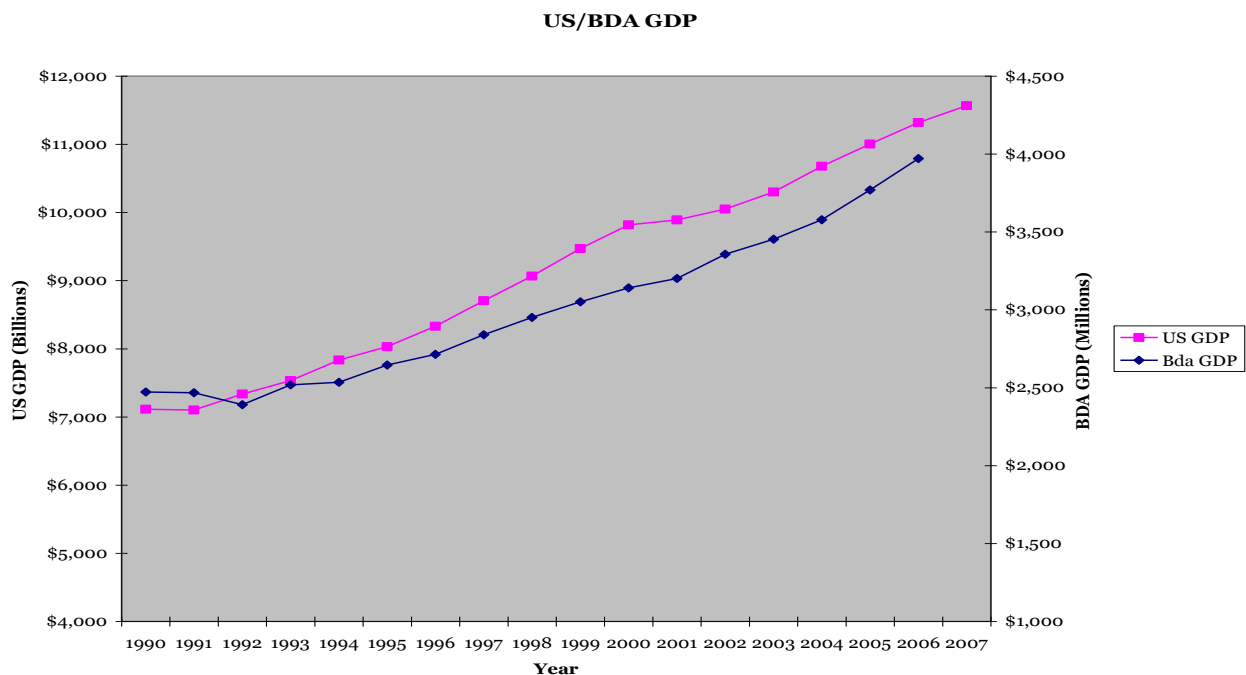


Summary of GDP: Bermuda 1990 – 2006

Over a third of Bermudians have never experienced a recession. By recession economists mean a period of declining income or spending or more formally, gross domestic product¹ (GDP).

The last recession ended in 1992, the result of a local credit crunch² triggered by fear of a U.S recession and geopolitical tensions associated with the first Gulf War. Economists measure growth as the percentage change in real or constant³ GDP. Growth averaged 2.4 percent during the nineteen nineties. This was the longest expansion for both the Bermudian and U.S. economies. Underpinning this growth were falling energy and food prices and the widespread use of computer and information technologies in production.

In the graph below, the scale on the left shows U.S. GDP in billions of dollars, whilst the scale on the right is for Bermuda's economy for 1990 to 2007.



¹ GDP is the value of all final goods and services produced within Bermuda in a year.

² 'In economic terms alone, the causes of the present situation stem primarily from an excessive and uncontrolled expansion of the money supply during much of the latter half of the eighties and a sudden reversal in 1989 and 1990.' Bermuda Monetary Authority (BMA), Report & Accounts, 1990, p 6.

'...the economy has been continually and mainly vulnerable to the influence of the financial sector and particularly to the actions and inactions of the Bermuda banks.' BMA, Report & Accounts 1991, p 9.

³ By real or constant we mean inflation-adjusted GDP. This is accomplished by holding prices constant and valuing goods and services at that constant (or base year) prices.

Four events caused the U.S. recession of 2001. The first was the bail out of [Long-Term Capital Management](#), a hedge fund, which started in 1998 and was completed in 2000. Secondly, there were the unrealised expectations of the dot-com or internet companies. The bursting of the dot-com bubble caused negative wealth effects, which led to declines in the consumer and investment spending components of GDP⁴. The events of September 11, 2001 led to greater overall uncertainty, which moved the U.S. economy deeper into recession. Fourthly, a series of accounting scandals that started with [Enron](#) in 2001 and ended with [Tyco International](#) and [WorldCom](#) in 2002 adversely affected business confidence and so affected investment spending on plant and equipment. The recession lasted for about two years.

