 million, whereas total sales were stronger at $283.9 million versus $249.0 million in 2002. As a consequence, the net purchase for the period was almost a third less at $91.8 million. In the second half of 2003, both purchases and sales strengthened to $508.5 million and to $503.2 million from $206.3 million and $301.0 million respectively, partly in response to the proceeds from the bond issue. The public corporations' refinancing activity did not impact gross foreign currency flows.

For the year, the Bank's net purchase from commercial banks rose almost three-fold to $187.2 million, in the context of modest improvement in tourism and the slowdown in credit growth. This outstripped both the 44.3% increase in the net sale to "other" customers (mainly the public corporations) to $154.5 million, and the $64.4 million net purchase from Government, which was 20.9% less than in 2002 because of the net proceeds from the bond.

Against this background, and taking into

TABLE 8: Central Bank Foreign Exchange Transactions (B$'000)

	COMMERCIAL BANK			GOVERNMENT			OTHER			TOTAL		
Period	Purchases	Sales	Net Purchase/ (Sale)	Purchases	Sales	Net Purchase/ (Sale)	Purchases	Sales	Net Purchase/ Sale	Purchases	Sales	Net Purchase/ (Sale)
Qtr.I	118,639	48,403	70,236	21,468	30,906	(9,438)	4,707	31,604	(26,897)	144,814	110,913	33,901
Qtr.II	93,611	67,695	25,916	23,772	31,842	(8,070)	6,521	29,570	(23,049)	123,904	129,107	(5,203)
Qtr.III	73,494	99,694	(26,200)	16,192	27,508	(11,316)	2,485	22,228	(19,743)	92,171	149,430	(57,259)
Qtr.IV	102,086	115,531	(13,445)	23,637	29,430	(5,793)	5,475	48,160	(42,685)	131,198	193,121	(61,923)
2000	**387,830**	**331,323**	**56,507**	**85,069**	**119,686**	**(34,617)**	**19,188**	**131,562**	**(112,374)**	**492,087**	**582,571**	**(90,484)**
Qtr.I	128,806	51,620	77,186	23,078	21,702	1,376	4,654	47,445	(42,791)	156,538	120,767	35,771
Qtr.II	89,598	59,517	30,081	25,484	41,936	(16,452)	2,083	33,304	(31,221)	117,165	134,757	(17,592)
Qtr.III	72,425	87,070	(14,645)	17,308	38,441	(21,133)	5,873	35,065	(29,192)	95,606	160,576	(64,970)
Qtr.IV	105,369	77,650	27,719	35,115	35,489	(374)	2,998	27,172	(24,174)	143,482	140,311	3,171
2001	**396,198**	**275,857**	**120,341**	**100,985**	**137,568**	**(36,583)**	**15,608**	**142,986**	**(127,378)**	**512,791**	**556,411**	**(43,620)**
Qtr.I	115,075	37,711	77,364	47,145	36,108	11,037	1,203	31,580	(30,377)	163,423	105,399	58,024
Qtr.II	95,189	48,506	46,683	120,569	69,896	50,673	1,838	25,241	(23,403)	217,596	143,643	73,953
Qtr.III	39,934	82,477	(42,543)	47,152	26,123	21,029	2,495	37,342	(34,847)	89,581	145,942	(56,361)
Qtr.IV	67,291	85,771	(18,480)	29,900	31,245	(1,345)	19,517	38,019	(18,502)	116,708	155,035	(38,327)
2002	**317,489**	**254,465**	**63,024**	**244,766**	**163,372**	**81,394**	**25,053**	**132,182**	**(107,129)**	**587,308**	**550,019**	**37,289**
Qtr.I	171,218	60,622	110,596	31,476	36,831	(5,355)	2,105	39,162	(37,057)	204,799	136,615	68,184
Qtr.II	142,937	84,058	58,879	25,507	31,379	(5,872)	2,499	31,803	(29,304)	170,943	147,240	23,703
Qtr.III	122,949	109,159	13,790	218,432	146,194	72,238	5,770	44,581	(38,811)	347,151	299,934	47,217
Qtr.IV	120,126	116,119	4,007	35,801	32,402	3,399	5,405	54,779	(49,374)	161,332	203,300	(41,968)
2003	**557,230**	**369,958**	**187,272**	**311,216**	**246,806**	**64,410**	**15,779**	**170,325**	**(154,546)**	**884,225**	**787,089**	**97,136**

SOURCE: The Central Bank of The Bahamas

account income on the invested balances, external reserves grew by $110.9 million during the year (29.7%) to $484.1 million, which was significantly above the year-earlier $60.8 million (19.5%) increase. Balances, which averaged $487.5 million over the course of the year, achieved a record month-end peak of $667.3 million in July. At year's end, reserves were equivalent to an estimated 16.6 weeks of non-oil merchandise imports compared to 12.0 weeks at end 2002. By law, the Central Bank is required to keep, at a minimum, external reserves which are equivalent to 50% of its demand (currency and deposit) liabilities. After discounting the external balances for this amount, the "useable reserves" stood at $137.4 million compared to $227.5 million in 2002.

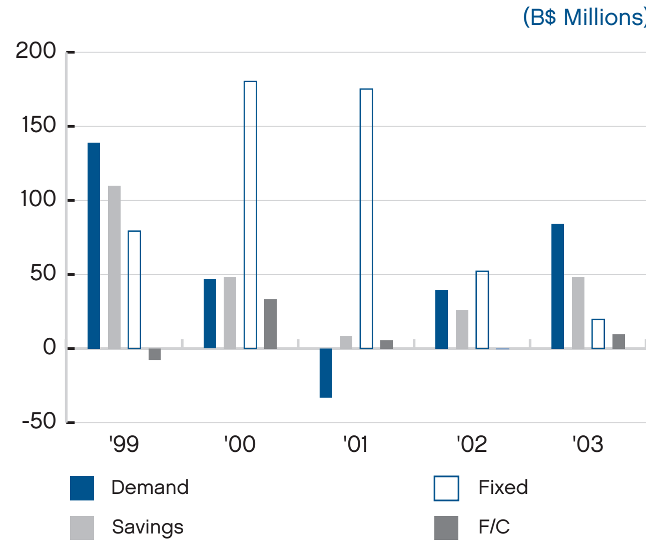
Money Supply

Concentrated mainly in an accelerated build-up of private sector balances, monetary expansion strengthened in 2003, halting the softening uptrend established since 2000. Narrow money (M1) rose further by 11.0% to $907.3 million, more than doubling the 2002 gain to comprise 22.7% of the overall stock. Stronger accumulations of both public corporations and private sector holdings reinforced more than twofold gains in demand deposits of $84.3 million (12.7%), while growth in currency in circulation firmed slightly to $5.3 million (3.4%).

Expansion in broad money (M2) quickened to $157.4 million (4.2%) from $119.3 million (3.3%) in 2002. Savings deposits growth, mainly attributed to private individuals, almost doubled at $48.1 million (7.6%), and outweighed slowed expansion in fixed deposits of $19.7 million (0.9%) vis-à-vis $52.2 million (2.3%) in 2002, when a larger net withdrawal of public corporation balances muted increased net placements by private business and private financial institutions.

Residents' foreign currency deposits recovered by $9.7 million (10.6%), cancelling out last year's marginal decline of $0.2 million (0.2%). As a result, overall money (M3) rose further by $167.1 million (4.4%) to $4,003.3 million, contrasting with more constrained

Changes in Bank Deposits



advances of $119.1 million (3.2%) and $158.1 million (4.4%) respectively, in the previous two years.

Bahamian dollar fixed deposits remained the largest component of the money stock (57.8%), followed by demand (18.7%) and savings deposits (17.0%). The remainder consisted of currency in the hands of the public (4.0%) and foreign currency deposits (2.5%).

Categorized by holder, private individuals held the largest share (55.1%) of Bahamian dollar deposits liabilities, followed by business firms (24.5%), the public sector (10.4%), private financial institutions (4.9%) and "others" (5.1%)–which included institutional investors.

Based on the value and number of deposit accounts, holdings in individual balances under $10,000 represented 90.5% of contracts, although only commanding 9.2% of the total value of deposit liabilities. Conversely, balances of over $50,000 constituted 76.4% of the value of deposits, but only 2.9% of the accounts, and placements valued between $10,000 and $50,000 represented 6.6% of the accounts and 14.4% of the value.

Domestic Credit

Growth in domestic credit slowed sharply to $50.6 million (1.0%) from $263.1 million (5.6%) in 2002 (see Table 9). With diminishing slack under the credit ceiling that has remained in place since 2001, private sector borrowing moderated significantly and credit flows to the public sector were nearly reversed to a net repayment. Bahamian dollar denominated net credit growth steadied at $107.4 million (2.5%), while foreign currency claims were reduced by $56.8 million (7.8%) following a $180.0 million (32.9%) advance which represented two-thirds of the 2002 expansion.

Reflecting a near reversal in net foreign currency claims, expansion in banking sector claims on the public sector slowed sharply to $8.6 million (1.0%) from $95.6 million (12.3%) in 2002. Government's use of the bulk of proceeds from the external bond issue to repay $125.0 million in foreign currency credit received in 2002, resulted in a net repayment of $144.9 million (22.2%) compared to the net borrowing of $25.4 million (4.1%) in 2002. Conversely, the refinancing of some $120 million in external multilateral debt for the Bahamas Electricity Corporation underpinned an increase in financial institutions' total claims on the rest of the public sector, by $153.5 million (70.0%) relative to the $70.2 million (47.1%) growth in 2002—the bulk of which was also in foreign currency.

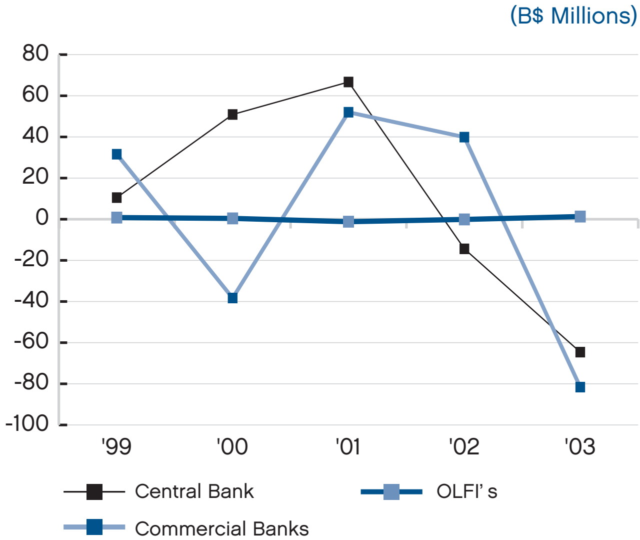
Led by a sharply accelerated reduction in consumer credit and a net repayment of foreign currency debt, private sector credit growth slackened to $31.8 million (0.8%) from $166.1 million (4.3%) in 2002. Expansion in the Bahamian dollar portion was nearly halved to $89.5 million (2.5%), while industrial sector repayment underpinned a decline in foreign claims by $57.7 million (12.3%), when contrasted

TABLE 9: Flow of Credit In The Financial System (B$ Millions)

	Outstanding as at 2000	Absolute Changes 2001	2002	2003	Outstanding as at 2002
Destination					
Government (net)	508.5	117.5	25.4	(154.9)	506.5
Central Bank	120.7	66.7	(14.4)	(64.6)	108.4
Commercial Banks	383.4	52.0	39.9	(91.6)	393.7
Other Financial Local Institutions	4.4	(1.2)	(0.1)	1.3	4.4
Rest of Public Sector	141.3	7.9	70.2	153.6	372.9
Central Bank	8.4	(0.5)	(0.3)	(0.3)	7.3
Commercial Banks	132.8	8.4	70.5	153.9	365.6
Other Financial Local Institutions	0.1	-	-	-	-
Private Sector	3628.8	273.3	167.5	42.0	4,111.6
Commercial Banks	3513.1	268.8	143.7	39.3	3,964.9
Other Financial Local Institutions	115.7	4.5	23.8	2.7	146.7
Financing					
Liabilities to the private sector & rest of the public sector	3559.0	119.1	119.1	167.1	4,003.3
Currency	151.4	1.3	1.3	5.3	160.1
Demand deposits	726.7	27.9	27.9	102.8	836.4
Savings deposits	600.6	28.6	28.6	47.3	682.4
Fixed Deposits	2080.3	61.3	61.3	11.7	2,324.4
International reserves	342.6	60.8	60.8	110.9	484.1
Other net external liabilities ( ) = increase	(429.2)	(183.6)	(183.6)	116.7	(613.8)
Capital and surplus	674.8	65.7	65.9	313.6	1,135.0
Other (net)	41.8	44.5	44.7	202.5	277.0

SOURCE: The Central Bank of The Bahamas

Changes in Net Claims on Government



with the 2002 increase of $16.8 million (3.7%).

Personal loans, which represented 62.6% of total claims, increased at an abated pace of $113.9 million (4.2%) compared to $163.9 million (6.4%) in 2002 (see Table 10). A further breakdown shows an extended net consumer credit repayment of $41.5 million (2.9%) from $4.4 million (0.3%) in 2002, in contrast to a nearly stable advance in housing loans—mainly residential mortgages—at $156.5 million (13.6%), and reduced growth in personal overdrafts of $2.3 million (4.7%) relative to the 2002 rebound of $11.9 million (32.5%).

The net credit repayment among most other private sector components was more sizeable in 2003, mainly reflecting net repayments during the first three quarters of the year, while growth in business sector loans narrowly outpaced personal lending in the fourth quarter. For the year, larger net sectoral repayments registered for construction ($59.6 million), transport ($33.0 million), manufacturing ($4.9 million), mining & quarrying ($4.2 million). These were joined by a contraction in sectoral claims for tourism ($20.0 million), private financial institutions ($7.7 million) and professional and other services ($1.1 million). Conversely, a larger net gain was registered for miscellaneous loans ($33.1 million), with a net upturn in lending for fisheries ($9.6 million), distribution ($3.1 million), agriculture ($1.6 million), and entertainment & catering ($1.0 million).

Despite the total decline in consumer lending, notable growth was evident for land purchase ($13.1 million) and home improvement

TABLE 10: Average Annual Percentage Changes in Retail Price Index, New Providence

Sector	2000		2001		2002		2003	
	$	%	$	%	$	%	$	%
Agriculture	8.7	0.2	15.8	0.4	9.0	0.2	10.6	0.2
Fisheries	6.8	0.2	6.7	0.2	5.3	0.1	14.9	0.3
Mining & Quarrying	21.9	0.6	23.6	0.6	21.0	0.5	16.7	0.4
Manufacturing	93.1	2.4	67.5	1.6	64.4	1.4	59.6	1.3
Distribution	181.9	4.8	225.5	5.4	220.6	5.0	223.7	5.0
Tourism	230.8	6.0	228.5	5.5	238.8	5.4	218.8	4.8
Entertainment & Catering	38.1	1.0	33.4	0.8	33.4	0.8	34.5	0.8
Transport	62.7	1.6	71.5	1.7	65.0	1.5	32.0	0.7
Construction	334.7	8.7	363.0	8.8	337.2	7.6	277.6	6.2
Government	89.0	2.3	115.4	2.8	170.0	3.8	74.5	1.7
Rest of Public Sector	131.1	3.4	133.2	3.2	202.5	4.6	347.0	7.7
Private Financial Institutions	12.0	0.3	28.2	0.7	36.6	0.8	28.9	0.6
Professional & Other Services	126.6	3.3	125.0	1.7	130.5	2.9	129.4	2.9
Personal	2,294.9	59.8	2,548.7	61.5	2,712.6	61.2	2,826.4	62.6
Miscellaneous	206.5	5.4	156.5	5.1	185.6	4.2	218.7	4.8
TOTAL	**3,838.8**	**100.0**	**4,142.5**	**100.0**	**4,432.5**	**100.0**	**4,513.3**	**100.0**

SOURCE: The Central Bank of The Bahamas

TABLE 11: Foreign Reserves Position (B$'000)

		2000	2001	2002	2003
1. THE CENTRAL BANK	EXTERNAL RESERVES (Beginning of Year)	404,041	342,561	312,399	373,168
a. SALES TO:					
i) Commercial Banks		331,323	275,857	254,465	369,958
ii) Government		119,686	137,568	163,372	246,806
iii) Other Customers		131,562	142,986	132,182	170,325
iv) Total Sales		582,571	556,411	550,019	787,089
b. PURCHASES FROM:					
i) Commercial Banks		387,830	396,198	317,489	557,230
ii) Government		85,069	100,985	244,766	311,216
iii) Other Customers		19,188	15,608	25,053	15,779
iv) Total Purchases		492,087	512,791	587,308	884,225
c. Gold Bullion		-	-	-	-
d. Reserve Tranche		(471)	(288)	641	800
e. SDR Tranche		89	(4)	(8)	(87)
f. Other		29,386	13,750	22,847	13,094
g. Unrealised (Depreciation)/Appreciation of Marketable Securities at market value		-	-	-	-
	INCREASE/(DECREASE) (During Year)	(61,480)	(30,162)	60,769	110,943
	EXTERNAL RESERVES (End of Year)	342,561	312,399	373,168	484,111
2. DOMESTIC BANKS	NET FOREIGN ASSETS POSITION (Beginning of Year)	(454,500)	(426,702)	(546,910)	730,471
a. Foreign Exchange Transactions		4,397	(44,690)	14,314	35,843
i) Net Purchase/(Sale): Central Bank		(56,507)	(120,341)	(63,024)	(187,272)
ii) Net Purchase/(Sale): Other Customers		60,904	75,651	77,338	223,115
b. Changes in Local Liabilities		383,042	290,461	335,500	412,801
c. Changes in Local Assets		355,244	410,669	519,061	296,130
	INCREASE/(DECREASE) (During Year)	27,798	(120,208)	(183,561)	116,671
	TOTAL NET FOREIGN ASSETS (End of Year)	(84,141)	(234,511)	(357,303)	(129,689)

SOURCE: The Central Bank of The Bahamas

($1.4 million) loans. By contrast, significant declines were posted for private cars ($22.5 million), consolidation of debt ($10.6 million), credit cards ($10.5 million) and for education ($7.9 million)—the latter reflects securitization and sale of a portion of Government guaranteed loans to institutional investors. In addition, net repayments occurred for furnishings & domestic appliances ($2.9 million) and travel ($2.2 million).

Interest Rates

In interest rate developments, the average spread between commercial banks' weighted average loan and deposit rates widened by 89 basis points to 8.11% during the year. The weighted average loan rate increased by 71 basis points to 12.04%, while the counterpart deposit rate fell by 18 basis points to 3.93%. Benchmark rates—the Central Bank's Discount Rate and commercial banks' Prime—held steady at 5.75% and 6.00%, where they have respectively remained since June and July 1999. However, the average 90-day Treasury bill rate fell by 72 basis points to 1.78%.

