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THE BAHAMAS BUDGET, FISCAL YEAR 2021/22

Unprecedented Measures for Unprecedented Circumstances

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On Tuesday 25th May 2021, history was made in the Caribbean, and indeed globally.

The World Bank announced a Development Policy loan for USD100 million to The Bahamas, which "responds to an emergency request from the government for exceptional International Bank for Reconstruction and Development (IBRD) assistance to respond to the COVID-19 crisis, given the disproportionate and severe economic impacts on The Bahamas due to its small size, heavy dependence on tourism, and vulnerability to natural disasters. The financing is part of a coordinated assistance effort by international financial institutions during the pandemic."

It is not immediately clear why this is a historically significant event, but the World Bank typically does not lend to countries which have 'graduated' based on certain criteria. The Bahamas graduated back in 1989. In other words, The Bahamas normally would not qualify for loans from the World Bank, but the prevailing exceptional circumstances have prompted a revision to this stance.

Ms. Tahseen Sayed, the World Bank's Country Director for Caribbean countries, described perfectly just how historic and exceptional this initiative is; "The exceptional support is in recognition of the extraordinary situation, as The Bahamas suffered major job losses and one of the highest GDP contractions in the region; and all this on the heels of the damages and losses caused by the 2019 Hurricane Dorian. It is extremely rare for a graduate country to receive IBRD financing, even on an exceptional basis. The last time exceptional financing was provided for an IBRD graduate was in 2008 in the wake of the Global Financial Crisis. Since the onset of the COVID-19 crisis, the World Bank has provided over USD800 million in financing for COVID-19 response and recovery in the Caribbean (for 12 countries) of which over USD200 million is in the form of concessional financing for the small island economies of Dominica, St Lucia, St Vincent & the Grenadines and Grenada; and for Haiti and Guyana."

A few months ago, I produced a report which outlined the uniquely dire socio-economic situation The Bahamas was in, with two crises hitting back to back - Hurriane Dorian and the pandemic. The fact that the Government of The Bahamas has maintained a reasonable level of socio-economic stability so far is testament to their capabilities, political will, and ability to access assistance from external parties including the multilateral lending institutions - most recently the World Bank. By no means could this be an easy task, and the Government is certainly dealing with a lot more than many, at least in a regional context.

On May 26th, the Government of The Bahamas delivered its Budget for the upcoming fiscal year July 2021-June 2022, outlining how it has managed the pandemic's implications from a fiscal and external (foreign reserve) standpoint. While there is some cause for cautious optimism based on a few growth-oriented initiatives and the revival of the US economy, the fundamentals still point to a need to restructure the existing unsustainable debt load and implement reforms to solidly place The Bahamas on a sustainable growth path.

HIGHLIGHTS OF THE BUDGET SPEECH

Economic impact

From Hurricane Dorian to the ongoing COVID-19 pandemic… these twin crises have presented the most significant obstacles for our continued national development in the last 100 years. Post-Dorian assessments estimated the cost of damages to be approximately BSD2.5 billion. An additional BSD1 billion was lost in government revenue.

In 2019, before the pandemic touched Bahamian shores, The Bahamas received more than 5.5 million arrivals by sea. In July 2020 at the beginning of the fiscal year, visitor arrivals totaled approximately 24,000, some 96.3% lower than the year prior. For stopover visitors, arrivals totaled just over 15,000 visitors, a contraction of 91.3% of the pre-COVID-19 year prior. These numbers represented an unheard-of decline in our tourism industry, resulting in falling government revenue and a slowing of domestic economic activity.

Short-term rentals in the Airbnb market have already shown signs of rebound since the careful reopening of our tourism sector in November. Occupancy rates have more than doubled, from 8.2% in November 2020 to 16.6% in March 2021. At the same time, there was a 2% increase in average daily rental rates and a 52% increase in room reservations.

Based on Central Bank data for the period end-March 2021, vacation home rentals and comparable hotel listings increased by 65.9% and 55.4%, respectively. This also impacted average daily room rates which similarly increased by 10.8% and 7.5% to BSD497.95 and BSD169.36 for vacation home rentals and hotel listings, respectively.

Revenue

Total revenues for FY2021/22 are projected at BSD2.247 billion dollars, representing an increase of BSD588.3 million or 35.5% over the projected FY2020/21 total revenue. Despite this improvement, revenues are projected to remain 7.5% below the BSD2.426 billion posted in FY2018/19, reflecting the fact that our economy will not likely return to full capacity during the upcoming fiscal year.

