

ANNUAL ECONOMIC REPORT **2004**



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1. OVERVIEW

The Cayman Islands economy grew by 0.9 percent in 2004, compared to 2.0 percent in 2003. Growth was strong in the first eight months of the year, but declined during the last four months after Hurricane Ivan hit Grand Cayman on 12 September 2004.

Consumer inflation rose by 4.4 percent in 2004 compared to 0.6 percent in the previous year. This was the highest increase since 1999 and was influenced by the significant disruptions to normal supply and demand conditions resulting from hurricane Ivan.

An *unemployment* rate of 4.4 percent was measured both during the spring and fall Labour Force surveys in 2004. Between spring and fall the employed labour force fell from 29,168 to 23,453, mainly on account of persons leaving Grand Cayman following the hurricane. During the same period, the unemployed labour force fell from 1,282 to 1,034.

Imports grew by 30.5 percent from \$553.5M in 2003 to \$722.4 million in 2004. While strong growth was being registered in the months prior to the hurricane, imports accelerated after the hurricane as households and businesses replaced damaged goods and started the rebuilding process.

The broad measure of money supply in the Cayman Islands rose from \$4.0B in 2003 to \$4.1B in September of 2004. During the same period, the net foreign position of retail banks increased by \$365.8M to \$2.6B as a \$675M decline in foreign liabilities outweighed a \$307.2M fall in foreign assets. Net domestic credit from the retail banks rose by \$133.8M in 2004 to \$1.5B.

Despite the ravages of Hurricane Ivan, Cayman's *financial services* sector performed well overall in 2004. Increases were seen in mutual funds registered (23.4%), insurance company licences (7.4%), stock exchange listings (16.6%) and stock exchange capitalisation (21.9%), and new company registrations (22.6%).

One notable exception was bank & trust licences, which has trended downward since 2000 and declined by 7.7 percent in 2004.

In *tourism*, air arrivals grew by -11 percent to 259,929 in 2004. This decline is mainly due to stay over tourist arrivals being stopped for approximately two months after Hurricane Ivan. Cruise arrivals also declined, by 6.9 percent during the same period, to 1,693,293.

In *real estate*, the value of properties transferred grew by 4.0 percent from \$326.0M in 2003 to \$339.2M in 2004.

The *construction* sector saw a 20 percent decline in building permit values, from \$177.6 million in 2003 to \$142.0 million on account of the hurricane's disruption to business activity in the latter part of the year. However, planning approvals jumped by 72.0 percent to \$470.0 million. Construction activity is expected to be very strong in 2005 as rebuilding efforts get underway.

Utilities consumption saw mixed performance in 2004. Water consumption expanded by 2.6 percent to 1,252.8M US gallons, while electricity consumption declined by 14.8 percent to 378.7 MWh. No information was available from the liberalised telecommunications industry.

The fiscal operations of central government for 2004 resulted in an overall deficit of \$41.7M. Total revenue amounted to \$336.4M, while total expenditure equalled to \$378.1M. With current revenue and expenditure at \$336.0M and \$349.2M, respectively, Government attained a current deficit of \$13.2M in 2004.

As at 31st December 2004, the stock of public debt stood at \$157.5M. This represented an increase of \$13.6M compared to December 2003. Disbursements amounted to \$24.5M, while amortisation totalled \$11.0M, and exchange rate gains added \$0.1M to the debt stock. Interest payments totalled \$7.9M during 2004.

In the Cayman Islands, economic growth is forecasted to rise from 0.9 percent in 2004 to 6.5 percent in 2005, influenced by the rebuilding effort that is currently underway following the passage of Hurricane Ivan. Unemployment is

forecasted at 4.6 percent in 2005, representing a slight increase from the previous year. Inflation, which spiked to 4.4 percent in 2004 on account of the disruption brought about by the hurricane, is projected to further increase to 7.6 percent.

2. INTERNATIONAL DEVELOPMENTS

Global economic growth was estimated at 5.0 percent in 2004, well above the historical average of 4.0 percent and the best performance in almost three decades. Accelerated growth was seen in industrialised countries, while economic expansion in emerging economies remained strong, particularly in China. The expansion was as a result of accommodative macroeconomic policies, rising corporate profits, and the wealth effects from strong housing and equity markets. In advanced economies, unemployment declined from 6.6 percent in 2003 to 6.3 percent in 2004, while inflation rose slightly from 1.8 percent in 2003 to 2.0 percent in 2004.

Table 2.1: World Economic Growth, 2002 - 2004 (%)

	2002	2003	2004
World Output	3.0	4.0	5.0
United States	1.9	3.0	4.4
Japan	-0.3	1.4	2.6
Germany	0.1	-0.1	1.7
France	1.1	0.5	2.3
Italy	0.4	0.3	1.2
United Kingdom	1.8	2.2	3.1
Canada	3.4	2.0	2.8
China	8.3	9.3	9.5
India	5.0	7.2	6.4
Russia	4.7	7.5	7.3
<i>Euro Area</i>	<i>0.8</i>	<i>0.5</i>	<i>2.0</i>
<i>Latin America & Caribbean</i>	<i>-0.5</i>	<i>1.9</i>	<i>5.5</i>
<i>Developing Asia</i>	<i>6.6</i>	<i>8.1</i>	<i>8.2</i>
<i>Middle East</i>	<i>4.3</i>	<i>5.8</i>	<i>5.5</i>
<i>Africa</i>	<i>3.5</i>	<i>4.6</i>	<i>5.1</i>

Sources: *World Economic Outlook*, IMF, April 2005; UN ECLAC

The US economy expanded by 4.4 percent in 2004, bolstered by continued strength in consumer spending, increases in corporate spending on equipment and software, and strong demand for new homes. Personal consumption expenditures rose by 3.6 percent in 2004, up from 3.3 percent in 2003. Household wealth increased as housing prices rose by 13.0 percent during the twelve-month period to September, and the S&P 500 index rose by 10.9 percent during the calendar year. While businesses did not increase spending on non-residential construction, expenditure on equipment & software rose on expectation of higher sales, corporate profits and cash flow. Other contributors to the increase in real GDP included government spending and exports.

Consumer prices rose from 2.3 percent in 2003 to 2.7 percent in 2004. The seasonally adjusted CPI for the twelve months ending December 2004 saw increases in energy (16.6%), food (2.7%) and all other items (2.2%). The current forecast is for inflation to reach 2.4 percent in the US.

Unemployment declined from an average of 6.0 percent in 2003 to 5.5 percent in 2004. The employed labour force increased by 1.6 million in 2004 to 140.1 million.

In the Euro Area, real growth accelerated from 0.5 percent in 2003 to 2.0 percent in 2004. This performance was influenced by a turn-around in Germany, the area's largest economy, which recovered from three years of stagnation. Domestic demand remained weak in the area, and growth was based on exports, despite an appreciation of the Euro. Inflation rose slightly from 1.8 percent to 2.0 percent, while unemployment edged up slightly from 8.7 percent in 2003 to 8.8 in 2004.

The UK economy grew by 3.1 percent in 2004, up from 2.2 percent in the previous year. Despite weakness in manufacturing, growth was seen in services, particularly transport, communications and financial services. Unemployment declined from 5.0 percent in 2003 to 4.8 percent in 2004, while consumer prices fell slightly from 1.4 percent to 1.3 percent during the same period.

Japan's economic expansion continued for the second consecutive year, with a pick-up in domestic demand and an expansion of exports. Real output rose from

1.4 percent in 2003 to 2.6 percent in 2004. Consumer price increased from -0.2 percent in 2003 to zero percent in 2004. Unemployment fell slightly from 5.3 percent in 2003 to 4.7 percent in 2004.

Developing Asian economies continued to show strong growth in 2004. The Chinese economy expanded by 9.5 percent, despite government's attempt to slow its growth. This expansion was fuelled by US\$847 billion in investments during the year, only 1.9 percent below the previous year. Consumer prices in China rose by 3.9 percent in 2004, compared to 2.7 percent in the previous year. India registered a real growth of 7.3 percent in 2004, slightly below the 7.5 percent attained in the previous year.

Preliminary estimates from the United Nations indicate that Latin America and the Caribbean grew by 5.5 percent during 2004, up from 1.9 percent in 2003. The fastest growing economies in the region were Venezuela (18.0%), which recovered from two years of negative growth due to political tensions; as well as Uruguay (12.0%) and Argentina (8.2%), both of which continued to rebound from Argentina's financial crisis of 2002. The Brazilian economy accelerated from 0.6 percent in 2003 to 5.2 percent in 2004 on account of commodity exports. Mexico expanded from 1.2 percent in 2003 to 4.1 percent in 2004 on strong investment flows and exports of manufactured goods. Haiti and Grenada were the only two countries experiencing negative growth for the year, registering rates of -3.0 and -1.4, respectively. Dominica experienced no growth (0.0%) during the year

Real growth in the Caribbean accelerated from 3.4 percent in 2003 to 4.3 percent in 2004, despite the impact of hurricanes Frances, Ivan, and Jeanne. This expansion was underpinned by strong performance in tourism. Belize and Trinidad & Tobago saw the highest levels of growth at 7.0 percent and 6.2 percent, respectively. Belize's tourism and agricultural sectors performed well in 2004, while Trinidad & Tobago's growth was led by hydrocarbons and petrochemicals.