On the lending side, average interest rate firming was evidenced for overdrafts, which rose by a 93 basis point to 11.56%, for consumer loans, by 76 basis points to 13.83%; commercial mortgages, by 54 basis points to 9.58%, and for residential mortgages, by 9 basis points to 8.99%. For deposits, the average savings rate fell by 11 basis points to 2.66%, and the average range for fixed deposit rates declined to 3.81% - 4.59% vis-à-vis 4.04% - 4.62%.

Net Foreign Assets

As a result of the decline in domestic foreign currency credit and build-up in external reserves, the financial system's net foreign liabilities fell by $227.6 million (63.7%) to $129.7 million during 2003 (see Table 11). This contrasted with the $122.8 million (52.4%) rise to $357.3 million in the previous year, when the system financed an increase in foreign currency credit to the public and private sectors. Commercial banks' net foreign liabilities contracted by $122.2 million (16.9%), whereas OLFIs' net foreign liabilities rose by $5.5 million to $13.1 million, partly owing to profit remittances.

The third component the net foreign assets position, external reserves, strengthened by $110.9 million (29.7%) to $484.1 million, compared to the $60.8 million (19.5%) improvement achieved in 2002. Based on increased net foreign inflows through the private sector, the average monthly level was higher by 23.9% at $487.5 million, rising from an end-January low of $385.2 million to a July peak of $667.3 million when the Government floated the US $200 million bond issue.

Bank Profitability

Subdued growth in domestic banks' earnings assets base and higher operating costs resulted in a decrease in bank profitability for the second consecutive year. In the four quarters through September 2003, the most recent annual period for which consolidated data are available, net income fell by $14.7 million (10.1%) to $130.4 million, after a $27.2 million (15.8%) fall-off in the comparative period in 2002. With the effective interest rate spread on Bahamian dollar loans and deposits remaining at 6.08%, a nearly stable interest margin of $271.8 million contrasted with a 7.9% rise in commission and foreign exchange income to $24.6 million, stemming from elevated transactions volume. These developments were more than offset by the 10.1% rise in operating costs to $184.7 million, linked to increased staff expenses which captured redundancy payments made at the close of 2002. Other income, net of depreciation and bad debt expenses however, improved by 12.6% to $18.8 million. In this respect, both depreciation and bad debt expenses were significantly elevated, partly reflecting amortization of goodwill and boosted loan-loss provisions relative to impaired loan servicing.

Expressed as a proportion of average balance sheet assets, the net income ratio (return on assets) softened to 2.30% from 2.73% in 2002. The gross earnings margin, the combined ratio of net interest income and commissions and fee income, narrowed by 35 basis points to 5.22%, while the operating cost ratio firmed by 10 basis points to 3.25%. Some stability was provided by the positive contribution from the ratio for other income, net of depreciation and bad debt expenses, which was relatively unchanged at 0.34%.

Other Financial Sector Developments

Other financial sector developments during 2003 were headlined by amendments to the regulatory framework for combating money laundering and the enhanced legal framework for the investment funds industry. The Central Bank remained on schedule to complete the transitioning of managed banks and trust companies to some minimal form of physical presence in The Bahamas. Sectoral activities were underscored by stable to increased balance sheet activities and increased confidence in the domestic capital markets.

Having implications for all financial sector licensees, on 31 December 2003, the Government enacted amendments to the Financial Transactions Act (FTRA), 2000 and the Financial Transactions Reporting Regulations (FTRR), 2000, to align The Bahamas' anti-money laundering regime and know-your-customer (KYC) standards with the new risk-based approach of the FATF's Revised 40 Recommendations on money laundering. The amendments impose additional customer identification requirements when the risks posed by business relationships warrant them, and an obligation for financial institutions to update KYC documentation whenever a material change occurs in the nature of existing relationships. In addition, the trigger value for the reporting of transactions under the Suspicious Transactions Reporting Guidelines was raised to $15,000 from $10,000. The statutory deadline for concluding the verification of existing customer identities was extended to April 1, 2004, with Bahamian dollar facilities of $15,000 or less exempted from having to satisfy the KYC documentation.

Banking Sector

Reflecting the Central Bank's objective to have all of its managed licensees complete the transition to a minimum level of physical presence in the jurisdiction by June 30, 2004, the number of banks and trust companies licensed to operate within or from within The Bahamas decreased by 17 to 284 during 2003. Public licensees fell by 20 to 169, versus an increase in restricted and non-active licensees by 3 to 116. By end-2003, 216 licensed institutions had fully complied with the physical presence requirements, 29 were transitioning towards full physical presence and 39 continued as managed entities. The reduction in managed licensees, while impacting license revenues collected by the Government, has not significantly affected employment which remained close to the 2002 estimate of 4,523. The latest balance sheet surveys indicated that the total international assets of banks approximated $290 billion, as compared to $6 billion in domestic assets.

Among the significant institutional changes on the domestic front was Bank of Nova Scotia Trust Bahamas Limited's acquisition of MeesPierson (Bahamas) Limited operations, the private banking and trust arm of Fortis Funds Services, which terminated its operations in The Bahamas. Also, the resident operations of Thorand Bank and Trust Limited were acquired by the Bermuda based Bank of N.T. Butterfield and Sons Limited in July 2003 and merged with the acquired business of Leopold Joseph to form the Bank of Butterfield (Bahamas) Limited.

Insurance Sector

Data from the Office of Registrar of Insurance Companies indicate that the number of licensed insurance companies, brokers and agents and managers in The Bahamas increased by 1 to 163 at end-2003, bringing the number of licensees operating in the domestic sector to 137 while the number of external insurers remained at 26. Combined assets of the domestic companies (life, health, property and casualty) for 2002, the latest date for which information was available, were $740.7 million—an increase of 2.5% over 2001. Approximately 75% of the total was concentrated among life and health insurance companies.

Consolidation efforts continued in the domestic insurance sector, as the Colina Insurance Company Limited applied to acquire Canada Life Insurance Company, receiving final regulatory approval in January 2004. In December 2003, Colina also applied for regulatory approval to acquire the operations of Imperial Life Financial Bahamas, a branch of the Canadian Desjardin Financial Security Life Assurance Company. The application is being reviewed by a committee of financial services regulators, including the Office of the Registrar of Insurance Companies, the Central Bank, the Securities Commission and the Ministry of Finance, who will make a final recommendation to the Minister of Finance on the transaction during 2004.

Securities Industry

The Securities Commission reported an increase in the number of active investment (mutual) funds operating from or within The Bahamas, to 721 in 2003 from 669 in 2002, with a corresponding 18.9% growth in the value of assets under management to $107.4 billion.

Developments in the securities industry were marked by the enactment of the Investment Funds Act (2003) and associated Regulations, which repealed and replaced the Mutual Funds Act, 1995. While encompassing the narrow definition of international funds which The Bahamas sought to attract under the 1995 law, the Act introduces a distinction between funds marketed and administered for sophisticated wealthy investors, standard funds—which may be sold to less sophisticated investors but subject to tighter supervision—and Specific Mandate Alternative Regulatory Test (SMART) funds. The regulatory structure for SMART funds will be industry driven, and tailored to the development and marketing of new products. Provisions have also been made for investment funds which have been constituted in other recognized jurisdictions to be registered to carry on business from within The Bahamas. The legislation retains provisions which permit only unrestricted fund administrators to license and administer multiple funds and with this, having to satisfy, among other things, more stringent capital and net worth requirements.

Capital Markets

Investor confidence was more upbeat in the domestic capital markets during 2003, gaining momentum in the second half of the year. Although the volume of shares traded on the Bahamas International Securities Exchange (BISX) increased by 17.8% to 3.569 million, the estimated value fell sharply by 50.6% to $7.4 million, partly reflecting the mix of securities that were traded. The second half upturn softened the decline in the BISX All Share Price Index, to 2.0% from the year-earlier drop of 13.0%. After losses of more than 10% in 2002, the fall-off in the broader Fidelity Capital Market Index, which also captures over-the-counter trading, narrowed to 0.6%. Total market capitalization on BISX decreased by 5.5% to $1.7 billion. For the first time in more than 12 months, new capital of $7.6 million was raised, by a distribution company during December.

The number of publicly traded companies in The Bahamas remained at 23; and the number of BISX listed entities was also unchanged at 16. Including two investment companies, four mutual funds and two preference share issues, total public securities trading in The Bahamas increased by 1 to 29 during the year. The addition reflected the Premier Commercial Real Estate Investment Company Limited which listed on BISX in September 2003. BISX, meanwhile also attracted its first set of international mutual funds, including the Grace Caribbean Fixed Income

Fund, and four others with combined net assets of approximately $90 million. During 2004, the Exchange also expects to attract listing and trading of at least three other previously established domestic mutual funds.

As regard market infrastructure issues, the appointed Select Committee on BISX, chaired by the Governor of the Central Bank, with responsibility for formulating a Government financial support strategy for the Exchange, presented its proposal to the Government in the fourth quarter of 2003. A decision on the Government's involvement is expected during the first half of 2004.

Credit Unions

The Department of Cooperative Development reported a decline in the number of credit unions by one (1) to 19 at end-2003. During 2003, total assets of these entities rose by a healthy 13.3% to an estimated $150.1 million, 85.0% of which was concentrated among the five largest unions with hotel and public sector membership. Gains during 2003 were mainly underpinned by the public sector credit unions' ability to attract more deposits through aggressive promotional drives to enlist more members and expanding the range of services offered.

International Trade and Payments

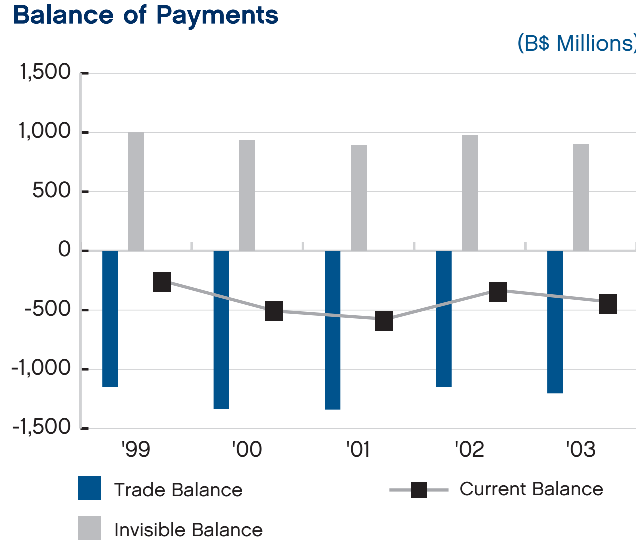
Preliminary balance of payments data for 2003 indicated a widening in the current account deficit, to an estimated $426.6 million from $339.2 million in 2002. Strengthened import demand caused the trade deficit to increase by 4.5%, while the surplus on the services account declined broadly by 8.1% (see Table 12). Together, these countered the reduced outflows associated with net income remittances.

With some strengthening in import demand, the merchandise trade deficit rose by 4.5% to an estimated $1,203.6 million. Non-oil merchandise imports were higher by 2.1% at $1,002.3 million, while export earnings fell by 4.8% to $424.7 million. Despite rising oil prices, reduced volumes consumed narrowed the oil bill by 2.0% to $284.3 million. Data for the first three quarters of the year indicate that the average per barrel cost of gas oil rose by 13.0% to $31.79; jet fuel, by 38.7% to $41.60; bunker 'c' fuel, by 18.6% to $35.68; motor gas, by 24.0% to $42.63; propane fuel, by 44.0% to $34.67 and aviation gas, by 19.0% to $96.70.

The estimated services account surplus decreased by $78.9 million (8.1%) to $901.5 million in 2003. Net travel inflows contracted by 2.7% to $1,477.3 million, mainly due to increased spending overseas by residents, which eroded a marginal increase in estimated tourism receipts. Net inflows associated with the offshore companies' local expenses also declined by 16.1% to $106.0 million. An increase in net outflows was estimated for transportation services, by 6.1% to $175.3 million; external insurance services, by 14.5% to $104.4 million and "other" services, by 5.2% to $292.5 million. In a partial offset, external payments for construction services fell by almost a third to $37.8 million, and net outflows for government services, by 5.8% to $57.3 million.

Under the income account, net remittances were lower by an estimated $47.4 million (22.5%) at $163.3 million, mainly due to a one-third decline in profit repatriation among banks and

Balance of Payments



other private sector companies to $112.7 million. Also, net official interest receipts fell by a third to $5.7 million, which was largely linked to increased interest payments on the public sector's external debt. Together, these outweighed increased net labour income remittances of 13.0% to $56.3 million.

The 8.4% decline in net transfer receipts to $38.8 million was explained by a 10.1% reduction in net inflows to the government, to $44.1 million. This countered the decline in net workers remittances of 21.0% to $6.4 million.

On the capital and financial account, the estimated surplus narrowed to $207.9 million from $380.5 million in 2002. Less significant in the overall trends, migrant workers net outflows rose to $37.4 million from $24.5 million in the previous year, while net financial net inflows tapered off to $245.3 million from $405.0 million last year. An 18.4% improvement in net private foreign investment inflows was largely the result of expanded net loan receipts of $158.8

TABLE 12: Balance of Payments Summary (B$ Millions)

	1999p	2000p	2001p	2002p	2003p
I) CURRENT ACCOUNT	(241.8)	(517.8)	(584.2)	(339.2)	(426.7)
i) Merchandise Trade (net)	(1,151.0)	(1,334.3)	(1,340.4)	(1,151.1)	(1,203.5)
Exports	462.3	575.9	423.1	446.3	424.7
Imports	1,613.2	1,910.2	1,763.5	1,597.4	1,628.2
ii) Services (net)	1,002.4	934.8	891.0	980.3	901.4
Travel	1,306.8	1,477.1	1,392.1	1,518.2	1,477.3
Transportation	(115.1)	(188.0)	(200.8)	(165.3)	(175.3)
Other	(189.3)	(354.3)	(300.3)	(372.6)	(400.6)
iii) Income (net)	(129.7)	(161.7)	(176.2)	(210.7)	(163.3)
Compensation of Employees	(41.0)	(51.1)	(48.5)	(49.9)	(56.3)
Investment Income	(88.7)	(110.6)	(127.7)	(160.8)	(107.0)
iv) Current Transfers (net)	36.4	43.4	41.8	42.3	38.8
Government	41.5	47.4	45.8	49.0	44.0
Private	(5.1)	(4.0)	(4.0)	(6.7)	(5.2)
II) CAPITAL AND FINANCIAL ACCOUNT	585.5	420.4	243.3	380.6	208.0
i) Capital Account (Transfers)	(13.6)	(16.5)	(21.3)	(24.5)	(37.4)
ii) Financial Account	599.1	436.8	264.6	405.3	245.4
1. Direct Investment	149.2	250.3	102.4	152.8	145.0
2. Other Investment	449.9	186.5	162.2	252.5	100.4
Central Gov't Long Term Capital Flow (net)	2.5	9.0	6.7	(21.4)	196.0
Other Public Sector Capital	(7.3)	(11.6)	(28.7)	(13.5)	(137.7)
Banks	93.4	(29.6)	120.4	183.6	(116.7)
Other	361.3	218.7	63.8	103.8	158.8
III) NET ERRORS AND OMISSIONS	(278.5)	36.1	310.4	19.3	329.8
IV) CHANGES IN EXTERNAL RESERVES ( ) = increase	(65.3)	61.5	30.0	(60.8)	(111.1)

SOURCE: The Central Bank of The Bahamas

million compared to $103.8 million in 2002. This more than offset the net private foreign direct investments decrease of 5.1%, which featured a contraction in net equity inflows to $60.6 million from $101.6 million alongside a $33.1 million boost in the inflow from real estate sales to $84.3 million.

Public sector developments featured a net external borrowing by the Government of $196.0 million, associated primarily with the mid-year US$200 million bond issue, as opposed to last year's net external debt repayment of $21.5 million. Public corporations registered an extended net external debt repayment of $137.8 million compared to $13.5 million in 2003, which principally reflected the $120.0 million refinanced multilateral debt. Domestic banks' involvement in the public sectors' refinancing activities as well as being recipients of the significant repayment of private sector domestic foreign currency debt, produced a net short-term capital outflow of $116.7 million. This contrasted with a net inflow of $183.6 million in 2002, which was associated with domestic foreign currency lending to the public and private sectors.

After adjusting for possible errors and omissions, the overall payments balance, as reflected in the change in the Central Bank's external reserves, was a larger surplus of $110.9 million compared to 2002's $60.8 million.

International Economic Developments

Notwithstanding the war in Iraq and the SARS epidemic, which dominated prospects in the first half of the year, subsequently eased geopolitical tensions, improved financial markets conditions and less intense energy cost increases secured more broad-base improvement in the global economy during 2003. The IMF estimates that world economic expansion strengthened to 3.2% in 2003 vis-à-vis 3.0% in 2002 and 2.4% in 2001. Output trends were led by strong gains in the world's largest economy, the United States, joined in the second half of the year by consolidating prospects in the other major economies. Developing countries also experienced improved growth, propelled by increased export demand from the industrialized countries. Although still accommodating, monetary policy easing was less aggressive among major countries; albeit, significant fiscal stimulus, in the context of lackluster revenue flows, contributed to a further increase in average budget deficits among the industrial countries. External sector trends were highlighted by a strengthening in global trade, facilitated by a deterioration in advance economies' current account imbalances.

The pace of real output growth in the advanced countries steadied at an estimated 1.8% in 2003; albeit, based on stronger growth in the United States where continued Federal spending on defense and homeland security, joined by strengthening household and business expenditures, pushed real output growth higher to 2.6% from 2.4% in 2002. After slackening in the first half to 3.1%, US real output gains accelerated to 6.0% in the second half when the expansion started to embrace the private sector. Estimated real output growth in Canada slowed to 1.9% from 3.3%, as the SARS outbreak caused activity to contract in the first half. In the United Kingdom, real GDP expansion eased to 1.7% from 1.9%, still upheld by softer interest rates and stronger government spending, but constrained by a lackluster first quarter showing. The slowing in the Euro area growth, to an estimated 0.5% from 0.9% in 2002, was attributed primarily to a contraction during the first half of the year, relative to significant export-led strengthening during the second half. Germany's flat outcome, which compared to an estimated 0.2% gain in 2002, was achieved after the second half's export-led recovery erased a first half contraction in output. Rising exports and increased business investments supported a strengthening in Japan's economic expansion, to an estimated 2.7% from 0.2% in 2002.

