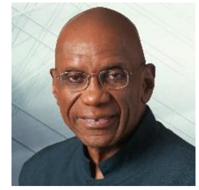


Economic Letter January 2019

More Cuts in Government Spending May be Expected in 2019

The decline in foreign reserves of the Central Bank which imperiled the exchange rate peg was caused by foreign spending in excess of foreign exchange inflows. Every year since 2013, the amount spent on purchases from abroad was greater than foreign exchange inflows by more than $100 million. In order to pay for the extra purchases, the Central Bank of Barbados provided foreign exchange from its reserves, which declined every year as a result.

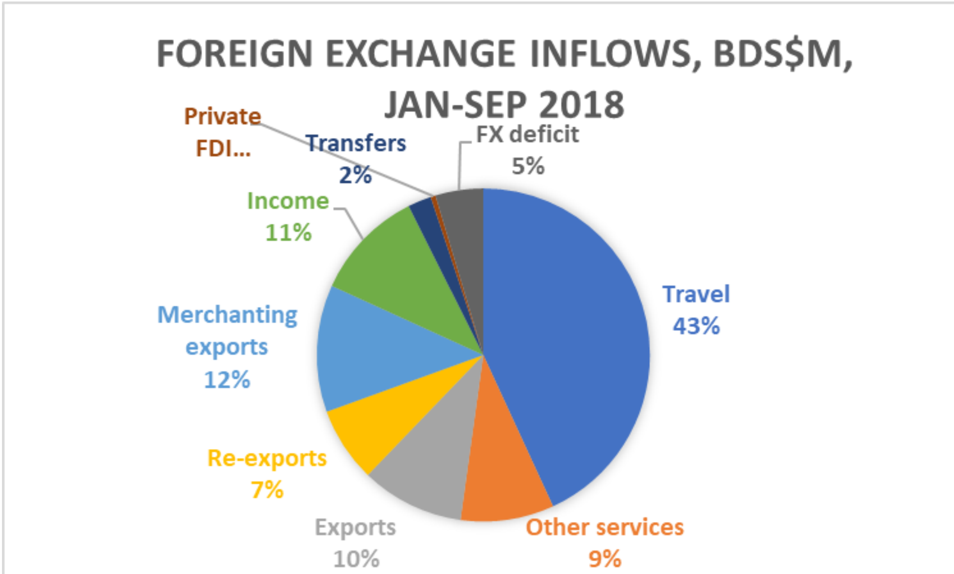
This imbalance has continued into 2018. According to the most recent data provided by the Central Bank, foreign purchases exceeded all inflows by $179 million in the first nine months. Private direct investment inflows, net of repayments, was a mere $18 million. In order to cure this underlying cause of the loss of foreign reserves, foreign purchases will have to be further reduced.

Foreign reserves are like a savings account that you dip into when your pay cheque doesn't cover your regular expenses. For the past few years, we've been spending more than our salary can cover, so we've been using up our savings to pay our bills. We recently got a loan from the bank, and now our savings are looking better. However, if we keep spending more on daily expenses than we're making from our salary, we will eventually use up the money we borrowed and be no better off. In short, the loans from the international financial institutions are not a solution; they offer an opportunity.

Government has the tools to reduce spending on foreign purchases, by increasing tax rates or cutting its own spending. Given that the burden of taxation was increased in 2018, the focus in 2019 will probably be on further expenditure reduction.

In time, the inflows of foreign exchange may increase. How soon that will occur depends on the effectiveness of policies to increase Barbados' external competitiveness. Between 2013 and 2017 Barbados fell from Number 47 in the *Global Competitiveness Report's* rankings to Number 72, mainly because of weak Government institutions and deteriorating Government finances. Investor confidence can be expected to revive when there is evidence of public sector reform, improved public services, and prudent Government finances. Early resolution of Government's default on US dollar debt is also essential to restoring investor confidence.

The financial support of the IMF, IDB and CDB has provided Government with a window of opportunity which should be used to address the imbalance of foreign spending and inflows, and the deteriorating competitiveness of our economy. A makeover of the public services, to raise the delivery of services to standards comparable to those of Canada, the US and the UK, is key to the achievement of both these objectives.



Foreign exchange inflows fell short of the amount needed to pay for purchases by 5 percent ($179 million). Data from the Central Bank of Barbados Press Release, September 2018, Table 3.