Table 2.2: Economic Growth, Selected Caribbean Economies,
2002 - 2004 (%)

	2002	2003	2004
Caribbean	1.8	3.4	4.3
Antigua and Barbuda	2.1	5.8	5.9
Barbados	-0.5	2.2	3.0
Belize	4.2	4.9	7.0
Dominica	-5.8	2.5	0.0
Grenada	-1.1	4.7	-1.4
Guyana	1.1	-0.6	1.5
Jamaica	0.9	2.3	1.9
Saint Kitts/Nevis	0.9	0.1	5.7
St. Vincent and the Grenadines	1.3	3.9	5.8
Saint Lucia	0.2	3.7	5.1
Suriname	3.0	5.6	4.0
Trinidad & Tobago	3.0	4.2	6.2

Sources: UN-ECLAC, Preliminary Overview of the Economies of Latin America and the Caribbean, December 2004

^P – Preliminary

3. THE MACROECONOMY

3.1 Economic Growth

The first eight months of 2004 were marked by very strong growth in tourism and healthy performance in financial services, construction, and real estate. The Cayman economy was on track for its best performance since 1999, when it was impacted by Hurricane Ivan on 12th September 2004. An assessment carried out by the United Nations Economic Commission for Latin America and the Caribbean (UN-ECLAC) estimated the impact of the hurricane at \$2.86 billion, including \$2.37 billion in damages and \$491M in losses of production and revenue.

The disruption to normal economic activity was significant during the last four months of the year. A fall in real output was seen in most sectors, with the exception of financial services, which continued to operate almost immediately following the hurricane, and construction, which saw a surge in activity resulting from reconstruction.

Overall growth for 2004 is estimated at 0.9 percent, below the 2.8 percent projected prior to the hurricane.

Table 3.1: GDP Estimates 2000 - 2004

	2000	2001	2002	2003	2004
GDP at Market Prices \$M	1,444.9	1,482.3	1,546.0	1,603.2	1,688.2
GDP at Constant 1986 Prices \$M	811.7	816.2	830.3	846.9	854.5
Change in Real GDP	1.0%	0.6%	1.7%	2.0%	0.9%

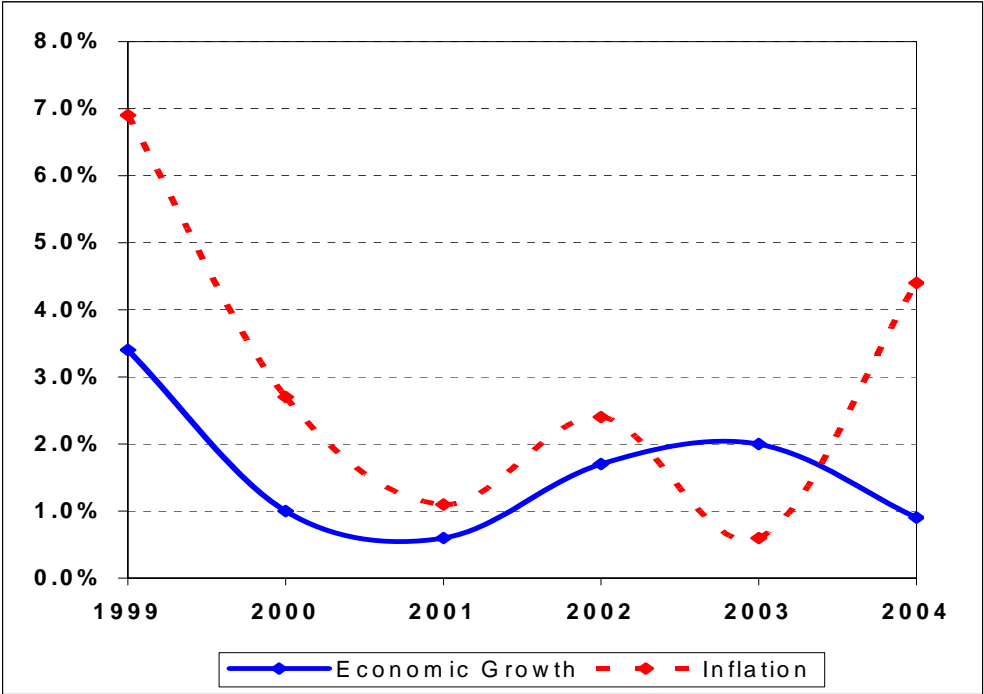
In dollar terms, real GDP (1986 prices) rose from \$846.9M in 2003 to \$854.5M in 2004, while nominal GDP (current prices) increased from \$1.6B to \$1.7B.

Nominal GDP per capita for 2004 was estimated at \$38,160, given a mid-year population estimate for the Cayman Islands of 44,240. It must be noted that, as a result of the hurricane, nominal GDP was impacted more by inflation rather than by real growth.

3.2 Inflation

Consumer inflation rose by 4.4 percent in 2004 compared to 0.6 percent in the previous year. This was the highest increase since 1999 and was influenced by the significant disruptions to normal supply and demand conditions resulting from hurricane Ivan. The Housing group rose by 7.4 percent, mainly on account of rental prices and insurance premiums following the hurricane. Notable increases were also seen in the following groups: Household Equipment (4.4%), Food (4.3%), Education & Medical (4.3), and Personal Goods & Services (4.3%). The only group which experienced a decline was Clothing (-4.3%).

Fig. 3.1: Economic Growth and Inflation, 1999-2004



3.3 Employment

The fall 2004 Labour Survey was conducted during the first two weeks in December, using the last week in November as the reference week. This survey used a smaller sample size and was restricted to Grand Cayman as the intent of the survey was to assess and compare pre and post hurricane labour activity.

The results of the survey indicate that the hurricane continued to affect labour force activity in Grand Cayman as far as December. Between the spring and fall survey, the labour force declined by 20 percent from 29,168 persons to 23,453 persons. This sharp decline in the labour force size was as a consequence of persons leaving Grand Cayman after the hurricane. The majority of those leaving were females, with the fall survey recording 11,021 females or 3,713 less than the spring survey. In a reversal to spring, males now accounted for the majority of the labour force approximately 53.0 percent.

Table 3.2: 2004 Labour Force Surveys

	Labour Force Surveys	
	Spring	Fall
Labour Force	29,168	23,453
Unemployment Rate	4.4%	4.4%
Caymanian	14,916	11,892
Employed	14,052	11,444
Un-Employed	864	448
% Share of Labour Force	51.1%	50.7%
Non-Caymanian	14,253	11,562
Employed	13,835	10,976
Un-Employed	418	586
Share of Labour Force	48.9%	49.3%
Labour Force by Gender		
Male	49.5%	53.0%
Female	50.5%	47.0%

The hurricane had a severe impact on multiple-job holders. Between spring and fall the number of multiple jobholders dropped almost by half from 711 to 392 persons. Less than 1 percent of the labour force remained as under-employed.

The participation rate¹ increased slightly as more persons aged 60 and over were available for work. Between spring and fall, the participation rate rose by 0.2 percent to 85.1 percent. Females in the fall survey recorded a drop in the participation rate from 81.9 percent in spring to 80.3 percent.

Similar to the spring survey, Caymanians represented 51.0 percent of the employed labour force. In fall, the employed labour force consisted of 11,444 Caymanians and 10,976 non-Caymanians. For Caymanians, the majority of the employed were females 50.8 percent and among non-Caymanians, males represented 58.6 percent of the employed.

Unemployment

The number of unemployed persons fell from 1,282 in spring to 1,034 in fall; however, the unemployment rate remained unchanged at 4.4 percent. In the fall survey, 666 persons or approximately 64.4 percent of unemployed were females; 512 persons were non-Caymanian.

Unemployed non-Caymanians totalled 586 with the remaining 448 persons being Caymanians. The respective unemployment rates were 5.0 percent for non-Caymanians and 4.0 percent for Caymanians. This represents an improvement in the employment status of Caymanians since spring of 2004 when the unemployment rate for Caymanians was 6 percent and for non-Caymanians 3 percent.

¹ The participation rate is the percentage of the population who are economically active, that is employed, self-employed or unemployed.

Higher unemployment rates for the 25 to 29 and the 35 to 39 year age groups were recorded in the fall with no significant change in participation rates. At the other end of the continuum are those aged 60 to 64 years – a group with a high unemployment rate coupled with a large increase in the participation rate. The members of this group therefore include a significant number of people who are newly drawn into the labour force and are unemployed.

Labour Imports

Table 3.3: Work Permits in Effect, December 2002-2004

	2002	2003	2004	Change 2002-2003	Change 2003-2004
Total by Class	15,779	17,123	20,508	+1,344	+3,385
Trades/Technical/Skilled	7,167	7,383	9,385	+216	+2,002
Unskilled	6,383	7,310	8,618	+927	+1,308
Professional	1,530	1,748	1,834	+218	+86
Admin/Managerial	699	682	671	-17	-11
Other	0	0	0	0	0

In 2004, the number of work permits increased by 3,385 to 20,508. During the first six months of the year, work permits increased by 1,498, driven by the stronger performances in tourism and construction industries. However, the disruption caused by the hurricane resulted in a divergence between the non-Caymanian labour force and the number of work permits in effect.