The developing countries' real output growth firmed to an estimated 5.0% from 4.6% in 2002. In Asia, the expansion steadied at an estimated 6.4%, supported by rising global demand for high-tech goods and a second half recovery of the tourism sector from SARS. Growth in the Middle East region, reinforced mainly by increased export revenues from oil, firmed to an estimated 5.1% from 4.8% in 2002. In Africa, the estimated real GDP gains strengthened to 3.7% from 3.1%, as rising global demand continued to boost the price of non-fuel exports. Amid highly divergent conditions across countries, the Caribbean and Latin America recorded an estimated 1.1% rebound in real output, benefiting from increased financial markets stability and stronger exports.

Average unemployment in the advanced economies advanced to 6.7% from 6.4% in 2002, with productivity gains, instead of larger payrolls, supporting the output expansion. The average unemployment rate firmed to 6.0% from 5.8% in 2002 for the United States, but stabilized for both Canada and the United Kingdom, at 7.6%, and 5.0% respectively. In the euro area, however, the average jobless rate deteriorated to an estimated 9.1% of the workforce from 8.4% in 2002, with Germany's average unemployment rising to an estimated 9.3% from 8.6% and France's, to an estimated 9.4% from 8.8%. For Japan, the average unemployment rate was nearly unchanged at 5.3% of the workforce, with some additional jobs generated by increasing output among export sector firms.

While marginally firmed, inflation in the industrial economies remained mild, at an estimated 1.8% compared to 1.5% in 2002, owing to muted labour market and internal demand influences. For the United States, average consumer price inflation eased to 1.9% from 2.4% in 2002, although price deflation emerged as a serious concern early in the year, amid slack consumer demand. Rising internal demand in the United Kingdom pushed inflation, minus mortgage interest costs, to 2.6% from 2.2% in 2002, just exceeding the Bank of England's 2.5% target. Currency appreciation underpinned a reduction in euro area inflation rate, to 2.0% from 2.3%. In particular, Germany's rate declined to 1.1% from 1.2%, while inflation in France rose to 2.4% from 2.2%. Despite rising medical costs and taxes, Japan registered another decrease in average consumer prices of 0.3%, attributed to weakness in household spending.

The depreciation of the US dollar, the base price for most primary commodities, alongside increased global demand for raw materials, resulted in a further rise in primary non-fuel commodities prices, by an estimated 5.0% in 2003 vis-à-vis the 0.6% marginal rebound in 2002. Average fuel prices also rose further by 14.4%, reflecting increased demand linked to weather conditions and supply disruptions associated with the war in Iraq. Despite OPEC's decision to cut oil production by 900,000 barrels a day, which took effect in November, the benchmark Brent crude oil price ended the year marginally lower by 1.2% at $29.78 per barrel—which was still above OPEC's target range of $22-$28. In precious metal markets, gold maintained its strong stance as a safe-haven alternative to equities, starting the year at $348.05 per ounce and rising steadily by 19.5% to $415.85 per troy ounce at end-December. Silver prices also rose by 24.3% to $5.94 per ounce at year's end.

Starting the year with concerns over the direction of global economic growth, major central banks maintained their accommodative monetary policies. In the United States, the Federal Reserve Bank reduced the key primary credit and target funds rates by a quarter point in June to 2.00% and 1.00%, respectively. The European Central Bank lowered its refinancing rate twice during the year, by 25 basis points to 2.50% in February and by 50 basis points to 2.00% in June. Meanwhile, the Bank of England cut its key repurchase rate to 3.75% from 4.00% in February, and to 3.50% in July, before returning the rate to 3.75% by the end of 2003 amid signs that inflation was firming. Although the Bank of Japan retained its discount rate at the historic low of 0.1%, it continued to provide positive liquidity support to keep money market interest rates low, and expanded the range of its assistance to the purchase of asset back securities linked to small and medium-sized enterprises.

The year was marked by a steady depreciation of the United States dollar against all major currencies, as the markets responded to both the widening trade and federal deficits and the narrowing in average interest rate differentials between the United States and other major countries. The United States' dollar recorded its largest depreciation against the Canadian dollar, by 17.5% to C$1.30. It fell by 16.7% against the euro to €0.79; by 9.8% against the pound sterling, to £0.56; by 9.7% against the Japanese yen, to ¥107.22 and by 10.4% relative to the Swiss franc, to SF1.24.

Fiscal policy was, on balance, expansionary during 2003, and provided important stimulus to the major economies. However, this and less robust revenue inflows caused the advanced countries' average deficit to GDP ratio to widen to an estimated 4.4% from 3.3% in 2002. In the United States, increased spending on military and homeland defense, along with a tax cut and tax rebates, further expanded the fiscal deficit to a record 4.9% of GDP from 3.4% in 2003. Higher outlays on public salaries, healthcare and education, caused a near doubling in the United Kingdom's fiscal deficit, to 2.9% of GDP from 1.5% in 2002. The consolidated fiscal deficit of the euro area worsened to 2.7% of GDP from the previous year's 2.3%, mainly reflecting deterioration in Germany and France's respective shortfalls, to 4.1% and 4.0% of GDP from 3.5% and 3.1% respectively in 2002—exceeding the European Union's Maastricht Treaty ceiling of 3%. Japan's fiscal deficit widened to 7.4% from 7.1% of GDP in 2002; whereas Canada increased its fiscal surplus to 1.0% of GDP from 0.8% in 2002, reflecting the government's aggressive financial strategy and lower interest costs on a declining public debt.

According to the Morgan Stanley Capital International index, global equity prices rebounded by 31.6% in 2003, following the previous two years' intensive fall-off of 17.3% and 20.6%, respectively. Investor confidence was buoyed both by the easing in geopolitical tensions and evidence of strengthening future prospects in the leading economies. In the United States, the Dow Jones Industrial Average (DJIA) closed the year a quarter of its value higher at 10,453.9 points and the broader S&P 500 index rose by 26.4% to 1,111.9 points. European markets also rebounded strongly, as Germany's DAX share price index advanced by 37.1% to 3,965.2 points; France's CAC 40 index, by 16.1% to 3,557.9 points, and United Kingdom's FTSE 100 index, by 13.6% to 4,476.9 points. Likewise, Japan's Nikkei 225 index rallied by 24.5% to 10,676.6 points.

The IMF estimates that world trade volumes, propelled by increased net import demand from advanced countries, rose further by 2.9% in 2003, after gaining 3.2% in 2002. As a result, the advanced countries' current account deficit deteriorated to an estimated 0.9% of GDP from 0.7% in 2002. Reflecting firmer net imports, the United States' current account shortfall rose to an estimated 5.0% of GDP from 4.6% in 2002. However, in the euro area, the currency caused a decrease in the estimated current account surplus, to 0.4% of GDP from 1.1% in 2000, with Germany's surplus reduced to 2.1% of GDP from 2.7%. Conversely, stronger export demand raised the Japanese current account surplus to nearly 3.0% of GDP from 2.8% in 2002, and similarly narrowed the United Kingdom's current deficit marginally below 2002's 0.9% of GDP.

At the 58th Annual Meeting of the International Monetary Fund/World Bank held in Dubai, United Arab Emirates during September 23-24, 2003, policymakers agreed that the vigorous pursuit of structural reforms and enhanced corporate governance and transparency were critical to sustaining stronger, globally balanced growth. Policymakers urged euro area economies to accelerate structural reforms aimed at labour markets, private investment and competition, and to address the fiscal pressure of their aging populations. Japan was commended for its continued efforts to strengthen the banking and financial sector; while the United States was urged to focus on strengthening its fiscal policy sustainability over the medium term. In addition, policymakers reaffirmed their commitment to a multilateral, rules-based approach to trade liberalization.

OPERATIONS

Banking

Currency Operations

Currency in circulation increased by 8.4% to $239.8 million at end-2003. Reflecting seasonal demand, the peak occurred again in December during the Christmas period, at $241.90 million. The old Bahamian sterling currency note liability of the Central Bank remained at B£28,719.31, which was equivalent to B$82,055.09.

Bahamian dollar banknotes, issued in denominations of $0.50, $1, $3, $5, $10, $20, $50 and $100, carried an increased (2.4%) circulation value of $226.7 million at end-December 2003. Although $100 and $50 banknotes represented 41.6% and 27.6% of the respective outstanding value, they accounted for only 4.0% and 5.3% of the total quantity in circulation. The $1 banknotes remained the largest quantity of bills in circulation at 65.4%, followed by $20 and $5 banknotes at 7.0% and 6.3%, respectively. At end-December 2003, $1 banknotes comprised 6.8% of the value of circulated banknotes; the $20 denomination, 14.6% and the $5 bill, 3.3%.

The total value of coins in circulation was $13.9 million, in denominations of 1¢, 5¢, 10¢ 15¢ and 25¢. The 25¢ piece is the most widely circulated by value at 35.7%, followed by the 10¢ (20.3%), 1¢ (25.1%) and 5¢ (11.0%); the 15¢ piece is circulated to a lesser extent (2.4%).

As issuer of the currency, the Central Bank is involved in all matters associated with banknotes and coins in circulation. These include currency design, the recording of all movements of currency in and out of circulation, and the examination of banknotes for reissue or destruction.

Foreign Exchange Transactions

The Central Bank's buying and selling rates for U.S. dollars vis-à-vis the commercial banks were respectively unchanged, at US$1.00 = B$1.0025 and US$1.00 = B$1.0040 for balances, and at par for cash transactions. Foreign exchange rates for the quotation of sterling were obtained each business day from the international market at 9:00 a.m. and 11:30 a.m. and at other appropriate intervals, according to the dollar value of transactions and market volatility. For sterling sales, the Central Bank maintained the policy of adding a commission of one half of one percent to the mid-rate.

The highest and lowest pound Sterling/Bahamian dollar rates employed by the Bank during 2003 were as follows:-

	Buying	Selling	Date Employed
Highest	1.7930	1.8020	31 December, 2003
Lowest	1.5491	1.5568	7 April, 2003

Relations with the Public Sector

As official registrar for the Government, the Bank oversees the issuance and redemption of Treasury bills and Registered Stocks and accommodates a secondary market for these securities.

The undiscounted value of Treasury bills outstanding has remained at B$179.4 million since May 2002, in line with continual rollover of maturing certificates. There were no holdings on the Bank's balance sheet at year's end, as maturity rollovers and sales shifted claims to commercial banks and the National Insurance Board.

BOX II : The Bahamas Payments System Modernization Initiative

The need to modernize The Bahamas' payments system was acknowledged by the Central Bank since the late 1990s when the Bank commissioned a special study to identify the available options for The Bahamas and to assist with the initial formulation of a strategy. Although the existing system was working adequately, modernization was considered necessary in order to bring the domestic payment systems up to international standards and to serve the development needs of all sectors of the economy. Technical assistance from the World Bank, in 1999, further advanced this effort, and led, in 2002, to the selection of the UK based consulting firm, Electronic Payments & Commerce Limited, to coordinate the implementation process for the Payments System Modernization Initiative (PSMI).

The modernization effort is proceeding in two (2) phases, the first of which is the introduction of the Real Time Gross Settlement (RTGS) System with a scheduled "go live" date of 28th May 2004. The second phase, the Automated Clearing House (ACH), has an implementation target of the first quarter of 2005. To provide the necessary focus to all issues related to the PSMI, a National Payments Council (NPC) was formally constituted in May 2003, consisting of the Central Bank and the Chief Executives of the participating seven (7) clearing banks. Its main responsibility is the development and maintenance of the national payments strategy for The Bahamas. As the scope of payments activities broadens membership in the NPC could be extended to include other key stakeholders, such as the Bahamas International Securities Exchange.

Considerable time and financial resources have already been committed to the PMSI process by both the Central Bank and the participating clearing banks. As the RTGS is viewed as a public good, and one in which the Central Bank has the most interest from the perspective of financial stability, the Bank has absorbed the infrastructure and software costs of the project, with implementation costs being shared equally between the Central Bank and the participating banks. Montran, which also provided the system in Barbados and The Netherlands Antilles, was the competitive bidder selected for supplying the system.

UNDERSTANDING RTGS & ACH SYSTEMS

RTGS systems are introduced to provide processing of high value and time critical payments among financial institutions and large customers of the financial institutions, reducing and in some cases eliminating risks commonly associated with manual or delayed payments clearance. The process provides for immediate, irrevocable transfer of value between parties. Payment instructions are processed and settled individually and continuously throughout the day. This is in contrast to more traditional net settlement systems, where instructions are processed ("cleared") throughout the day, but net inter-bank settlements occur typically at the end of the day.

The irrevocable nature of RTGS payments means that payee banks and their customers receive funds with certainty, or so called finality, and are able to use the funds immediately. Other payments system risks that an RTGS system would mitigate include:

- Credit Risks
- Liquidity Risks
- Operational Risks
- Systemic Risks

Credit risks stem from the possibility that parties within the payments system may be unable to fully meet their financial obligations, either at the moment when they are presented or at some time in the future. An RTGS system provides for immediate payment or, alternatively, immediate discovery of the possibility of non-payment.

Liquidity risks arise whenever parties within the payments system have insufficient funds to satisfy their financial obligations at the instant when they are presented. One element of The Bahamas' RTGS system that would address this risk would be the ability of participants to obtain intra-day credit from the Central Bank, fully secured by collateral such as Government bonds and, by definition, repayable by the close of the business day.

Operational risks within a payments system relate to the possibility that technical malfunctions, human errors and other disruptions could impede the functioning and reliability of the payments infrastructure. Such disruptions could also contribute to or exacerbate credit and liquidity risks. Adequate safeguards can be provided against operational failures by ensuring that redundant technology exists, and that adequately trained staffing is in place throughout the system. Having sound accounting and financial controls within each participant's treasury operations minimizes payment errors; albeit, when errors occur, the rules governing the operation of the system would outline how value could be recovered.

Systemic risk exposures arise whenever there is a potential for problems within an individual financial institution to spread to other institutions and create more general difficulties or instability in the system. Such risks can be caused by any one or a combination of the other risks identified. In this regard, good prudential oversight of financial institutions minimizes such occurrences.

Preliminary work has already started on the Automated Clearing House (ACH), which will result in the elimination of the current manual system of cheque processing, and accommodate direct debit and credit transfers. Instead of the physical presentation of cheques for payment among clearing banks, it is anticipated that the payment details will be captured electronically and submitted to the Clearing House for processing. The physical movement and storage of processed cheques would also be curtailed, and this may include a halt to the practice of returning cancelled cheques to their owners, with reliance instead on storage of the digital image. This would reduce banks' cost of providing chequing services.

IMPLICATIONS FOR THE BAHAMAS

In addition to management of payments system risks, an RTGS system would result in more immediate settlement of payments within the financial system, providing for efficient use of idle financial resources of financial institutions. For a fee, on a per transaction basis, private individuals and firms would also have access to the RTGS infrastructure to process large value payments and could also save on working capital needs. This could have advantages, for example, in real estate and mortgage transactions where final payment transmittal and contract execution could be more closely linked in time.

The ACH would embrace private sector transactions more generally and directly. Once it becomes operational, the processing cycle for local checks will be significantly reduced, also adding more efficiency and less uncertainty in private sector transactions. The ACH will also permit more efficient processing of other private payment transfers such as direct payroll debits and facilitate domestic e-commerce and non-cash retail point-of-sales transactions. Eventually, it is expected to diminish the reliance on the use of cash and cheques within the economy.

Some aspects of direct debits transactions already exist among local retail banks for automatic payment of utility bills over the internet and via other electronic means. A number of local insurance companies also permit regular premium payments by way of standing orders and direct debits. These services, however, only permit transfer of values among customers of the same bank. The ACH and the enhanced infrastructure provided by the RTGS System should eventually facilitate direct payments transfers between all participants in the banking system. As the largest single originator of small-value payments, the public sector's transactions could represent a significant share of the total ACH activity.

Bahamas Government Registered Stock (BGRS) maturities during the year of $53.3 million, as compared to new bond issues of $136.1 million, resulted in an outstanding stock of $1,386.9 million. The maturity structure for existing bonds ranged between 2004 – 2023, bearing variable yields of the Nassau Prime Rate (6.00%) plus 0.09375% -1.50% per annum. Fixed rates of interest varied between 5.75% - 10.50% per annum.

Currently, all securities issued are priced at par and the Bank uses a pro-rating methodology to allocate bonds to over-subscribers, after fully allotting the requested applications from small individual and institutional investors. The Bank continued its review of this framework and is expected to present a proposal on the adoption of a market driven mechanism for the issuance, pricing and secondary trading of Government bonds to the Government during 2004.

The Bank also provides Registrar and Transfer Agent functions for the Bridge Authority bonds. The outstanding stock was unchanged at $28.0 million, with maturities ranging between 2014 – 2029. Variable yields on the bonds are at Nassau Prime Rate (6.000%) plus a spread of 1.000% - 1.625% per annum.

Relations with Banks

In accordance with Section 19 of the Central Bank of The Bahamas Act 2000, banks are required to maintain "Statutory Reserves" against their Bahamian dollar deposit liabilities. Since being established in 1974, the reserve ratio has remained at 5.0%, with a minimum 80% to be held in deposit balances at the Central Bank. Based on growth in the Bahamian dollar deposit base, required reserves rose by 5.1% to $154.3 million at end-2003. Banks' excess balances at end-December 2003 stood at $95.9 million, representing some 39.3% of their total deposits held with the Central Bank and 14.9% higher than in 2002. Growth was mainly due to increased foreign currency purchases made from the system during 2003.

Banks also maintain balances at the Central Bank to facilitate the cheque clearing arrangements, which continue to be managed by the Central Bank. During 2003, the volume of cheques processed was relatively constant at approximately 3.9 million; however, there was a 4.9% hike in associated value to $6,314 million. The payments systems modernization initiative, which gathered momentum during the year, is expected to eliminate the manual check clearing system, although in its first phase it will introduce automation and provide for the real time settlement of large and time critical payments on a gross basis (see article in Box II).

Investment Currency Market

Through the Banking Department, the Bank continued to provide investment dollars to residents to facilitate, among other things, overseas purchases of securities and real estate. The premium bid and offered rates were unchanged at 20% and 25%, respectively. The Investment Currency Market opened the year with a balance of $1,875,815.44. Purchases totalled $804,905.12 and sales $18,712.58, for a closing balance of $2,662,007.98 at end-December, 2003.

Exchange Control

During 2003, the Exchange Control Department continued its efforts to improve the processing of applications for foreign exchange transactions in the official and Investment Currency Markets, as well as capital account related matters.

