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Publisher's Note

The Economic Review is published three times a year in June, September and December, by the Central Bank of Barbados. It is prepared by the Bank's Research Department and contains articles of research undertaken at the Bank. In addition, we welcome contributions of a non-technical and empirical nature on economic and policy issues in the Caribbean. Book reviews and surveys are also welcome. All submitted papers are reviewed by the Editorial Committee* and external referees.

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Review of Economy

Real economic activity expanded by an estimated 3.3% for the first three months of 2007, compared to 4.2% recorded for the corresponding period of 2006. This fifth consecutive first quarter increase was led mostly by strong performances in the non-traded sectors. However, the external current account deficit remained moderate over the review period as a result of slower import growth, and slightly higher travel credits. The surplus from the capital account was sufficient to offset the current account deficit and the net international reserves (NIR) of the monetary authorities rose during the same period. Given the sluggish imports, commercial bank credit to the non-financial private sector also grew, though at a slower rate than in the first three months of 2006. The growth of domestic deposits outpaced that of credit, but liquidity conditions in the banking system remained relatively tight. After reporting a surplus in the first quarter of 2006, for the comparable period of 2007, the central government registered a moderate fiscal deficit which was financed mainly by domestic sources.

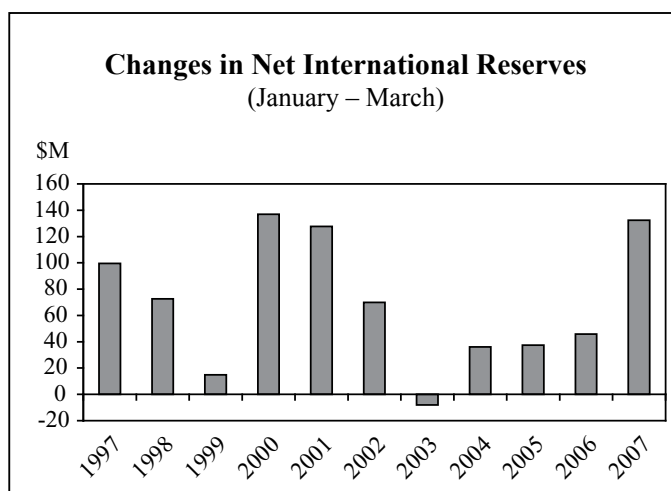
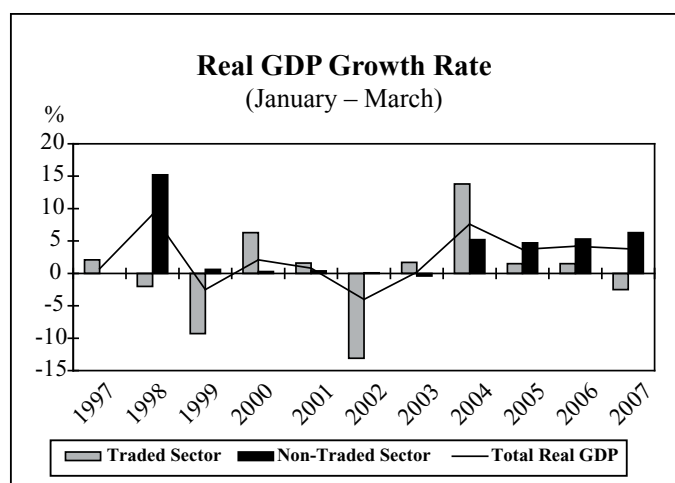
Following four successive first quarter increases, traded sector output declined by an estimated 2.7% for the first three months of 2007. This outturn was driven by the weak performance of tourism and the slower growth rates of the manufacturing, sugar and non-sugar agriculture and fishing industries. In contrast, the non-traded sectors

continued to expand markedly as output rose by an estimated 5.8% in the January to March period of 2007, approximately 0.5 percentage points higher than the rate for the similar period of the previous year. The wholesale and retail industry, transportation, storage and communication and business and other services were the main contributors to the high performance in the non-traded sectors. Owing to this robust outturn in the non-traded sectors, the rate of unemployment remained within single digits at the end of March 2007. Relative to the first quarter of 2006, the average inflation rate contracted by 0.6 percentage points to an estimated 6.4% at the end of March 2007, largely on account of lower prices for fuel and light.

The NIR grew by \$140.8 million or \$94.8 million more than was reported for the first quarter of 2006. Available foreign reserves at the end of the review period were enough to cover 17.3 weeks of imports of goods and services, up from the 15.5 weeks registered during the corresponding period of 2006.

Over the first three months of 2007 commercial bank credit to the non-financial private sector continued to decelerate. The resultant growth rate was below that of domestic deposits, which expanded at a faster rate than in the equivalent period of 2006. Nevertheless, the liquidity conditions in the banking system remained tight.

For the January-to-March period, central government recorded a fiscal deficit of \$26.4 million, in contrast

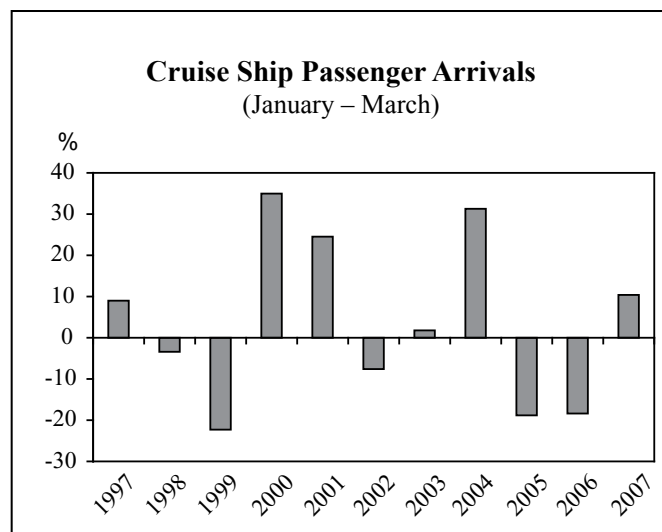
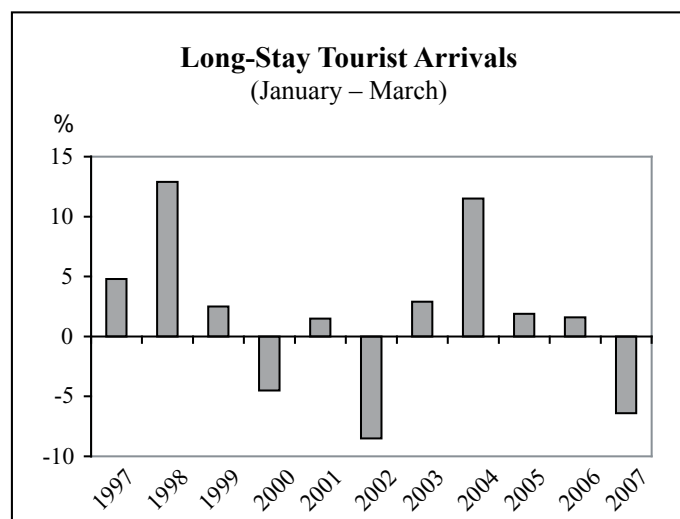


to a surplus of \$71.3 million for the same period a year ago, largely because of a contraction in the receipts of value added tax (VAT), personal and excise taxes. The decline in the VAT receipts reflected the strong outturn in the first quarter of 2006 when taxes collected at the end of 2005 were recorded in the first three months of 2006. Current expenditure increased slightly during the review period, while the expansion in capital expenditure slowed relative to the rate in the corresponding period of last year. At the end of the fiscal year (FY) 2006/2007, the central government's deficit was estimated at 2.8% of GDP, compared to 2.9% of GDP during the FY 2005/2006.

Production, Prices and Employment

Tourism

Following a decrease of 1.7% in the first quarter of 2006, real tourism value added for the equivalent period of 2007 declined by 3.8%, as the contraction in long-stay visitors outweighed the growth in cruise passenger arrivals. The number of long-stay guests fell by 6.8%, after recording a 1.6% increase for the same period of the previous year. Higher airfares and the timing of Cricket World Cup (CWC) 2007 matches may have contributed to softening in some tourist markets during the first quarter. Over the



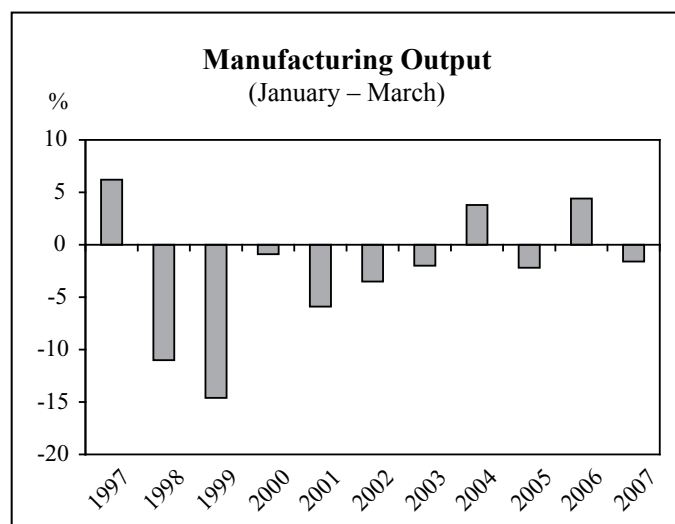
review period arrivals from Trinidad and Tobago and other CARICOM member countries declined by 18.7% and 28.3%, respectively, and accounted for more than half of the contraction in visitor arrivals. This downturn marked the first substantial decrease in two years. Additionally, fall-offs in arrivals were also registered for Germany, other international markets, the United Kingdom, and other European markets. Visitors out of the United Kingdom, Barbados' largest market, declined by 2.1% or 1,220 persons. Similarly, arrivals from the United States contracted by 6.4%, a much larger decrease when compared to the corresponding period one-year earlier (2.4%). Canada was the only market segment to record an increase in visitors (2.7%), albeit well below the growth (8.9%) experienced in the equivalent period of 2006.

On account of lower fuel costs, cruise ship arrivals registered their third consecutive quarterly expansion, estimated at 15.3%. This contrasts with the 18.4% reduction reported for the same period one year ago.

Manufacturing

In the January-to-March period of 2007, output from the manufacturing sector fell by an estimated 1.6%, relative to an expansion of 4.4% observed during the similar period one year ago. Production of electronics and chemicals declined by 29% and 0.5%, respectively, following increases of 4.4% and 5.6% in the first three months of 2006. At the

same time the production of other non-metallic mineral products also fell, by 12.2%. The lacklustre performance of the non-metallic mineral sub-sector, which was significantly below the rise of 30.4% registered for the comparable period one year earlier, was on account of moderating construction activity. Conversely, food production and beverages and tobacco improved by 3.8% and 9.4%, respectively, in contrast to the declines of 1.5% and 7.4% respectively, reported in the first quarter of the previous year.



Agriculture and Fishing

Owing to the late start of the harvest, sugar production grew by a modest 0.7% during the review period, after rising by 26.1% during the first quarter of 2006. Additionally, real value added in non-sugar agriculture expanded marginally compared to an increase of 1.5% in the corresponding period a year ago. After three years of consecutive declines, milk production went up by 3.2% for the January-to-March period of 2007, as producers increased the stock of lactating cattle through importation. The growth in chicken production slowed marginally to 3.0%, from 3.3% a year ago. However, fish catches were virtually unchanged from the 3.9% expansion registered in 2006.

International Business and Financial Services

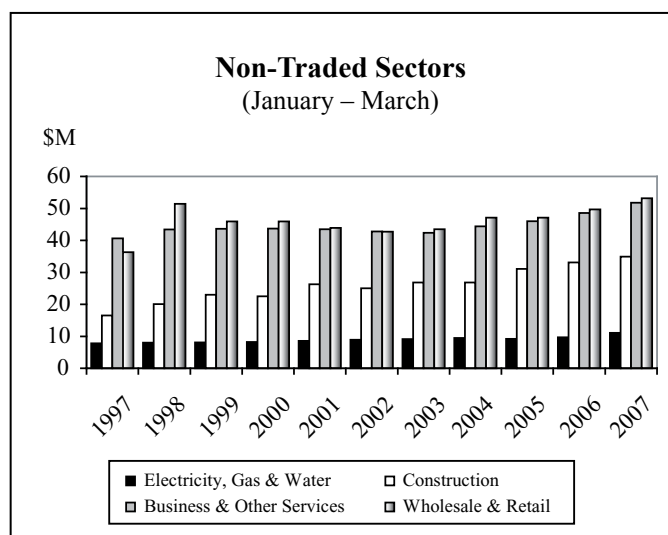
At the end of the first quarter of 2007, one hundred and seventy-seven new licences were issued some sixty-six more than those approved one year earlier. There were 108 new registrations of International Business Companies, compared to 91 in the corresponding period of 2006. New licences were granted to 64 societies with restricted liability, relative to 18 for the January-to-March period of 2006, while four new exempt insurance companies were issued with licences, up from two in 2006. There were no new licences recorded for exempt insurance management companies, while one new licence was granted to offshore banks compared to none in 2006.

Construction

The growth in construction value-added slowed to approximately 5.4% during the first three months of 2007, down from 6.5% in the comparable period of 2006 and 16% in 2005, as the construction boom, which started in 2005, continued to taper off. Domestic consumption of cement fell by 2.3% for the review period, in contrast to the increase of 33.6% recorded during the first quarter of last year.