The hurricane had both a short and long-term effect on work permit holders. In the initial period after the hurricane, the disruption in normal business activity resulted in 18.9 percent decline in the non-Caymanian labour force. However, work

permits for most of these persons would have been considered valid at year end in the absence of official notification.

The longer-term effect of the hurricane was to create greater demand for occupations in the construction, repair and household services. Employers responding to the needs of clients, increased their staff complements and replaced non-returning employees, whose permits would have still been valid.

In the trades/technical/skilled category, work permit numbers rose by 27.1 percent from 7,383 in 2003 to 9,385. Work permit numbers for many occupations within this category such as carpenters, carpenter helpers, masons, drywall masons, electricians, foreman (construction) and painters more than doubled.

In the unskilled category, which rose by 17.9 percent from 7,310 in 2003 to 8,618, this rise was attributable to greater demand for specific occupations such as unskilled worker (helper) construction (+619), janitor/domestic (+229), mason's helper (+222), and gardener (non-hospitality) (+102). Work permits for domestic workers, the largest occupation within this category, fell slightly by 30 to 3,243.

Growing demand for more accountants (+155) led to a rise in the professional category, which rose by 4.9 percent from 1,748 in 2003 to 1,834 in 2004. Occupations under this category that saw a decline included professional manager (-44), lawyer (attorney) (-16), and managing director (-6).

In the admin/managerial category, increases in many of the occupations such as professional manager (construction) (+42), office manager (non-professional) (+34), fund administrator (+19), were unable to offset the decline in the two largest occupations: manager-non-professional (commercial) (-138) and chief executive officer (-30). Between 2003 and 2004, work permit numbers in the admin/managerial category fell from 682 to 671.

3.4 Trade

The *value* of merchandise imports grew from \$553.5M in 2003 to \$722.4M in 2004 or by \$168.8M (See Table xx). Fuel imports rose over the same period from \$41.6M to \$69.0M.

With the \$168.8M growth in imports and a \$2.2M decrease in exports, Cayman's trade deficit expanded by \$171.1M in 2004 to reach \$720.3M.

Table 3.4: Merchandise Trade, 2002-2004 (\$M)

	2002	2003	2004	Change 2002-2004
Imports	494.4	553.5	722.4	168.8
<i>Fuel</i>	45.7	41.6	69.0	27.4
Exports	3.0	4.3	2.1	2.2
Balance	-491.4	-549.2	-720.3	-171.1

3.5 Money & Banking

Information was only available up to September 2004 at the time of this report.

Money Supply

The broad measure of money supply in the Cayman Islands rose from \$4.0B in 2003 to \$4.1B in 2004. This expansion resulted from increases in demand deposits (+\$90.6M), and savings and time deposits (+64.9M) and, to a lesser extent, currency with the public (+\$11.3M). These increases were partially offset by \$49.9M decline in foreign currency deposits held by residents.

Table 3.5: Money and Banking Summary, 2003 - 2004 (\$M)

	2003	September 2004	Change 2003-2004
Money Supply	4,028.9	4,145.8	+116.9
Currency with the Public (CI\$)	54.3	65.6	+11.3
Demand Deposits (CI\$)	344.2	434.8	+90.6
Savings/Time Deposits (CI\$)	346.2	411.1	+64.9
Foreign Currency Deposits by Residents	3,284.2	3,234.3	-49.9
Net Foreign Position	2,276.7	2,642.5	+365.8
Foreign Assets	4,657.5	4,348.3	-307.2
Foreign Liabilities	2,380.8	1,705.8	-675.0
Net Domestic Credit	1,380.8	1,514.6	+133.8
Net Credit to Government	-11.6	-45.3	-33.7
Credit to Other Public Sector	7.6	15.2	+7.6
Credit to the Private Sector	1,384.8	1,544.7	+159.9

Net Foreign Position of Retail Banks

The net foreign position of retail banks increased by \$365.8M to \$2.6B as a \$675M decline in foreign liabilities outweighed a \$307.2M fall in foreign assets.

Net Domestic Credit

Net domestic credit from the retail banks rose by \$133.8M in 2004 to \$1.5B. A \$159.9M increase in credit to the private sector was partially offset by a \$33.7M decline in net credit to Government. Credit to other public sector entities increased by \$7.6M.

Loans & Advances to the Private Sector

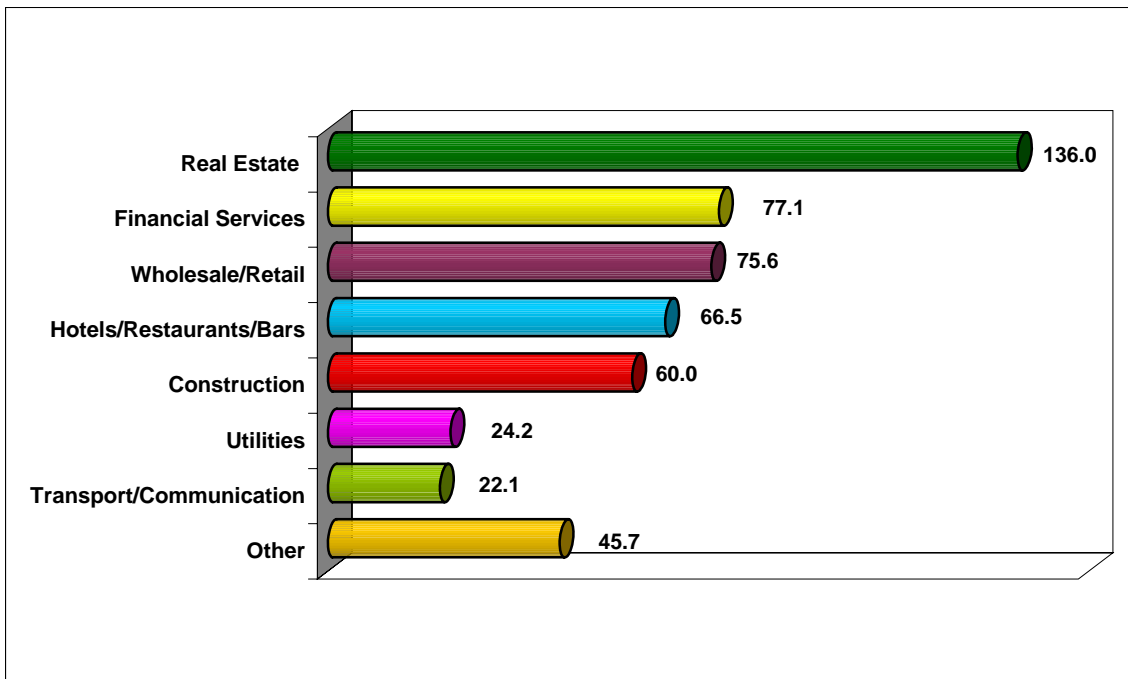
As at September 2004, loans and advances to the private sector from retail banks in the Cayman Islands totalled \$1.4B (See Table 3.5), representing an 11.6 percent increase over the previous year. Credit to businesses fell by \$70.8M to \$507.2M largely on account of financial intermediation. Credit to households rose by \$230.7M to \$1,037.5M due mainly to real estate mortgage loans (+\$134.3M), land and other real estate activities (\$51.7M), and miscellaneous personal loans (+\$31.8M).

Table 3.6: Loans & Advances to the Private Sector 2003-2004 (CI\$M)

	2003	Sep. 2004
Total Loans and Advances to the Private Sector	1,384.8	1,544.7
Businesses	578.0	507.2
Households	806.8	1,037.5

Of the \$507.2M in loans to businesses, real estate loans accounted for \$136.0M or 26.8 percent (see Figure 3.3). The second largest category of loans to businesses was for financial services (\$77.1M). Other major categories included wholesale/retail (\$75.6M), hotel/restaurant/bar (\$66.5M), and construction (\$60.0M) (see figure 3.3 below).

Fig. 3.3: Credit to Businesses, September 2004 (\$M)



4. SECTORAL DEVELOPMENTS

4.1 Financial Services

Despite the ravages of Hurricane Ivan, Cayman's financial services sector performed well overall in 2004. Increases were seen in insurance company licences, mutual funds, stock exchange listings & capitalisation, and company registrations. One notable exception was bank & trust licences, which has trended downward since 2000.

Banks & Trusts

The number of bank & trust licences declined by 27 (or 7.7%) in 2004 to 322, while pure trust companies increased by 2 to 124.