Subsequent to the additional liberalization measures introduced in 2002, there was a marked decrease in the overall volume of approvals granted at the Exchange Control Counter for foreign exchange facilities. The Bank has undertaken additional public relations efforts to ensure customer awareness of the increased authority delegated to the banks. The Department continued to explore options for further delegation of Exchange Controls and

BOX III :
List of Authorized Dealers and Agents
As At 31st December, 2003

Authorized Dealers*

- Bank of The Bahamas (International) Limited ‡
- British American Bank (1993) Limited ‡
- Citibank, N.A. ‡
- Commonwealth Bank Limited ‡
- Finance Corporation of Bahamas Limited ‡
- FirstCaribbean International Bank (Bahamas) Limited ‡
- Royal Bank of Canada, The ‡, §
- Scotiabank (Bahamas) Limited ‡

Authorized Agents**

- Ansbacher (Bahamas) Limited ‡
- Bank of Butterfield (Bahamas) Limited
- Bank of Nova Scotia Trust Company (Bahamas) Limited, The
- Bank of The Bahamas Trust Limited
- Chase Manhattan Private Bank & Trust Co., Bahamas Ltd., The
- CIBC Trust Company (Bahamas) Limited
- Cititrust (Bahamas) Limited
- Fidelity Merchant Bank & Trust Limited ‡
- First Caribbean International Finance Corporation (Bahamas) Limited ‡
- ITK Trust Company Limited
- Latin American Investment Bank Bahamas Limited
- Leadenhall Bank & Trust Co. Limited
- Lloyds TSB Bank & Trust (Bahamas) Limited ·
- Morgan Trust Company of The Bahamas Limited
- Pictet Overseas Trust Corporation Limited
- Royal Bank of Canada Trust Company (Bahamas) Limited ‡
- SG Hambros Bank & Trust (Bahamas) Limited ‡
- UBS Trustees (Bahamas) Limited

NOTE: * An Authorized Dealer is a bank which has been authorized by the Central Bank to deal in gold and all foreign currencies, and for this purpose can open and maintain accounts in such currencies within the limits laid down in Exchange Control Notices issued by the Bank. Under authority delegated by the Central Bank, an authorized dealer can approve certain applications for foreign currency within specified limits.

** An Authorized Agent is a bank or trust company authorized by the Central Bank to deal in Bahamian and foreign securities and to act as a custodian for securities in accordance with the terms of Exchange Control Regulations Act, 1965 and Exchange Control Notices issued by the Bank.

‡ Member of the Deposit Insurance Corporation as at December 2003

§ Also licensed as an Authorized Agent

– Licensee is non-active

refinement of its guidelines for the banks and the general public—all with the objective of improving the overall efficiency of Exchange Control operations. In addition, training commenced for Freeport, Grand Bahama staff, to better prepare them to process a broader range of transactions, particularly those traditionally dealt with exclusively by the Nassau office, i.e. capital account (share and loan matters) and assessment of foreign currency accounts held by companies for their own benefit or for the benefit of clients.

Further efforts were made to organize and analyse the statistical information received by the Department. The creation of a database of private sector foreign currency loans in 2002 and the implementation of a survey of the structure and management of pension plans of retail banking sector institutions in The Bahamas has assisted the Department in providing useful data to policy makers.

During the year, the Bank maintained close contact with domestic banks to monitor and record foreign exchange transactions and to provide assistance in the implementation of exchange control guidelines. Both the number of Authorized Dealers and Authorized Agents operating at the end of 2003 was unchanged at eight (8) and remained at eighteen (18), respectively (see Box III).

Research

The Research Department continued to perform its important role in the collection, analysis and dissemination of economic and financial data, for the purposes of informing policy decisions and providing timely information to the public. The main outlets for this work remained the publication of the Bank's Quarterly Statistical Digest, Quarterly Economic Review and Annual Report. Research was conducted into important economic and policy issues, in support of the Bank's monetary policy framework, and the formulation of the technical advice to the Government and other agencies, both domestic and international.

From the 2003 Research Agenda, work was finalized on a study of capital market development issues, which was presented at the 35th Annual Monetary Studies Conference of the Caribbean Centre for Monetary Studies (CCMS), hosted by the Eastern Caribbean Central Bank (ECCB), St. Kitts, in November; analysis of trends in public sector debt, and payments system reform. Preliminary research was also undertaken in the area of foreign direct investment in The Bahamas, mortgage lending, and economic conditions on selected major Family Islands of The Bahamas. In collaboration with the Bank for International Settlements, a preliminary framework was developed for the analysis of the international banking statistics, from which a paper was presented at the BIS Meeting of Experts in October, 2003.

A regular feature of the Department's annual work programme is the annual survey on the Gross Economic Contribution of banks and trust companies in The Bahamas, which provides comprehensive information on the sectors' employment and expenditure trends within the economy—the results of which are published each year in the March Economic Review. In 2003, the exercise was extended to encompass the entire financial sector, and the survey on domestic pension funds was updated and published in the June 2003 Economic Review.

In response to the needs of the Bank's Monetary Policy Committee, the Department maintained regular reviews of, and updated its forecasts of monetary and credit conditions; assisted with development of proposals for modernization of the Government securities market and began work on the development of a framework for external reserves targeting. Preliminary work commenced on an evaluation of the current Bahamian dollar open position limit applicable to domestic banks' foreign currency transactions. The Department also executed a special survey on recent credit trends in the domestic insurance sector relative to the impact that the credit limits policy might have had, and assisted with the development of an analytical framework for assessing credit quality among local banks.

During the year, the Department, through a number of initiatives, continued to strengthen its data collection and compilation capabilities, including completion of the migration of the public sector debt database to the upgraded version of the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS) 2000+, and made further enhancements to the FAME database system to address reporting needs for International Banking Statistics and to facilitate the automated production of statistics for the Bank's publications. The Department also participated with the Department of Statistics in the completion of the project to provide information compilation methodologies and sources for the IMF's General Data Dissemination System (GDDS) metadata project. The Bahamas' metadata was released on the Fund's website in 2003. In addition, preliminary steps were taken to start publishing details on the issuance, and outstanding tranches of Bahamas Government Registered Stocks and Treasury bills on the international Bloomberg system.

Recognizing the importance of adequate reference resources to support its research activities, the Bank moved forward in its efforts to develop a strategy to modernize the Library services. With the benefit of a consultancy carried out by an expert from the Joint IMF-World Bank Library, a modernisation proposal was finalized in August 2003. A principal focus of this initiative will be to increase the use of electronic technology in the delivery of library services, and to increase the staff's accessibility to online resources.

As responsibility for administration of the website remained with the Research Department during 2003, the Department spearheaded an upgrade and structural re-design of the Bank's website, and devolved various website maintenance functions to other directly affected departments. Responsibility for the overall co-ordination of the website's administration will devolve to the Administration Department in 2004. The website has become a critical outlet for the dissemination of the Bank's publications and operational policy guidelines. In addition to the Economic Review and Annual Report, the Quarterly Statistical Digest was made available through the site, with effect from the November 2003 report. During 2004, the Department will become more active in disseminating information on monetary policy through the site.

In continuation of the Bank's efforts to improve the quality and timeliness of economic and financial data reported to the Central Bank, the Research Department conducted a number of onsite visits to domestic banks, to address issues and developments related to the Bank's reporting requirements.

Bank Supervision

During 2003, the Bank Supervision Department remained focused on its mission "to promote and maintain the safety, soundness and integrity of the Bahamian banking and financial system."

Work continued on the review and development of supervisory regulations, guidelines and policies, strengthening the new regulatory framework enacted in 2000. In ongoing consultation with the industry and other interested public parties, several new prudential guidelines were finalized while active feedback continued to be received on other draft policy documents. Strengthening of domestic and international cooperative mechanisms continued to be a high priority for the Bank, along with industry preparation for the eventual adoption of the new capital framework (Basel II).

Senior Bank Supervision staff were also actively involved in discussions with industry participants on the amendments to the Financial Transaction Reporting Act (FTRA) and the Financial Transaction Reporting Regulations (FTRR). Internally, emphasis was placed on restructuring of the Department's operations to more effectively organize resources around policy, supervision and administrative activities.

Restructuring of the Department

The Bank formally commenced its restructuring of the Department in November 2003, which aimed at integrating the on-site and off-site examination functions, providing additional resources to the Policy Unit and establishing a formal Administration and Operations Unit.

The main objectives of the restructuring are to:

- separate the accountabilities normally associated with supervision and regulation;
- permit more timely and effective responses to correspondence from licensees and key stakeholders in the financial sector;
- provide for a more effective process of assessing the safety and soundness of licensees, and better align staffing resources to the type of business activities carried out by licensees;
- provide for a more effective and consistent approach to the evaluation of the risks associated with the business activities carried out by licensees with greater emphasis on the early identification of emerging risks and system-wide issues; and
- develop more comprehensive reporting systems and formats, permitting supervisory issues and trends to be identified on a timely basis.

The Supervision Unit

The Supervision Unit is responsible for all aspects of the onsite and offsite examinations relative to legal and regulatory compliance including, governance structures and prudential indicators. Almost two thirds of the Department's staff is dedicated to these activities.

Salient features of off-site supervision continue to be the regular monitoring and review of licensees, through analysis of prudential and annual public reports; fit and proper reviews of proposed directors and senior management of licensees; and approval of significant changes to a licensee's arrangements. The on-site examinations process focuses on the adequacy of licensees' general risk management, corporate governance structures, internal controls, safety and soundness, compliance with prudential norms and regulations, as well as "know your customer" (KYC) and anti-money laundering (AML) procedures.

The Policy Unit

This Unit was established formally in 2002, charged with the research, development and implementation of supervisory policies that are consistent with international best practices, and which effectively address the supervisory issues of the Bahamian banking and trust industry. In establishing the priorities of its work programme, the Unit seeks to address those deficiencies and weakness identified by the Central Bank's Basel Core Principle Self-Assessment, the preliminary findings of the 2002 IMF Module II Financial Sector Assessment, and the regulatory reform agenda established by the Bank through its Policy Advisory Committee. The Policy Advisory committee has ultimate responsibility for Bank Supervision policy matters.

The Administration and Operations Unit

The main functions of this Unit are to provide back office support for supervisory activities, with direct responsibility for ensuring that licensees satisfy reporting requirements; maintaining databases of information relating to licensees; and monitoring and analysis of balance sheets to assess capital adequacy and liquidity trends of licensees. The Unit also coordinates the human resources and training needs of the Department and provides administrative support for the operations of the Deposit Insurance Corporation and the Agricultural Credit Guarantee Fund.

Supervisory Activities

During 2003, the Department made recommendations to the Governor regarding issuance, revocation or amendments of bank and trust licenses, including issuance of 12 new licenses, and revocation of 29 existing licenses. The latter represented primarily the closure of managed or "shell" banks. At end-2003, the number of banks and trust companies operating

TABLE 13: Banks and Trust Companies Licensed in The Bahamas

	PUBLIC			RESTRICTED			NON-ACTIVE T & NOM			
	B&T	B	T	B&T	B	T(Nom)	B&T	B	T	TOTAL
December 2002	108	63	18	6	9	89	4	3	1	301
Add Licenses issued in 2003	1	1	1	0	0	9	0	0	0	**12**
Less Licenses revoked in 2003	12	6	1	1	2	7	0	0	0	**29**
Sub Totals	**97**	**58**	**18**	**5**	**7**	**91**	**4**	**3**	**1**	**284**
Licenses upgraded or downgraded	-3	-1	0	0	1	0	3	0	0	0
December 2003	**94**	**57**	**18**	**5**	**8**	**91**	**7**	**3**	**1**	**284**

B=Bank, T=Trust, T(Nom)=Nominee Trust
Note: Gross from License Fees during 2003 amounted to approximately $6,913,500

SOURCE: The Central Bank of The Bahamas

TABLE 14:
Onsite Examinations Conducted (2001-2003)

Description	2001	2002	2003
Examinations			
Licensees (physical presence)	71	59	33
Managed Banks	44	32	22
Domestic Licensees	2	2	3
Follow-up examinations	4	9	6
Total Examinations	**115**	**102**	**64**
Examinations Report			
Finalized Reports	70	64	37
Reports in Progress	0	6	6
Total Reports	70	70	43
Follow-up Exams Required	**10**	**6**	**8**

SOURCE: The Central Bank of The Bahamas

within or from within The Bahamas stood at 284 (see Table 13).

Discontinuation of "Managed" Banking Institutions

In accordance with revised standards implemented at the end of 2000, no banking or trust entity may be licensed in The Bahamas unless strict minimum operating requirements are met. The *Guidelines for the Minimum Physical Presence Requirements for Banks and Trust Companies Licensed in The Bahamas* require that all licensees establish a physical presence in The Bahamas, with a minimum level of dedicated senior management staffing and physical facilities, including documentation of activities and record keeping, by June 30, 2004. The program to discontinue the operations of licensees which do not meet these minimum standards, is progressing according to plan. As at December 31, 2003, 216 were in full compliance with the physical presence requirements, 29 were in the process of meeting the requirements, and 39 remained under approved administration.

On-site Examinations of Banks and Trust Companies

The second cycle of on-site examinations of licensees by the Central Bank of The Bahamas continued during the year, with increased focus on safety and soundness issues. The safety and soundness review includes an evaluation of policies and procedures addressing corporate governance, internal controls and business risk assessment. During 2003, examinations of two large domestic retail banks were completed. The examination of the large retail banks, together with the broader focus and enhanced examination methodology, resulted in fewer examinations being completed during the year, compared to 2002. Table 14 summarizes the number of onsite examinations carried out during 2003, with comparative statistics for 2002 and 2001.

TABLE 15: Requests for Cooperation from Foreign Regulatory Authorities in 2003

Country	No. of Requests	Completed	Responses Outstanding
Ecuador	2	2	
Argentina	1	0	1
British Virgin Islands	1	1	
Peru	1	1	
United States	7	4	3
Netherlands Antilles	2	2	
Germany	1	1	
Barbados	2	2	
Russia	1	1	
Guatemala	2	2	
Alabama	1	1	
Belize	2	2	
Cayman Island	1	1	
Australia	1	1	
Turkey	1	1	
Bolivia	1	1	
Brazil	1	0	1
Lesotho	1	1	
Curacao	1	1	
Total Requests	30	25	5

SOURCE: The Central Bank of The Bahamas

Consolidated Supervision

In 2003, the Department continued its cooperation in international cross border supervision, by granting approval for the Swiss Federal Banking Commission (SFBC) to conduct several on-site examinations of licensees owned by Swiss institutions. The Superintendencia General de Entidades Financieres de Costa Rica (SUGEF), the Costa Rican Financial Services Regulatory Agency, was granted approval to conduct three on-site examinations of licensees owned by Costa Rican financial groups. The Department actively cooperated with other foreign regulators during the year, receiving 30 requests for information on a variety of regulatory issues, from 19 regulatory bodies. Responses were concluded on a majority of these (See Table 15). This compares to the processing of 41 information requests from 18 countries in 2002.

The Bank also concluded negotiations on a memorandum of understanding (MOU) with the Costa Rican Regulatory Authority (SUGEF), and executed the agreement during the first half of 2003. Discussions were ongoing with the Guatemalan Regulatory Agency to conclude an agreement, which is expected to be signed early in 2004. Negotiations with Mexico, Panama and Brazil are ongoing; the Bank hopes to sign supervisory MOUs with regulators from these and other countries in 2004 and beyond.

Offsite Supervisory Activities

During 2003, the Department carried out in-depth assessments of the ongoing financial positions of all active banks and trust companies. The operating viability of the licensees as going concerns and their compliance with the Bank's requirements regarding liquidity, solvency, risk and management, were investigated and appraised.

With a view to promoting 'fit and proper' management of banks and trust company licensees, the Bank sought to ensure that persons who control and manage the business of banks and trust companies possess the highest credentials and have the appropriate experience to carry out their responsibilities. Accordingly, the Department vetted and approved the appointments of 125 directors and 143 senior officers. During the year, 92 meetings were held with the management of licensees to discuss prudential issues.

The Department continued to be vigilant in its practice of collecting and disseminating information on instances of attempted fraud or questionable activities brought to its attention by targeted institutions, the public, or other regulatory agencies. The Bank's website is constantly updated with notices to the public, providing timely warning and available information of instances which are identified by the Central Bank. Further, the Attorney General's Office, the Royal Bahamas Police Force, the Postmaster General, the Bahamas Telecommunications Corporation, the Registrar General and other financial sector regulatory authorities are routinely advised of these matters. During 2003, the Bank's website was enhanced to permit users to conduct interactive queries regarding the official list of Bahamian licensees.

Asset Quality Monitoring

Beginning in the first quarter of 2003, the Department significantly upgraded its analysis and monitoring of the quality of domestic retail banks' loan portfolios, as part of the general enhancement of supervisory practices in the jurisdiction. These institutions are required to submit detailed quarterly reports on loans quality and provisions. The Bank published its Guidelines for the Management of Credit Risk during the second half of 2003. These are intended to assist all licensees in establishing and revising their credit risk management policies in line with Bahamian requirements and international best practices and standards.

Bank Supervision Policy Issues and Developments

Supervisory policies and guidelines continue to be developed in a consultative framework, where industry participants and the wider public are allowed to comment on policy documents before these are finalized. In addition to the extensive use that is being made of the Bank's website to disseminate documents, the Bank has periodically convened meetings for the purpose of discussing proposed regulatory changes with its licensees and professional associations. Significant policy developments have also taken place within the cooperative framework established by the Group of Financial Sector Regulators, which comprises the Central Bank of The Bahamas, the Securities Commission, the Office of the Registrar of Insurance, the Bahamas Compliance Commission and the Office of the Inspector of Corporate Service Providers.

Prudential Regulations

The Bank invited public comment on seven draft prudential regulations during 2003, which addressed the following:

- Large exposures;
- Liquidity management;
- New appointments (of directors and executives);
- Equity investments and acquisitions by licensees;
- Acquisition of shares in a licensee;
- Payment of dividends; and
- Foreign currency exposures.

These regulations are scheduled for release in 2004.

Risk Management Guidelines

Comprehensive risk management guidelines are in the process of being developed. In October 2003, the first supplement entitled, *Guidelines for the Management of Credit Risk* was released to licensees. Guidelines covering impaired assets, liquidity risk, large exposures, interest rate risk, compliance risk and operational risk are scheduled to be released in 2004. Other guidelines on electronic banking, outsourcing, capital adequacy and dormant accounts are also being developed.