Other Non-Traded Sectors

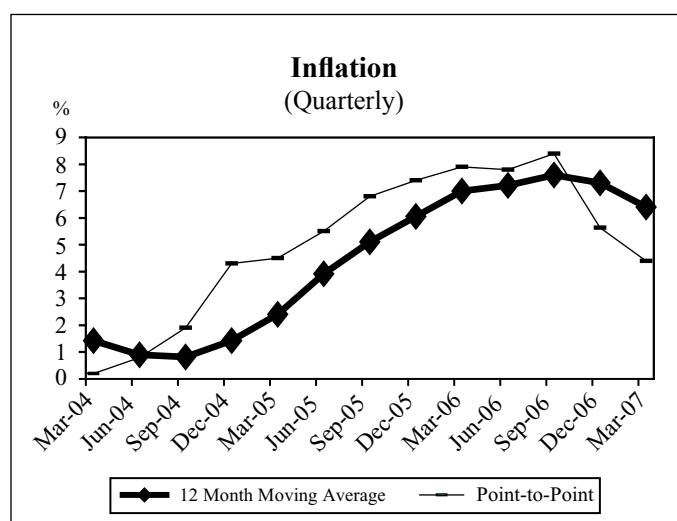
Over the January-to-March period, output from the wholesale and retail sub-sector grew by 7.1%, compared



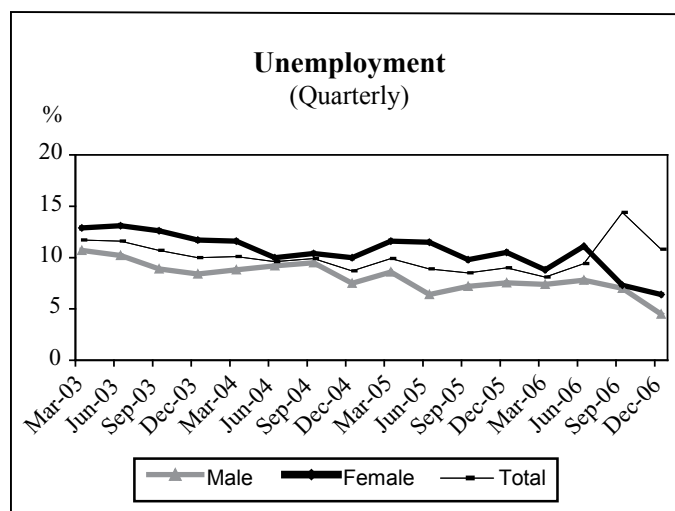
to an expansion of 5.4% during the same period of 2006. Preparations surrounding the staging of CWC 2007 helped to boost growth in transport, storage and communications to an estimated 7.2%, up from 5.0% in the first three months one year ago. Value added from business and other services also rose, by 6.5% or 1 percentage point higher than the increase in the first quarter of 2006. Additionally, growth in electricity, gas and water (6.9%) was 1 percentage point up on the rate reported one year earlier. For the period under review, output in mining and quarrying declined by 10.6%, in contrast to the surge of 13.5% registered for the corresponding period of 2006. The mining sub-sector was adversely affected by the depletion of existing oil wells.

Prices and Employment

At the end of March, the twelve-month moving average rate of inflation declined slightly to 6.4%. The major increases were in the housing (9.2%), food (8.2%), and household operations and supplies (7.9%) sub-categories. The point-to-point rate between March 2006 and March 2007 was 4.4%.



The rate of unemployment at the end of March declined slightly to 7.8%, 0.3 percentage points lower than the rate recorded at the end of March 2006. The average unemployment rate for males was 6.7% compared to 7.4% one-year prior, while the average unemployment rate for females

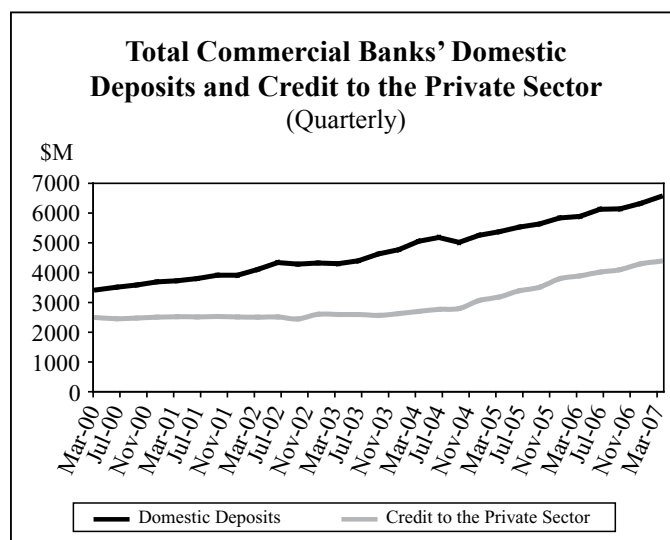


was 8.9%, up slightly from 8.8% in the corresponding period of 2006. The continued decline in the unemployment rate reflects the positive growth of the economy over the last five years.

Financial Sector

Deposits

Total domestic deposits in the banking system grew by 5.6% (\$366.8 million) in the first quarter of 2007,



compared to an increase of 1.6% (\$93.5 million) during the same period of 2006. Growth in deposits can be attributed to the expansion in deposits of financial institutions, private individuals and statutory bodies, as well as foreign currency deposits of residents. Over the review period, deposits of statutory bodies recorded a rise of 30.5% (\$49.5 million), compared to the growth of 15.8% (\$33.7 million) in the first three months of 2006, while the deposits of private individuals and foreign currency deposits of residents increased by \$66.6 million and \$65 million, respectively. Deposits of financial institutions grew by \$149.1 million, owing to an expansion in holdings of private institutions (\$94.1 million) and public financial institutions (\$54.9 million). Government deposits increased by \$8.3 million, after declining by \$17.4 million in the first quarter of 2006. In contrast, the deposits of business firms fell by 0.9% compared to a contraction of 2.1% reported one-year prior, mostly on account of decreases in the deposits of distribution and agricultural firms.

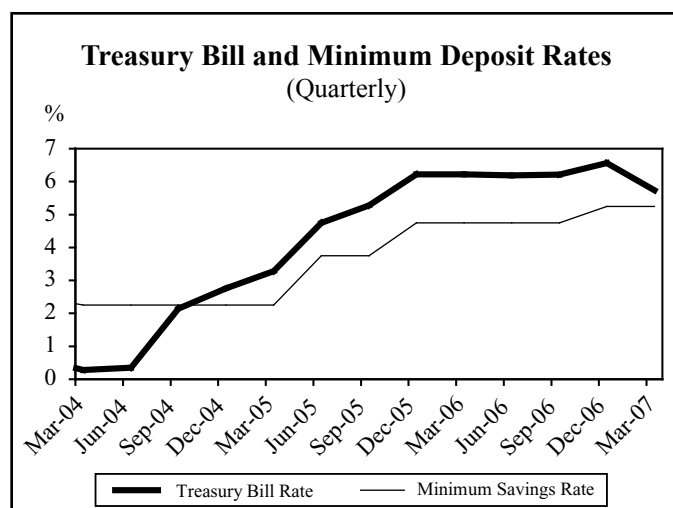
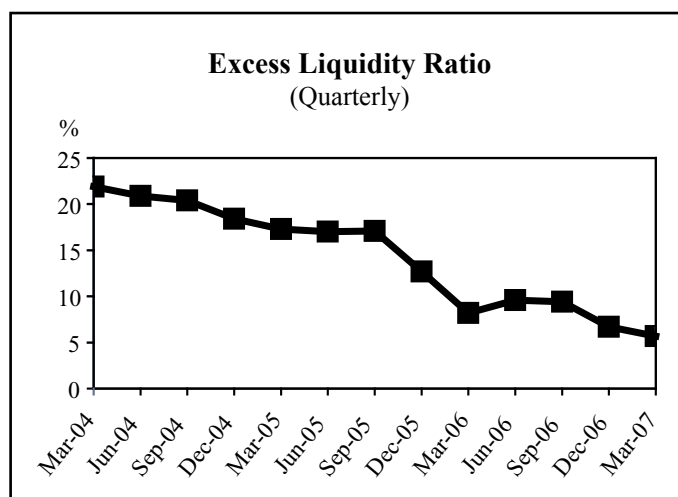
Credit

Commercial bank credit to the non-financial private sector rose by 0.43% (\$18.6 million) during the first three months of 2007, or 2.2 percentage points below the rate of growth observed for the comparable period of 2006. Credit to the personal sector grew by 2.1% (44.3 million), down from 3.9% (\$70.7 million) a year ago,

partly on account of increases in credit card outlays (2.3%) and mortgage loans (4.7%). Lending to the distribution sector was up by \$11.3 million during the review period, compared to an increase of only \$1.4 million experienced in the corresponding period of 2006, mostly driven by the \$17.5 million growth in lending to retail companies. Total credit extended to financial institutions rose by \$110.2 million for the period under review, following the \$31.3 million increase recorded for the comparable period last year.

Liquidity and Interest Rates

The excess liquidity ratio fell by 1.2 percentage points to 5.5% at the end of March 2007, which partly reflected the reduction of the commercial banks' holdings of treasury bills. Over the January-to-March period, the average three-month treasury bill discount rate fell by 0.82 percentage points to 5.74%, while the six-month treasury bill discount rate increased to 6.50%, up from 6.16% at the end of March 2007. The weighted average deposit rate was 5.22%, some 0.94 of a percentage point above the rate at the end of March 2007. Similarly, the prime lending rate increased by 0.5 of a percentage point to 10.15% at the end of the first quarter of 2007, while the weighted average interest rate on selected loans moved from 9.33% to 9.82% during the same period.



Summary Accounts of the Banking System
(\$Million)

	2005				2006				2007 ^P
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.
Net International Reserves	1,780.8	1,659.2	1,442.4	1,611.1	1,730.2	1,610.6	1,613.2	1,695.6	1,944.3
Monetary Authorities	1,227.9	1,214.1	1,149.5	1,239.1	1,282.5	1,167.4	1,136.4	1,198.5	1,334.4
Commercial Banks	553.0	445.2	292.9	371.9	447.7	443.2	476.8	497.1	609.9
Net Domestic Assets	3,121.5	3,370.3	3,656.2	3,583.9	3,527.1	3,801.2	3,984.0	4,081.5	3,983.7
Credit to public sector	508.4	528.8	625.0	380.4	164.5	331.0	387.6	337.1	161.4
Central Government (net)	734.1	784.4	902.8	650.5	392.6	603.4	631.8	433.1	391.4
Rest of Public Sector	(225.7)	(255.7)	(277.8)	(270.1)	(228.1)	(272.4)	(244.2)	(95.9)	(230.0)
Credit to Rest of Financial System	260.5	298.4	301.8	312.9	344.1	261.9	339.7	343.2	454.3
Liabilities to Other Financial Institutions	453.3	475.4	417.2	514.6	551.3	558.7	565.4	597.3	700.6
Credit to Private Sector	3,185.8	3,395.3	3,513.8	3,791.8	3,890.5	4,015.3	4,098.7	4,292.9	4,311.4
Liabilities to the Private Sector	4,902.3	5,029.5	5,098.6	5,195.0	5,257.3	5,411.9	5,597.2	5,777.1	5,928.0
Currency in Circulation	392.0	403.0	419.0	448.6	436.8	431.8	433.1	465.0	458.3
Demand Deposits	1,548.0	1,576.5	1,604.3	1,563.3	1,530.9	1,515.6	1,672.2	1,794.7	1,780.1
Time Deposits	343.8	352.4	405.1	491.1	556.0	625.3	584.6	552.7	672.7
Savings Deposits	2,618.5	2,697.6	2,670.2	2,692.1	2,733.5	2,839.2	2,907.2	2,964.7	3,016.9
MEMO:									
Domestic Deposits	5,638.8	5,763.0	5,852.4	6,019.4	6,112.9	6,350.8	6,494.3	6,586.7	6,953.5
Liquid Assets	1,233.5	1,218.9	1,157.1	1,254.2	1,293.1	1,286.5	1,279.7	1,312.1	1,454.0
Loans & Advances	3,429.7	3,630.2	3,788.9	4,081.8	4,240.5	4,382.3	4,469.5	4,713.7	4,871.0

Source: The Central Bank of Barbados

P: Provisional

Government Securities

Treasury bills outstanding at the end of March 2007 were \$497.9 million, compared to \$551.8 million for the corresponding period of last year. Of the amount outstanding this year \$275.3 million were held by commercial banks and trust companies, \$46.4 million by the Central Bank and \$176.1 million by other entities. The nominal value of savings bonds at the end of the review period totalled \$116.2 million. There was a Treasury note issue in February, bringing Government's total outstanding debentures and treasury notes to \$2,512.9 million at the end of March 2007.