Expenditure

To date, the direct cost of Government's response to the pandemic has exceeded BSD290 million. The Bahamas' direct spending on its COVID-19 response approximates 2.5% of GDP. The government has provided approximately BSD194.9 million in direct COVID-19 related support for the nine months ending March 2021.

Recurrent expenditures widened over the same period last year, by BSD129.6 million to BSD1.9 billion and equated to 75.4% of the budget.

COVID-19 related expenses inflated recurrent expenditure by BSD180.0 million for the year-to-date. The current budget still anticipates some BSD100.0 million in direct COVID-19 related support in the form of food assistance, unemployment assistance and health sector support - as well as the revenue foregone on the Government's Employment Incentive Programme and other growth initiatives.

As a result of the measures outlined in this budget, recurrent expenditure is estimated at BSD2.83 billion for FY2021/22, an increase of BSD270.1 million or a 10.6% increase over the projected spend for FY2020/21.

We are projecting some BSD372.4 million in capital outlays in FY2021/22. While this is below the BSD515.5 million budgeted in FY2020/21, it represents an increase over the projected BSD200 million in actual capital expenditure for this fiscal year 2020/21.

Deficit, debt, and fiscal responsibility

As of present, the prevailing circumstances have compelled us - with the concurrence of the Opposition and expert economists here and abroad - to invoke the Exceptional Circumstances clause of the Fiscal Responsibility Act that permits short term deviations from the path to fiscal consolidation and to run higher deficits than would be undertaken during normal times. I do not want the House to forget that, prior to Dorian, it was this administration that brought down the deficit to its lowest point in 10 years.

We will maintain our focus on fiscal reform through strengthening the collection of existing taxes, improving tax policy, ensuring equity in government taxation, and focusing on new areas of revenue generation.

While conditions did not allow for the budgeted contributions to the various sinking funds during this fiscal year, as at end-March 2021 the balance stood at BSD195.4 million to settle external bonds and BSD13.3 million to settle domestic commitments. The government has budgeted increased future payments over the next three years to compensate for this.

Projected fiscal deficit of BSD1.3 billion or 11.3% of GDP last fiscal year (FY2020/21). As a result of these revenue and expenditure developments, the fiscal deficit is estimated to come in at BSD951.8 million or 7.7% of GDP for FY2021/22.

The major portion of this deficit will be funded through external sources - including an anticipated bond offer and ongoing operations with our multilateral partners...we are pursuing an opportunity with one of our key multilateral partners to help support the potential bond offering, through a guarantee, which should secure interest cost savings for the government.

The impact on government borrowing, as a result, is an expansion of total debt to BSD9.5 billion or 82.8% of GDP as at end-March 2021. Given the substantial increase in financing required during the current fiscal year and the anticipated financing for the new fiscal period, debt servicing charges have increased over BSD100 million from the prior period.

Reserves / External sector

As at end-April 2021, external reserves stood at USD2,253.0 million, an increase of 12.9% over the USD1,994.9 million held in March 2020 at the onset of the COVID-19 pandemic.

BAHAMAS BUDGET FISCAL YEAR 2021/2022 ANALYSIS

FISCAL REVENUES

After falling 21% y/y in FY 2020/21 to BSD1.66 billion, recurrent revenues are forecast to rise to BSD2.24 billion in FY2021/22. This would mark only the second time in history that the government would reach this level of revenue collection. I believe there are risks to this revenue figure actually being collected.

Property taxes are forecast to reach the highest level ever at BSD159 million in FY2021/22, 30% above the prior historical high of BSD123 million in FY2017/18, and 45% more than the pre-pandemic level of BSD109 million. Government expects BSD14 million in additional real property tax revenue to come from the initiative to upgrade the real property tax roll.

VAT revenues are not expected to recover to pre-pandemic level until FY2022/23. VAT revenues will increase to BSD845 million and will account for 38% of total Government revenues in FY2021/22. VAT measures announced include:

- Increased VAT on real estate transactions over BSD2 million, expected to generate only BSD2 million in additional revenues.
- Legal amendments clarifying that VAT applies the full value of rentals on all vacation home marketplaces.