Table 4.1: Bank & Trust Companies, 2002 - 2004

	2002	2003	2004	Change 2003- 2004
Bank & Trust Licences	383	349	322	-27
Class 'A' Bank & Trust Licences	30	27	23	-4
Class 'B' Bank & Trust Licences	348	316	295	-21
Class 'B' Bank & Trust Licences (Res.)	5	6	4	-2
Trust Companies	125	122	124	+2
Trust Companies, Unrestricted	58	49	49	-
Trust Companies, Restricted	67	73	75	+2
External Position of Banks (US\$B)				
Assets (US\$B)	1,015.2	1,038.9	1,110.4 ¹	+71.5
Liabilities (US\$B)	980.0	996.8	1,048.3 ¹	+51.5

¹ June 2004

Class 'A' bank and trust licences² totalled 23 in December of 2004, down by four for the year. Three entities did not renew their licence in 2004. These included Bank of Nova Scotia Trust Company (Cayman) Ltd., which merged with Scotiabank (Cayman Islands) Ltd.; Mercury trust limited; and Euro Bank Corporation, which was in voluntary liquidation in 2003. Julius Baer Trust Company (Cayman) Ltd. downgraded its licence from Class 'A' to Class 'B.'

Class 'B' bank & trust licences fell by 23 to 299 in 2004, impacted by a continuation of mergers & acquisition and consolidation within this global industry.

Despite the decline in the number of bank & trust licences, the external asset position of banks increased by US\$71.5B to US\$1,110.4B. Liabilities increased by US\$51.5B during the same period to US\$1,048.3.

Insurance

Table 4.2: Captive Insurance Companies, 2002 – 2004

	2002	2003	2004 ¹	Change 2003-2004
Total Insurance Licences	629	672	722	+50
Class 'A' Licences (Domestic)	29	28	29	+1
Class 'B' Licences (Captives)	600	644	693	+49
Unrestricted	532	581	634	+53
Restricted	68	63	59	-4
Financial Position of Captives (US\$B)				
Premiums	4.2	4.9	5.6	+0.7
Net Income	0.7	0.3	0.5	+0.2
Net Worth	3.5	3.6	4.8	+1.2
Total Assets	17.7	19.2	22.3	+3.1

¹ Financial position as at September 2004

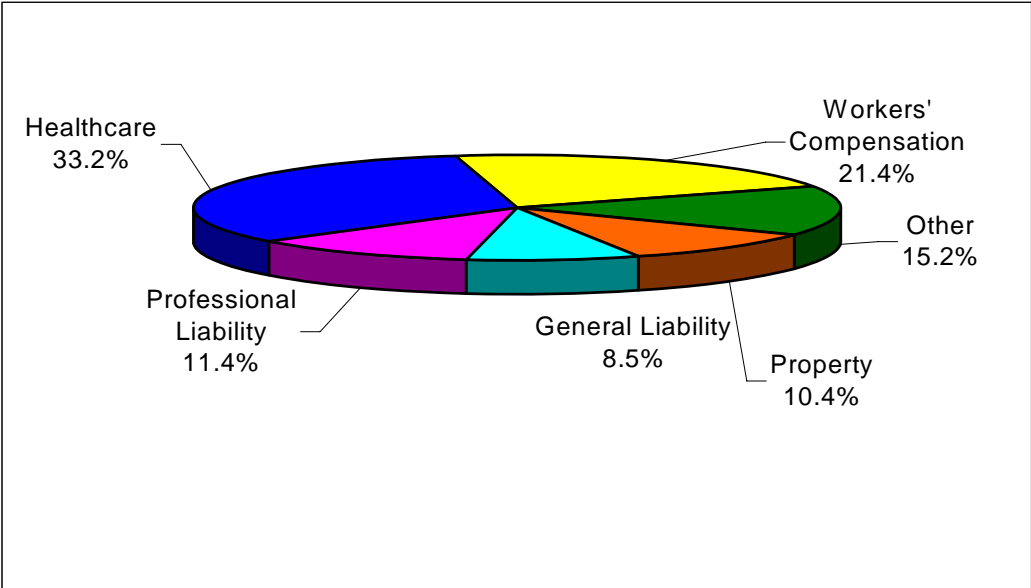
² A Class "A" license allows the licence holder to conduct business both inside and outside the Cayman Islands. A Class "B" licence holder is permitted to conduct business other than from within the Cayman Islands.

The total number of insurance licences increased by 50 (or 7.4%) to 722 in 2004. Class 'A' insurance licences increased by one to 29, as Government established the Cayman Islands National Insurance Company (CINICO) to cover the health insurance needs of civil servants, veterans, seamen, pensioners, uninsurables, and other persons for whom it is responsible.

Class 'B' (captive) licences increased by 49 to 693, with notable increases seen in the following categories: healthcare (18), professional liability (13), workers' compensation (12), and products liability (11).

Premiums for captives rose by US\$0.7 billion to US\$5.6 billion, while net income increased US\$0.2 billion to US\$0.5 billion.

Fig. 4.1: Captive Insurance Licences by Primary Class of Business, 2004

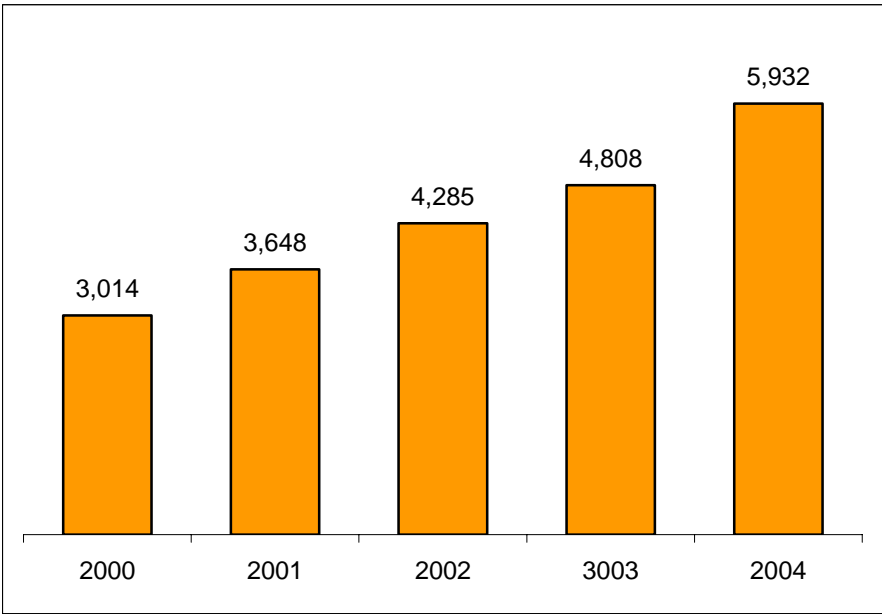


Captive insurance licences continued to be dominated by the following categories of businesses: healthcare (33.2%), workers' compensation (21.1%), professional liability (11.4%), property (10.4%), and general liability (8.5%).

Mutual Funds

Mutual fund registrations were up by 1,124 (or 23.4%) during 2004 to 5,932. The Cayman Islands continued to be the global leader in hedge funds management with 42 percent of funds domiciled there, followed by the USA (15%), Bermuda (11%), Luxembourg (10%), and BVI (6%). The prospects for the Cayman Islands in hedge fund management are good, given the highly sophisticated financial infrastructure that has developed over the years.

Fig. 4.2: Mutual Funds Registered, 2000 – 2004



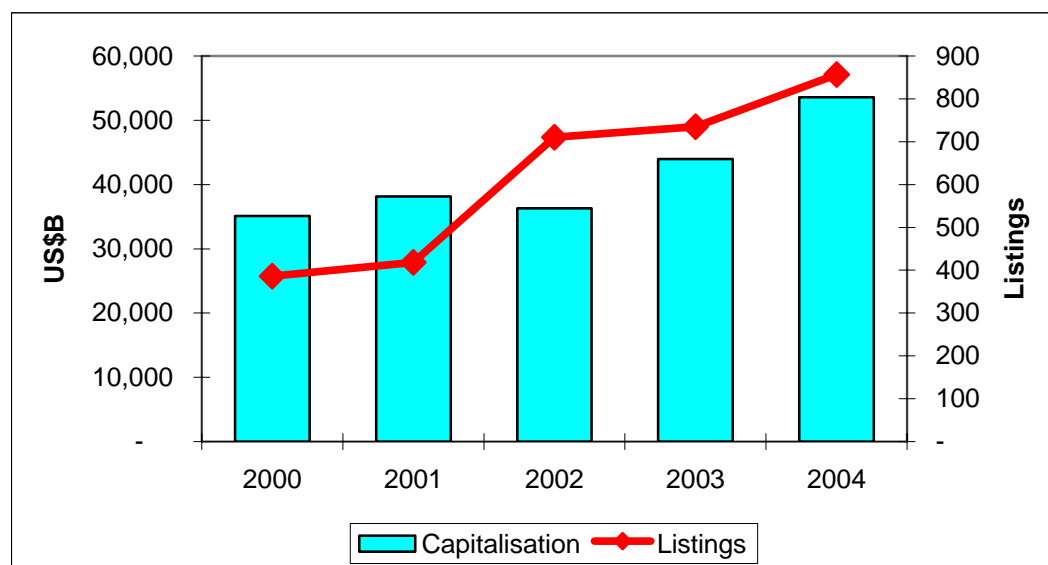
Stock Exchange

The Cayman Islands Stock Exchange (CSX) was granted ‘recognised stock exchange’ status by the UK Inland Revenue’s Board on 4th March 2004. This recognition means that interest on securities listed by CSX can be paid to UK citizens without deduction of UK taxes. Furthermore, securities listed on the CSX are considered ‘qualifying investments’, allowing them to be held by individual UK investors in Personal Equity Plans (PEP) and Individual Savings Accounts (ISA).