Public Sector

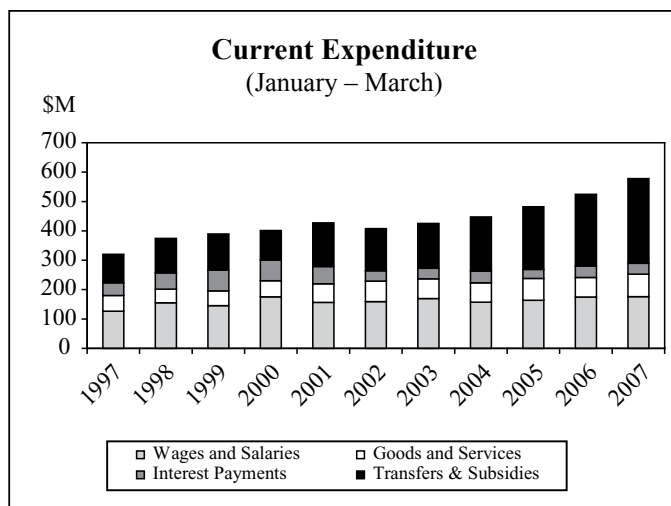
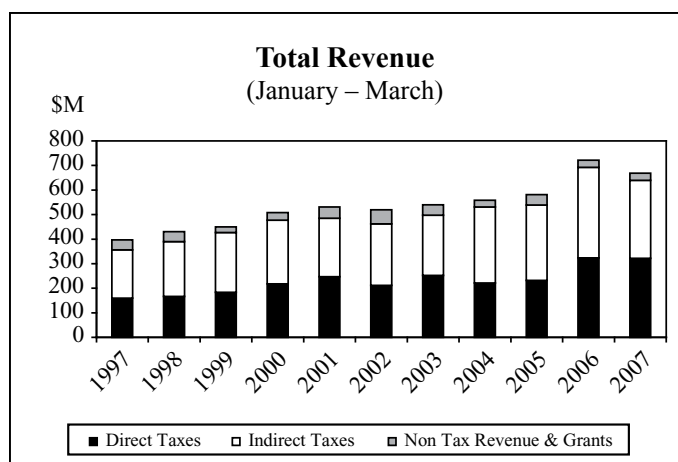
Revenue

For the first three months of 2007, total central government revenue fell by 8% to \$663.7 million, in contrast to growth of 24.2% recorded for the same period one year earlier. This outcome was attributed to broad-based reductions in all categories of revenue. Indirect tax receipts decreased by 14.3% or \$52.8 million partly as a result of lower collections of excise taxes (\$29.6 million or 46.2%) and value added tax receipts (\$35.4 million or 15.7%). In addition, direct taxes declined by 1.4% or \$4.6 million for the January-to-March period of 2007, in contrast to an

increase of 39.9% or \$92.4 million for the same period of 2006. Collection of personal tax receipts contracted by 8.9% on account of an upward revision of the personal allowance, and the decline in the personal tax rate from 37.5% to 35%. Similarly, property tax receipts fell by 3.3% as a result of government's property revaluation exercise at the beginning of 2006, which had led to an extraordinary expansion in property tax intake for the first quarter of 2006. Corporate taxes were sluggish following growth of 56% in the review period last year owing to broadening of the tax base in 2006. Non-tax revenue and grants decreased by 1.3%, relative to the first quarter of 2006.

Expenditure

For the review period, total government spending went up by 6% to \$690.1 million, after an expansion of 10.8% in the corresponding period of the previous year. Current expenditure grew by 9.9% or \$52 million, compared to the 8.9% increase recorded over the equivalent period one year ago, on account of higher transfers and subsidies (17.7%), wages and salaries (0.5%) and goods and services (15.2%). However, capital expenditure decreased by 16.7%, down by \$20.6 million from the \$123.3 million expended during the comparable period of the prior year, owing to near completion of most of the infrastructural work undertaken by Government.



Government Financing
(\$Million)

	Fiscal Year				January-March			
	2003/04	2004/05	2005/06	2006/07	2004	2005	2006	2007
Domestic Financing	(1.4)	192.6	(4.0)	177.2	4.7	31.9	(75.2)	29.6
Central Bank	(17.1)	(18.2)	(26.9)	85.2	(105.9)	(101.4)	(24.3)	(1.0)
Commercial Banks	38.7	62.6	(279.5)	91.5	66.4	67.9	(138.1)	(40.7)
National Insurance Scheme	60.8	7.5	104.4	56.0	20.00	47.00	10.00	8.00
Private Non-Bank	38.1	90.1	267.3	52.7	38.8	31.1	101.7	57.2
Divestment	0.0	0.0	31.4	0.0	0.00	0.00	31.4	0.00
Other	(122.0)	50.6	(100.7)	74.8	(14.6)	(12.7)	(55.9)	6.1
Foreign Financing	143.6	(48.3)	184.3	24.3	(19.5)	(26.4)	3.9	(3.2)
Capital Markets	0.0	0.0	245.2	135.8	0.00	0.00	0.00	0.00
Project Funds	55.3	54.0	47.7	36.7	10.2	4.8	21.7	19.6
Policy Loans	0.0	0.0	0.0	0.0	0.00	0.00	0.00	0.00
Amortisation	(100.7)	(102.3)	(108.6)	(148.2)	(29.7)	(31.2)	(17.8)	(22.8)
Divestment	189.0	0.0	0.0	0.0	0.00	0.00	0.00	0.00
Total Financing	142.2	144.3	180.3	201.5	(14.8)	5.5	(71.3)	26.4

Source: The Central Bank of Barbados

Financing

The fiscal deficit was mostly financed by domestic entities. Government borrowed \$8 million from the National Insurance Scheme, \$57.2 million from Private Non-Bank institutions, and \$6.1 million from other sources. At the same time, Government increased its net deposits at the Central Bank by \$1.0 million, while commercial banks reduced their net holdings of government debt by \$40.7 million. Net foreign financing was a negative \$3.2 million during the review period as the \$22.8 million expansion in amortisation payments offset project fund inflows of \$19.6 million.

Fiscal Year (FY) Operations

At the end of FY 2006/2007, central government's budget deficit was estimated at \$201.5 million, compared to the FY 2005/2006 deficit of \$180.3 million. Total revenue

increased by 2.7% or \$59.3 million when compared to the previous fiscal year as the decline in personal taxes was outweighed by the growth in corporate, property and miscellaneous taxes. Additionally, indirect taxes also fell, despite the rise in stamp and import duties.

Total expenditure for the FY 2006/2007 grew by \$80.5 million (3.4%), after increasing by \$279.2 million (13.5%) in the FY 2005/2006. The main categories that expanded were goods and services, transfers and subsidies, and interest payments. Goods and services rose by 8.9% (\$20.7 million) partly reflecting payments made for various services such as the financing of road maintenance works and outlays on street lighting services. Transfers and subsidies, went up by 4.5% (\$35.2 million), reflected, inter alia, defence spending in respect of the CWC 2007 and transfers to LIAT in respect of operating expenses. Expenditure on major projects for CWC 2007, the Coastal Zone Management Unit and the Education Sector Enhancement Programme,

Government Operations
(\$Million)

	Fiscal Year			January-March				
	2004/05	2005/06	2006/07	2003	2004	2005	2006 ^P	2007
Total Current Revenue	1,918.3	2,161.5	2,220.8	539.8	558.4	581.1	721.5	663.7
Tax Revenue	1,820.3	2,042.3	2,118.7	497.6	531.2	538.8	692.2	634.8
<i>Direct Taxes</i>	749.6	859.2	954.6	252.2	221.5	231.6	324.0	319.5
Personal	303.2	306.3	301.1	113.6	102.4	93.1	103.6	94.4
Corporate	286.9	359.9	430.5	110.2	88.4	116.4	182.0	181.6
Levies	0.0	0.0	0.0	4.70	0.00	0.00	0.00	0.00
Stabilization	0.0	0.0	0.0	0.00	0.00	0.00	0.00	0.00
Property	112.9	137.4	150.9	14.8	19.10	15.1	25.1	24.3
Other	46.5	55.6	72.1	9.0	11.6	7.1	13.3	19.2
<i>Indirect Taxes</i>	1,070.7	1,183.1	1,164.1	245.3	309.7	307.2	368.1	315.4
Consumption	0.0	0.0	0.0	0.0	0.0	0.00	0.00	0.00
Stamp	18.9	22.0	27.3	3.5	4.3	5.0	6.2	8.4
VAT	598.2	682.7	669.2	134.4	157.8	152.7	225.5	190.1
Excises	149.4	172.2	146.1	34.3	51.9	64.2	64.0	34.5
Import Duties	193.0	180.5	199.8	34.8	58.2	50.2	39.0	50.2
Hotel & Restaurant	0.0	0.0	0.0	0.2	0.0	0.0	0.0	0.0
Other	111.3	125.8	121.7	38.2	37.5	35.1	35.5	32.2
Non Tax Revenue & Grants	98.0	119.2	102.1	42.3	27.1	42.2	29.3	28.9
Current Expenditure	1,838.9	2,001.6	2,084.5	425.3	447.7	482.1	524.8	576.8
Wages & Salaries	645.5	687.5	691.1	169.4	157.0	163.5	175.0	175.8
Goods & Services	213.2	233.2	253.9	67.5	65.8	74.3	66.2	76.2
Interest Payments	263.4	298.9	322.1	36.0	40.0	31.2	39.1	37.0
External	103.5	105.7	119.5	14.6	20.5	9.7	9.3	7.3
Domestic	159.9	193.1	202.7	21.3	19.5	21.5	29.9	29.6
Transfers & Subsidies	716.7	782.1	817.3	152.4	184.8	213.2	244.5	287.7
Current A/C Balance	79.4	159.9	136.3	114.5	110.7	99.0	196.7	86.9
Capital Expenditure	223.5	252.4	246.6	120.6	94.3	104.3	123.3	102.7
Net Lending	0.3	87.8	91.2	0.8	1.6	0.2	2.1	10.6
Total Expenditure & Net Lending	2,062.7	2,341.8	2,422.3	546.7	543.6	586.6	650.2	690.1
Overall Balance	(144.4)	(180.3)	(201.5)	(6.9)	14.8	(5.5)	71.3	(26.4)

Source: The Central Bank of Barbados

P: Provisional

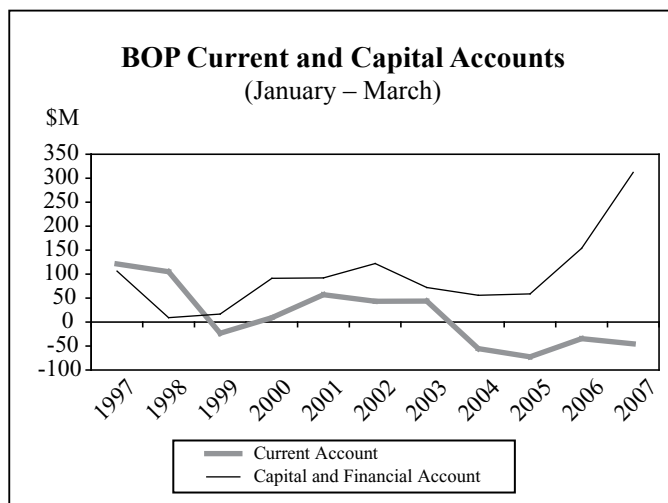
contributed to higher on-budget capital expenditure (3.2%) in FY 2006/2007, following the 8.9% increase in FY 2005/2006.

Despite government borrowing on the international capital market towards the end of 2006 and commercial banks reducing some of their holdings of government securities, domestic sources surpassed foreign sources as the main provider of funding for government operations. Domestic finance was \$177.2 million for the fiscal year 2006/2007. Government borrowed \$56 million from the National Insurance Scheme, \$52.7 million from Private Non-Bank institutions and \$74.8 from other sources. By the end of the fiscal year 2006/2007, Government had decreased its net deposits at the Central Bank by \$85.2 million, while commercial banks had reduced their net holdings by \$91.5 million. On the foreign side, Government borrowed \$135.8 million on the international capital market and received \$36.7 million in project funds, which offset the expansion of \$148.2 million in amortisation payments for the fiscal year 2006/2007.

Foreign Trade and Payments

Current Account

During the first three months of 2007, the external current account was in deficit for the fourth consecutive first quarter, expanding to \$40.4 million from \$34.7 million in the similar period of the previous year. The main factors behind this performance were an increase in foreign interest payments coupled with slower spending on imports. Travel credits increased slightly and domestic exports declined. Retained imports grew at a slower rate of 1.6% (\$11.3 million), compared to 6.5% (\$44.4 million) for the same period of last year. Consumer goods imports rose by 14.3%, occasioned by higher spending on food and beverages, pharmaceuticals and other manufacturing goods. Spending on intermediate and capital goods contracted by 6.1% and 4.5%, respectively. The decrease in imports of intermediate goods was on account of a fall-off in fuel imports.



Over the period under review, domestic exports declined by approximately 12.9% (\$16.3 million), in contrast to the expansion of 50.8% (\$42.5 million) observed in the comparable period of 2006. The downturn reflected mainly a decrease in sales of electronic components (\$10.2 million) and cement (\$4 million).

However, re-exports went-up by approximately 25% (\$23.3 million). Net receipts from services expanded by approximately 7.1% for the first quarter of 2007, following a rise of 4.5% for the corresponding period of the previous year, benefiting mainly from increased tourism receipts related to higher average expenditure per visitor. Net transportation outflows grew by 6.2% during the first three months of 2007, after registering a 6.4% expansion in the corresponding period of 2006. Additionally, income outflows increased over the review period partly on account of rising external interest payments.