FISCAL YEAR	BSD Millions in VAT Revenue
FY2018/19	897
FY2019/20	876
FY2020/21	N/A
FY2021/22*	845
FY2022/23*	994
FY2023/24*	1,137

*Forecast

FISCAL EXPENDITURE

The Budget Speech estimated the cost of the response to the pandemic at BSD290.0 million in FY2020/21. In spite of this, relative to prior years, recurrent expenditure was relatively contained in FY2020/21 at BSD2.556 billion. Recurrent expenditure for the FY2021/22 will reach a historical high of BSD2.826 billion before declining over the subsequent two years. The comprehensive spending review under the guidance of the Inter-American Development Bank (IDB) is expected to aid the government in identifying new opportunities for savings.

ITEM	Recurrent Expenditure (BSD Millions)
FY2020/21 Recurrent Expenditure	2,556
FY2020/21 COVID-19 Direct Expenditure Impact	290
FY2020/21 non-COVID-19 Expenditure	2,266
FY2019/20 Recurrent Expenditure	2,533
FY2018/19 Recurrent Expenditure	2,418

Subsidies to public non-financial corporations are projected to grow to BSD363 million in FY2021/22, equivalent to 13% of recurrent expenditure. While this marks an improvement over FY2018/19 and FY2019/20, more must be done to contain transfers to lossmaking state-owned enterprises (SOE). The FY2021/22 level of subsidies amounts to 43% of budgeted VAT revenues, which demonstrates the burden that unprofitable SOEs place on the population.

For FY2021/22 Wages & Salaries are budgeted to increase versus FY2020/21 budget, to BSD670 million. However, the budgeted figure for the next fiscal year remains lower than the average over the prior 5 fiscal years. Wages & Salaries will account for 24% of budgeted expenditure, and 35% of budgeted Tax Revenues for the coming fiscal year.

INTEREST PAYMENTS

In FY2021/22, public debt servicing costs are budgeted to increase by BSD116 million (30%) over the budgeted figure for FY2020/21, to reach BSD512 million. This marks the highest level of debt servicing costs in The Bahamas' history, and accounts for 18% of budgeted recurrent expenditure.

The largest interest payment in FY2021/22 will be on the USD825 million bond issued in October and December 2020, with a coupon rate of 8.95%. This was the largest cross-border debt issuance in the Caribbean in 2020, according to the UN-ECLAC[1].

1 Economic Commission for Latin America and The Caribbean, Capital flows to Latin America and the Caribbean: 2020 year-in-review. Washington D.C., March 2021.

LARGEST INTEREST PAYMENTS FY2021/22			
Item #	Item	Interest FY2021/22 (USD)	Interest Rate
2411204	USD825.0M due October 10, 2032	73,837,500	8.95%
2411156	USD750M Notes (2026-2028)	45,000,000	6.00%
2411141	USD300M Bond (20112009) JP Morgan	20,850,000	6.950%
2411155	USD300M Notes	17,250,000	5.75%
2411140	USD200.0M Notes Due May 15, 2033, JP Morgan	13,250,000	6.625%

FISCAL DEFICIT

Primary Fiscal Balance

When we look at any deficit or debt number now and compare it to GDP, we must first remember that the denominator (GDP) contracted in 2020, making it more important and revealing to analyze the nominal deficit amount and debt balance.

A primary fiscal deficit (when we are in deficit before we service our interest) by definition means that we are borrowing to pay the interest on our existing debt. The Bahamas was already facing a primary fiscal deficit before the pandemic, with a double shock to the economy (Dorian and COVID) in FY2019/20 generating a BSD489 million primary deficit. The primary deficit is estimated to have widened 90% in FY2020/21 to BSD930 million. The primary balance is not expected to return to surplus until FY2022/23.

FY	Primary Balance BSD millions	Primary Balance (%) of GDP
FY2018/19	114.7	0.9
FY2019/20	-489.0	-4.2
FY2020/21	-930.2	-8.6
FY2021/22	-439.3	-3.6
FY2022/23	109.6	0.8
FY2023/24	307.6	2.2

Overall Fiscal Deficit

The overall fiscal deficit is estimated to have reached BSD1.3 billion in FY2020/21, up 59% y/y and over 6 times the level of FY2018/19, as government revenues were impacted by reduced economic activity, and social assistance and health outlays increased. To bring into context the level of the deficit, BSD1.3 billion was the level of the entire National Debt in the fiscal year ended June 1997, 24 years ago. For FY2021/22, the overall deficit is budgeted to reach BSD952 million and to gradually decline to BSD152 million by FY2023/24.