This ‘recognised’ status of the CSX, along with growth in mutual fund registrations in the Cayman Islands, has had a positive impact on listings and

capitalisation. Listings increased by 122 (or 16.6%) during 2004 to 857, while capitalisation rose by US\$9.6 billion (or 21.9%) to US\$53.5 billion.

Fig. 4.3: Stock Listings and Market Capitalisation, 2000 – 2004



Company Registrations

Total company registrations rose by 2,055 (or 3.0%) during 2004 to 70,133. During the same time, new company registrations increased by 1,638 (or 22.6%) to 8,892.

Table 4.3: Company Registrations, 2002 – 2004

	2002	2003	2004	Change 2002- 2004
Total Company Registrations	65,259	68,078	70,133	+2,055
New Company Registrations	7,016	7,254	8,892	+1,638

Ship Registrations

New ship registrations totalled 186 in 2004, the same level as the previous year. Pleasure yachts accounted for 164 (or 88.2%) of the new registrations, followed by general cargo (12 or 6.5%).

Major Developments in the Financial Industry

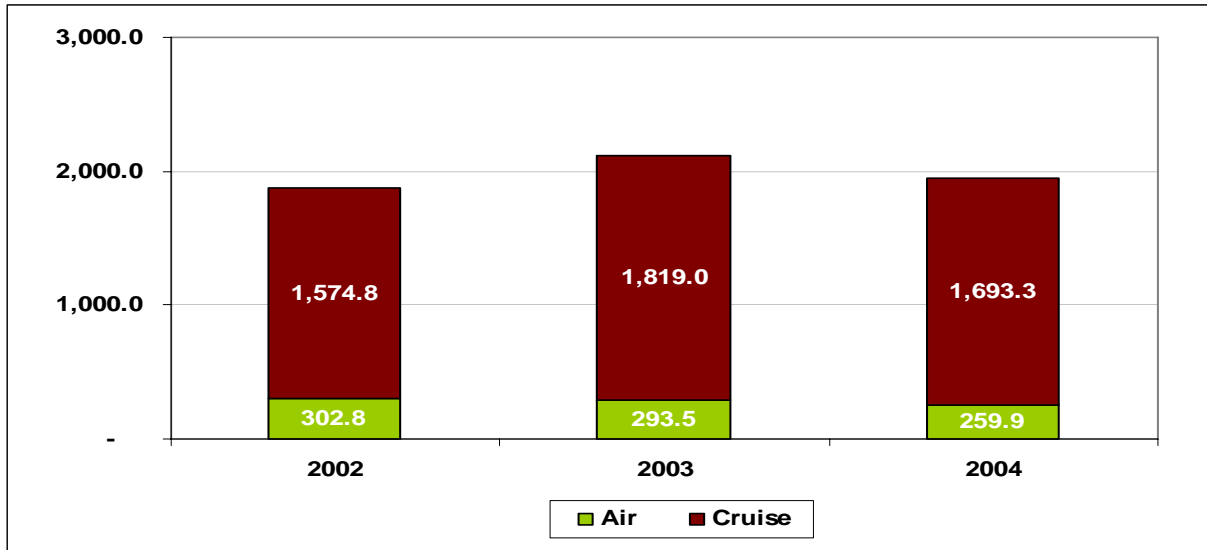
On 13 February 2004 the Legislative Assembly of the Cayman Islands voted to accept the European Union Savings Directive (EUSD). The directive will require banks in the Cayman Islands to disclose to EU tax authorities, details of interest paid to EU residents. Originally slated to take effect on 1 January 2005, the implementation date was pushed back to 1 July 2005 to allow the Swiss parliament to approve the plan.

The market for legal services underwent some transformation in 2004, and law firms positioned themselves to take advantage of global business opportunities. The law firm of Hunter & Hunter merged with Bermuda-based Appleby Spurling & Kemp to form Appleby Spurling Hunter. Boxalls joined with Jersey-based Ogier & Le Masurier to form Ogier Boxalls, the first law firm to span both the European and Caribbean offshore markets. Maples and Calder, one of the world's leading law firms in hedge funds and structured finance, announced the establishment of a new office in Jersey in September 2004. The firm also announced the acquisition of the British Virgin Island's second largest law firm Smith-Hughes, Raworth & Mckenzie. In October 2004, Mourant du Feu & Jeune opened a new legal practice in the Cayman Islands. Other new entrants to the Cayman market in recent years have included Conyers Dill & Pearman; Stuarts, Attorneys at Law; and Turner & Roulstone.

4.2 Tourism

A total of 1,953,222 tourists visited the Cayman Islands through December 2004. This figure represented a decrease of -7.5 percent over the same period in 2003.

Fig. 4.4: Visitor Arrivals thru December ('000), 2002 - 2004



Cruise Arrivals

Cruise ship visitors totalled 1,693,293 during 2004, compared with 1,818,979 in 2003 - a decrease of -6.9 percent. This contraction was primarily as a result of cruise ship arrivals being halted for almost two months immediately following Hurricane Ivan.

Air Arrivals

Air arrivals thru December grew by -11.4 percent from 293,517 in 2003 to a total of 259,929 in 2004. Again, this decline is mainly due to stay over tourist arrivals being stopped for approximately two months after Hurricane Ivan.

Globally, travel confidence returned robustly in 2004 as concerns over SARS and geopolitical activities continued to lessen. According to the World Tourism Organisation, a 10 percent increase in international tourism arrivals was recorded over 2004; representing the strongest recovery in almost twenty years, and following three years of stagnant growth. Despite such improvement, however, several countries within the Asian region were significantly impacted by the end of the year after being devastated by a tsunami.

Domestically, the tourism sector was on the rebound for the first time since 2001 prior to Hurricane Ivan. This was greatly due to the strong performances of both the air and cruise sectors during the first half of the year. Immediately following the hurricane, regular visitor arrivals were temporarily suspended with cruise and air arrivals being returned on 1 November and 20 November, respectively.

Prior to hurricane Ivan, there were 2,292 hotel rooms, 963 Condominium/Apartment rooms and 131 guesthouse rooms available for rental. However, this supply was significantly reduced as many properties sustained 15 to 45 percent damage. Additionally, the 365-room Ritz-Carlton hotel which was scheduled to open in December 2004 is now scheduled to open in October 2005. According to impact assessments conducted by the United Nations European Commission for Latin America and the Caribbean (UN ECLAC), overall damages to the tourism sector amounted to CI\$281.9 million; with CI\$109.5 million and CI\$172 million, attributed to hotels, and condominiums/apartments/guesthouses, respectively. Additional damages of CI\$0.4 million were sustained by boats and yachts.

Major Developments in Tourism

Air services were enhanced at the end of the year as Cayman Airways introduced its new route to Boston in December.

With capacity constraints being forecasted in the medium term (on account of several properties permanently withdrawing from the room stock as they are either demolished, diverted to other uses or both), implementation of the National Tourism Management Policy Plan will serve to further benefit the tourism industry. The five-year NTMP plan which was launched in April 2004, provides a framework for sustainable development of the tourism industry over the next five years and aims to protect and enhance the marine environment, attract a more discerning, higher spending visitor and develop a highly skilled Caymanian tourism workforce.

Plans to convert the Department of Tourism (DoT) to a statutory Tourism Authority were suspended earlier in the year. An examination of alternative funding options for this transition has now been undertaken instead.

4.3 Construction

Widespread property damage on Grand Cayman and to a lesser extent on Cayman Brac was the impact of Hurricane Ivan. In Grand Cayman, the overall estimated damage to buildings resulting from the catastrophe was \$1.9 billion as the triple forces of rain, seawater and wind battered property.

Table 4.4: Grand Cayman: Summary of Damage to Buildings Caused by Hurricane Ivan, 2004

Sector & Sub Sector	\$M
TOTAL	1,949.4
<u>Social Sectors</u>	1,265.4
Housing	1,221.9
Education	36.2
Health	7.3
<u>Productive Sectors</u>	538.0
Commerce	429.0
Tourism	109.5
<u>Infrastructure*</u>	146.0
Telecommunications	48.1
Public Buildings	42.4
Electricity	33.9
Road Transport	10.0
Ports & Airports	6.8
Water & Wastewater	4.8

Source: ECLAC, 'The Impact of Hurricane Ivan in the Cayman Islands,' 2004

*- Includes assets such as equipment

In the first nine months of 2004, construction activity continued to expand with both planning approval and building permits demonstrating growth. Building permit values, which experienced an initial decline in the first half of the year, increased by 5.7 percent to \$137.3 million before the hurricane. Prospects for future development in the first nine months of 2004 were also stronger with project approval values climbing to \$338.3 million, exceeding the 2003 annual total of \$273.9 million. Compared to the same period last year, higher numbers for both building permits and project approvals were also registered in September 2004.