Capital and Financial Account

The capital and financial account recorded a surplus of approximately \$312.1 million or more than twice the surplus for the similar period in 2006, the highest first quarter surplus in ten years. The upturn was as a result of expansions in both short-term and long-term capital inflows. Pre-shipment financing for the sugar harvest and loan proceeds for the prison and airport projects accounted for the

Balance of Payments
(January-March)
(\$Million)

	2003	2004	2005	2006	2007
Current Account Balance	43.7	(55.6)	(72.7)	(34.7)	40.4
Merchandise Trade	(368.9)	(462.9)	(527.5)	(506.9)	(534.3)
Total Exports (BOP basis)	107.7	102.9	145.4	212.7	217.7
Domestic Exports	74.9	64.5	83.7	126.2	109.9
Sugar	0.00	0.8	0.00	0.00	0.2
Electronic Components	6.4	7.0	8.0	16.1	5.9
Chemicals	9.8	9.7	14.1	14.7	14.5
Food/Beverages	21.5	16.1	21.8	26.5	32.7
All Other	37.2	30.9	39.8	68.9	56.6
Total Imports (BOP basis)	496.9	586.6	673.8	735.6	766.3
<i>Retained Imports</i>	511.9	604.6	682.8	727.2	738.5
Consumer Goods	191.3	246.5	265.5	261.6	299.1
Capital Goods	109.9	132.7	131.2	181.3	173.1
Intermediate Goods	208.9	222.7	284.0	280.8	263.6
Miscellaneous Goods	1.8	2.7	2.1	3.5	2.7
Services (Net)	442.5	451.0	507.7	530.5	568.2
Travel Credits	512.6	524.6	587.8	618.2	632.9
Other	39.8	55.0	47.8	57.6	77.6
Investment Income (Net)	(61.6)	(72.9)	(92.5)	(97.8)	(135.1)
Transfers (Net)	31.6	29.2	39.3	39.5	60.8
Capital and Financial Account	72.1	55.8	58.7	153.7	312.1
Long term	19.6	(53.8)	(20.3)	72.6	135.6
Public Sector	(24.2)	(34.5)	(12.0)	10.9	55.6
Disbursement	32.6	(1.9)	20.2	29.6	80.4
Amortization	56.8	32.6	32.1	18.7	24.9
Private Sector	43.8	(19.4)	(8.4)	61.7	80.0
Disbursement	46.4	2.2	48.8	81.3	119.2
Total Outflows	2.6	21.5	57.2	19.6	39.1
Other	10.4	16.1	5.6	11.4	55.6
Short-term	42.1	93.6	73.5	69.7	120.9
Errors & Omissions	113.2	81.8	19.6	2.7	(20.1)
Balance for Official Financing	229.0	82.0	5.7	121.7	251.6
Official financing (Net)	0.00	0.00	0.00	0.00	0.00
IMF	0.00	0.00	0.00	0.00	0.00
Other Financial Institutions	0.00	0.00	0.00	0.00	0.00
Reserve movements (CBB basis)					
(-Increase/+Decrease)	(229.0)	(82.0)	(5.7)	(121.7)	(251.6)
Change in NIR (IMF basis)					
(-Increase/+Decrease)	8.1	(36.0)	(37.4)	(45.9)	(140.8)

Source: The Central Bank of Barbados

bulk of short-term flows, which amounted to \$120.9 million. Net long-term inflows were estimated at \$135.6 million or approximately \$63 million above the inflows reported for the first quarter of last year and included a bond issue raised on behalf of a statutory corporation, and receipts for real estate. Additionally, miscellaneous inflows grew owing to increased foreign currency receipts from commercial banks.

Regional Economic Developments

Overview

Economic activity within the Caribbean region strengthened during 2006. Higher construction value-added spurred growth in Jamaica and the Organisation of Eastern Caribbean States (OECS) while The Bahamas benefited mainly from increased tourist arrivals and Trinidad and Tobago continued to enjoy the gains associated with relatively high world oil prices. Inflation in the majority of Caribbean territories was below the rate experienced in 2005 as oil prices moderated.

Tourism

During 2006, the tourism industry in the Caribbean region benefited chiefly from increases in long-stay visitors while the regional cruise industry experienced a downturn affecting several destinations in the first half of the year. However, from the third quarter of 2006, the number of cruise ship passengers expanded as a result of moderating oil prices. In Jamaica, there was an increase in stopover visitors of 13.8% and cruise ship passenger arrivals grew 17.7% during 2006. This improvement was supported by a 5% expansion in the number of hotel rooms, along with the refurbishing of properties and product upgrades plus promotions by stakeholders and additional airlifts. For 2006, tourism activity rose by 6.1% in the OECS, with long-stay visitors increasing by 3% reflecting higher arrivals out of the Caribbean and US markets. Arrivals from the UK and other major European markets declined however, partly as a result of a decrease in airlift from the UK. Additionally, cruise ship passenger arrivals went up

by 0.3%. Long-stay arrivals to Belize grew by 4.8% but cruise ship arrivals decreased by 18% over the same period. Total visitor arrivals to The Bahamas, over the January-to-October period of 2006, fell by 4.7% to 3.9 million persons with long stay arrivals expanding by 0.5%, and cruise passengers declining by 6.4%. The local cruise industry was adversely affected by the increased competition from other Caribbean and extra regional markets. During the first six months of 2006, Trinidad and Tobago registered a reduction in long stay arrivals of 2.7%, while Guyana reported a contraction in long-stay visitors of 2.7% for the whole of 2006.

Mining and Quarrying

In Jamaica, value added in crude bauxite expanded by 12.3% in 2006 and alumina production was up by 0.3%, following the 1.6% increase recorded in the previous year. In 2006, mining and quarrying output in Guyana decreased by 22.3%, mainly reflecting the closure of the Omai gold mine in the previous year along with the loss of markets in the bauxite industry. The output of bauxite, gold and diamonds, respectively, declined by 12.2%, 23.1% and 4.6%.

Construction

After six consecutive years of moderate growth, construction value added in Jamaica contracted, primarily on account of a cement shortage in the domestic market caused by internal problems at the sole cement plant. In contrast, by the end of 2006 the OECS experienced an upturn in construction activity driven by infrastructural developments pertaining to CWC 2007. Positive gains were registered in the construction industry in The Bahamas throughout the year, mostly because of the increase in tourism-related investments coupled with the continued rise in residential building.

Agriculture

During 2006, the region's agricultural performance was mixed. After two consecutive years of sizable declines, the Jamaican agricultural sector rose by 15.9% owing to favourable weather conditions and improved farming practices. Additionally, Guyana also registered

an expansion of 5.5% in agriculture for 2006. Agricultural production in the OECS grew by 10.8% relative to the 11.7% decline reported for the corresponding period of 2005. This was mainly attributed to the significant increase in the banana crop, especially in St. Lucia and Dominica. Grenada's output of cocoa, nutmeg and mace also rose, however, St. Kitts and Nevis reported lower levels of agriculture production with the closure of the sugar industry in 2005.

Prices and Interest Rates

By the end of 2006 the average inflation rate in Trinidad and Tobago was 8.3%, as monetary and fiscal policies dampened the upward pressures on consumer prices. Jamaica's inflation rate declined sharply from 15.8% to 8.6% in 2006, primarily as a result of strong growth in agricultural production, relative stability in the exchange rate and moderating international oil prices. Despite rising price levels in medical services, housing, fuel and food in the first quarter of 2006, Guyana's inflation rate at the end of 2006 decreased from 8.2% to 4.6%. By the end of 2006 the inflation rate in the OECS declined by 3.2 percentage points as international oil prices moderated to 1.4%. The inflation rate in The Bahamas fell marginally to 1.8% at the end of 2006, driven mainly by lower prices for transportation and communications, education and recreation and entertainment services. In contrast, the inflation rate in Belize increased, from 3.7% in 2005 to 4.3% in 2006, partly on account of higher electricity rates, and widening of the sales tax base.

For the year 2006, the weighted average lending rate in The Bahamas decreased by 36 basis points to 9.63% while the weighted average deposit rate increased by 52 basis points to 3.76%. Jamaica's average loan rate eased from 22% at the end of December 2005 to 21.9% by the end of December 2006, while the interest rate on the 3-month treasury bill declined from 13.34% to 12.26%. The weighted average lending rate for Guyana contracted by 38 basis points by the end of 2006, while the savings rate fell from 3.38% to 3.19% over the same period and the average 3-month treasury bill rate expanded by 42 basis points to 4.16%.

Financial Sector

In the January to December period of 2006 domestic credit in the OECS grew by 16.5%. Loans to the private sector rose by 18% while total deposits rose by 21%. Credit to the private sector in The Bahamas advanced by B\$524.4 million for the first three quarters of 2006, approximately 58% above the figure observed for the corresponding period of 2005. The growth was mainly attributed to greater demand for mortgages and consumer credit. Domestic deposits expanded by B\$257.6 million, as broad-based gains were registered for all categories of deposits. In Jamaica, domestic credit and deposits of commercial banks grew by J\$21.1 billion (15.9%) and J\$15.3 billion, respectively. The rise in domestic credit occurred on account of increased borrowing by the personal, manufacturing and tourism sectors. In Guyana, over the review period, private sector credit increased by 17.8% compared to an increase of 8.4% recorded in the previous year, while total deposits rose by 10.8%, largely reflecting higher transfers by Guyana's migrant workers and new branch locations of commercial banks. During 2006, loans and advances in Trinidad and Tobago expanded by 12.1%, and domestic deposits increased by 20.5%.

Exchange Rates

During 2006, the Jamaica dollar depreciated by approximately 4.0% to J\$66.9 per US\$1.00. The Trinidad and Tobago dollar remained relatively unchanged, while the Guyana dollar rose by 1.1% to G\$203.9 per US\$1.00.

Government Operations

With buoyant petroleum revenues Trinidad and Tobago recorded an estimated fiscal surplus of TT\$3.7 billion during the first ten months of 2006, but this was approximately TT\$1.3 billion below the surplus of 2005. For the first nine months of 2006 The Bahamas' fiscal deficit was estimated at B\$31.3 million, about B\$80.7 million lower than the figure reported for the same period of 2005. The improvement in the deficit was occasioned by an expansion of 18.7% in revenue compared to an upturn in expenditure of 7.9%. The OECS region recorded an estimated fiscal deficit of EC\$448.8 million during 2006, a deterioration of EC\$160.7

million when compared to the corresponding period of 2005. The widening of the deficit was as a consequence of a 50.3% rise in capital expenditure, associated mostly with CWC 2007-related projects during the first nine months of 2006. A fiscal current account surplus was recorded as a result of strong growth (15%) in current revenue, which outweighed a 10.6% increase in current expenditure. In Guyana, the operations of the central government during the year 2006 resulted in a fiscal deficit of G\$21.5 billion, worsening by approximately G\$0.8 billion relative to the deficit at the end of 2005. Similarly, central government operations in Jamaica led to a deficit of J\$30 billion, approximately J\$3.2 billion more than the figure registered at the end of the previous year. The increase in the deficit was on account of wage settlements reported in the second half of the year, and higher interest payments.

Foreign Sector Developments

During the first nine months of 2006, The Bahamas' external current account deficit was estimated at B\$699.6 million, compared to the B\$82.4 million experienced over the similar period of 2005, reflecting a higher import bill occasioned by a rise in international oil prices along with a marked reduction in net service inflows. The capital and financial account recorded a surplus of B\$435.8 million, owing to greater private sector inflows for tourism-related projects. By December of 2006, the current account deficit in Guyana amounted to US\$181.4 million from US\$157.6 for the comparable period one year ago, reflecting higher merchandise imports. As a result of increased price levels of imported commodities, Jamaica's current account deficit widened by US\$18.2 million to US\$1096.4 million in 2006. However, the capital account registered a surplus of US\$2.0 million, about 50.7% above the figure for the similar period of 2005. In the OECS, during 2006, the external current account deficit deteriorated as a result of strong import growth, partly reflecting the vibrancy in construction activity coupled with increased import prices. In addition, domestic exports rose because of greater demand for bananas, soap, dental cream, cocoa and rice. Trinidad and Tobago's external current account surplus grew by US\$1,054.3 million to reach US\$4,654.9 by the

end of 2006. This growth was on account of higher prices and increased volumes of energy exports.

International Economic Developments

Overview

Economic activity in the global economy went up by 3.1% during the first three months of 2007, in comparison to the 3.7% increase reported in the corresponding period of 2006. This growth reflected the rapid expansion of exports and domestic demand for goods and services in the Japanese economy, as well as a moderate economic performance in the United States. The Euro area continued to improve, with mild inflation and strong currency markets. Emerging market economies benefited from a slowdown in the rate of inflation in the first quarter, but these markets underperformed as they rose by only 2.5%, compared to the 4.5% increase experienced in the similar period of 2005.

Industrial Economies

In the United States, real GDP grew by an estimated 0.6% for the first three months of 2007, following the 5.6% registered during the same period of the prior year. This outcome was primarily as a result of a reduction in exports as well as a downturn in federal government spending. On account of the fall in exports, coupled with stronger import demand, a further deterioration of the trade deficit occurred during the period. The unemployment rate declined in the first quarter of 2007 to 4.7%, compared to 5.1% in the equivalent period of 2006. The inflation rate fell to 3.3% by the end of March 2007, relative to 3.4% in the corresponding period of 2006, as ongoing productivity gains and strong foreign competition offset the pass-through effect of gasoline price increases.

Over the period January-to-March 2007, real GDP growth in Canada was estimated at 0.9%, partly reflecting the slowdown in the US economy. Despite the reduction in the demand for automobiles and building materials by the US market, Canadian exports increased, led mostly by exports in machinery and equipment and some primary

commodities. Additionally, spending on residential construction and by government slowed over the first quarter of 2007. During the review period the unemployment rate was reported at 6.5%. Owing to higher prices for food and imported goods, the rate of inflation in Canada, at the end of March 2007, was above the forecasted rate. Thus, Canada maintained its monetary policy stance, keeping the overnight rate at 4.25%.