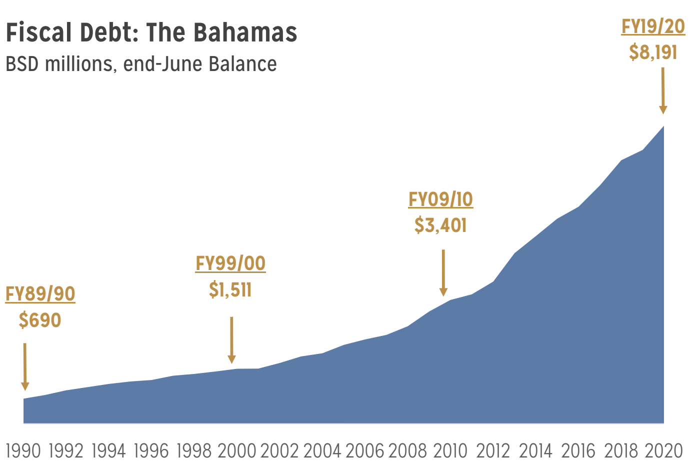
GOVERNMENT DEBT

Debt is estimated to have ended FY2020/21 at BSD9.47 billion, rising 15.7% y/y. Debt is expected to expand by a further 13.5% over the current level by FY2023/24. The debt-to-GDP ratio will decline as GDP improves, but debt is not expected to decline in the coming 3 fiscal years.

FY	BSD MILLIONS	DEBT TO GDP %
FY2018/19	7,527	57.9
FY2019/20	8,191	71.0
FY2020/21	9,476	87.7
FY2021/22	10,386	84.3
FY2022/23	10,595	79.4
FY2023/24	10,755	76.3

Half of The Bahamas' debt has been acquired since FY2012/13. In fact, 30 years ago, the country's public debt stood at BSD690 million.

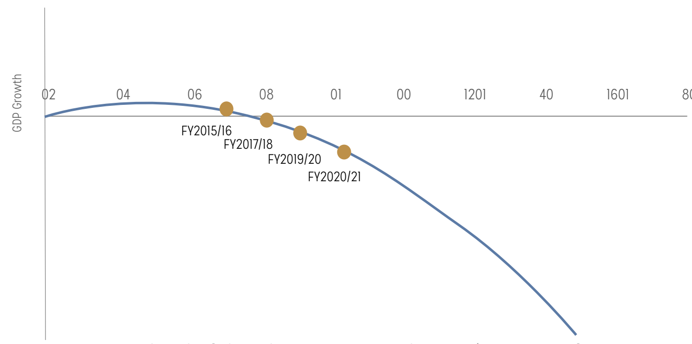
Fiscal Debt: The Bahamas
BSD millions, end-June Balance



Source: Central Bank of The Bahamas E-GDDS, Budget 2021/22 Ministry of Finance, Marla Dukharan

It is important to note that up to a certain point, acquiring debt has a positive impact on GDP. According to the IMF, up to around 30% of GDP, debt has a positive impact on growth, but beyond 30%, this positive effect diminishes with each additional dollar of debt until around 56% of GDP. At this point every additional dollar of debt has a negative impact on GDP. Debt-to-GDP in The Bahamas crossed the 56% threshold in FY2017/18 and is expected to close FY2020/21 at 87.7%.

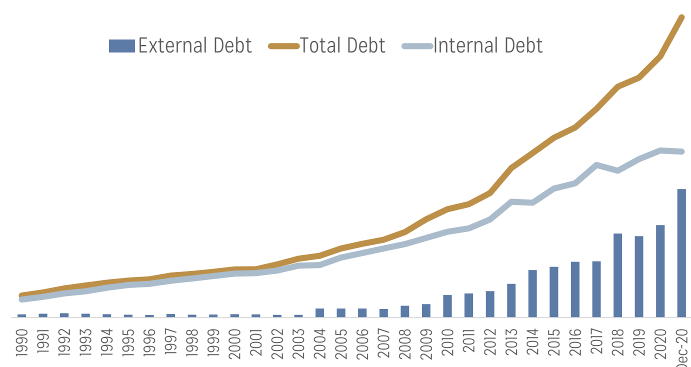
Growth and Debt: The Bahamas
GDP growth percent and debt-to-GDP percent



Source: IMF, Central Bank of The Bahamas E-GDDS, Budget 2021/22 Ministry of Finance, Marla Dukharan

There has also been a shift from Domestic Debt to External Debt, which creates balance of payments pressures over time. External debt accounted for roughly 43% of total central government debt in December 2020. This compares to 21% at the end of FY2010/11. A total of USD225 million in interest payments to non-residents are slated for FY2021/22. To put this in perspective, total goods exports averaged USD219 million annually over the 5 years prior to COVID[2], meaning it takes roughly a year's worth of goods exports to generate enough USD to pay interest on government debt for the coming fiscal year.