The impact of this U.S. recession on Bermuda was most heavily felt in 2001, when growth in GDP fell to 1.9 percent - the lowest rate since 1994. Despite U.S. misfortunes, the Bermudian economy responded positively. A wave of insurance incorporations boosted the capital and surplus of the local market. Additional jobs resulted and average employment income increased by seven percent. Whilst the U.S. languished, the Bermudian economy recorded strong growth figures that became stronger as the U.S. responded positively to a fiscal stimulus of tax cuts and increased government spending and unusually low interest rates.

Since 2002, Bermudian growth has averaged 4.4 percent; for the U.S. economy the figure is 2.7 percent. In 2005 and 2006, local growth accelerated to 5.3 percent and 5.4 percent respectively. Financial services, which include the insurance risk-taking, brokerage and management activities of international and local businesses, accounted for over two-thirds of Bermuda's 2004 to 2006 growth⁵.

The data on economic growth appear to suggest that growth in excess of three percent is possible only with rising inflation. Over the last five years, growth has come at the cost of a more than doubling in the rate of inflation from 2.1% to 4.7%, as measured by the GDP implicit price index (IPI)⁶.

⁴ The components of GDP include: consumer spending + investment spending + government spending + export spending - import spending.

⁵ [National Economic Report](#) of Bermuda 2007, Ministry of Finance, Government of Bermuda, table 2, p 16.

⁶ IPI is the ratio of current and constant GDP for a given year. It measures the changes in prices of all final goods and services. GDP is calculated annually, but unfortunately the Government is slow to release GDP figures. 2006 data was released in January 2008.

It is difficult to assess the state of the economy in 2007 without gross domestic product (GDP), balance of payments and employment data. There are, however, data in the public domain that allow a glimpse of some of the major trends in spending. For heuristic reasons, we will take the expenditure approach to national income accounting.

Consumer spending is by far the largest spending category. Three-quarters of all spending is by consumers. The best proxy for consumer spending is the [retail sales index](#) (RSI), which is published by the Department of Statistics on a two month delay. The data in the RSI represent 70 percent of all retail activity, but it does not include the largest part of consumer spending, spending on services. The latest RSI figures put retail sales for 2007 at \$1.11 billions, which is about the same as 2006. Unless there was a significant increase in spending on services, it is unlikely that consumer spending increased. It follows that if the economy grew in 2007, it probably wasn't consumer driven as was the case in 1996 to 1999.

Investment spending on new homes and buildings as well as business equipment, typically accounts for 14 percent to 18 percent of GDP. Spending in this sector is relatively volatile. John Keynes, an influential British economist from 1920-1946, described investment spending as driven by 'animal spirits'. By that he meant, profit maximising behaviour could not explain the ebb and flow of business spending. Much of the supply response by developers to the demand for housing and buildings was fuelled by animal spirits.

During a virtuous investment spending cycle, commercial and residential real estate demand are strong, prices are expected to rise, credit is plentiful, and risk is under-priced. When this scenario begins to unwind, demand slows and as a result price expectations set by developers and realtors are not met. A concomitant of a weaker market is inventory accumulation of existing homes and buildings. It would not be an exaggeration to say that we are at the end of a virtuous residential cycle. The state of affairs in the commercial sector is less clear. We know from the [Budget Statement](#) that employment is down in construction. If GDP growth came from investment spending, then it came from either commercial real estate or spending on plant and equipment.

Domestic demand likely increased in 2007 because government spending was six percent higher than in 2006. The ratio of debt to GDP, now at 6.4 percent, is at a record high. It would be an exaggeration to infer that government borrowing or spending is out of control, just as it would be an act of denial to discount the impact of rising debt. Fiscal conservatives will argue that the present generation should be mindful of saddling future generations with too much debt.

The Bermudian economy is finally showing signs of maturation. We rely totally on exports and that reliance is further underscored by dependence on one sector – international business. This is a disturbing trend, which is why the events of the last three years are welcomed. The economy has grown a third pillar from investment income on foreign assets held by Bermuda residents⁷.

Investment income (\$739 million in 2006) earns more foreign currency than tourism (\$493 million in 2006), although those earnings go to relatively few hands. Since the end of the last recession in 1992, Bermudians have earned more foreign currency than they have spent. Parts of the resulting surpluses have been converted into income generating assets. Bermuda's new economic pillar is unique in that ownership of the underlying asset that is generating the foreign currency is in Bermudian hands. The new pillar also achieves a social objective of broadening the economy's narrow base.

Craig Simmons
April 14, 2006

This information has been compiled in conjunction with our economic consultant , Mr Craig Simmons , and we wish to thank him for assisting us with our educational programmes.

⁷ [Balance of payments](#) or more accurately, the current account on the balance of payments documents how Bermuda earns and spends foreign currency.