Real GDP in the Euro area expanded by 3% by the end of March 2007, led by continued strong growth in domestic demand and investment. At the end of March 2007, the unemployment rate was recorded at 7.2%, approximately 1.4 percentage points less than the figure for the same period one-year earlier. In March 2007, the European Central Bank raised the minimum bid rate by 25 basis points to 3.75%, as inflationary pressures remained buoyant. Consumer prices rose by 2.3%, compared to 2.2% for the corresponding period of last year.

During the first quarter of 2007 real GDP in the United Kingdom grew by 2.7%, attributed mostly to increased domestic demand, arising from improved levels of private consumption and fixed investment. Nevertheless, the unemployment rate rose over the first quarter of 2007 to 5.5%, following the 4.7% reported for the corresponding period of the previous year. By March 2007, the inflation rate was 2.6%, up from 2.0% at the end of March 2006, despite moderation of food, transportation and energy prices.

Activity in the Japanese economy continued to recover steadily as growth in real GDP was estimated at 2.7% at the end of March 2007. Output in Japan reflected primarily strong exports and increases in domestic demand as a result of higher business investment. In addition, prices remained relatively stable. Consequently, the Bank of Japan left the benchmark rate unchanged at 0.5%.

Emerging Markets

In Asia, economic growth continued to expand for the first quarter of 2007, notably in the largest economies of the region. In China, economic activity was led by industrial production, despite the volatility in the Chinese stock market in late February. The Peoples Bank of China raised the benchmark lending rates and deposit rates by 27

Economic Indicators: Industrial Economies

Countries	Real Output (% Growth)		Unemployment (% Rate)		Inflation (% Rate)	
	2006 Q1	2007 Q1	2006 Q1	2007 Q1	2006 Q1	2007 Q1
Canada	2.9	0.9	6.8	6.5	2.2	2.2
Euro Zone	1.3	3.0	8.6	7.2	2.2	2.1^P
France	1.4	1.9	9.9	8.7	1.7	1.7
Germany	0.8	3.3	9.2	7.0	2.0	2.0
Italy	0.1	1.5^P	8.1	7.8^P	2.0	2.2
Japan	2.8	2.7	4.4	4.1	-0.3	0.3
United Kingdom	1.8	2.7^P	4.7	5.5^P	2.0	2.6
United States	5.6	0.6	5.1	4.7	3.4	3.3

Source: Various Central Banks and National Statistical Offices, IMF Estimates

P: Provisional

Q1= First quarter

basis points to 6.39% and 2.79% respectively, in an effort to reduce inflationary pressures. Meanwhile, the Reserve Bank of India increased its policy rate by 25 basis points to 7.75% at the end of March 2007. In contrast, on account of easing inflation, the Malaysian monetary authorities maintained the benchmark interest rate of 3.5%. Growth in the Malaysian economy was encouraged by large trade surpluses and strong foreign direct investment inflows. In Taiwan and Hong Kong, the labour market remained robust, recording low unemployment rates of 3.9% and 4.3%, respectively. The outcomes were as a result of a gradual shift to an emerging service-based economy.

Activity in Latin America expanded in the first quarter of 2007. Brazil's economy grew by 4.8%, compared to 2.3% for the January to March period of 2006. Inflation slowed to about half the rate recorded for the corresponding period in the previous year and the Central Bank reduced its key interest rate by 25 basis points to 12.75%. In Mexico, industrial production remained sluggish, indicating a slowdown within the economy, while the inflation rate was 4.2% at the end of March 2007. Economic activity remained robust in Argentina as a result of the improved levels of industrial production during the first three months of 2007.

Commodity Prices

Commodities	Mar-06	Mar-07	% Change
Total (Index of Market Prices)	192.3	206.2	6.8
Non-Fuel (Index of Market Prices)	156.3	195.0	19.8
Food (Index of Market Prices)	131.6	146.3	10.0
Sugar (US ¢ / lb) 28.9	32.3	10.5	
Bananas (US \$ / metric ton)	880.7	646.7	-36.2
Rice (US \$ / metric ton)	297.7	326.8	8.7
Wheat (US \$ / metric ton)	174.4	199.1	12.4
Soybeans (US \$ / metric ton)	213.0	240.0	11.25
Metals (Index of Market Prices)	220.7	311.5	29.2
Aluminium (US \$ / metric ton)	2,432.5	2,757.1	11.8
Iron Ore (US ¢ / metric ton unit)	77.4	77.4	0.0
Copper (US \$ / metric ton)	5,123.7	6,465.3	20.75
Silver (US ¢ / troy ounce) 1	1,037.5	1316.0	21.2
Gold (US \$ / troy ounce) 1	510.1	654.9	22.1
Petroleum (US \$ / barrel)	60.9	62.1	1.9

Source: IMF Commodity Prices

Commodity Prices

The overall commodity price index rose by 6.8% during the first quarter of 2007, partly on account of broad-based growth in non-fuel commodities.

At the end of March 2007, petroleum prices grew by 1.9%, while the price of non-fuel commodities jumped by an estimated 19.8%. The price of food commodities increased by 10% as moderate expansions in the prices of wheat, soybeans, rice and sugar overshadowed the sharp

contraction in banana prices (36.2%). Moreover, with the exception of iron ore, the prices of all other metals grew during the first quarter of 2007. Despite higher levels of production within most of the countries, the prices of copper and aluminium rose by 20.8% and 11.8%, respectively, while iron ore prices remained the same as at the end of March 2006. The prices of silver and gold increased by 21.2% and 22.1%, respectively.

**Caribbean Stock Markets****Barbados Stock Exchange (BSE)**

The BSE recorded an overall improvement in performance during the quarter ending March 2007. This was indicated by a sharp increase in trading volume with 133.63 million shares crossing the floor compared with 3.76 million shares traded for the same period in 2006. The volume leader in the regular market was First Caribbean International Bank (FCIB) which accounted for 97.6% (130.44 million) of the total shares traded. This outturn was on account of FCIB shareholders accepting the offer by Caribbean Imperial Bank of Commerce (CIBC) Investments (Cayman) Limited to purchase shares at \$3.27 per share, which resulted in 129.75 million shares being traded on February 02, 2007. This transaction was also the determining factor in FCIB being the value leader of shares traded for the first quarter of 2007, with a total value of \$426.73 million. The second most liquid securities for the review period by volume and value were Sagicor Financial Corporation (SFC) and Barbados Shipping & Trading Limited, respectively.

**Top Five Performing Companies
Based on Number of Shares Traded
December 2006 - March 2007**

Institution	Volume Traded (Millions)
First Caribbean International Bank	130.4
Sagicor Financial Corporation	0.528
Barbados Shipping & Trading Limited	0.480
Fortress Caribbean Property Fund	0.320
Barbados Farms Limited	0.272

Source: Barbados Stock Exchange

During the quarter, seven local companies advanced and six declined. Most noticeably, it was the 2.8% and 2.9% contractions in the share prices of FCIB and SFC, respectively - the two largest weighted companies in the local index - that were the main contributors to the overall reduction in

the local index by 1.8% to 3,597.40 points at the end of the quarter. This decrease also dampened the performance of the Composite Index, which moved from 943.05 to 945.61, to record a marginal increase of 0.3% for the review period. The market capitalisation for the Composite Index also registered a modest expansion, of 0.4% for the quarter.

**Barbados Stock Exchange Statistics
(End of Month)**

Index	Dec. 2006	Mar. 2007
Local	3,661.5	3,597.4
Cross-Listed	1,972.3	2,015.1
Composite	943.1	945.6
MARKET CAP. (\$M)		
Local	9,908.7	9,739.4
Cross-Listed	10,607.4	10,856.7
Composite	20,516.1	20,596.1

Source: Barbados Stock Exchange

Market capitalisation for cross-listed companies moved from \$10.61 billion to \$10.86 billion, a 3.3% rise for the quarter, as the Cross-Listed index advanced to 2,015.13, up by 2.2%. Two companies in particular, RBTT Financial Holdings Limited and One Caribbean Media Limited, were responsible for the favourable performance of the cross-listed index with increases of 6.8% and 4.1%, respectively.

Jamaica Stock Exchange (JSE)

During the first quarter of 2007, there was a significant expansion in trading volume on the JSE, with total shares traded being recorded at 396,027,039 units at a value of JAM\$4,788 million. Cable & Wireless Jamaica Ltd. and Supreme Ventures Limited remained the top two volume leaders for yet another quarter, with 113,688,171 shares and 50,829,608 shares traded, respectively. These top performers were followed by the National Commercial Bank of Jamaica Ltd, which traded 29,910,764 shares.

By end-March 2007, only 5 companies had advanced, 35 declined and 2 remained unchanged. This contributed to the overall decrease in the JSE Index for the

first quarter, moving from 100,677.96 at the beginning of the period, to end the period at 90,595.04, down 10.0%. The major companies advancing were: Salada Foods, registering the best performance of a 37.5% increase in share price; Supreme Ventures (16.7%) and Mobay Ice Company (6.7%). The Dyoll Group, which had a positive performance in the previous quarter, recorded the largest share price decline of 71.1% during the review period.

Trinidad and Tobago Stock Exchange (TTSE)

During the first quarter of 2007, the TTSE Index decreased by 4.1% to close at 929.11 points. In an unusual performance, the number of companies registering declines in their share prices (17) outnumbered those advancing (13), while only three companies traded firm. The major two advancers – both from the manufacturing sector- were Point Lisas Industrial Port Development Corporation Limited with 26.3% and Readymix (West Indies) Trinidad Limited with 21.1%.

After a 52-week share price high of \$1.85, Jamaica Money Market Brokers Limited registered the largest price reduction for the first quarter of 2007, contracting by 39.5% to a price of \$1.12. Volume leaders for this quarter included National Commercial Bank Jamaica, with 7,900,885 shares, Republic Bank Limited (6,190,637 shares) and Trinidad Cement Limited (3, 277,107 shares).

Emerging Markets

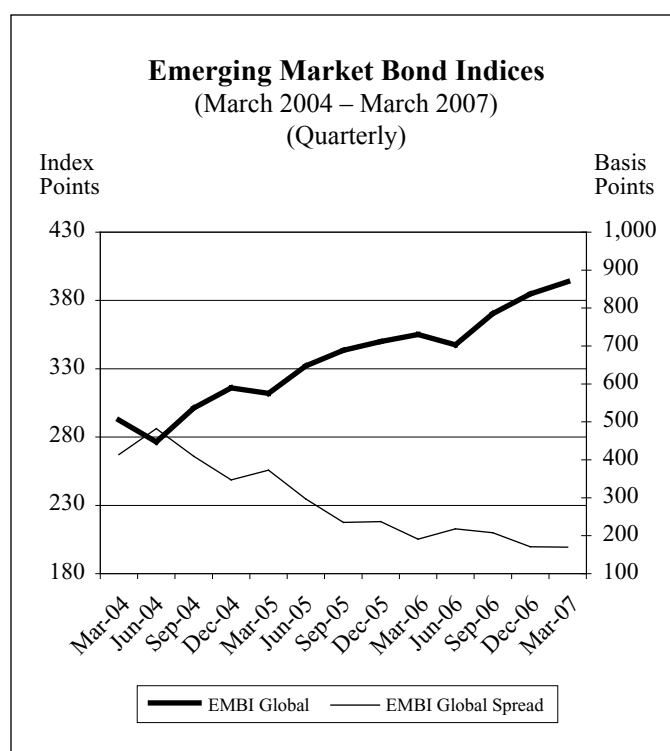
Bond Markets

Returns on emerging market bond indices were up by 9 index points at the end of the first quarter of 2007, despite a rapid revaluation of security prices that occurred near the end of February 2007. This was sparked by the geo-political tensions in the Middle East, which continued to drive uncertainty in the energy-market, as the United Nations Security Council took steps to further enforce economic sanctions on Iran. However, global risk aversion began to fade as the US equity market stabilised and a decline in the Japanese yen offered some renewed support for Latin American debt and equities,

which outperformed the majority of the Asian securities in the review period.

Most of the emerging market economies demonstrated an ability to withstand the pressures of a weaker US economy. In spite of the slump in the US sub-prime housing market (further amplified by the bankruptcy filed by New Century Financial Corporation), emerging bond markets rallied by the end of the first quarter of 2007.

In Latin America, the Republic of Peru's economy was sufficiently supported by financial initiatives that it embarked on a new debt-restructuring programme. Mexico's securities market continued to be one of the favourites in the emerging market world. Additionally, there was a surge in Brazilian Real-dominated bond issuance, as these local currency bonds could reduce the risk of a sudden rise in borrowing costs for the Brazilian government, if the Real weakens. In Venezuela, local and foreign investors remained bullish although that nation has been plagued with many disruptive economic developments. Additionally, low inflationary pressures, high foreign reserves levels and an



improved economic environment also encouraged more global investors to participate in the bond markets of Latin American countries. On the other hand, Chinese bond markets recovered strongly by the end of the first quarter of 2007, while other Asian bond markets failed to see a great deal of gains at the end of the period, following an earlier slump in asset prices.

Equity Markets

During the first quarter of 2007, the Latin American equity market outperformed the Asia market, as reflected by the 5.3% rise in the Latin America index, in contrast to the decline in the Asia index by 0.4%. Both the Chilean and Mexican indices rose by 8%, while the Argentine Merval and the Brazilian Bovespa grew by 2.5% and 2.9%, respectively. The Venezuela Caracas index was the only under-performer for the review period (down by 6.7%) in the selected Latin American equity index.