Relations with External Auditors

In November 2003, the Central Bank invited senior members of the auditing profession to establish an Auditor's Advisory Committee, to provide, among other things, a forum for cooperation with the profession; and discussion on accounting, auditing and reporting matters pertaining to licensees. In the short-term, the Committee's work will include reviews of guidelines on *Procedures for Voluntary Liquidations and The Subsequent Revocation of a Banking or Trust License,* issued on September 16, 2003 and draft guidelines outlining the expected *Relations between External Auditors and the Central Bank* which is scheduled to be released for public comment in March 2004.

Disclosure Requirements

By statute, licensees are required to publish their audited financial statements in the Official Gazette of the Government of The Bahamas, making them available to the public. To enhance transparency and comparability of audited financial statements, the Bank plans to issue draft guidelines on *Minimum Disclosure Requirements for Licensees* for public consultation in March 2004, after initial consultation with the Bahamas Institute of Chartered Accountants (BICA) and the Auditors Advisory Committee. These guidelines will outline the minimum requirements for the presentation of licensees' audited financial accounts in accordance with International Accounting Standards (IAS).

Corporate Governance

Recognizing the importance of its licensees adhering to sound governance, the Central Bank of The Bahamas, in December 2001 issued comprehensive *Guidelines for the Corporate Governance of Banks and Trust Companies Licensed to Do Business within or from within The Bahamas.* Licensees were required to be fully compliant with these guidelines by December 2003. As part of their role in this process, the Boards of Directors of licensees must annually certify that they have assessed their organizations' corporate governance and risk management frameworks. The Boards are also required to report any material deficiencies in governance structures and submit action plans for addressing them.

Leading up to the implementation of the Guidelines, the Policy Unit participated in a number of training seminars and meetings with licensees and industry associations. The Unit also represented the Department at the first Caribbean Corporate Governance Forum held in St. Kitts, Eastern Caribbean, in September, 2003. The Forum, sponsored by the Commonwealth Secretariat and the Global Corporate Governance Forum, was organized to, among other things, raise the profile of corporate governance among the region's public and private sectors. One outcome from the meeting was the establishment of a Caribbean Technical Working Group on Corporate Governance (CTWG), charged with establishing regional priorities for further work on corporate governance. The Bahamas will participate in the work of this Body.

Regulatory Co-ordination

Since 2001, the Group of Financial Services Regulators (GFSR) has adopted a collaborative approach to the development of financial sector-wide policy. An important task of the Group has been its work on developing a proposal to consolidate the regulatory resources of The Bahamas' financial services sector The Group's final recommendations in this regard will be presented to the Government during 2004.

During the period, considerable progress was made towards increasing supervisory co-ordination and co-operation between regulators. An information sharing protocol is being prepared, in accordance with the regulatory Memorandum of Understanding, which will provide the modus operandi for cooperation among Members in this regard.

Additionally, the Bank Supervision Policy Unit, with the assistance of the other financial services regulators, completed the development of a database of all regulated financial sector entities and financial groups. The database supports the regulators' efforts to (1) conduct joint onsite inspections, (2) coordinate the license applications process and (3) conduct effective supervision on a consolidated basis within the jurisdiction.

Licensing Requirements

The Central Bank, during the year, released guidelines which addressed existing licensing and operating requirements and introduced new standards as follows:

- Guidelines for Assessing the Fitness and Propriety of Applicants for Regulated Functions;
- Minimum Standards for Character and Financial References;
- Guidelines for the Minimum Physical Presence Requirements for Banks and Trust Companies Licensed in The Bahamas; and
- Minimum Standards for Letters of Comfort

Basel II Issues

The developments related to the new Basel II capital adequacy framework are being closely monitored by the Policy Unit. In response to the Third Consultative Paper, issued by the Basel Committee on Banking Supervision, a position paper was released outlining the Central Bank's likely approach to the implementation of Basel II (see article in Box IV). Representatives from the Unit serve on the Caribbean Group of Banking Supervisors (CGBS) Technical Working Group on Basel II, and the Unit developed templates for the CGBS's regional Capital Adequacy Quantitative.

IMF Financial Sector Roundtable

In May 2003, The Bahamas was requested to present a paper on offshore banking at the first Financial Sector Roundtable organized by the International Monetary Fund in Washington D.C. in May 2003. The meeting brought together banking, securities and insurance regulators from both offshore and onshore centres, along with the IMF, World Bank and the standard setting bodies

BOX IV : The New Capital Accord – Issues for The Bahamas

CURRENT STATUS OF THE BAHAMAS

In 1992, The Bahamas implemented the 1988 Basel Capital Accord (Basel I). The Central Bank monitors compliance with Basel 1 on a quarterly basis as part of the review of the financial condition. To date, however, the 1996 amendments to Basel 1 related to Market Risk and Netting Arrangements, have not yet been introduced. However, a capital charge for market risk is scheduled to be introduced in 2004 after appropriate studies are carried out to determine the licensees for which market risk is a material consideration. Due to Bahamian exchange control requirements and the limited capital markets activities of banks in The Bahamas, the Bank expects that domestic retail banks will be below the Basel I materiality thresholds for market risk.

Additionally, the liability driven nature of international/offshore banking in The Bahamas has led to capitalization levels which are considerably higher than the 8% minimum risk asset ratio requirement. Therefore, for the majority of Bahamian licensees, the introduction of Basel 2, which mandates an additional capital charge for operational risk, should not reduce the capital ratios of offshore/international licensees to levels of concern.

B. SPECIFIC BASEL II ISSUES FOR THE BAHAMAS

Pillar 1 – Minimum Capital Adequacy

The New Capital Accord provides countries with over 40 embedded options for implementation at national discretion. The Central Bank recognizes the complexity involved and thus the need to develop specific expertise in the New Accord.

Pillar 2 – Supervision Review

The Bahamas supports the introduction of Pillar 2 into the new capital adequacy framework. The implementation of pillar two should not be a major challenge for the Central Bank of The Bahamas as The Banks and Trust Companies Regulation Act, 2000 (BTCRA) empowers the Inspector to require a licensee to augment its capital should the need arise. The ability of the Central Bank to require additional capital has been the practice since the inception of banking supervision and has been well accepted by licensees. However, to strengthen this practice and to increase transparency, the Central Bank is considering the use of target and trigger minimum capital ratios which, at the onset, will be communicated to the licensees.

Additionally, the onsite examination function has initially concentrated on banks' compliance with AML measures in The Bahamas, corporate governance and safety and soundness issues. Implementation of Basel 2 will require that supervisors regularly review the process by which banks self- assess their capital adequacy, the risk position of the bank, the resulting capital levels and the quality of capital held. These requirements will result in an overview of the current methodology in place and the concerned examination templates. The role of the external auditors in the Basel II environment will also be reviewed and a final position will be taken in consultation with the Bahamas Association of Certified Accountants, in due course.

Pillar 3 – Market Discipline

Market discipline, through disclosure of both quantitative and qualitative information, is an important mechanism for reducing the potential for moral hazard by allowing enhanced monitoring of the bank's activities by its shareholders and depositors. As such, The Central Bank supports the introduction of this pillar. The more sophisticated and dynamic the market, the better disclosure serves as a disciplining measure. The Bahamas' international market is therefore well suited for such a mechanism as market participants and stakeholders tend to be financially aware and educated.

The Bahamas currently requires that audited financial accounts are made available to the public. Accounts are published in the local gazette and should be available to the bank's customers upon request. However, additional work will be required in order to ensure full compliance with Pillar 3. The Bahamas is currently drafting a minimum disclosure guideline for licensees which is consistent with the disclosure requirements of Basel II, in terms of both the frequency and content of disclosures. The external auditors' role as regards checking and auditing of additional disclosures will have to be considered. Several domestic retail banks are already disclosing certain financial information on a voluntary quarterly basis. However, as there will be a semi annual disclosure requirement for all public licensees and a quarterly disclosure requirement for all large retail banks, extra operational costs may result for the licensees. .

The Bahamas has a second challenge, as it serves as a host jurisdiction for banks from many different countries. The nature of offshore banking dictates that the bank's clients are not resident in The Bahamas. Therefore, The Bahamas must consider the best means of ensuring that critical financial information reaches those various overseas markets, so that it can serve as a disciplining mechanism for the bank. The Internet is likely to be the most cost effective and efficient means of achieving this goal. The Bank is considering the use of its website as a repository for its licensees' financial information. The Bank is also currently considering the models provided by the United States Federal Reserve's National Information Centre and those used by some OFCs.

Calculation of the Operational Risk Capital Charge

The basic indicator approach, which uses gross income to determine the capital charge for operational risk, also poses some concern for the Central Bank of The Bahamas. The Bank expects that most institutions will use this method to assess operational risk charges. However, the Basel Committee was advised of The Bahamas' concern regarding the apparent penalty attracted by banks with high gross income in business lines such as consumer lending.

Earlier proposals of the Basel Committee placed the charge for operational risk in Pillar 2, thereby giving national regulators the discretion to allocate specific capital charges for operational risks, based on the relevant country circumstances. The Committee was advised, that while The Bahamas agreed that a specific charge was appropriate for operational risks, the Pillar 2 treatment seemed a better alternative to the current proposal of a specific charge in Pillar 1.

Market Risk

The market risk component of Pillar 1 has not substantially changed from the 1996 amendments to Basel I. As mentioned earlier, the adoption of market risk into the capital adequacy structure for licensees is being studied.

C. CONSIDERATION OF THE VARIOUS APPROACHES

As a host jurisdiction for a number of US and EU country banks, the Central Bank of The Bahamas must pay attention to the positions taken by these countries. The Bank has observed that the United States has indicated that only about 10 to a maximum of 20 banks are likely to use the Advanced Internal Ratings Based (IRB) approach in 2006. The EU appears to be taking the position that its banks will be allowed flexibility in terms of options under the new accord. Therefore, it will be necessary for The Bahamas, even in the short-term, to

BOX IV (Continued)

become familiar with all approaches of the Basel 2, as some licensees will be using the more advanced approaches, as required by their head offices.

The international banks in The Bahamas, whose parent institutions adopt the advanced approaches in 2006 may be in a strong position to implement the IRB approach in the short-term, as much of the underlying data (probability of default, exposure at default, loss given default, and expected contract maturity of exposure) relate to the home country, and in most instances would be the same as or similar to the parent bank. Nevertheless, the outright application of even the standardized approach poses particular challenges for The Bahamas, as it will require the approval of ratings agencies (where they exist) as they relate to the licensees and will require enhanced co-ordination with home country supervisors.

D. THE LIKELY APPROACH OF THE BAHAMAS

The Bahamas will probably allow its licensees to use a range of approaches as appropriate to their size and complexity, while also taking into account the approaches of their parent banks, where applicable. The Bahamas, along with other Caribbean banking supervisors, will be undertaking a quantitative impact study to determine the effects of Basel II on the respective banking systems, to inform regional decisions on the approved methodologies for calculating capital adequacy. However, it is expected that for stand-alone licensees which are solely incorporated in The Bahamas and where The Bahamas serves as home regulator, the simplified standardized and standardized approaches appear to be the most suitable approach in the short term. Transition to more advanced approaches may be permitted after an initial two-year period.

The Central Bank will have to give approval to those subsidiaries and branches where the parent bank plans to implement a more advanced approach on a consolidated basis throughout the banking group. The Central Bank would need to ensure that the home supervisor is capable and willing to provide adequate consolidated supervision of the group. This would include home country supervisor approval for the global use of models and the back testing of models throughout an international bank group. As an alternative, the Central Bank could require those affected licensees to implement a dual capital adequacy approach (i.e. one for head office and another for The Bahamas). This would result in differences in required regulatory capital.

However, because of the high minimum initial capital requirements in The Bahamas, which have resulted in high capital adequacy ratios, the Bank does not expect the use of a less risk-sensitive approach, such as a simplified standardized approach, to result in reallocations of capital or competitive inequalities between stand alone banks and Bahamian subsidiaries of foreign banks. Additionally, it is expected that some licensees may opt not to invest in a more expensive system to more efficiently measure regulatory capital because they are required to maintain the high minimum levels in any event.

including the Basel Committee, the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS). The roundtable provided The Bahamas an opportunity to provide detailed information on its existing regulatory/supervisory regime, and to coordinate planning of new initiatives with colleague jurisdictions and regulators.

IMF Module II International Financial Sector Assessment

The IMF carried out a substantive assessment of The Bahamas' financial sector regime during October/November 2002. It had been agreed with the Government that the mission's scope should include the banking, securities, and trust and company services sectors of the Financial Services Industry.

In addition to the standing methodologies of the Basel Committee and International Organization of Securities Commissions (IOSCO), the mission employed the new Methodology for Assessing Compliance with Anti-Money Laundering and Combating the Financing of Terrorism Standards (dated October 11, 2002) agreed between the IMF, the World Bank and the Financial Action Task Force (FATF). The IMF's final assessment report is under review by the Government and is expected to be released in 2004.

A separate mission was undertaken by an independent law enforcement expert provided by the Caribbean Financial Action Task Force in late April 2003, to review anti-money laundering issues outside the competence of the Fund's mission.

Legal and Regulatory Developments

Anti-Money Laundering

At the end of December, 2003, the Government enacted amendments to the Financial Transactions Reporting Act (FRTA) and the Financial Transactions Reporting Regulations (FTRR), which provided the basis for financial institutions to implement a risk based approach to customer due diligence and anti-money laundering procedure. The amendments realign the Bahamas' KYC regime with the Financial Action Task Force's (FATF's) Revised 40 Recommendations issued in June 2003 with specific regard to the implementation of a risk rating framework for assessing the money laundering risks that client relationships pose to licensees. To assist licensees with the implementation of the amended framework, the Central Bank will issue new *Guidelines for Anti-Money Laundering and "Know-Your-Customer" Procedures* during 2004, to address, among other things, minimum requirements for a risk rating framework.

Counter-Terrorism

The Bahamas is highly conscious of the need to play its part in the heightened global efforts to prevent the use of the financial system to further the ends of terrorism.

A comprehensive Terrorism Bill was placed before Parliament during the second half of 2003, to address the Eight Special Recommendations of the FATF. Once enacted, the law should remedy those areas, where based on the review of The Bahamas' responses to terrorism in the Self Assessment Survey completed in 2002, the FATF found partial compliance with six of the Special Eight Recommendations, non-compliance with one and the non-applicability of one Recommendation. In addition to formally criminalizing terrorism and making it a predicate crime under the anti-money laundering regime, the law will provide for the seizure and confiscation of terrorist assets; reporting of suspicious transactions related to terrorist financing; and strengthening of existing mechanisms for cooperation in this regard between The Bahamas and other countries.

Cooperation with International and Regional Regulatory Bodies

Basel Committee on Banking Supervision

In February 2003, the Committee on Banking Supervision, in cooperation with the Working Group on Cross-Border Banking, issued Account Opening and Customer Identification Guidelines and a general guide to good practice based on the principles of the Basel Committee's paper on Customer Due Diligence for Banks. The guidelines focused on some of the mechanisms that banks can use in developing an effective customer identification programme. The Bahamas' position on customer due diligence is not dissimilar to the Committee's guidelines. The document did not address the other elements of the Customer Due Diligence for Banks paper, such as the ongoing monitoring of accounts. However, the Committee stressed that these elements should be considered in the development of effective customer due diligence, anti-money laundering and combating the financing of terrorism procedures.

In July 2003, the Central Bank responded to the Committee's request for comments on the third consultative paper on the New Capital Accord, Basel II. The Bank noted that the Basel II offered a number of advantages over the current Basel Capital Accord in terms of risk sensitivity, in particular, the use of external credit rating agencies to determine credit risk weights for sovereign debt exposure, other counterparties and financial instruments, as compared to the current OECD non-OECD classifications. However, while there were advantages to the implementation of the new Accord, the Bank anticipates important challenges related to resource availability and training, and the need for enhanced home-host country supervisory co-operation.

Offshore Group of Banking Supervisors

The Bank Supervision Department participated in the OGBS' meetings held in Mauritius in July 2003, where, among other issues, the following were discussed:

- The revised FATF 40 Recommendations on Money Laundering;
- Review of members' action to combat the financing of terrorism;

- Review of the experience of members in implementing the Basel Committee on Banking Supervision's paper on Customer Due Diligence for Banks; and
- Review of the experience of members with the IMF Offshore Financial Centre /Financial Sector Assessment Programme, and consideration of the future programme of FATF style mutual evaluations to be based on the revised 40 Recommendations.

Financial Action Task Force (FATF) / Caribbean Financial Task Force (CFATF)

The Bank continued its commitment to the process of review of the FATF 40 Recommendations through its participation, as part of the CFATF delegation, in the FATF's Working Group established for this purpose. These meetings have been attended by the Inspector of Banks and Trust Companies and the Bank's Legal Counsel. During the year, the Working Group met in Europe, Asia and Canada in an effort to complete the review process. In June 2003, the Revised 40 Recommendations were introduced at the FATF plenary in Germany. The Bank's team was satisfied that the CFATF's views on areas such as client confidentiality and international cooperation were reflected in the revised Recommendations. The amendments to the FTRA and FTRR, referred to earlier, have brought The Bahamas into full compliance with the FATF's Revised 40 Recommendations.

Association of Supervisors of Banks of the Americas (ASBA)

ASBA held its annual Plenary in Panama in May 2003, with the main focus being Basel II and related implementation issues for members. Several working sessions were held, with the Manager, Bank Supervision, of the Central Bank of The Bahamas chairing the session on Pillars II and III – Supervisory Review and Market Discipline. ASBA's board has established a Research and Implementation Committee to assist in researching the best implementation tools for its members. The Bahamas also participated in the preparation of comments on Basel II submitted to ASBA by the Caribbean Group of Banking Supervisors (CGBS).

ASBA's Board agreed to convene a Strategic Planning Session of representatives of the five regional groupings of the Americas, held in Washington in November, 2003. The first draft of the Strategic Plan was laid before the Board at its December, 2003 meeting. The Final Plan will be presented to the Members in June, 2004 at the annual plenary and conference.

In 2003, a decision was made that the Association's head office would remain in Mexico and in late 2003, office space was contracted. The office will be relocated to the new premises by March, 2004.

Caribbean Group of Banking Supervisors (CGBS)

At the May, 2003 meeting of the CGBS the Manager, Bank Supervision Department, presented a paper entitled 'The Impact of Money Laundering and Terrorism Threats on Regional Banking Systems and Necessary Supervisory Responses. The CGBS has established a Members intranet, which should become fully operational in 2004. The intranet is to be administered by the Bank of Jamaica, the current Chair of the Group. Also, a common database of information to be shared by Members has been established at the Bank of Jamaica Secretariat. It is expected that this will be a valuable tool as Members seek to fully coordinate their work.

The CGBS has established a Working Group on Basel II implications and Consolidated Supervision issues arising therefrom. The Group met in 2003 to draft the CGBS' response to the Third Consultative Paper on Basel II. These issues will be further advanced in 2004.