Building Permits

The hurricane's disruption to business activity in the latter part of the year led to a 20 percent decline in building permit values, from \$177.6 million in 2003 to \$142.0 million. In 2004, only 232 building permits were issued between July and December, compared to the 452 issued in the same period in 2003.

Prior to the hurricane, construction work on several of the projects in the apartment/condo category was in the early stages. This was the only category that demonstrated an increase in building permit values rising by one percent to \$46.1 million.

Table 4.5: Building Permits, January -December (\$M)

Category	2002	2003	2004	Change 2003-2004
Apartment/Condo	50.9	45.7	46.1	+0.3
House	46.3	67.0	66.8	-0.2
Commercial	22.8	15.6	7.5	-8.1
Government	0.3	4.1	1.2	-3.0
Hotel	111.4	9.8	0.0	-9.8
Industrial	4.9	20.3	7.9	-12.4
Other	6.2	15.0	12.5	-2.5
Total	242.9	177.6	142.0	-35.6

Planning Approvals

Overall, project approvals for the three islands in 2004 climbed by \$196.1 million (72.0%) to \$470.0 million. The Sister Islands accounted for \$13.7 million or three percent.

The major project receiving approval was Phase I, the 'Waterfront Village' of the West Indian Club. The entire project, a neo traditional community spanning over 240 acres from Seven Mile Beach to North Sound is expected to be developed over the next 20-25 years. The development includes multi-priced attached residential homes, single-family homes, a beach development, marina and the Waterfront Village. It is the largest project of its type in the history of the Cayman Islands.

In the commercial category, project approval values soared from \$30.3 million in 2003 to \$135.1 million 2004. Phase I of the West Indian Club, which consists of four blocks of commercial space, accounted for approximately \$102.3 million or 76 percent.

Approval values in the industrial category rose by 52 percent from \$7.5 million in 2003 to \$11.4 million in 2004. This rise is attributable to telecommunications investment in the Sister Islands, which accounted for \$4.0 million or 35.0 percent of approval values.

Another significant project to the island is the first new hotel since the Ritz Carlton. Valued at \$45 million and located in East End, the Mandarin Oriental is a 5-star resort catering to high-end discerning visitors.

In the apartment/condo category, 'Water's Edge' was the largest condominium development receiving approval in 2004. This new development valued at \$28.0 million boasts 36 new units of a minimum 3,140 sq ft. During the year, several new smaller condominium developments in Beach Bay, Spotts and 'Water Cay' in Northside also received approval. The apartment/condo category also rose by \$87.1 million from \$66.7 million in 2003 to \$153.8 million 2004.

For the first time in four years, approval values in the House category fell from \$84.2 million in 2003 to \$74.1 million in 2004 or by (-12%). A possible reason for the decline is the switch by Grand Caymanian households from single-family homes to apartment/duplexes.

The Sister Islands, in contrast to Grand Cayman, saw demand strengthen for single-family homes with planning approval values rising from \$4.1 million in 2003 to \$6.6 million in 2004.

Table 4.6: Planning Approvals, January -December (\$M)

Category	2002	2003	2004	Change 2003-2004
Apartment/Condo	82.2	66.7	153.8	+87.1
House	63.9	84.2	74.1	-10.1
Commercial	49.3	30.3	135.1	+104.8
Government	1.1	55.1	4.2	-50.9
Hotel	9.7	0.0	45.0	+45.0
Industrial	11.1	7.5	11.4	+3.9
Other	26.7	30.2	46.4	+16.2
Total	243.9	273.9	470.0	+196.1

Major Developments in Construction

Hurricane Ivan caused substantive damage and significant interruptions in business activity. As a result, projects such as the Ritz Carlton Hotel, scheduled for completion in 2004, were delayed. Originally scheduled to open in December 2004, the new target date for the opening of the Residences (Ritz Carlton condominiums) and the hotel section of the Ritz development is October 2005.

Reconstruction is also expected to continue into the first six months of 2005 as both businesses and homeowners adjust to the longer supply chains for rebuilding.

4.4 Real Estate

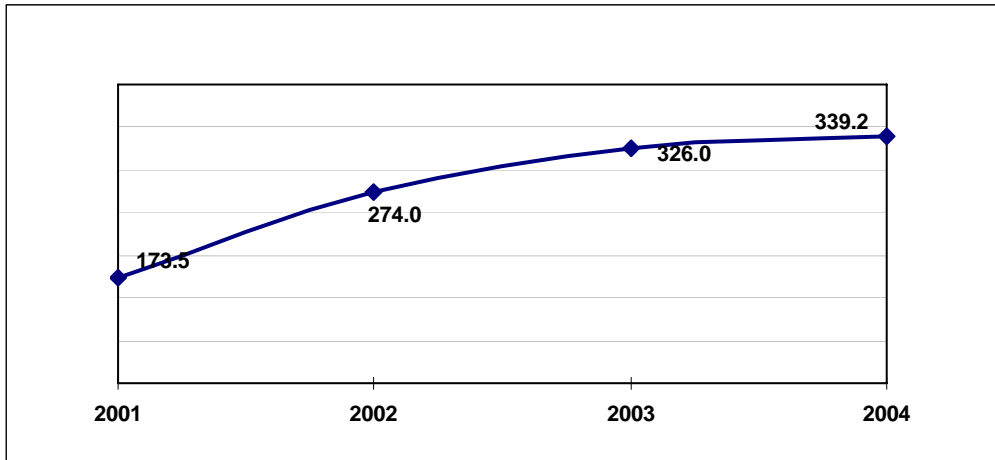
Prior to Hurricane Ivan, investment in real estate was rising with both the volume and value of properties transferred demonstrating significant growth. Between January and June 2004, the volume of property transferred peaked to 1,236 – a five-year high, values also rose by 49.3 percent to \$251.3M.

The impact of the hurricane dampened activity in real estate sales, given the reduction in the number of available properties on the market. UN ECLAC estimates suggest that 83 percent of the housing stock in Grand Cayman was damaged. According to Coldwell Bankers in its *Market Report – Year End 2004 and Property Listings*, this reduction in available properties is attributable to higher rental demand, delayed insurance settlements and mortgage re-negotiations.

In the immediate aftermath of the hurricane, the rental market experienced a substantial boost with undamaged residential and commercial space being absorbed at a record rate and at a significantly higher price.

Between 2003 and 2004, the value of properties transferred, rose by 4 percent from \$326.0M in 2003 to \$339.2M. Freehold real estate transfers accounted for \$337.3M and leasehold transfers for \$1.9M. The number of properties transferred dropped slightly by 100 from 2,562 in 2003 to 2,462 in 2004.

Fig. 4.5: Value of Property Transfers (\$M), 2000-2003



Major Developments in Real Estate

Reconstruction will continue throughout the first half of 2005. Prospects for the future remain positive with many owners taking the opportunity to upgrade existing properties. Despite the onset of higher prices, strong demand for real estate is expected until the shortage of available properties is alleviated. Between 2003 and 2004 the Consumer Price Index registered a 7.4 percent price increase in the housing group.

In the residential segment, there is heavy pre-selling of proposed apartment developments with many newly completed developments all sold-out.

4.5 Utilities

Water consumption increased by 2.6 percent between January and December from 1,220.8 million gallons in 2003 to 1,252.8 million gallons in 2004. This rise in both commercial and residential water usage was consistent with strong economic growth before the hurricane, which outweighed the decline in output during the last four months of the year.

Damages to the plants and equipment for the two main local water supply companies, Consolidated Water Company, Limited (CWCO) and Water Authority-Cayman (WAC), were estimated at CI\$1.3 million and CI\$3.6 million, respectively.

Total electricity usage in the Cayman Islands fell during 2004 as a direct result of hurricane Ivan. A decrease of 14.5 percent was noted as consumption was registered at 378.7 Million MWH at year-end compared to 444.3 million MWH in 2003. Between January and December 2004, commercial usage amounted to 191.5 million MWH, a decline of -16.8 percent. A decrease was also noted for Residential usage, which fell by -13.3 percent to 183.1 million MWH, and Public lighting consumption also contracted by -10.2 percent to 4.1 million MWH.

Electrical service was fully restored to all connectable areas of Grand Cayman on 30 November. As reported by Caribbean Utilities Company (CUC), the sole electricity provider, insured damage to its power plant units, transmission and distribution subsystems, buildings, materials inventories and other items was estimated at CI\$35 million.

At the time of this report, data on telecommunications were unavailable.

The telecommunications industry was damaged extensively as a result of hurricane Ivan and sustained a total impact of CI\$79.5 million, of which 60 percent was damage to assets and 40 percent were business losses.

In April, the telecommunications industry in the Cayman Islands was officially liberalized and ended the more than 35-year monopoly of the incumbent telecommunications provider, Cable & Wireless (C&W). At the start of this deregulation phase, discounted mobile rates were introduced by C&W but were later adjusted to reflect customers' actual averaged minutes as they were deemed anti-competitive by other enterprises.