Share prices in companies such as Alfa and Cemex from Chile and Grupo Aeroportuario del Sureste and

Vitro from Mexico, led their respective indices to strong quarterly gains. Eletrobras, a Brazilian state controlled utility company, and Aracruz Cellulose, a pulp exporting company, were two of the major equity movers on the Brazilian Bovespa index. Venezuelan equities remained volatile over the period, as inflation concerns and private sector acceptance of the nationalization of utility companies continued to influence the market.

China and Malaysia were the top equity performers, both recording double-digit increases of 16.0% and 12.1%, respectively. These performances were overshadowed by index declines in Hong Kong's Hang Seng (-1.4%), India's Mumbai (-5.5%) and Thailand's SET (-0.9%). Chinese banks led the Shanghai index at the end of the first quarter, by accounting for the majority of the share issuance during the period. Export companies in Malaysia and Singapore registered solid share price performances over the quarter, which generated favourable gains.

Currency Markets

Latin American currencies remained relatively stable, with the peso in Argentina, Mexico and Chile rising

Emerging Market Equity Indices
(Quarterly)

Country/Region	Index	Dec-06	Mar-07	% Ch
Argentina	Merval	1,542.4	1,580.9	2.5
Brazil	Bovespa	44,473.7	45,804.6	2.9
Chile	IPSA	2,693.4	2,929.0	8.0
Mexico	IPC	26,448.3	28,747.7	8.0
Venezuela	Caracas	52,233.7	48,945.7	-6.7
Latin America		2,995.7	3,163.2	5.3
China	Shanghai	2,675.5	3,184.0	16.0
Hong Kong	Hang Seng	19,964.7	19,692.6	-1.4
India	Mumbai	13,786.9	13,072.1	-5.5
Indonesia	Jakarta	1,805.5	1,830.9	1.4
Malaysia	Kuala Lumpur	1,096.2	1,246.9	12.1
Philippines	PSE	2,982.5	3,203.6	6.9
Singapore	Straits Times	2,985.8	3,231.2	7.6
South Korea	Seoul	1,434.5	1,452.6	1.2
Thailand	SET	679.8	673.7	-0.9
Taiwan	Weighted	7,823.7	7,884.4	0.8
Asia		371.5	370.1	-0.4

Source: Bloomberg Service

Emerging Market Currencies
(Quarterly)

Country/Region	Currency	Dec-06	Mar-07	% Ch
Argentina	Peso	3.1	3.1	1.3
Brazil	Real	2.1	2.1	-3.4
Chile	Peso	533.4	539.3	1.1
Mexico	Peso	10.8	11.0	2.0
Venezuela	Bolivar	2,147.3	2,147.3	0.0
China	Yuan	7.8	7.7	-0.9
Hong Kong	Dollar	7.8	7.8	0.5
India	Rupee	44.3	43.5	-1.8
Indonesia	Rupiah	8,994.0	9,121.0	1.4
Malaysia	Ringitt	3.5	3.4	-2.0
Philippines	Peso	49.0	48.3	-1.5
Singapore	Dollar	1.5	1.5	-0.6
South Korea	Won	930.0	940.6	1.1
Thailand	Baht	35.5	32.4	-8.6
Taiwan	Dollar	32.6	33.1	1.4

Source: Bloomberg Service

by 1.3%, 2.0% and 1.1%, respectively, by the end of the first quarter of 2007. Meanwhile, the Brazilian Real fell by 3.4%, notwithstanding the good performances by the Real-dominated bonds and stocks, which were amongst the highest paying securities on the international market.

Most Asian currencies strengthened vis-à-vis the US dollar during the first quarter of 2007. The Philippines peso gained on high growth expectations and speculation of robust economic expansion from overseas investors in national assets. Thailand's Baht also appreciated, on account of increased demand for local currency by the nation's exporters. The Malaysian Ringgit recorded its second quarterly gain, supported by strong investor confidence in the economy. Confidence also returned to South Korea, as the won gained 1.1% from a four-month low that resulted from the rapid selling off of emerging market equities. In Taiwan the dollar declined as overseas investors borrowed in this currency to take advantage of lower local interest rates, in order to buy higher-yielding assets elsewhere in the region.

International Interest Rates

United States of America

With the apparent moderation of output growth in the first quarter of 2007, and the expectation that the increase in real output for the whole of 2007 will be below trend, the Federal Open Market Committee (FOMC) held interest rates constant at 5.3% for the quarter ending March 2007. However, the US labour market remains tight and core inflation continued to be an area of concern over the review period. The latter is likely to dictate the Federal Reserve's (Fed) action, with an anticipated loosening in rates being delayed until the second half of the year. It is expected that price corrections in the housing market could create a drag on consumption growth and thus lead to more aggressive Fed cuts than previously anticipated. Ultimately, the predominant risk to the Fed's action remains inflation, but analysts predict that if the present softness in housing and capital spending deepens, there could be some risk of recession.

Europe

Despite conflicting economic data during the quarter, the European Central Bank (ECB) raised interest rates by 25 basis points to 3.8%. Importantly, data tended to reaffirm the ECB's worries about upside risks to price stability over the medium-term. A significant number of ECB Council members have interpreted the data releases as confirmation that growth will remain strong and inflationary pressures will be elevated, therefore justifying the current tightening phase. The futures market points to a gradual tightening in the ECB's monetary policy over the next few quarters.

United Kingdom

The Bank of England's (BoE) Monetary Policy Committee (MPC) raised the official Bank Rate paid on commercial bank reserves by twenty-five basis points to 5.25% during the first quarter of 2007, the first move since November 2006. The rate change has been made on the expectation of continued strong output growth. In addition, domestic demand has increased steadily and credit expansion remains rapid. With the margin of spare capacity in the economy appearing to be limited, there has been added pressure on domestic pricing. The CPI inflation continues to hover around 2.7% with all likelihood that it will rise further above the target in the near term, but this pressure is expected to abate as the declines in energy and imported price inflation filter through.

It is against this background that the MPC judged that an increase in rates was necessary to bring the CPI inflation back to the target in the medium-term. However, with first quarter activity remaining strong, the housing market slowing only gradually, and underlying inflationary pressure remaining, the market expected that the BoE would make a further rate hike by May. As global growth falls off and the effect of past monetary tightening is felt later this year, the economy is likely to slow sufficiently to negate the possibility of further increases for the remainder of the year.

Canada

During the first quarter, the Bank of Canada (BoC) judged that the economic factors were sufficiently balanced and did not require any monetary policy adjustment, and the target overnight rate was held at 4.25%. Although the slowing of the U.S. economy has had a moderating effect on economic growth and inflation in Canada, robust domestic

demand kept the increase in real output healthy, while stronger-than-expected economic expansion outside North America led to a rise in the demand for, and prices of, many commodities. This assisted the economy in operating just above its production capacity during the first quarter of 2007.



US-CARICOM Trade Relations: The Likely Benefits of a Bilateral with The US

Overview

The plethora of bi-lateral trade agreements that have emerged in the wake of the sluggish pace of multi-lateral negotiations in recent years has led some Caribbean leaders to consider the possibility of bi-lateral arrangements so that the region is not left behind and disadvantaged. The US market, because of its proximity and interconnection with many Caribbean countries, is important to the region and transparent US-CARICOM trade relations are critical. Previous arrangements such as the Caribbean Basin Initiative (CBI) did not allow for sufficient market access to the US markets when compared to agreements like the North American Free Trade Area (NAFTA) and the more recent Dominican Republic-Central America Free Trade Area (DR-CAFTA) that excluded CARICOM member countries. The latter arrangement is especially of concern to the Caribbean region because of the disproportionate coverage, scope and market access it offers DR-CAFTA member countries over their CARICOM counterparts.

In light of these developments, an examination of the likely benefits of a US-CARICOM bilateral agreement, given the limitations of existing trading arrangements with the US and the impact that recent trade relations between the US and other territories might have on the Caribbean region, is vital.

This article reviews the existing arrangements between the US and CARICOM, and considers the likely impact of recent developments in the western hemisphere that might put member countries at a fundamental

disadvantage, and the possible benefits of a bilateral accord with the US as the way forward.

US-CARICOM Trade Arrangements

With the US being one of the world's largest consumers, many CARICOM and Central American countries, along with the Dominican Republic find themselves competing for market access. Consequently, amongst these individual countries many different trade agreements have been formed with the US over the years. Such arrangements included the CBI, NAFTA, Central America Free Trade Area (CAFTA) and the DR-CAFTA.

The CBI, which grants benefits to 24 member countries¹, mostly governed trade relations between the US and the Caribbean and until recently Central America. One of its major goals, was to expand foreign and domestic investment within the countries' non-traditional sectors, thereby broadening their economies and enhancing exports. Under the CBI, the member countries were granted duty-free entry to the United States for a wide range of products grown and manufactured in CBI countries. At the same time under the Caribbean Basin Economic Recovery Act (CBERA), clothing manufactured in qualified CBI countries, from US yarns and fabrics, as well as non-textile products excluded from earlier CBI legislation, entered the US free of quota and duty². One key difference between the CBI and the DR-CAFTA agreements is that the CBI is unilateral, whereas the DR-CAFTA is reciprocal. In other words, the CBI operates under several concessions agreed to only by the major trading partner (US), while under the DR-CAFTA the member countries are also included in the agreed concessions.

This arrangement failed to provide meaningful growth in exports from the CARICOM territories. Evidence shows that even though US markets accounted for over 40% of CARICOM's total exports, this figure has not changed significantly over the period of the agreement. Furthermore, the majority (60%) of CARICOM exports to the US is petroleum by Trinidad and Tobago. Barbados' trade accounted for a relatively meager 18% in 2002. In comparison, CAFTA countries export share was 38.8%,

¹ These countries mostly originate from Central America and the Caribbean. Member countries include Antigua and Barbuda, Aruba, the Bahamas, Barbados, Belize, Costa Rica, Dominica, Dominican Republic, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Montserrat, Netherlands Antilles, Nicaragua, Panama, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Trinidad and Tobago and British Virgin Islands.

² See the website <http://www.trade.gov/media/publications/pdf/cbi2000.pdf>

and significantly more if the Dominican Republic which exports over 80% to the US is added.

Reasons for a US-CARICOM Bilateral Agreement

It is a fact that the CBI did increase market access somewhat, but it did not seem to have provided significant trade gains for CARICOM countries. Some believe that this may reflect CARICOM's inability to utilise and understand the preferential access criteria. A study by Ledermen and Ozden (2005)³ showed that preferential access under a Free Trade Agreement (FTA) was easier to use than under the CBI. These results suggest that the DR-CAFTA member countries will expand their preference utilisation rate on top of the advantage they already have over their CARICOM counterparts operating under the CBI.

Indeed, the DR-CAFTA may further solidify the gains accruing to Central American countries and the Dominican Republic, as these member countries will now have secure benefits of increased access to their largest export market, with the enhanced possibility for growth in foreign direct investment, and institutional strengthening across a range of trade and investment-related areas. A World Bank (2005a)⁴ study showed, that with DR-CAFTA, the US's demand for Dominican Republic exports could rise from 10

to 20 percent. Vigorous competition for market access in the US has been evident for several years but CARICOM has been under more and more pressure in recent years. Methanol production has been a dominant market in the US for CARICOM, but competition from top exporters of Methanol in Central America under the DR-CAFTA may change this. Therefore, CARICOM can only regain some leverage when competing with Latin American markets by negotiating a CARICOM-US FTA.

Quite apart from DR-CAFTA member countries, other countries are seeking to benefit from improved market access to the US. For instance, Trinidad and Tobago is one of the top exporters of Liquefied Natural Gas (LNG) to the US, while its close rivals like Qatar, Algeria and Malaysia are presently only marginal exporters to the US LNG market but this can change if these countries form new trade relations with the US. The exports of these countries could become more competitive because of economies of scale, offsetting the geographical advantage, which Trinidad presently enjoys. Other areas of potential for increased competition to Trinidad and Tobago, and The Bahamas include the export of Anhydrous Ammonia (AA), refined petroleum and methanol into the US market. AA exports from Trinidad and Tobago now have to compete more evenly with exporters from Canada and Russia. Similarly, refined petroleum from The Bahamas and Trinidad and Tobago, which benefits from duty free access to the US, currently faces competition with exports from countries like Venezuela and Russia.

CARICOM-US: Some Considerations

Although benefits could increase for some CARICOM members under a US-CARICOM bilateral accord, losses are likely as well. This agreement could be detrimental to the agriculture and manufacturing industries for some members because of its reciprocal nature, unlike the unilateral arrangement under the CBI. These industries are important for these economies because of their foreign exchange earning capacity and employment generation.

The 2005⁵ World Bank study has shown that a free trade arrangement offered enhanced market access to the US market when compared to the arrangements of the CBI and the Generalised System of Preferences (GSP)⁶. This result

³ Chapter IV - Economic Effects of DR-CAFTA: More Art than Science in "Challenges of CAFTA: Maximizing the Benefits for Central America" edited by C.F. Jaramillo, D. Lederman, M. Bussola, D. Gould and A. Mason, published by The World Bank. See the Websites www.jamaica-gleaner.com, www.imd.org and www.ernm.org

⁴ World Bank. (2005a), "Dominican Republic Review of Trade and Labour Competitiveness", Report no. 30542-DO, World Bank, Washington, D.C.