Central Government Debt: The Bahamas
BSD millions, end-June Balance



Source: Central Bank of The Bahamas E-GDDS, Budget 2021/22 Ministry of Finance, Marla Dukharan

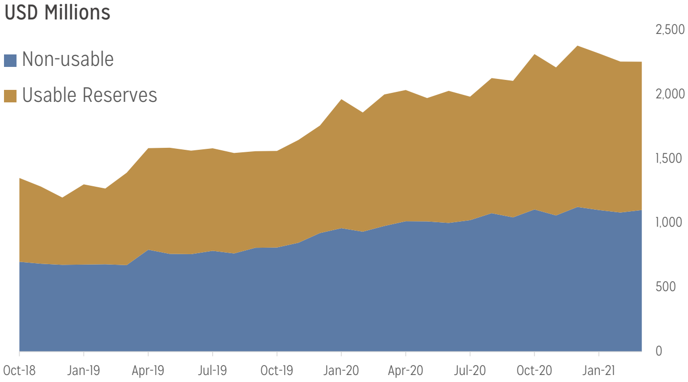
2 Central Bank of The Bahamas, Quarterly Statistical Digest, February 2021. Table 7.2 External Trade.

According to the IMF[3], external loans approved since June 2020 from multilateral lenders include the IMF's Rapid Financing Instrument (roughly USD250 million), IDB Policy Based Loans (USD225 million), a Caribbean Development Bank (CDB) loan (USD40 million), and the recent Development Policy Operation by the World Bank (USD100 million). While these funds are largely for budgetary support, from a Balance of Payments standpoint, it helps illustrate that most of the improvement we have seen in international reserves this year has been from these and commercial external borrowing.

INTERNATIONAL RESERVES

Foreign reserves expanded 12.7% y/y in March 2021 to USD2.25 billion, based on Government borrowing. Usable reserves expanded at the same pace to USD1.1 billion - roughly half of total reserves.

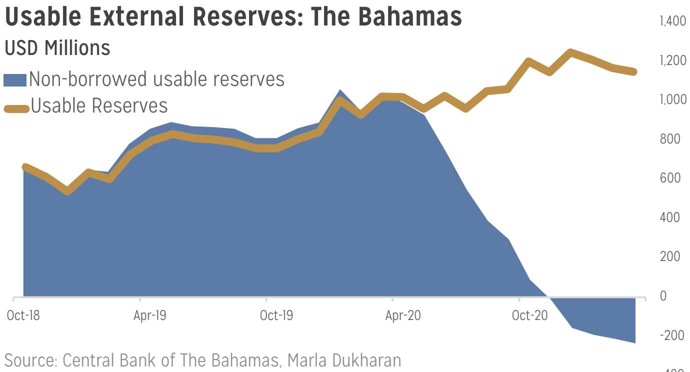
External Reserves: The Bahamas
USD Millions



Source: Central Bank of The Bahamas, Inter-American Development Bank, Marla Dukharan

Non-borrowed usable reserves actually became negative at the end of December 2020, so all usable reserves are borrowed, as the government took on a total of USD1.46 billion in additional external debt.

Usable External Reserves: The Bahamas
USD Millions



Source: Central Bank of The Bahamas, Marla Dukharan

3 International Monetary Fund, Staff Report for the 2020 Article IV Consultation, January 2021.

CONCLUSION

I believe that the commitment to fiscal responsibility articulated in this budget and demonstrated by this administration is commendable and unique. I am not aware of any independent country in the Caribbean which has legislated and implemented any such fiscal responsibility framework / fiscal rules, without the commitment to do so under an IMF supported program.

The Bahamas is in the midst of the worst crisis in its history. And while the authorities and the Multilateral lending agencies are clearly doing all that they can and should to keep The Bahamas afloat, the data unfortunately suggest that the current situation is still unsustainable from a fiscal and external standpoint. As such, an orderly debt reprofiling exercise is preferable, versus a disorderly debt restructure / balance of payments crisis. It is worth reiterating here that any such outcome would not necessarily reflect on the authorities as much as it reflects The Bahamas' acute vulnerability, and indeed, that of every country in the Caribbean.

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