Table 4.7: Utilities Consumption, Jan thru Dec, 2002 - 2004

	Jan-Dec 2002	Jan-Dec 2003	Jan-Dec 2004	Change 2003-2004
Water				
Water Consumption (US millions of gallons)	1,056.1	1,220.8	1,252.8	32.0
Electricity				
Electricity Usage (MWh)	425.6	444.3	378.7	-65.6
Telecommunications				
Telephone/Fax Paid Minutes	39.7	36.3	--	--
Internet Lines	9,181	9,909	--	--
Telephone Lines	33,200	32,967	--	--

Major Developments in Utilities

Earlier in the year, CUC announced a new (price cap) rate setting method to substitute its previous 15-percent return on rate base mechanism. Additionally, following negotiations with government, CUC completely suspended implementation of its 3.0 percent rate hike which was scheduled for 1 August 2004.

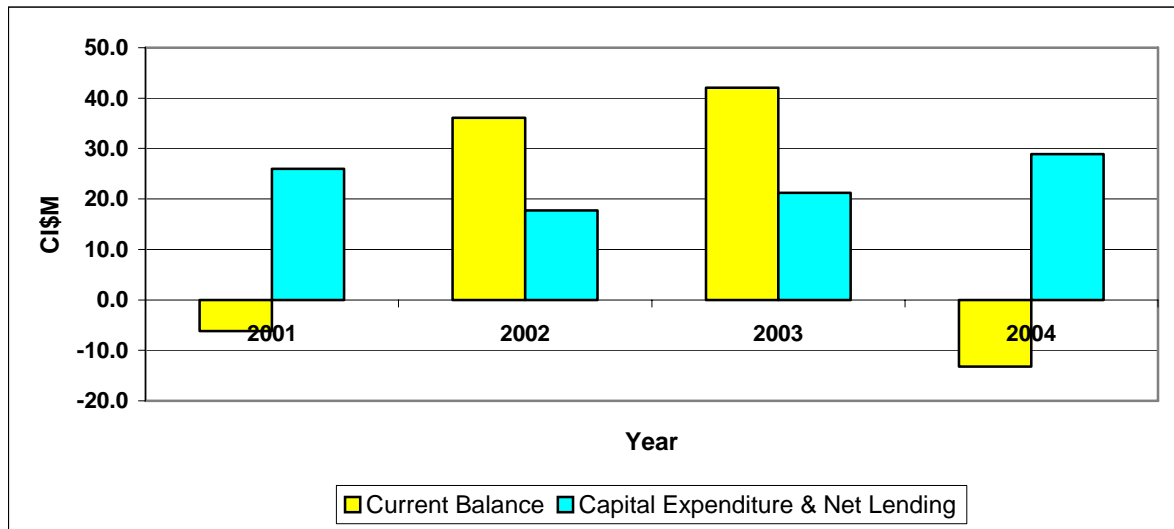
Further developments within the telecommunications sector included Cingular Wireless' acquisition of AT&T Wireless to form Cingular Wireless LLC, a joint venture between SBC Communications Inc. and BellSouth Corp in October. As a result of the merger, Cingular now serves former AT&T Wireless customers in the Cayman Islands as well as other Caribbean markets. Like the former AT&T Wireless, Cingular uses GSM/GPRS technology—the world standard for wireless communications; therefore, customers will be able to use their wireless phones in more countries. Similarly, in December, Digicel enhanced its services and was the first mobile provider in the region to introduce pre-paid roaming to the United Kingdom as well as around the Caribbean.

5. CENTRAL GOVERNMENT OPERATIONS

5.1 Summary

The fiscal operations of central government in 2004 resulted in an overall deficit of \$41.7M, with total revenue amounting to \$336.4M and total expenditure totalling \$378.1M. Capital expenditures and net lending amounted to \$28.9M, while the current deficit amounted to \$13.2M.

Figure 5.1: Current Balance and Capital Expenditure, 2000-2004



5.2 Revenue

Current revenue rose \$9.8M in 2004 to \$336.0M, with coercive revenue increasing by \$16.5M to \$303.2M, and non-coercive revenue declining by \$6.7M to \$32.8M (See Table 5.1 below). Capital revenue amounted to \$0.4M in 2004.

Table 5.1: Summary of Central Government Operations, 2002-2004

	2002	2003	2004
Total Revenue	314.1	326.2	336.4
Current Revenue	314.0	326.2	336.0
Coercive Revenue	276.8	286.7	303.2
Taxes on International Trade & Transactions	106.7	117.6	132.2
Domestic Taxes on Goods & Services	150.8	146.1	144.8
Taxes on Property	14.3	17.3	22.3
Fines	1.3	1.3	0.8
Other Taxes	3.7	4.4	3.1
Non-coercive Revenue	37.2	39.5	32.8
Sale of Goods & Services	30.5	33.8	30.7
<i>Health Service Fees</i>	<i>4.5</i>	<i>0.7</i>	<i>0.0</i>
Investment Revenue	6.7	5.7	2.1
Capital Revenue	0.0	0.0	0.4
Total Expenditure	295.7	305.2	378.1
Current Expenditure	277.9	283.7	349.2
Personnel Costs	150.1	138.9	159.0
Supplies & Consumables	68.2	61.3	88.0
Subsidies	38.1	58.8	70.4
Transfer Payments	17.7	18.8	24.5
Interest Payments	3.9	5.9	7.3
Capital Expenditure & Net Lending	17.7	21.5	28.9
Capital Acquisition	3.1	7.7	10.0
Capital Development	14.5	13.5	19.2
Net Lending	0.1	0.3	-0.3
Current Balance	36.1	42.5	(13.2)
Overall Balance	18.4	21.0	(41.7)
Financing	(18.4)	(21.0)	41.7
Net Borrowing	(10.5)	12.4	13.8
Disbursements	10.9	136.9	23.3
Loan Repayment	(21.4)	(124.5)	9.5
Change in Cash (minus = increase)	(7.9)	(33.4)	27.9

The \$16.5M increase in coercive revenue was influenced by taxes on international trade and transactions (+\$14.6M) and property (+\$5.0M), which more than compensated for small declines in other areas. Taxes on international trade and transactions were on the increase throughout the year, but were accelerated after Hurricane Ivan as demand for construction materials, household furnishings, and replacement vehicles surged (See Table 5.2 below). Travel and cruise ship tax revenues declined by \$1.2M to \$9.9M, while revenue from the Environmental Protection Fee declined by \$0.3M to \$4.7M. This fee is levied on both air passengers (\$3.20 per person) and cruise ship passengers (\$1.20 per person) departing the Cayman Islands.

Table 5.2: Taxes on International Trade & Transactions, 2002 – 2004 (\$M)

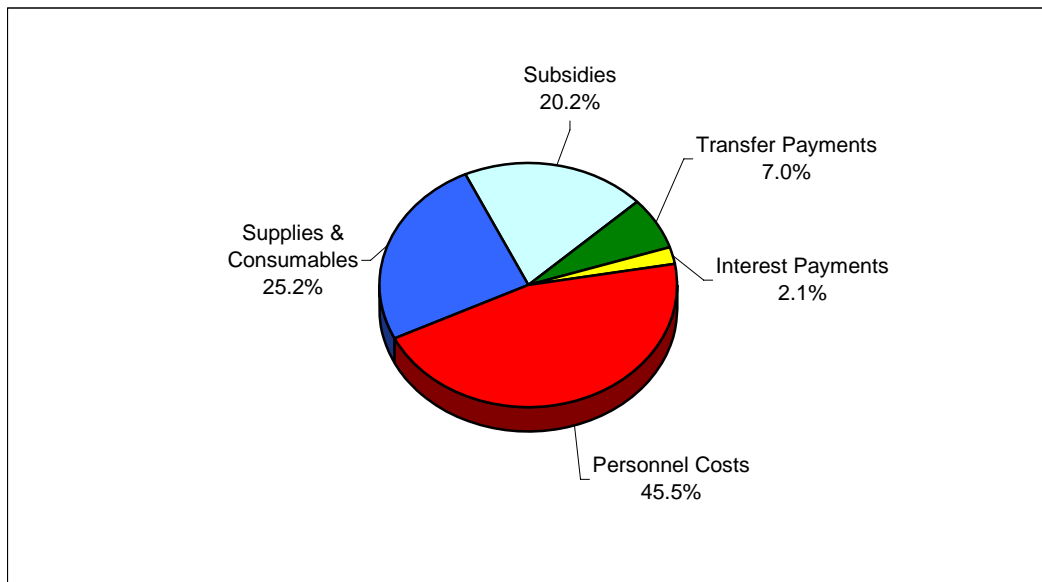
	2002	2003	2004	Change 2003-2004
Import Duties	92.6	101.5	117.6	+16.1
<i>Gasoline & Diesel</i>	18.6	18.7	16.1	-2.6
<i>Alcoholic Beverages</i>	12.8	11.5	13.3	+1.8
<i>Motor Vehicles</i>	7.3	8.8	15.3	+6.5
<i>Tobacco Products</i>	2.5	2.5	2.8	+0.3
<i>Other Imports</i>	51.4	60.0	70.1	+10.1
Travel & Cruise Ship Tax	9.6	11.1	9.9	-1.2
Environmental Protection Fee	4.5	5.0	4.7	-0.3
Total	106.7	117.6	132.2	+14.6

Non-coercive revenue declined by \$6.7M to \$32.8M, on account of a \$3.6 decline in contributions from statutory bodies (investment income), and a \$3.1M decline in the sale of goods and services. The decline in the sale of goods and services is consistent with the disruptions to the operations of government following the hurricane.