⁵ World Bank (2005a), "Dominica Republic Review of Trade and Labour Competitiveness", Report No. 30542-DO, World Bank, Washington, D.C.

⁶ GSP is a formal system of exemption from the more general rules of the World Trade Organisation (WTO), formerly, the General Agreement on Tariff and Trade. It exempts the WTO member countries from the Most Favoured Nation for the purpose of lowering trade barriers for developing countries, without doing so for rich industrialised countries. See the Website <http://www.unctad.org/Templates/Page.asp?intItemID=1418&lang=1>

reflects the straightforwardness of using the preference criteria⁷ of the NAFTA unlike the difficulties shown under the CBI. FTA market access rules also offered more security for entrepreneurs when making long-term investment decisions than under the CBI. However, the fact still remains that a US-CARICOM FTA will result in a relaxation of the current tariff preference rule, which will affect CARICOM countries' exports of goods under these preferential concessions. In return, concessions made to the US by Central American countries under the DR-CAFTA, allow for 80 percent of US consumer and manufacturing exports and a sizeable amount of US farm

exports to be duty-free. These concessions will be hard to match by CARICOM because a trade pact that warrants the removal of tariffs would severely hurt the smaller and less developed CARICOM members, whose import tariffs account for almost half of government revenues. Thus, trade creation mechanisms must be central to any bilateral negotiation between CARICOM and the US.

Conclusion

In the current global environment, CARICOM must embark on a bold new strategy to boost regional exports. One such strategy could involve a bilateral agreement with one of its main export markets, such as the US. The benefits accruing to DR-CAFTA member countries suggest that CARICOM could also benefit from a similar bilateral. These rewards must be weighed against the likely losses that could result from the reciprocal nature of this agreement.

⁷ The NAFTA preference criteria designated by the letters "A" through "F" show how your product qualifies for a NAFTA tariff rate. A preference criterion is required in Field # 7 of the Certificate of Origin for each export product. See the Website <http://www.export.gov/logistics/exp>.



Management of Capital Flows: Comparative Experiences and Implications for Africa (The United Nations 2003) A Review by Alvon Moore*

Introduction

Outbreaks of financial crisis in the developing world and emerging markets have brought the issue of the management of capital flows into focus. Given the crisis in the emerging markets, United Nations Conference on Trade and Development (UNCTAD) considered it useful to engage discussions on the financial policies and capital account regimes in Sub-Saharan Africa (SSA) and to draw appropriate lessons from the ways in which the capital account in other regions were managed.

Management of Capital Flows: Comparative Experiences and Implications for Africa is the end product of this discussion. The publication provides a variety of country experiences on how capital account liberalisation was implemented and could be a useful guide for policy makers faced with the inevitable task of liberalising their financial sector. It reviews the experiences of the East and South-East Asian countries before and after the 1997 financial crisis and also looks at the experience of the Organisation for Economic Co-operation and Development (OECD) member countries with regard to capital account liberalisation. Also, it presents reasons for the collapse of the economies of the affected countries and outlines the measures taken to restore and integrate these economies globally. Several authors challenge aspects of the international financial architecture, which emphasises capital account liberalisation and explains international financial crisis in relation to weak corporate governance and competition policy. Additionally, the macroeconomic and institutional structure of the African countries is examined to determine their impact on the increase and management of the flow of capital in these countries.

The publication consists of seven articles. Paper 1 analyses the issues of corporate governance and changes in the international competitive environment from the developing country perspective in relation to the proposed new international financial architecture. Paper 2 outlines the sequence and pace at which OECD member countries implemented capital account liberalisation. In papers 3, 4

and 5 the authors examine the experience of the economies in East and South-East Asia, while papers 6 and 7 assess the macroeconomic weaknesses of the SSA region and the effects on foreign direct investment (FDI) due to capital account liberalisation.

Paper 1: Corporate Governance, Competition, The New International Financial Architecture and Large Corporations In Emerging Markets

The paper by Singh, Singh and Weisse outlines the issues involved in the proposed reforms and provides developing countries with an appreciation of whether they will help to promote long-term economic growth.

The authors acknowledge that the financial crisis in the Asian economies, followed by crises in the Russian Federation and Brazil resulted in widespread concerns among the G-7 industrial countries about the stability of the international financial system. Concerns were also raised about whether the system should be reformed to establish a “new international financial architecture”, especially in developing countries. The “new international financial architecture” is centered around corporate governance and is closely connected to domestic and international competition policies in an environment of globalisation and liberalisation.

Singh et al. also discuss the causes of the financial crisis. They saw no merit in the argument that poor corporate governance and inadequate competition between large firms was a reason for the Asian crisis since the evidence suggest that product market competition in developed and developing countries was quite similar. Instead, they conclude that a credible explanation for the crisis was the removal of controls over private sector borrowing and the full acceptance of financial liberalisation, especially in the period preceding the crisis.

In the paper, mention is also made of the close relationships between corporate governance and corporate finance as weak points in the institutional structure. Singh et al. however, argue that studies indicate that the patterns of corporate finance did not change before and during the crisis. The authors suggest that conglomerates in developing countries were efficient and their debt positions were in line with those firms in the developed markets. They further claim that conglomerates’ difficulties with

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debt arose because of the unmonitored and volatile short-term flows of external capital created by the absence of government's control of capital movements, which were essential to the traditional state-guided economic systems.

Although acknowledging the existence of a competitive environment, the paper emphasises the need for developing countries to develop effective competition policies because of extensive privatisation and the current huge international merger wave. It also stresses that, in the interest of economic development, developing countries should be allowed by the World Trade Organisation (WTO) to fashion their competition policy to suit their own needs. On the whole, it is the responsibility of developing countries to critically assess the proposed reforms involved and to make informed judgments of the desirability or applicability of their implementation.

Paper 2: The OECD Experience with Capital Account Liberalisation

Griffith-Jones, Gottschalk and Cirera examine the process and pace of capital account liberalisation in different member countries of the OECD. They discuss the OECD Code of Liberalisation of Capital Movements, created in 1961 to promote capital account liberalisation among the OECD member countries. The code expanded gradually over time and permitted member countries to pursue gradual liberalisation of their capital account to suit their specific country needs and circumstances. From the 1960s until the late 1980s, this feature of gradualism allowed countries to liberalise their capital account at their own pace. Another important aspect of the code was that of sequencing where member countries were first allowed to liberalise long-term capital flows followed by the liberalisation of the more volatile short-term flows.

The authors note that pressures of liberalisation and the process of deregulation in the domestic financial sector in the late 1970s caused some OECD countries to speed up the process of capital account liberalisation. Membership of some OECD countries to the European Economic Community and the dire need of newer members of the OECD to catch up with the original members were also identified by the authors as reasons for the increased pace of liberalisation.

Griffith-Jones et al. identify three patterns of liberalisation among member countries of the OECD, which they characterise as waves. The first wave comprised the developed countries of the OECD area. These countries undertook a fairly gradual liberalisation path until the early 1980s when the process was accelerated. The second wave pertained to the middle-income countries, which, due to the diversity among the OECD member countries, were initially allowed to pursue liberalisation more gradually than the industrialised countries. The third wave consisted of the emerging economies that liberalised their capital accounts before or at the time of entry into the OECD owing to membership requirements. The authors conclude that forced premature liberalisation of the emerging economies has resulted in more than half of them experiencing deep and costly financial crises.

As a result of the experiences of the emerging economies, the writers suggest that the OECD return to the original features of gradualism and sequencing so as to promote orderly capital account liberalisation, especially within countries with weak and poorly regulated domestic financial systems. The article emphasises the need for developing countries to be well represented in the international arena in the implementation of capital account liberalisation, in order to limit the extent to which unwanted measures are implemented. The authors recommend that since the costs of crises to countries are high, it is best that the national authorities weigh the pros and cons of autonomously implementing capital account liberalisation rather than allowing the developed countries to freely impose the objective of full capital account convertibility, a step which the developing countries may not be prepared for.

Paper 3: Management of the Capital Account: A Study of India and Malaysia

In this paper, Rajaraman evaluates the similarities and differences used by India and Malaysia in their approach to capital account management. The author demonstrates how the two countries, which are somewhat different from a macroeconomic perspective, especially in terms of long-term rates of growth and their degree of openness, have used different means of controlling the size

and compositions of their capital flows, and yet arrive at a notable convergence in the management of their capital account after the East Asian crisis of 1997.

Rajaraman notes that the currency crisis ended Malaysia's long tradition of openness of current and capital accounts. In 1998, the country imposed capital exit barriers, the currency (Ringgit) was pegged to the dollar and interest rate lowered. India's response to their external liquidity crisis in mid-1991, when foreign reserves fell to an all time low, was to open the capital account. Since 1991 the external price of the currency (Rupee) has been market determined, even though there has been periods of intervention by the Reserve Bank of India. The author notes that since the crisis both countries have enjoyed significant amounts of capital inflows to the point where the capital account management problem was one of too much rather than too little. In essence this article illustrates that the transition to full capital convertibility needs not be similar across countries and a country's control of its capital flow is essential for macroeconomic control over the real sector.

Paper 4: China: Managing Financial Integration

This paper focuses on how the Chinese economy integrated globally during times of financial crisis. Its author, Wei Ge, identifies the case of China as very essential in demonstrating how an economy in transition, with recognisable structural and institutional weaknesses, can integrate smoothly into the global economy, while minimising the potential cost. He argues that since its integration into the global economy in 1979, China, has not only survived the crisis, but also achieved impressive rates of growth. Moreover, its currency has remained stable, and net inflow of foreign capital and international reserves has been fairly strong.

Ge notes that one reason for China's credible performance is that, in spite of the progress made in achieving greater economic openness, the Chinese economy has remained largely domestically based. Heavy reliance is placed on private domestic savings, while foreign capital inflows play only a minor role in meeting domestic investment needs. This eases the burden of conducting monetary policies and prevents the economy from being

overly exposed to external risk. Additionally, the domestic financial sector is fairly insulated from foreign influence and competition. Despite the surge in external debt, the composition as well as the debt-related risk indicators have been quite manageable, suggesting a fairly conservative attitude towards the handling of external debt. Ge also mentions, that contrary to the recommended sequence of economic liberalisation, that is, opening up of the current account followed by the capital account, China opened its trade account together with allowing FDI inflows. The opening of the rest of the current account followed, as did the entry of foreign commercial and portfolio flows. The author concludes that the evolving sequence has been a result of trial and error, careful monitoring and controlled experiments.

Paper 5: Post-Crisis Financial Reforms in The Republic of Korea

In this paper, Lee discusses the restructuring and liberalisation steps taken by the Republic of Korea after the financial crisis, which he argues was caused primarily by crony capitalism, non-transparent corporate performance and asymmetric information. Consequently the restructuring efforts focus on establishing a well-developed capital market by applying global economic standards, both qualitative and quantitative. Some of the standards used included; international accounting standards, transparency, corporate governance, the Bank for International Settlements (BIS) ratio and the debt-to-equity ratio.

These global standards were not all implemented or enforced with equal strength. Lee identifies the two most distinctive global standards introduced as the BIS capital adequacy ratio, which is a ratio used to manage a banks credit risk, and the leverage ratio commonly known as the debt-to-equity ratio. Firms were required to attain the BIS ratio of over 8 per cent within a year following the outbreak of the crisis, and all conglomerate groups were to reduce their leverage ratio to below 200 per cent by the end of 1999. The attainment of these targets, especially within the period specified, appeared almost impossible for all the firms targeted for reform. These standards resulted in a marked reduction in bank lending and a significant number

of illiquid firms, with only a moderate increase in share issuing and trading. External finance was obtained mainly through the sale of companies and hostile takeovers, and was used as a means of restructuring the economy as well as allowing firms to meet the required standards.

The author also made special mention of government intervention. Government intervened in banks' portfolio selection and management and forced bank mergers on the grounds that the enlarged banks would be in a better position to handle the existing non-performing loans more effectively. The interventionist policy was justified on the grounds that it prevented market disruptions. Critics of this government policy argued that the injection of funds into banks with non-performing loans should have been undertaken mobilising private funds through market operations.

Lee concludes that the standards enforced have contributed remarkably to the economic recovery in the Republic of Korea, with growth rates of 10.9 and 8.8 per cent in 1999 and 2000, respectively. He added, that Korea's recovery compared to the other crisis-hit Asian economies was testament to the strength of the adopted global standards; however, flexibility in the enforcement of the global standards could have avoided unnecessary hardship.

Paper 6: Public Debt and Macroeconomic Management in Sub-Saharan Africa (SSA)

Rwegasira and Mwega highlight the fact that high external debt and its servicing remain a major problem in many SSA countries. They argue that the empirical evidence show that high external debt has a negative impact on growth and macroeconomic stability and that large fiscal deficits have undermined the credibility of domestic policies and contributed to the high levels of external debt. The authors confirm that with large fiscal deficits Africa's access to external finance has been significantly reduced and the authorities has become very dependent on domestic borrowing from the Central Bank and the sale of government securities to the public. However, domestic borrowing is constrained by the size of Africa's capital and money markets. High interest rates are required to

place domestic debt, therefore liberalising the financial system in the face of large budget deficits will increase the stock of domestic debt. The authors recommend that, given the limitations associated with money creation and domestic borrowing, it is paramount that the SSA countries address the size of their budget deficits to ensure a stable macroeconomic environment. They also point out that large budget deficits could undermine the objectives of exchange rate policy and raise the possibilities of real exchange rate misalignment in the SSA countries.