Human Resources and Training

The Bank Supervision Department currently comprises fifty-two (52) persons. The Department has made provisions in its 2004 budget to recruit an additional nine (9) persons, two (2) at management level and seven (7) at the technical level. The Department has budgeted for significant training in core bank supervision practices and policy matters, and for advanced management training in 2004. Technical staff have continued to benefit from training provided by the Financial Stability Institute(FSI) the Centre for Monetary Studies of Latin American and the Caribbean (CEMLA), the Caribbean Group of Banking Supervisors (CGBS), the United States Federal Reserve System, and the Association of Supervisors of Banks of the Americas (ASBA), among others.

In October 2003 the Central Bank co-hosted a seminar with the FSI and ASBA on the new Capital Accord and Consolidated Supervision for the Caribbean and Latin American Regions. Fifteen persons from the Department participated in the course. In November 2003, The Bank sponsored a Bank Analysis and Examination course for Bank Supervision staff and regional regulators. Senior personnel from the United States Federal Reserve System conducted the course.

Deposit Insurance Corporation

The Central Bank of The Bahamas is responsible for the administration of the Deposit Insurance Corporation (DIC). As at December 31, 2003, the number of member institutions in Fund stood at thirteen (13) (see Box III). With growth in domestic banks' Bahamian dollar deposits, premiums levied and collected amounted to some $1.62 million in 2003, compared to $1.55 million in 2002. The accumulated assets of the Fund stood at $7.2 million, as at end-2003, compared with $5.7 million at end-2002.

During the year, the DIC increased its public awareness activities by participating in a Cooperative Forum hosted by The Bahamas Cooperative League. The League was enlightened on the advent and purpose of the Scheme and offered insights as to how a similar insurance mechanism could be devised for credit unions.

BOX V :
Banks and Trust Companies Licensed to Operate within and from within The Bahamas As at December 31, 2003

Public Banks

1. Banca Serfin, S.A.
2. Banco BBM S/A
3. Banco Bilbao Vizcaya Argentaria Brasil S.A.
4. Banco Bilbao Vizcaya Argentaria, S.A.
5. Banco Boavista InterAtlantico S.A.
6. Banco Cacique S.A.
7. Banco de Bogota (Nassau) Ltd.
8. Banco Espirito Santo, S.A.
9. Banco Fibra S.A.
10. Banco Itaú BBA S.A.
11. Banco Santander Bahamas Int'l Ltd.
12. Banco Santander Central Hispano, S.A.
13. Banco Santander Portugal, S.A.
14. Banco Votorantim S.A.
15. Bank Hofmann (Overseas) Ltd.
16. Bank Leu Ltd.
17. Bank of Baroda
18. Bank of Nova Scotia Int'l Ltd.
19. Bank of Nova Scotia, The
20. Bank of the West
21. BankBoston Banco Multiplo S.A.
22. BankBoston, N.A.
23. BGP Banca di Gestione Patrimoniale SA
24. BIPAN Overseas Bank Ltd.
25. Boavista Banking Ltd.
26. British American Bank (1993) Ltd.
27. BSI AG
28. Citibank, N.A.
29. Citicorp Banking Corp.
30. Cofivalle Finance (Bahamas) Ltd.
31. Commonwealth Bank Ltd.
32. Coral Credit Bank Ltd.
33. Credit Lyonnais
34. Credit Lyonnais Suisse (Bahamas) Ltd.
35. Credit Suisse First Boston
36. First Overseas Bank Ltd.
37. FirstCaribbean Int'l Finance Corp. (Bahamas) Ltd.
38. Gonet Bank & Trust Ltd.
39. Hang Seng Bank (Bahamas) Ltd.
40. Harris Trust & Savings Bank
41. HongKong & Shanghai Banking Corp. Ltd., The
42. HSBC Bank Bahamas Ltd.
43. HSBC Republic Bank (Suisse) S.A.
44. Latin American Investment Bank Bahamas Ltd.
45. Metropolitan Bank (Bahamas) Ltd.
46. National Bank of Canada
47. PNC Bank, N.A.
48. Riggs Bank N.A.

BOX V - (Continued)
Banks and Trust Companies Licensed to Operate within and from within The Bahamas
As at December 31, 2003

Public Banks (continued)

49. Royal Bank of Canada
50. Rural Int'l Bank Ltd.
51. Santander Investment Bank Ltd.
52. Santander Merchant Bank Ltd.
53. Scotiabank (Bahamas) Ltd.
54. Standard Chartered Bank
55. State Bank of India
56. Union Bancaire Privée (Bahamas) Ltd.
57. Votorantim Bank Ltd.

Public Banks and Trust Companies

58. Andbanc (Bahamas) Ltd.
59. Ansbacher (Bahamas) Ltd.
60. Arner Bank & Trust (Bahamas) Ltd.
61. Austrobank (Overseas) Ltd.
62. Banca del Gottardo
63. Banca del Sempione (Overseas) Ltd.
64. Banco Atlantico (Bahamas) Bank & Trust Ltd.
65. Banco del Istmo (Bahamas) Ltd.
66. Banco del Pichincha Ltd.
67. Banco Nacional de Mexico S.A.
68. Banco Popular Int'l Ltd.
69. Banistmo Int'l (Bahamas) Ltd.
70. Bank of Butterfield (Bahamas) Ltd.
71. Bank of Hawaii
72. Bank of Nova Scotia Trust Co. (Bahamas) Ltd., The
73. Bank of The Bahamas Ltd.
74. Bank of Tokyo-Mitsubishi Trust Co., The
75. BankBoston Trust Co. Ltd.
76. Banque Privee Edmond de Rothschild Ltd.
77. Banque SCS Alliance (Nassau) "Ltd."
78. Barclays Bank Plc
79. Barrington Bank Int'l Ltd.
80. BBA-Creditanstalt Bank Ltd.
81. BBM Bank Ltd.
82. BluBank Ltd.
83. BSI Overseas (Bahamas) Ltd.
84. BSJ Int'l Bank & Trust Co. Ltd.
85. CIBC Trust Co. (Bahamas) Ltd.
86. Citco Bank & Trust Co. (Bahamas) Ltd.
87. Citibank-Colombia (Nassau) Ltd.
88. Cititrust (Bahamas) Ltd.
89. Corner Bank (Overseas) Ltd.
90. Credit Suisse (Bahamas) Ltd.
91. Credit Suisse First Boston (Bahamas) Ltd.
92. Credit Suisse Wealth Management Ltd.
93. Cuscatlan Int'l Bank & Trust Ltd.
94. Darier, Hentsch Private Bank & Trust Ltd.
95. Dartley Bank & Trust Ltd.

Public Banks and Trust Companies (continued)

96. Deltec Bank "&" Trust Ltd.
97. Deutsche Bank Trust Co. Americas
98. Eni Int'l Bank Ltd.
99. Equator Bank Ltd.
100. Eurobanco Bank Ltd.
101. Ferrier Lullin Bank & Trust (Bahamas) Ltd.
102. Fidelity Merchant Bank & Trust Ltd.
103. Finance Corp. of Bahamas Ltd.
104. Finter Bank & Trust (Bahamas) Ltd.
105. First Trust Bank Ltd.
106. FirstCaribbean Int'l Bank (Bahamas) Ltd.
107. Gottardo Trust Co. Ltd.
108. Guaranty Trust Bank Ltd.
109. Habib Banking Corp. Ltd.
110. Hottinger Bank & Trust Ltd.
111. HSBC Investments (Bahamas) Ltd.
112. Intercredit Bank & Trust Ltd.
113. Istituto Bancario San Paolo di Torino – Istituto Mobiliare Italiano S.p.A. (San Paolo IMI S.p.A.)
114. ITK Trust Co. Ltd.
115. J Safra Bank (Bahamas) Ltd.
116. J. P. Morgan Trust Co. (Bahamas) Ltd.
117. JPMorgan Chase Bank
118. Leadenhall Bank & Trust Co. Ltd.
119. Leu Trust & Banking (Bahamas) Ltd.
120. MeesPierson (Bahamas) Ltd.
121. Mizuho Corporate Bank (USA)
122. MMG Bank & Trust Ltd.
123. National Bank of Canada (Int'l) Ltd.
124. Occidental Bank & Trust Int'l Ltd.
125. Oceanic Bank & Trust Ltd.
126. Pasche Bank & Trust Ltd.
127. PIB Trust Co. Ltd.
128. Pictet Bank & Trust Ltd.
129. POBT Bank & Trust Ltd.
130. Pribanco Internacional Ltd.
131. Private Investment Bank Ltd.
132. Private Trust Corp. Ltd., The
133. Royal Bank of Canada Trust Co. (Bahamas) Ltd.
134. Royal Bank of Scotland (Nassau) Ltd., The
135. Safra Int'l Bank & Trust Ltd.
136. Santander Central Hispano Bank & Trust (Bahamas) Ltd.
137. Sentinel Bank & Trust Ltd.
138. SG Hambros Bank & Trust (Bahamas) Ltd.
139. SG Hambros Bank & Trust (Bahamas) Ltd. [Resident Branch]
140. Sud Bank & Trust Co. Ltd.
141. Syz & Co. Bank & Trust Ltd.
142. Transamerica Bank & Trust Co. Ltd.
143. UBS (Bahamas) Ltd.

BOX V - (Continued)
Banks and Trust Companies Licensed to Operate within and from within The Bahamas
As at December 31, 2003

Public Banks and Trust Companies (continued)

144.	Unibanco – Uniao de Bancos Brasileiros S.A.	
145.	Union Bancaire Privee	
146.	United European Bank & Trust (Nassau) Ltd.	
147.	Westrust Bank (Int'l) Ltd.	
148.	Winterbotham Trust Co. Ltd., The	
149.	Overseas Union Bank & Trust (Bahamas) Ltd.	LQD
150.	Banco Internacional de Costa Rica Ltd.	LQD
151.	Prime Bank & Trust (Bahamas) Ltd.	LQD

Public Trust Companies

152.	ATC Trustees (Bahamas) Ltd.	
153.	Bamont Trust Co. Ltd.	
154.	Bank of The Bahamas Trust Ltd.	
155.	BSI Trust Corp. (Bahamas) Ltd.	
156.	Cayside Trust Co. Ltd.	
157.	Credit Lyonnais Management Services (Bahamas) Ltd.	
158.	Credit Suisse Trust Ltd.	
159.	Euro-Dutch Trust Co. (Bahamas) Ltd.	
160.	Experta Trust Co. (Bahamas) Ltd.	
161.	Ferrier Lullin Trust Co. (Bahamas) Ltd.	
162.	Hang Seng Bank Trustee (Bahamas) Ltd.	
163.	HSBC Asset Management (Bahamas) Ltd.	
164.	New World Trust Corp.	
165.	Pictet Overseas Trust Corp. Ltd.	
166.	St. James Trust Co. Ltd., The	
167.	UBP Int'l Trust Ltd.	
168.	UBS Trustees (Bahamas) Ltd.	
169.	Coutts Trustees (Bahamas) Ltd.	LQD

Restricted Banks

170.	Bank of America, N.A.	
171.	Colonial Int'l Banking Corp. Ltd.	
172.	Commercial Bank of Kuwait S.A.K., The	
173.	International Merchant Bank Ltd.	
174.	Investindustrial Bank Ltd.	
175.	Liverpool-West Indies Bank Ltd.	
176.	Lloyds TSB Bahamas (Americas) Ltd.	LQD
177.	R. I. F. C. Bank Ltd.	LQD

Restricted Banks and Trust Companies

178.	Belgravia Int'l Bank & Trust Co. Ltd.	
179.	Elco Bank & Trust Co. Ltd.	
180.	Fidelity Bank & Trust Int'l Ltd.	
181.	Glen Bank & Trust Co. Ltd., The	
182.	Security Atlantic Bank Ltd.	

Restricted Trust Companies

183.	Anco Trust Corp. Ltd.	
184.	Ark Ltd.	
185.	Arndilly Trust Co. Ltd.	

Restricted Trust Companies (continued)

186.	Atlaw Trustees Ltd.	
187.	Bitmore Ltd.	
188.	CAPS A.A. Trust Co. Ltd.	
189.	Cromwell Trust Co. Ltd.	
190.	Fiduciary Trust Co. (N.P.) Ltd.	
191.	Grampian Trust Co. Ltd.	
192.	Heritage Trust Co. Ltd., The	
193.	Hermes Trust Co. Ltd.	
194.	Hermin Trust Co. Ltd.	
195.	Kattegat Trust Co. Ltd., The	
196.	Laurentide Insurance & Mortgage Co. Ltd.	
197.	Marien Holdings (Bahamas) Ltd.	
198.	Nashville Trust Co. Ltd.	
199.	Portland Trustee Ltd.	
200.	Ranco Capital Trust Group Ltd.	
201.	Sarofina Ltd.	
202.	Securitas Holding Corp.	
203.	SG Hambros Corporate Services (Bahamas) Ltd.	
204.	Teddington Trustees Ltd.	
205.	TK Trust Co. Ltd., The	
206.	Troika Trust Ltd.	
207.	Trubasem Services Ltd.	
208.	Barnacle Two Ltd.	LQD
209.	Devon Trust Co. Ltd.	LQD
210.	Manasco Management Ltd.	LQD
211.	Sovereign Trust Co. Ltd.	LQD
212.	Sunisles Trustees Ltd.	LQD
213.	Worldwide Trust Services Ltd.	LQD

Restricted Nominee Trust Companies

214.	Adansonia Investments Ltd.
215.	Albacore Investments Ltd.
216.	Amazonas Investments Ltd.
217.	BAHTCO Holdings Ltd.
218.	Bannervale Investments Ltd.
219.	Bay State Corp. Ltd.
220.	Beaumont Nominees Ltd.
221.	C. B. Management Ltd.
222.	C.B. Strategy Ltd.
223.	Cape Ann Corp. Ltd.
224.	Cedar Holdings Inc.
225.	Chase Manhattan Trust Corp. (Nominees) Ltd., The
226.	Cipriani Corp. Ltd.
227.	Delacroix Ltd.
228.	Delaroche Ltd.
229.	Dragonian Investments Ltd.
230.	Durrington Ltd.
231.	Ebony Nominees "Ltd."
232.	Elco (Nominee) Ltd.

BOX V - (Continued)
Banks and Trust Companies Licensed to Operate within and from within The Bahamas
As at December 31, 2003

Restricted Nominee Trust Companies (continued)

233. Elco (Trustee) Ltd.
234. Erie Ltd.
235. Fife Ltd.
236. First Nat'l Nominees Ltd.
237. FirstCaribbean Int'l (Bahamas) Nominees Co. Ltd.
238. Frederick Investments Ltd.
239. Goshen Investments Ltd.
240. Grahamco Ltd.
241. Hamaca Nominee Ltd.
242. HSBC Nominees Nassau Ltd.
243. I. B. A. Nominee Trust Ltd.
244. Ivory Nominees "Ltd."
245. Lighthouse (Nassau) Ltd.
246. Lighthouse Consulting (Nassau) Ltd.
247. Lighthouse Corporate Holdings (Nassau) Ltd.
248. Lighthouse Nominess (Nassau) Ltd.
249. LTSB Nominees Ltd.
250. Maddox Ltd.
251. Magog Ltd.
252. March Ltd.
253. Maridi Investment Co. Ltd.
254. Mercury Nominees Ltd.
255. Morgan Guaranty Nominees (Bahamas) Ltd.
256. Nomco Ltd.
257. Nominees (Bahamas) Ltd.
258. Orion Nominees Ltd.
259. Pelican Investments Ltd.
260. Prosperite Nominees Ltd.
261. Providence Associates Ltd.
262. Remus Investments Ltd.
263. Romulus Investments Ltd.
264. Saussure Nominees Ltd.
265. Scotia Nominees (Bahamas) Ltd.
266. Superior Ltd.
267. Three Keys Ltd.
268. Trunoms Ltd.
269. Universe Nominees Ltd.
270. Virgo Holdings Inc.
271. Welland Ltd.
272. Wolnoms Ltd.
273. Wun Holdings Inc.

Restricted (Non-Active) Banks

274. P. T. Bank Central Asia
275. Standard Chartered Bank Bahamas Ltd.
276. Gulf Union Bank (Bahamas) Ltd. LQD

Restricted (Non-Active) Banks and Trust Companies

277. Bank of America Trust & Banking Corp. (Bahamas) Ltd.
278. Monteverdi Int'l Bank & Trust Co. Ltd.
279. Pan American Bank Ltd.
280. Riggs Bank & Trust Co. (Bahamas) Ltd.
281. Gulf Union Bank Ltd. LQD
282. Lloyds TSB Bank & Trust (Bahamas) Ltd. LQD
283. Socimer Int'l Bank Ltd. LQD

Restricted (Non-Active) Trust Companies

284. Canbank Nominees (Nassau) Ltd.

EXPLANATORY NOTES

LQD
Denotes that licensee is in liquidation.

Public Licensee:
A public bank and/or trust company is one which is permitted to carry on banking and/or trust business with members of the public.

Restricted Licensee:
A restricted bank and/or trust company is one which is allowed to carry on business for certain specified persons which are usually named in the licence.

Nominee Trust Licensee:
A nominee company is a restricted licensee which holds securities and other assets in its name on behalf of clients of its parent bank or trust company, but carries on no other trust business.

Non-Active Licensee:
A non-active company is one which is either in voluntary liquidation or wishes to keep the word bank or trust in the company's name even though it is not carrying on any banking or trust business.

International Association of the Deposit Insurers (IADI)

The DIC is one of 25 founding members of IADI and is committed to the implementation of international best practices and standards. Bank Supervision staff represented the Fund at the second Annual General Meeting and Conference of the IADI in Seoul, South Korea, in October 2003. BSD staff also represented the DIC at the first Caribbean Regional Committee Meeting held in Kingston, Jamaica, in April 2003. The meeting addressed issues unique to Caribbean deposit insurers and countries contemplating or in the process of establishing deposit insurance systems.

Computer

During 2003, the Department committed significant resources to the development and implementation of the document management workflow application, developed using the technology of Lotus Notes and Domino, together with the Emerging Technology Services' (ETS) Business in a Box software product, which takes advantage of this technology for messaging, security, systems management and data distribution and replication. The correspondence tracking modules, which have been introduced for the Exchange Control and Bank Supervision Departments, have improved the recording, tracking and dissemination of information; and streamlined the turnaround time for responses to external customers' queries. For Bank Supervision, the emphasis has been on managing licensee information databases and all activities related to individual licensees. The Human Resources module facilitates online processing of employee forms, better management, communication and dissemination of personnel information and services within the Bank, and provides important human resources metrics.