5.3 Expenditure

Current expenditure rose by \$65.5M to \$349.2M in 2004. Increases were seen in supplies and consumables (+\$26.2M), personnel costs (+\$20.1), subsidies (+\$11.6M), transfers payments (+\$5.7M) and interest payments (+1.4M). Supplies and consumables were impacted by restoration costs associated with Hurricane Ivan, including professional fees, materials & supplies, leases, and other operating expenses. The \$20.1M rise in personnel costs to \$159.0M mainly reflecting an \$11.9M increase in wages and salaries (mostly temporary) and a \$7.1M increase in past pension contributions. Some deferred past pension contribution for 2003 were paid in 2004 to coincide with a stronger liquidity position early in the year. The rise in subsidies reflected contributions to Cayman Airways, the National Roads Authority, and the Health Services Authority and health insurance. Increased transfer payments were aimed at bringing relief to households in the aftermath of the disaster.

Figure 5.2: Share of Expenditure, 2004



Personnel costs accounted for 45.5 percent of current expenditure, followed by supplies & consumables (25.2%), subsidies (20.2%), transfer payments (7.0%), and interest payments (2.1%).

Capital expenditure and net lending rose by \$7.4M to \$21.5M. Capital acquisitions increased by \$2.3M to \$10.0M, while capital development rose by \$5.7M to \$19.2M. Major capital development projects during 2004 included the Prospect primary schools and roads development. Net lending amounted to - \$0.3M as statutory bodies paid more interest to government than the interest government paid on there behalf.

5.3 Financing

The overall deficit of \$41.7M was financed by net borrowing flows of \$13.8M and a drawdown of cash to the tune of \$27.9M.

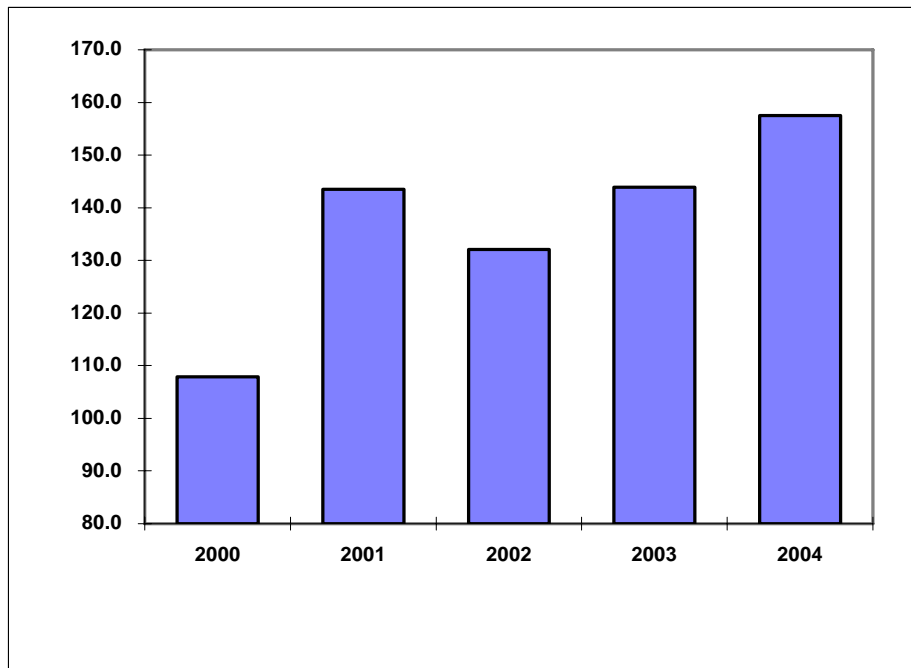
6. DEBT

As at 31st December 2004, the public debt stock stood at \$157.5M. This represented an increase of \$13.6M compared to December 2003. Disbursements amounted to \$24.5M, while amortisation totalled \$11.0M, and exchange rate gains added \$0.1M to the debt stock. Interest payments totalled \$7.9M during 2004.

Table 6.1: Public Debt Summary, 2002-2004 (\$M)

	2002	2003	2004
Disbursed Outstanding Debt	132.1	143.9	157.5
Net Financing Flows	-11.7	11.8	13.5
Disbursements	10.9	137.9	24.5
<i>less</i> Amortisation	22.6	126.1	11.0
Interest Payments	4.5	5.6	7.9
Exchange Rate Gains/(Losses)	(0.3)	...	0.1

Figure 6.1: Public Debt, 2000-2004 (\$M)



Central Government Debt

The disbursed outstanding debt of Central Government stood at \$145.3M at the end of 2004 (See Table 6.2), representing an increase of \$13.8M over the previous year. Net financing flows were influenced by \$23.3M in disbursements and \$9.5M in amortisation. All disbursements were from First Caribbean International Bank (Cayman) Ltd. These included \$8.0M in general financing under Loan Law 2003, \$8.0M for the construction of the Prospect Primary School and the National Archives under Loan Law 2 of 2003, and \$7.3M for road development under Loan Law 2004. Interest payments totalled \$7.3M during the year in review.

Table 6.2: Central Government Debt, 2002-2004 (\$M)

	2002	2003	2004
Disbursed Outstanding Debt	119.1	131.5	145.3
Net Financing Flows	-10.4	12.4	13.8
Disbursements	10.9	136.9	23.3
<i>less</i> Amortisation	21.3	124.5	9.5
Interest Payments	3.8	5.1	7.9
Exchange Rate Gains/(Losses)

Self Financing Debt³

Self-financing debt stood at \$12.2M (See Table 6.3) in December of 2004, down by \$0.2M from the previous year. There was one disbursement of \$1.2M from the Caribbean Development Bank (CDB) to the Cayman Islands Development Bank (CIDB) for mortgage financing. Amortisation totalled \$1.5M during the year, while exchange rate gains added \$0.1M to the debt stock on

³ Self-financing loans are raised by Government on behalf of Government agencies. These agencies are required to reimburse Government for servicing these loans.

account of a depreciation of the US dollar against the Euro. Interest payments amounted to \$0.6M during 2004.

Table 6.3: Self-Financing Debt, 2002-2004 (\$M)

	2002	2003	2004
Disbursed Outstanding Debt	13.0	12.4	12.2
Net Financing Flows	-1.3	-0.6	-0.3
Disbursements	0.0	1.0	1.2
<i>less</i> Amortisation	1.3	1.6	1.5
Interest Payments	0.7	0.6	0.6
Exchange Rate Gains/(Losses)	-0.3	...	0.1

7. MACROECONOMIC OUTLOOK

After peaking at 5.1 percent in 2004, the global economy is forecasted to decelerate modestly to 4.3 percent in 2005. Higher oil prices and rising interest rates are likely to exert some downward pressure on growth. It is anticipated that the United States and China will continue to be the engines of growth for the global economy in 2005. The US is the largest economy, while China has been one of the fastest growing economies and has emerged as a manufacturing powerhouse with a population of 1.3 billion.

In the Cayman Islands, economic growth is forecasted to rise from 0.9 percent in 2004 to 6.5 percent in 2005, influenced by the rebuilding effort that is currently underway following the passage of Hurricane Ivan. Unemployment is forecasted at 4.6 percent in 2005, representing a slight increase from the previous year. Inflation, which rose to 4.4 percent in 2004, is expected to average 7.6 percent in 2005. This is due to the fact that demand and supply conditions, particularly for housing, will continue to be abnormal when compared to the first eight months of 2004.

Table 7.1: Macroeconomic Outlook for the Cayman Islands, 2005 (%)

	2003	2004	2005
Economic Growth	2.0	0.9	6.5
Unemployment	4.1	4.4	4.6
Inflation	0.6	4.4	7.6

It must be noted that there are significant risks to this forecast. The economic impact of Hurricane Ivan, estimated \$2.8B, was unprecedented in scale and highlighted how vulnerable the islands are to natural disasters. There have been no similar events in recent times to model from, and there are several variables that could impact growth, unemployment and inflation. These include, but are not restricted to the following:

- the rate at which financial resources, building materials, and skilled labour can be mobilised during the reconstruction phase,
- the rate at which the supply of tourist accommodation can be expanded to meet demand, and
- the pace at which the resident population of Grand Cayman returns to near its pre-Ivan level.

There are possible external risks to the forecast that could impact the forecast for the Cayman Islands as well.

- While the global economy has so far accommodated the rise in oil prices without any significant increase in inflation, geopolitical events could disrupt the international oil market and stifle economic growth.
- The depreciation of the US dollar has been orderly so far, partly reflecting a significant imbalance in the US trade deficit of US\$650B, or 5 percent of GDP. Growing US trade and federal budget deficits could result in abrupt and disruptive changes in exchange rates and global trade.
- While the US dollar is still considered the “international reserve currency,” the extent to which the Euro is adopted as an alternative, could impact the value of the US dollar, and by extension, interest rates and inflation.