Since the late 1980s many of the SSA countries have opened up their financial systems. This has been followed by an expansion in the volatility of capital flows and the number of terms and conditions on which external finance has been made available. Rwegasira and Mwega suggest that the reform be implemented in a phased manner and that the public debt and its specific sources of finances be carefully planned. They also express concerns that, because of the problems associated with the public debt in the SSA countries, opening up of the capital account may lead to capital flight and expose the economy to adverse external developments.

Paper 7: Capital Flows, Capital Account Regimes and Foreign Exchange Regimes in Africa

The paper by Ndikumana examines the capital account regimes and the flow of capital in the SSA countries. He shows that, despite the global increase in capital flows to developing countries, global trends in FDI show that flows to Africa are by no means significant. Although, recently, they have been increasing they are much lower than those of other developing regions. Moreover, Ndikumana argues that private capital inflows have been limited due to weaknesses of the macroeconomic environment, underdeveloped financial systems, high country risk and exchange rate misalignment. It is suggested that sustained economic reform is needed to improve the investment climate in SSA.

Many African countries have moved towards greater capital account openness by liberalising their capital account and exchange rate regimes. Most African countries have moved from "soft pegs" to independently floating exchange rate regimes. The author describes the

transition as puzzling due to the countries underdeveloped financial system and weak regulatory environment. The liberalisation process has not resulted in income growth, price stability or a better trade performance. Ndikumana stresses that apart from the need to sustain macroeconomic stability, attention needs to be paid to the scope, speed and sequencing of capital account liberalisation to minimise the potential adverse effects and to maximise the potential gains.

Ndikumana also explores the notion of African countries abandoning exchange rate management and adopting a strong foreign currency or forming currency unions, so as to promote trade and to rid themselves of the challenges of sustaining effective fiscal and monetary policy. The author, however laments, that due to the evidence from African countries in the *Communauté Financière Africaine*, currency unions do not necessarily lead to increased trade or the insulation of economies from fiscal indiscipline.

As in the article by Rwegasira and Mwega, high levels of capital flight are also cause for concern. Ndikumana emphasises that there is urgent need for institutional reform aimed at improving accountability and transparency and the creation of an investment friendly environment to control the high levels of capital flight.

Conclusion

The publication presents a wealth of country experiences with capital account liberalisation and thus provides a valuable source or reference to which policy makers in developing countries can refer when seeking to liberalise their financial systems.

The last two papers provide reasonable evidence to indicate that efforts to integrate Africa into the global financial system through rapid liberalisation may not result in increased inflows but in greater volatility, exchange rate instability and higher volumes in capital flight. This is due to its external debt and servicing problems and the weak institutional framework and macroeconomic climate. Capital account liberalisation if adopted fully should be

slow, sequenced and adapted to the country situation. Much is to be learnt from the Asian experience. Once a sound institutional and macroeconomic framework is established, countries should pace and sequence liberalisation to suit their economy. The liberalisation processes implemented were either carefully monitored or involved restrictions or government interventionist policies.

Apart from being relevant to Africa, the experience drawn from the East Asian countries can be useful in the design of appropriate policies in other developing countries, like those of the Caribbean. With the establishment of the Caribbean Single Market and Economy (CSME), Caribbean economies are in the process of liberalising their financial markets. These countries although somewhat similar in size may need to implement liberalisation measures at different speeds, justified by differences in the macroeconomic structure of some of the countries and the stock and means of foreign inflows. For example, Trinidad and Tobago's economy is more suitable to capital account liberalisation than Barbados' because of Trinidad and Tobago's relatively sure and large stock of foreign reserves as a result of buoyant petroleum and natural gas industry, which is an attraction for large FDI inflows. The manufacturing and tourism industry are also important sources of foreign reserves for the Trinidad and Tobago economy. Barbados, on the other hand is predominantly a service industry dependant on tourism and the increasingly important finance, insurance and business industry. These two industries are however relatively unstable and largely dependent on external influences, as demonstrated by consequences for both industries from the September 11th terrorist attacks. Therefore, Barbados should approach liberalisation gradually and should always have some measure of capital control in place so as to protect the level of international reserves. In addition the Barbadian authorities should note that, China and Malaysia, while in the process of liberalising their capital account, maintained a stable exchange rate and pegged their currency to the dollar respectively. Conversely, India's currency remains market determined but not without regular interventions from the Reserve Bank of India.



The Low-Income Countries of the Commonwealth of Independent States: Progress and Challenges In Transition

A Review by Natalia Morgan*

The book entitled, “The Low-Income Countries of the Commonwealth of Independent States: Progress and Challenges in Transition”, is edited by Clinton R Sheills of the International Monetary Fund (IMF) and Sarosh Sattar of the World Bank, and involves collaborative work from other world leading economic researchers on transition economies. The main focus of the text is the macroeconomic problems faced by the Commonwealth of Independent States (CIS) from the 1990s until around 2001 when these countries began to re-gain some level of macroeconomic stability. Thus the various authors focused on areas centred on the main objective of the CIS-7 Initiative, which is to promote poverty reduction, economic growth, and debt sustainability among the low-income countries of the CIS, which comprise Armenia, Azerbaijan, Georgia, the Kyrgyz Republic, Moldova, Tajikistan, and Uzbekistan, hereafter called CIS-7. These states were once dependent on the Soviet Union for substantial transfers and subsidies and to oversee their trade agreements.

As a result of the break up of the Soviet Union, the CIS-7 lost the economic ties they had with regional and international partners and found themselves with cancelled fiscal transfers, severe shocks in energy prices, and problems related to structural inflexibility and weak institutions. Therefore, a significant effort was made to rebuild their individual economies by forming new states, democratic institutions, and market economies. This rebuilding effort proved difficult and, beginning in the early 1990s, much international assistance was secured to help keep living standards from declining disastrously; however, this came with the cost of high debt service capacity.

Hence, within this book of collaborative research, various articles are presented on topics that deal with the structural adjustment of the CIS-7, international assistance and their impact on these economies by way of poverty alleviation and resource allocation. For students, researchers and policy-makers dealing with transition economies, this text is a must read. It is an easy to understand, interesting, and very detailed document. The book is structured into a series of ten chapters, the main elements of which are reviewed next.

In the overview chapter by Samuel Otoo, Sarosh Sattar and Ekaterine Vashakmadze, the tone of the book is set. The authors argued that after the move from the Soviet Union to individual market economies, the CIS-7 found themselves faced with many macroeconomic and developmental issues, related to the following patterns:

- A decline in the standards of industrial output, labour activity and average monthly wages, as well as higher unit labour costs.
- Lower growth rates of per capita income, fewer employees in every 10,000 persons with education, less developed infrastructure and fewer fixed assets per capita.
- A reduction in exports to countries outside of the Former Soviet Union, and consequently, larger current account deficits.

In light of these patterns, Jane Falkingham in chapter six, focused on the evolution and current status of the living standards of the CIS-7. She laments that “the resultant decline in GDP per capita during the early transition years led to large increases in poverty and inequality”.

The decrease in real output stemmed primarily from the withdrawal of subsidies from Moscow which were used to provide free levels of high human capital, education and health care, as well as extensive social services.

Additionally, Falkingham discusses several factors that contributed to poverty in the CIS-7, including the geographical location of the citizens of the country, education, employment, refugees and internally displaced persons, and household size and demographic composition. With respect to both urban and rural poverty, Falkingham believes that households that are located in the urban developments face higher risks of being poor than those in the rural areas. Yet in countries where more than half the population is found in rural areas, the risk of poverty tends to be lower in the urban areas than in the rural. Louise Cord, Ramon Lopez, Monika Huppi and Oscar Melo, in a similarly-focused chapter (chapter seven) argues that the

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risks attained by the more rural-dominated countries arose from a more historical experience, which occurred after the break-up of the Soviet Union. From the perspective of poverty alleviation, both sets of authors suggest that efforts must be made to promote pro-poor growth and to build and protect human capabilities. The building of capabilities would help to create opportunities for the poor in areas of health, education, and employment.

In the restructuring of CIS-7, assistance from the international community was required. Chapter three, written by Philip R. Lane, reviewed and evaluated the contributions made to these low-income countries by International Financial Institutions (IFIs). He argued that they provided assistance in three areas: policy advice, technical assistance and financial support. The IMF advised on macroeconomic stabilisation, balance of payment issues, and fiscal affairs, while the World Bank assisted with structural adjustment issues, public finances, and financial sector reform. With the help of the IFIs, the CIS-7 have been able to make reasonable progress since the mid- 1990s.

When looking at poverty reduction, public expenditure comes into play, but is it as important as it seems? In chapter five, Mary Betley argues that the CIS-7 found themselves under more budgetary rules as their economies went through the restructuring phase. They tried to intensify spending, but were constrained by their individual budgets, and public expenditure in the national income decreased drastically. Thus with such low rates of public spending relative to GDP, growth and poverty alleviation efforts depended solely on sound management of scarce public resources.

In chapter four, Richard Pomfret discusses the role of structural reform in the transition experience of the CIS-7. He premised that each of these countries share varying features but have similar conditions, for instance, they all have low-income levels. Thus the paper deals with policy reform and economic performance, while analysing the seven key functions of structural reform, which are the liberalisation of internal markets and international trade, enterprise reforms and enforcement of budget constraints, facilitation of new entry, banking and other financial market reforms, land privatization and redistribution, transport and telecommunications, and reform of other infrastructure services.

Similar to the paper written by Philip Lane, the article by Richard Pomfret also focuses on the rebuilding process of the economies and the entry of new industries into these economies. Using indicators prepared by the European Bank for Reconstruction and Development (EBRD), he found that the Kyrgyz Republic ranked the highest, followed by Moldova, Tajikistan and Uzbekistan. The author also observed that the level of liberalisation was uneven across the seven countries, with Kyrgyz Republic, Moldova and Uzbekistan recording the highest liberalisation indices in 1995 followed by Armenia and Georgia and then Tajikistan and Azerbaijan. Furthermore, Pomfret suggested that the movement from planned to market economy has halted in the first three countries since the mid 1990s while it increased speedily in the last four where there were interventions by conflicts between 1992-1994.

Thomas Helbling, Ashoka Mody, and Ratna Sahay, in chapter 2, mostly focus on the external debt problems found within the CIS-7, and conclude that with the exception of Azerbaijan (which is a net exporter), these countries suffered from a serious external debt problem. There was virtually no debt found within these low-income countries around 1992, after which it steadily increased as many of the leading financial institutions, such as the IMF and the World Bank, sought to provide assistance. However, without close monitoring, most of the funds were put to unintended purposes.

Even though many challenges were faced and policies implemented, in order for the countries of the CIS-7 to better their economies there needed to be an effective and impactful combination of international assistance and domestic and political efforts. In addition, Constantine Michalopoulos, in chapter ten, posits that there must be an increased level of regional cooperation, trade and integration to contract the increasing external current account deficits and to overcome the damages caused by conflict and the break up of the Soviet Union. He mentions that through market forces, international trade helps in the advancement of resource allocation, productivity and growth, which are the key elements for sustainable poverty alleviation. Michalopoulos argues for the development of trade agreements, not only within the CIS market and other developing groups like the Eurasian Economic Community or the Central Asian

Cooperation Organisation, but also outside with leading developed countries such as the United States and countries within the European Union. In addition, he supports more diversified trade, following the lead of Armenia, which is re-exporting diamonds to Belgium and swapping scrap metal and foodstuff in exchange for electricity with Iran.

In the final chapter of the book, David Kennedy, Samuel Fankhauser, and Martin Raiser reviewed the energy and water issues faced by Central Asia and the south Caucasus regions, that is, mostly the CIS-7, along with their neighbours. The authors argue that both water and energy have become major critical issues for these countries for two primary reasons. The first is that they are the main forms of production within these countries along with the fact that they are the region's core natural resources. Secondly, the distribution of these resources across countries is uneven, for instance Armenia, Georgia, the Kyrgyz Republic, and Tajikistan share considerable water resources, while Azerbaijan, Kazakhstan, Turkmenistan, and Uzbekistan all benefit from having rich energy reserves. Evidently, this unequal distribution in resources gives rise to potential gains from trade but it is also the source of reoccurring arguments amongst the countries.

Thus the central argument within the paper looks at whether or not the reform of domestic power (and water) tariffs is the key to obtaining economic benefits from regional trade in both electric power and water. After the break up of the Soviet Union, the price of the energy resources across borders suddenly increased while domestic

prices remained constant. Therefore, for the countries' energy importers this meant a growing quasi-fiscal burden, which is mostly associated with a rise in foreign debt to energy-exporting countries. Since energy is not traded efficiently, geographically, countries which reside upstream tend to use more water to generate hydropower than is economically needed. Hence moving towards cost-recovery tariffs in energy would result in the realisation of significant benefits from trade, the discovery of necessary investments for the region's power systems, and incentives for the more efficient use of energy and water resources.

In concluding it can be agreed that for the future, it will be essential for both countries and donors to translate a better understanding of the development changes facing the CIS-7 into more effective reform, implementation and external assistance. Therefore for the CIS-7 to better their economies they would have to continue addressing the prevalent issues they face such as debt and financing, regional cooperation and governance through the help of the IMF, World Bank, EBRD and the Asian Development Bank.

Some of the issues discussed in the book could have some relevance to the low-income countries of the Caribbean. In particular trade liberalisation among the regional countries is pertinent, as well as moving towards becoming efficient within the trading system of the global economy. In this sense, the steps taken to establish the Caricom Single Market and Economy (CSME) is a positive one.