The Department continued to make major enhancements and upgrades to existing systems and miscellaneous modifications to maintain and boost systems' performance. Additional modules were developed for the Banking Department's Currency System, the Bridge Authority Bonds System and the Dormant Accounts System. More development was also undertaken for the Research Department within the FAME Statistical Database environment to improve efficiency in the recording and processing of financial sector data.

With plans underway to implement a Real Time Gross Settlement System (RTGS), the Computer Department will assume the lead role in providing the enabling in-house technology support to launch as well as to service the Bank's external clients, once the system is fully operational. An initial step in the Department's increased role has been the assumption of direct responsibility for daily maintenance of the SWIFT system and hardware, which is to function as the communications infrastructure for the RTGS system.

Legal Unit

The Legal Unit, which falls under the Governor's office, advises the Central Bank of The Bahamas on legal matters arising in connection with the operation and administration of the Bank. The Unit is also involved in the policy development work of the Bank, participating in the Policy Advisory Committee, to ensure that policy determinations are consistent with applicable legislation, and manages the Bank's relations with external counsel.

Internal Audit Unit

Activities of the Internal Audit Unit during 2003 focused on ensuring that adequate control procedures were adhered to in the Bank's financial transactions and on heightening awareness of operational risks within the organization.

During 2003, the Unit conducted Control Self-Assessment workshops for the Bank's management team, in an effort to foster a more risk conscious work environment. The operational risk aspect of these sessions heightened awareness of the Bank's dependence on key persons at the departmental level and on the need to ensure that adequate back-up resources existed to prevent disruptions to the delivery of critical internal and external services. Similar workshops are planned during 2004 for non-managerial staff.

Audits of key operational areas included currency operations and external reserves management activities of the Banking Department. The Unit also successfully completed reviews of foreign exchange trading operations, reconciliations of correspondent bank accounts, bank transfers, including the Swift operations, telephone operations, staff loans and sundry debtors. Written reports were presented to management and executive staff on the audit results, which were designed to encourage responses and identification of dates by which corrective action would be taken.

The Bank sought to ensure that skills of the Internal Audit Unit continued to be enhanced, and that staffing resources remained adequate. Including the Internal Auditor, staffing has increased to four persons since 2002. Internal Audit staff members attended and benefited from seminars sponsored by the local chapter of the Institute of Internal Auditors, in addition to other overseas training.

In 2004, the Internal Audit Unit will continue to focus on crucial areas of the Bank's operations, using risk based auditing techniques. Key processes of internal departments have been identified and ranked with the intention of developing a three year audit plan. The 2004 work plan will include follow-up reviews of areas completed in 2003 which indicated need for improvements, as well as audits of new areas such as the Bank's Disaster Recovery Plan, payroll processing, the Dormant Accounts system, budgeting and financial reporting.

Monitoring of major projects under development, including RTGS and ACH, will significantly engage the resources of the Internal Audit Unit during 2004. Of particular note in this regard will be the Bank's key role as service provider for the RTGS, and the manner in which accounting procedures and controls are modified to conform with the requirements of the RTGS and ACH systems.

ADMINISTRATION

The Board

The composition of the Bank's Board of Directors was unchanged in 2003. The Board meets monthly, chaired by Governor Julian Francis. Deputy Governor, Wendy Craigg, is also a member, and the external Directors are Dr. Pandora Johnson, Vice President, Research, Planning and Development, The College of The Bahamas, and Mr. Carleton William, MBE, a retired businessman.

Administration Department

During 2003, the Bank formally established the Administration Department, partly to centralize those operations and logistical support services previously handled by the Human Resources and Accounts Departments. More broadly however, the function of the Department is to provide structure, service and support in the following areas:

- Supervision of operations in relation to the Physical Plant Maintenance, Cafeteria and Food Services and Logistics services;
- Administration of procedures and policies relating to the purchasing and procurement of goods, services and equipment;
- Establishment and administration of a registry of contracts, service agreements and insurance policies maintained by The Central Bank;
- Management of the Bank's liability of all personnel authorized to utilize bank vehicles as a regular duty related to their respective job;
- Management of the Central Bank Numismatic Program;
- Planning and coordination of all programmes categorized as special events or conferences hosted by any of the Bank's operating departments, inclusive of the Governor's Office; and
- Guidance and coordination of all physical and civil works conducted at any of the bank's several properties.

Through this refocusing of efforts, the Bank expects to achieve substantially improved processes in these areas.

Overseas Meetings and Conferences

Governor Julian Francis' attendance at overseas meetings in 2003 included representation of The Bahamas at regularly scheduled meetings of the FTAA Negotiating Group on Competition Policy in Panama and Mexico; participation in the Association of Supervisors of Banks of the Americas (ASBA) Meeting in Miami during February; CARICOM Central Bank Governors Meetings in Barbados, during May and November; Bank of England and Bank for International Settlements Meetings in England and Switzerland, respectively, during June, and the IMF/World Bank Meetings in Dubai, during September. The Governor also attended a seminar on the New Basel Accord in Washington, D.C. during January, a Bahamas Roundtable hosted by Institutional Investment in New York during May and a World Bank Conference on "Aligning Financial Supervisory Structure with Country Needs" in Washington, D.C. during December.

Deputy Governor, Mrs. Wendy Craigg's travels included regular attendance at the FTAA Negotiating Group on Services meetings in Panama and Mexico. The Deputy Governor also attended the Executive Committee Meeting of the

Caribbean Centre for Monetary Studies (CCMS) in Trinidad and Tobago during March, the 5th WTO Ministerial Meeting in Cancun, Mexico, during September, and in November, a Payment and Securities Settlement Systems Conference and the Regional Monetary Studies Conference in Washington, D.C. and St. Kitts, respectively.

The Bank was also represented at a significant number of overseas meetings, conferences and seminars by other members of its management team as well as non-management employees.

Staff Training, Development and Relations

As the Bank was engaged in a number of priority projects during 2003, resources dedicated to the completion of the Job Evaluation and Compensation Review Exercise were more limited. It is anticipated that the exercise will be completed by the end of the first quarter 2004, producing a framework for better alignment of compensation levels to skills requirement.

Additional resources were devoted to the Performance Management Programme, as the Bank contracted with a local consultant to review the Performance Management Cycle, the Performance Guides of employees, and role specifications for structure and consistency. Workshops were also conducted for management and staff to develop and refine performance standards consistent with the Bank's performance expectations.

The Bank's commitment to training and development was again evidenced by the significant number of professional and technical training opportunities available to employees during the year. Bank sponsored training programmes encompassed employees' participation in approximately 50 seminars, courses and workshops conducted overseas and 32 conducted locally. In addition, more than 40 employees enrolled in continuing education programmes benefited from tuition reimbursements and subsidies under the Staff Training incentive programme. At year's end, five employees were pursuing full-time studies locally on in-service awards, and one employee had engaged an internship with a local accounting firm.

At the Annual Long Service Awards Presentation in January, recognition was given to nine employees who, during the past year, had achieved milestones of 10, 20 and 30 years of continuous service.

Public Relations

The Bank hosted its 20th Annual Art Exhibition and competition in 2002. Over the years, the exhibition has been very instrumental in identifying young Bahamian talent, and allowing the Bank to award scholarships to talented artists in the high school category. At the opening ceremony marking the event, the Bank expressed its appreciation to the various high schools, which had regularly participated in the competition since its inception, and to past Governors Sir William Allen and Senator the Honourable James Smith for sustaining the event during their respective tenures in office.

Staff Complement

With the recruitment of 15 persons, the retirement of 10, the resignation of 4 and the termination of 1, the staff complement stood at 237 as at end-December 2003, compared to 232 in 2002. This was inclusive of 219 permanent and 15 contract staff. Of the 10 persons who retired, 3 were retained on a contractual basis.

The Bank was saddened, during the year, by the death of Mr. Kenneth Knowles, Chief Maintenance Officer, a recent retiree.

Acknowledgement

The Board of Directors extends its sincere appreciation to all Bank staff for their continuous dedicated service during the past year.

MANAGEMENT'S REPORT

The Central Bank of The Bahamas' Financial Statements for the year ended December 31, 2003, along with comparative figures for 2002 are shown on pages 61 to 78.

Total assets of the Bank rose by $42.4 million (7.2%), attributed to the $111.2 million (29.8%) expansion in external assets to $484.3 million. The latter included a $57.4 million (45.4%) increase in foreign currency deposits to $183.7 million and $52.9 million (22.6%) in marketable securities to $287.4 million. "Other Assets" decreased by $68.2 million (34.0%) to $132.6 million, representing a $72.0 million (100.0%) reduction in holdings of Bahamas Government Treasury bills, a $0.78 million (1.1%) decline in the Bank's advances to Government to $71.0 million and increased investments in Bahamas Government Registered Stock of $5.1 million (13.2%) to $43.8 million.

The Bank's liabilities growth mainly occurred in demand obligations, which advanced by $41.1 million (8.6%) to $518.8 million. Currency in active circulation were higher by $18.6 million (8.4%) at $239.9 million; deposits held for banks, by $14.3 million (6.2%) at $244.5 million; deposits by the Bahamas Government and its agencies, by $8.5 million (43.8%) at $28.0 million and "other liabilities", by $0.4 million (2.6%) at $15.2 million.

As a result of reduced yields on foreign currency deposits, operating income during 2003 declined by $2.1 million (8.2%) to $23.4 million, while expenses increased by $1.7 million (8.5%) to $22.4 million. Consequently, profits from operations were considerably lower by $3.9 million (78.4%) at $1.1 million.

The Central Bank of The Bahamas

FINANCIAL STATEMENTS

DECEMBER 31, 2003

BDO Mann Judd
P. O. Box N 10144
Nassau, The Bahamas

Pannell Kerr Forster
P. O. Box N 8335
Nassau, The Bahamas

REPORT OF THE AUDITORS TO THE DIRECTORS OF THE CENTRAL BANK OF THE BAHAMAS

We have audited the accompanying balance sheet of The Central Bank of The Bahamas as at 31 December 2003 and the related statements of profit, changes in capital and reserves and cash flows for the year then ended. These financial statements are the responsibility of the management of The Central Bank of The Bahamas. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly in all material respects, the financial position of The Central Bank of The Bahamas as at 31 December 2003 and the results of its operations, changes in capital and reserves, and cash flows for the year then ended, in accordance with International Financial Reporting Standards, and in all material respects, comply with The Central Bank of The Bahamas Act, 2000.

BDO Mann Judd

Pannell Kerr Forster

Chartered Accountants
Nassau Bahamas
23 April, 2004

THE CENTRAL BANK OF THE BAHAMAS

BALANCE SHEET

At 31 December 2003

(Amounts expressed in Bahamian dollars)

	Notes	2003	2002
		$	$
ASSETS			
FIXED ASSETS	4	12,236,321	12,747,197
EXTERNAL ASSETS	5		
Foreign currency deposits		183,720,002	126,321,223
Marketable securities issued or guaranteed by foreign governments	6	287,360,250	234,420,418
Accrued interest receivable on foreign currency		3,945,184	3,840,808
International Monetary Fund	7		
Bahamas reserve tranche		9,281,646	8,481,962
Special drawing rights		16,941	103,844
		484,324,023	**373,168,255**
OTHER ASSETS			
Bahamas Government treasury bills	8	--	72,026,739
Bahamas Mortgage Corporation bonds	9	300,000	300,000
Advances to the Bahamas Government	10	71,018,608	71,786,900
Bahamas Government registered stocks	11	43,781,600	38,636,000
Loans to Bahamas Government agency	12	6,350,000	6,750,000
The Bridge Authority bonds	13	597,000	569,000
Accrued interest, receivables and other accounts		10,524,808	10,700,675
		132,572,016	**200,769,314**
		$629,132,360	**$586,684,766**

The notes on pages 67 to 78 form an integral part of these financial statements.

THE CENTRAL BANK OF THE BAHAMAS

BALANCE SHEET

At 31 December 2003

(Amounts expressed in Bahamian dollars)

	Notes	2003	2002
		$	$
LIABILITIES, CAPITAL AND RESERVES			
DEMAND LIABILITIES			
Notes in circulation		226,708,766	208,561,319
Coins in circulation		13,199,008	12,706,676
Deposits by commercial banks	14	244,499,134	230,212,189
Deposits by The Bahamas Government and Bahamas Government agencies		27,973,814	19,496,618
Deposits by international agencies	15	967,167	599,450
Accrued interest, payables and other accounts		4,409,548	3,078,894
Provision for payment into the Consolidated Fund	17	1,000,000	3,000,000
		518,757,437	**477,655,146**
OTHER LIABILITIES			
International Monetary Fund allocation of special drawing rights	16	15,201,453	13,907,884
CAPITAL AND RESERVES			
Authorised and fully paid capital		3,000,000	3,000,000
Exchange equalisation account	17	1,043	338,969
Contingency reserve	17	750,000	750,000
Other reserves	17	13,758,811	19,834,495
General reserves	17	77,663,616	71,198,272
		95,173,470	**95,121,736**
		$629,132,360	**$586,684,766**

The statements were approved by the board of directors and authorised for issue on 23 April, 2004, and are signed on its behalf by:

GOVERNOR

DIRECTOR

The notes on pages 67 to 78 form an integral part of these financial statements.

STATEMENT OF PROFIT

For the year ended 31 December 2003
(Amounts expressed in Bahamian dollars)

	Notes	2003	2002
		$	$
INCOME	18	23,414,680	25,527,680
EXPENSES	19	22,362,946	20,620,463
NET PROFIT FOR THE YEAR		**$1,051,734**	**$4,907,217**

The notes on pages 67 to 78 form an integral part of these financial statements.

STATEMENT OF CHANGES IN CAPITAL AND RESERVES

For the year ended 31 December 2003

(Amounts expressed in Bahamian dollars)

	Authorised and Fully Paid Capital	Exchange Equalisation Account	Contingency Reserve	Other Reserves	General Reserves	Total
	$	$	$	$	$	$
Balance at 1 January 2002	3,000,000	740,400	750,000	25,057,035	63,667,084	93,214,519
Net profit for the year	--	--	--	--	4,907,217	4,907,217
Transfer of unrealised exchange losses	--	(401,431)	--	--	401,431	--
Transfer from other reserves to general reserves	--	--	--	(5,222,540)	5,222,540	--
Transfer to Consolidated Fund	--	--	--	--	(3,000,000)	(3,000,000)
Balance at 31 December 2002	$3,000,000	$338,969	$750,000	$19,834,495	$71,198,272	$95,121,736
Net profit for the year	--	--	--	--	1,051,734	1,051,734
Transfer of unrealised exchange losses	--	(337,926)	--	--	337,926	--
Transfer from other reserves to general reserves	--	--	--	(6,075,684)	6,075,684	--
Proposed transfer to Consolidated Fund	--	--	--	--	(1,000,000)	(1,000,000)
Balance at 31 December 2003	**$3,000,000**	**$1,043**	**$750,000**	**$13,758,811**	**$77,663,616**	**$95,173,470**

The notes on pages 67 to 78 form an integral part of these financial statements.

STATEMENT OF CASH FLOWS

For the year ended 31 December 2003

(Amounts expressed in Bahamian dollars)

	2003	2002
	$	$
CASH FLOWS FROM OPERATING ACTIVITIES		
Profit for the year	1,051,734	4,907,217
Adjustment for items not involving the movement of cash:		
Amortisation of premiums on marketable securities	3,287,822	2,214,393
Depreciation	1,042,934	1,121,391
Unrealised exchange gains	--	(369,128)
Interest income	(22,006,577)	(22,180,904)
Interest expense	240,461	295,928
Net cash used in operating activities before changes in operating assets and liabilities	(16,383,626)	(14,011,103)
(Increase)/decrease in operating assets:		
International Monetary Fund – Special Drawing Rights	580,788	418,577
Receivables and other accounts	(1,088,157)	(404,589)
(Decrease)/increase in operating liabilities:		
Notes in circulation	18,147,447	1,939,457
Coins in circulation	492,332	748,023
Deposits by commercial banks	14,286,945	41,476,193
Deposits by The Bahamas Government and Bahamas Government agencies	8,477,196	6,892,105
Deposits by international agencies	367,717	51,879
Payables and other accounts	1,330,654	(899,739)
Net cash provided by operating activities	**26,211,296**	**36,210,803**

The notes on pages 67 to 78 form an integral part of these financial statements.

STATEMENT OF CASH FLOWS

For the year ended 31 December 2003

(Amounts expressed in Bahamian dollars)

	2003	2002
	$	$
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of marketable securities	(106,500,000)	(39,500,000)
Proceeds from maturities of marketable securities	62,000,000	62,000,000
Premium paid on marketable securities	(11,727,654)	(2,897,046)
Purchases of fixed assets	(608,921)	(701,602)
Proceeds from sale of fixed assets	76,863	50,828
Purchases and rediscounts of Bahamas Government treasury bills	(57,032,706)	(283,204,280)
Proceeds from sales and maturities of Bahamas Government treasury bills	129,059,445	309,981,560
Advances to Bahamas Government	(34,000,000)	(28,768,292)
Proceeds from Bahamas Government	34,768,292	13,926,408
Purchase of The Bridge Authority bonds	(28,000)	(36,300)
Purchases of Bahamas Government registered stocks	(22,145,000)	(38,482,100)
Proceeds from sales and maturities of Bahamas Government registered stocks	16,999,400	33,855,200
Repayments of loan to Bahamas Government agency	400,000	400,000
Interest received	23,158,707	21,842,084
Net cash provided by investing activities	**34,420,426**	**48,466,460**
CASH FLOWS FROM FINANCING ACTIVITIES		
Payment to the Consolidated Fund	(3,000,000)	(2,500,000)
Interest paid	(240,461)	(295,928)
Net cash used by financing activities	(3,240,461)	(2,795,928)
Net increase in cash and cash equivalents	57,391,261	81,881,335
Cash and cash equivalents at beginning of the year	126,365,971	44,484,636
Cash and cash equivalents at end of the year	$183,757,232	$126,365,971
Cash and cash equivalents are comprised of the following:		
Foreign currency deposits	183,720,002	126,321,223
Cash on hand (included in accrued interest, receivables and other accounts)	37,230	44,748
	$183,757,232	**$126,365,971**

The notes on pages 67 to 77 form an integral part of these financial statements.

1. INCORPORATION AND ACTIVITIES

The Central Bank of The Bahamas (the Bank) was established under The Central Bank of The Bahamas Act Chapter 321, and was continued under The Central Bank of The Bahamas Act, 2000 (the Act). As at 31 December 2003, the Bank had 234 (2002: 230) employees and its main place of business is located at Frederick Street, Nassau, Bahamas. The Bank's principal business is the provision of Central Banking facilities for the Commonwealth of The Bahamas. In accordance with the Act it is the duty of the Bank to promote and maintain monetary stability, credit and balance of payments conditions conducive to the orderly development of the Bahamian economy.

2. BASIS OF PREPARATION

The accompanying financial statements have been prepared on a going concern basis and in accordance with International Financial Reporting Standards (IFRS). The preparation of the financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the year. Actual results can differ from those estimates.

3. ACCOUNTING POLICIES

Significant accounting policies used in the preparation of these financial statements are noted below.

Revenue recognition

Revenues are recognised under the accruals concept.

Foreign currencies

Transactions in currencies other than Bahamian Dollars are converted at the rates of exchange ruling at the time of the transactions. Balances in currencies other than Bahamian Dollars at the balance sheet date are converted at the closing rate of exchange prevailing at the balance sheet date.

The net change in the Bank's assets and liabilities arising from movements in currency exchange rate is included in the statement of profit and, in accordance with Sections 32(2)(a) and 32(2)(b) of the Act, the unrealised portion is transferred to an exchange equalisation account.

Fixed assets

Fixed assets are recorded at cost less accumulated depreciation. Depreciation is provided in equal annual installments so as to write off the cost of assets other than land over their estimated useful lives. The following rates are used:

Buildings & renovations	2% p.a.
Office equipment	20% or 33% p.a.
Computer software	33% or 50% p.a.
Office furniture & fittings	20% p.a.
Other fixed assets	20% or 33% p.a.

3. ACCOUNTING POLICIES (continued)

Marketable securities issued or guaranteed by foreign governments

Marketable securities issued or guaranteed by foreign governments are classified as held-to-maturity investments, and are stated at amortised cost, using the effective interest rate method. Such investments are subject to review for impairments.

Bahamas Government treasury bills

Bahamas Government treasury bills are classified as available-for-sale investments and are stated at fair value.

Bahamas Mortgage Corporation bonds

Bahamas Mortgage Corporation bonds are classified as available-for-sale investments and are stated at fair value.

Advances to the Bahamas Government

The advances are classified as loans and receivables originated by the enterprise and not held for trading. These loans, which are payable on demand, are stated at cost. These loans are subject to review for impairment.

Bahamas Government registered stocks

Bahamas Government registered stocks are classified as available-for-sale investments and are stated at fair value.

Loans to Bahamas Government Agency

The loans are classified as loans and receivables originated by the enterprise and not held for trading. These loans, which have a fixed maturity period, are measured at amortised cost, using the effective interest rate method. These loans are subject to review for impairment.

The Bridge Authority bonds

The Bridge Authority bonds are classified as available-for-sale investments and are stated at fair value.

Numismatic coins

Numismatic coins which are specially minted or packaged as collectors' items and which are not issued for monetary purposes are not included in coins in circulation. Any profit or loss arising from the sale of these coins is included in the statement of profit.

3. ACCOUNTING POLICIES (continued)

Retirement benefit costs

The Bank operates a defined benefit contributory pension plan covering substantially all full-time employees. The cost of providing such benefits is determined using the projected unit credit method, with actuarial valuations being carried out at each balance sheet date. Actuarial gains and losses which exceed 10% of the greater of the present value of the Bank's pension obligations and the fair value of the plan's assets are amortised over the expected average remaining working lives of the participating employees. Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the amended benefits become vested.

The amount recognised in the balance sheet represents the present value of the defined benefit obligation as adjusted for the unrecognised actuarial gains and losses and unrecognised past service costs, and reduced by the fair value of plan assets. Any asset arising as a result of this calculation is limited to the unrecognised actuarial losses and past service cost plus the present value of available refunds and reductions in future contributions to the plan.

Fiduciary items

No account is taken in these financial statements of assets held or liabilities incurred by the Bank in a fiduciary capacity.

4. FIXED ASSETS

	Land $	Buildings and renovations $	Office Equipment $	Computer Software $	Office Furniture & Fittings $	Other Fixed Assets $	Total $
COST							
1 January 2003	2,452,938	11,595,976	4,867,312	4,744,876	2,694,645	551,794	26,907,541
Additions	--	38,843	355,389	172,531	42,158	--	608,921
Disposals	--	--	(53,612)	--	(35,006)	(127,696)	(216,314)
Transfer	--	(39,423)	39,423	--	--	--	--
31 December 2003	2,452,938	11,595,396	5,208,512	4,917,407	2,701,797	424,098	27,300,148
DEPRECIATION							
1 January 2003	--	3,097,129	4,001,855	4,532,231	2,128,251	400,878	14,160,344
Charge for the year	--	248,773	515,425	75,217	160,589	42,930	1,042,934
Disposals	--	--	(47,490)	--	(35,006)	(56,955)	(139,451)
31 December 2003	--	3,345,902	4,469,790	4,607,448	2,253,834	386,853	15,063,827
NET BOOK VALUE							
31 December 2003	**$2,452,938**	**$8,249,494**	**$738,722**	**$309,959**	**$447,963**	**$37,245**	**$12,236,321**
31 December 2002	**$2,452,938**	**$8,498,847**	**$865,457**	**$212,645**	**$566,394**	**$150,916**	**$12,747,197**

Buildings and renovations include work in progress totalling $66,783 (2002: $93,998) which is not depreciated.

5. EXTERNAL ASSETS

External assets comprise of those assets defined as such by Section 18(1) of the Act. The Act also requires that the value of external assets shall not at any time be less than 50% of the value of the aggregate of the notes and coins in circulation and other demand liabilities of the Bank. At the year end, external assets represented approximately 93.33% (2002: 78.12%) of such liabilities.

6. MARKETABLE SECURITIES ISSUED OR GUARANTEED BY FOREIGN GOVERNMENTS

Section 18(1) of the Act requires that marketable securities issued or guaranteed by foreign governments, which mature beyond 5 years, shall at no time constitute more than 30% in value of the Bank's external assets. At 31 December 2003 marketable securities held by the Bank which mature after 5 years constituted 11.61% (2002:1.50%) of the Bank's external assets.

	2003	2002
	$	$
Within 60 days	15,000,110	14,998,943
60 days to 1 year	18,035,182	48,351,473
1 to 5 years	198,136,728	165,490,805
After 5 years	56,188,230	5,579,197
$287,360,250	**$234,420,418**	

Market value of these securities at the balance sheet date was $290,155,535 (2002: $242,532,825). These securities bear interest at rates varying between 4.37% and 7.50% (2002: 4.37% and 7.50%).

7. INTERNATIONAL MONETARY FUND

Bahamas Reserve Tranche

The International Monetary Fund (IMF) reserve tranche represents the amount by which the Bahamas quota of Special Drawing Rights (SDR) with the IMF exceeds subscriptions payments as noted below:

	2003		2002	
	SDR (millions)	$	SDR (millions)	$
Quota	130.3	193,622,495	130.3	177,145,390
Subscription payments in promissory notes	(119.0)	(176,777,660)	(118.5)	(161,098,846)
Subscription payments in currency	(5.1)	(7,563,189)	(5.6)	(7,564,582)
Reserve tranche	SDR6.2million	$9,281,646	SDR6.2million	$8,481,962

The reserve tranche was purchased from The Government of The Bahamas in 1976.

7. INTERNATIONAL MONETARY FUND (continued)

Subsequent to that purchase, the Bank has funded 25% of each increase in the IMF subscriptions of The Bahamas by issuing interest-free promissory notes which are payable on demand. In the opinion of the Directors it is not probable that an outflow of resources employing economic benefits will be required to settle these promissory notes, which total $46,275,821 (2002: $41,797,788). Consequently, this amount is regarded as a contingent liability and is not recognised in the Bank's balance sheet.

Special Drawing Rights

This amount represents SDR holdings with the IMF, is repayable on demand and bears interest at rates varying from 1.51% to1.88% (2002: 1.91% to 2.33%).

8. BAHAMAS GOVERNMENT TREASURY BILLS

Bahamas Government Treasury Bills were discounted at rates ranging between 1.48% and 3.04% (2002: 2.49% and 2.52%) and mature as noted below:

	2003	2002
	$	$
Within 60 days	-	19,202,497
60 days to 1 year	-	52,824,242
	-	**$72,026,739**

9. BAHAMAS MORTGAGE CORPORATION BONDS

These bonds bear interest at a rate of 2.00% (2002: 2.00%) per annum below the Prime rate and mature as noted below:

	2003	2002
More than 5 years	**$300,000**	**$300,000**

10. ADVANCES TO THE BAHAMAS GOVERNMENT

Sections 28(3) and 28(4) of the Act require that advances to the Government which, may be outstanding at any one time shall not exceed 10% of either the annual average ordinary revenue of the Government over the three preceding years for which the accounts have been laid before Parliament or the estimated ordinary revenue of the Government for the year, whichever is the less.

At the balance sheet date, advances to the Government approximated 10.00% (2002: 10.00%) of the lesser of such revenues. Of those advances $34,000,000 (2002: $34,768,293) bear interest at rates of 1.09% (2002: 1.99% and 4.21%). The remaining advances were interest free during both 2003 and 2002. The advances are repayable on demand.

11. BAHAMAS GOVERNMENT REGISTERED STOCKS

Section 29(1)(c) of the Act requires that the total amount of Government issued or guaranteed securities held at any time by the Bank which mature beyond five years after their date of issue shall not exceed 20% of the demand liabilities of the Bank. At the balance sheet date, Bahamas Government registered stocks held by the Bank which mature beyond five years after their date of issue was approximately 8.43% (2002: 8.09%) of such liabilities.

The Act further requires that any holdings of Government issued or guaranteed securities should not have maturities extending beyond 20 years from the date of their acquisition. The Bank held no such securities maturing beyond 20 years at either 31 December 2003 or 2002.

Bahamas Government Registered Stocks bear interest at rates ranging between 6.28% and 9.50% (2002: 6.16% and 8.75%) and mature as noted below:

	2003	2002
	$	$
60 days to 1 year	900	500
1 to 5 years	40,500	2,900
More than 5 years	43,740,200	38,632,600
	$43,781,600	**$38,636,000**

12. LOANS TO BAHAMAS GOVERNMENT AGENCY

This balance is comprised of three loan facilities made available to a Government agency in accordance with Section 29(l)(f) of the Act.

The advances bear interest at 2.00% (2002: 2.00%) and mature as noted below:

	2003	2002
	$	$
1 to 5 years	-	125,000
More than 5 years	6,350,000	6,625,000
	$6,350,000	**$6,750,000**

13. THE BRIDGE AUTHORITY BONDS

These bonds bear interest at rates ranging from 1.00% to 1.25% (2002: 1.00% to 1.25%) per annum over the Prime rate, and mature as noted below:

	2003	2002
More than 5 years	**$597,000**	**$569,000**

14. DEPOSITS BY COMMERCIAL BANKS

Deposits by commercial banks consist of current account balances deposited as statutory reserves in accordance with Section 19 of the Act.

The present level of the statutory reserves applicable to commercial banks is 5% of the total Bahamian dollar deposit liabilities of which at least 4% must be placed on deposit with the Bank. These deposits are interest free and are repayable on demand subject to maintenance of minimum balances required by the Act.

15. DEPOSITS BY INTERNATIONAL AGENCIES

The Bank is designated as the fiscal agency for the Commonwealth of The Bahamas. Deposits by international agencies include deposits in Bahamian currency by The World Bank, The International Monetary Fund, The Inter-American Development Bank and the Commission of the European Development Fund. These deposits are interest free and are repayable on demand.

16. INTERNATIONAL MONETARY FUND ALLOCATION OF SPECIAL DRAWING RIGHTS

In accordance with a resolution of The Board of Governors of the IMF, effective 11 December 1978, The Bahamas became a participant in the Special Drawing Rights Department of the IMF, receiving a total allocation of SDR 10,230,000 between 1979 and 1981. The Special Drawing Rights allocation bore interest during the year at rates varying between 1.51% and 1.88% (2002: 1.91% and 2.33%) and is repayable on demand.

17. RESERVES

a. Exchange equalisation account

Under the terms of Sections 32(2)(a) and 32(2)(b) of the Act, this account represents the net unrealised profits or losses arising from the revaluation of foreign currency assets and liabilities of the Bank at the balance sheet date.

b. Contingency reserve

This reserve is maintained in accordance with the provisions of Section 7(1) of the Act.

c. Other reserves

In accordance with the provisions of Section 7(1) of the Act, the Bank has determined that an amount of $6,075,684 should be transferred from other reserves to general reserves. In 2002 an amount of $5,222,540 was transferred from other reserves to general reserves.

d. General reserves

Section 7(2) of the Act requires that at the end of any year where the amount in the general reserves exceed twice the authorised capital of the Bank or 15% of its demand liabilities, whichever is greater, the excess shall be paid to the Consolidated Fund unless the Minister of Finance determines otherwise.

17. RESERVES (continued)

The balance of the general reserves at the year end amounted to $77,663,616 (2002: $71,198,272) equivalent to 15% (2002:15%) of demand liabilities prior to a provision of $1,000,000 (2002: $3,000,000) to be paid into the Consolidated Fund.

18. INCOME

	2003	2002
	$	$
Interest income	22,006,577	22,180,904
Other operating income	1,408,103	3,346,776
	$23,414,680	**$25,527,680**

19. EXPENSES

	2003	2002
	$	$
General & administrative expenses	11,198,290	9,695,074
Staff costs	9,881,261	9,508,070
Depreciation expense	1,042,934	1,121,391
Interest expense	240,461	295,928
	$22,362,946	**$20,620,463**

20. THE DEPOSIT INSURANCE CORPORATION

In accordance with Section 5(1) of the Protection of Depositors Act, 1999, the Bank has made an initial capital contribution of $500,000 representing 100% of the paid-up portion of the capital of The Deposit Insurance Corporation. This Corporation was established to manage The Deposit Insurance Fund, which was established to protect funds deposited with member institutions.

In the opinion of the Directors, the Bank does not have the power to govern the financial and operating policies of The Deposit Insurance Corporation so as to attain benefits from its activities. Consequently, The Deposit Insurance Corporation is not treated as a subsidiary in these financial statements.

Additionally, the Directors do not consider that the investment in The Deposit Insurance Corporation will be recoverable, and consequently the Bank has made a full provision against this investment.

21. COMMITMENTS

The Bank is committed to rent office space under two operating leases. The Bank is committed to the following future payments under the lease agreements:

Year	
2004	**$76,078**

22. CONCENTRATIONS OF ASSETS AND LIABILITIES

The Bank has the following concentrations of assets and liabilities.

EXTERNAL ASSETS	2003	2002
	%	%
Geographic Region		
North America	92.11	91.00
Europe	4.84	5.66
Other	3.05	3.34
Industry		
Financial Sector	100.00	100.00

OTHER ASSETS	2003	2002
	%	%
Geographic Region		
Bahamas	100.00	100.00
Industry		
Government Sector	100.00	100.00

DEMAND LIABILITIES	2003	2002
	%	%
Geographic Region		
Bahamas	99.82	99.87
Other	0.18	0.13
Industry		
Financial Sector	100.00	100.00

OTHER LIABILITIES	2003	2002
	%	%
Geographic Region		
International Agencies	100.00	100.00
Industry		
Financial Sector	100.00	100.00

23. CONTIGENT LIABILITIES

The Bank is party to a number of asserted and unasserted claims in the normal course of business, including a number from a former licensee, which are at varying stages of the judicial process. The Bank is vigorously defending all such claims and is of the opinion that the outcome, which cannot presently be determined, will not adversely affect its operations.

24. OFF BALANCE SHEET ITEMS

The Bank has off balance sheet items totalling $47,059,741 (2002: $40,812,980). These items, which are held in a fiduciary capacity, comprise of offsetting assets consisting of bank accounts, and liabilities consisting of dormant retail customer accounts of $30,003,155 (2002: $27,118,067) and a sinking fund of $17,056,586 (2002: $13,694,913).

25. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Directors consider that with the exception of marketable securities issued or guaranteed by foreign Governments, all of the Bank's financial assets and liabilities are carried at amounts approximating to fair value. The market value of those marketable securities is as stated in note 6.

26. MATURITIES OF FINANCIAL INSTRUMENTS

Except as otherwise stated in notes 6 to 16, the Bank's significant financial assets and liabilities mature within one year of the balance sheet date.

27. INTEREST RATE RISK

Except as otherwise stated in notes 6 to 16, the Bank's financial assets and liabilities do not carry any exposure to interest rate risk.

28. CREDIT RISK

The Directors do not consider that the Bank is exposed to any significant credit risk because its financial assets consist primarily of cash and securities issued or guaranteed by either foreign Governments or The Bahamas Government.

29. DEFINED BENEFIT CONTRIBUTORY PENSION PLAN

The Bank operates a defined benefit contributory pension plan for the majority of its employees.

The amount recognised as an asset in the Balance Sheet in respect of the Bank's defined benefit contributory pension plan is as follows:

29. DEFINED BENEFIT CONTRIBUTORY PENSION PLAN (continued)

	2003	2002
	$	$
Present value of funded obligations	(25,074,880)	(23,543,143)
Fair value of plan assets	28,443,876	26,901,042
	3,368,996	3,357,899
Unrecognised actuarial gains	(366,962)	(297,450)
Net assets calculated in accordance with paragraph 54 of International Accounting Standard 19	**$3,002,034**	**$3,060,449**

The (expense)/income recognised in the statement of profit in respect of the Bank's defined benefit pension plan is as follows:

	2003	2002
	$	$
Current service cost	968,783	856,800
Interest cost	1,469,771	1,479,757
Expected return on plan assets	(1,801,176)	(1,800,448)
Actuarial adjustment	9,516	-
	646,894	536,109
less: decrease in amounts limited by paragraph 58 of International Accounting Standard 19	-	(988,591)
	$646,894	**$(452,482)**

Movements in the net asset recorded in the balance sheet are as follows:

	2003	2002
	$	$
Net asset at beginning of the year	3,060,449	1,993,690
Net (expense)/income recognised in the statement of profit	(646,894)	452,482
Employer contributions	588,479	614,277
Net asset at end of the year	**$3,002,034**	**$3,060,449**

29. DEFINED BENEFIT CONTRIBUTORY PENSION PLAN (continued)

Principal actuarial assumptions used at the balance sheet date are as follows:

	2003	2002
Discount rate	6.25%	6.75%
Expected return on plan assets	6.75%	7.00%
Expected rate of salary increase	7.30%	7.30%
Average expected remaining working lives of employees (years)	14.0	14.0

The actual return on plan assets during the year was $1,976,752 (2002: $1,853,540).

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