

The Impact of the Global Financial Crisis on the Eastern Caribbean Currency Union

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Outline

- Introduction
- Developments in the financial sector
- Economic performance
- Impact on fiscal sustainability
- Market developments
- Response by authorities

Introduction

- The ECCU comprises of 8 countries: Anguilla, Antigua & Barbuda, Dominica, Grenada, Montserrat, St Kitts & Nevis, St Lucia, St Vincent and the Grenadines.
 - Population: 611,285 (2008)
 - GDP: US\$4.7 billion (2008)
 - Per capita Income: US\$7,745
 - Exchange rate: 1US\$ = EC\$2.70 (since July 1976)
 - Principal exports: Tourism, Agriculture, Financial Services
 - Other flows: Remittances, Foreign Direct Investment

ECCU and IFIs

- 6 of the independent countries are members of the IMF, World Bank (and most of its affiliates)
- ECCU countries are not members of IDB, despite efforts to join over a decade ago.
- Access to IDB resources are through the Caribbean Development Bank

Developments in the financial sector

- The banking system comprises of:
 - 14 local banks
 - 5 foreign branch banks
- The ECCU experienced no direct impact from the global financial crisis as financial institutions held very little of the toxic assets.
- The financial sector has been affected by other factors:
 - The collapse of the C.L. Financial conglomerate due to a poor business model exposed by the fall in energy prices and real estate values in the USA.
 - Led to the insolvency of two pan Caribbean insurance companies
 - Fraud charges brought by the US SEC on an offshore bank, Stanford International Bank, in Antigua led to a run on deposits on a Stanford owned domestic bank.

Dev. In the financial sector

- Indirectly: The financial sector has been adversely affected by the slowdown in economic growth:
 - Reduction in tourism arrivals
 - Fall-off in foreign direct investment
 - Decline in remittances
 - Increase in unemployment
 - Decline in Government revenues

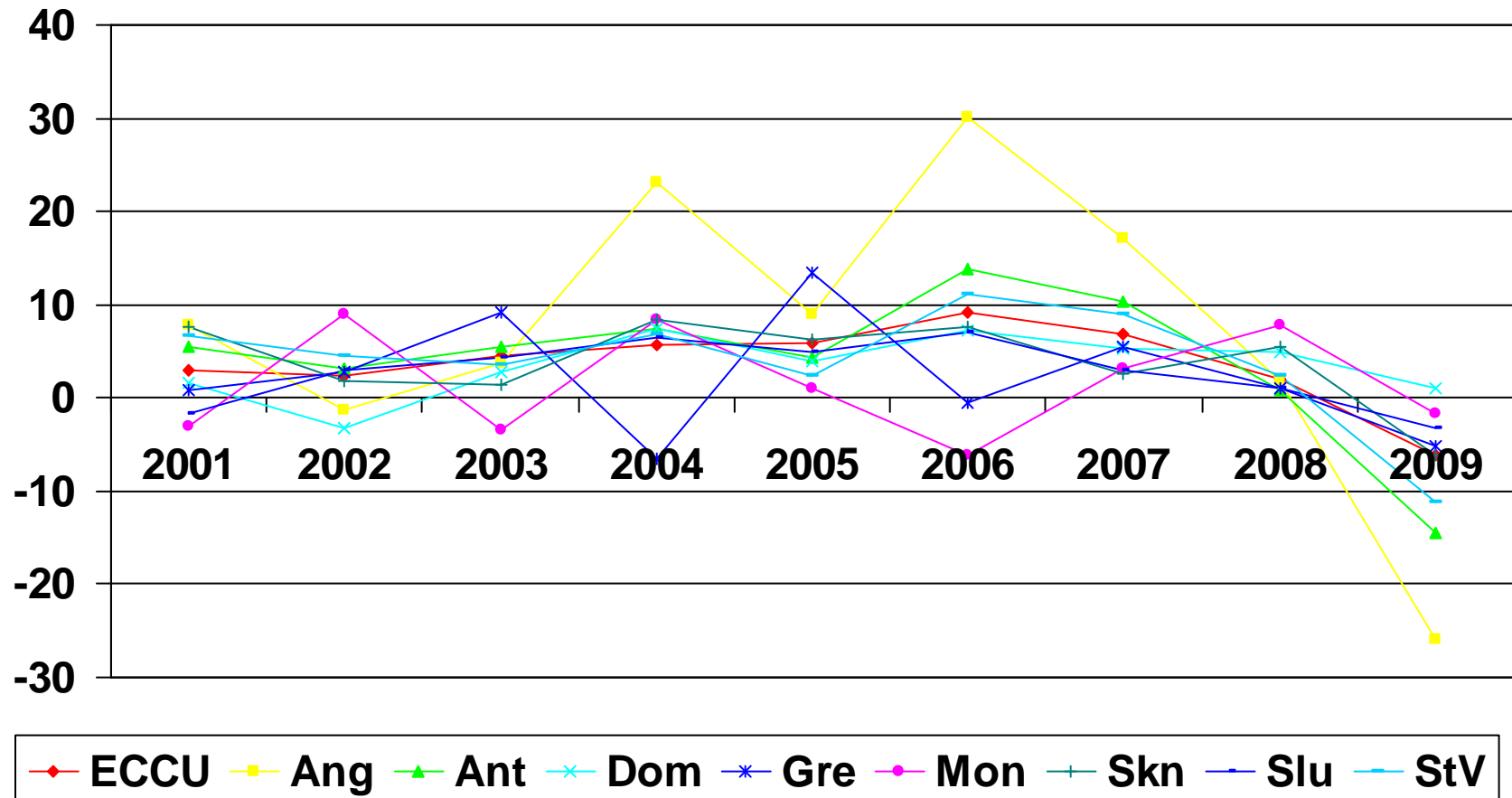
Dev. In the financial sector

- Domestic Liquidity:
 - Excess reserves declined in 2008, but recovered in 2009 as official inflows boosted domestic liquidity
 - Perceived risk of local banks has led to liquidity skewed towards foreign banks
- Deposits:
 - Growth has slowed in the last 12 months
- Credit:
 - Credit growth from the commercial banks has slowed
- Non performing loans:
 - NPLs have increased as a result of the economic conditions

Economic Performance

- Preliminary estimates put the decline in economic activity during the first half of 2009 at 7%.
- Due to the significant decline in stay over arrivals.
- Construction sector has been negatively affected by:
 - Lower investment, both foreign and local
 - Slower disbursement of credit by the banking sector for housing
 - Lower levels of public sector investment due to fiscal constraints

Real Growth rates

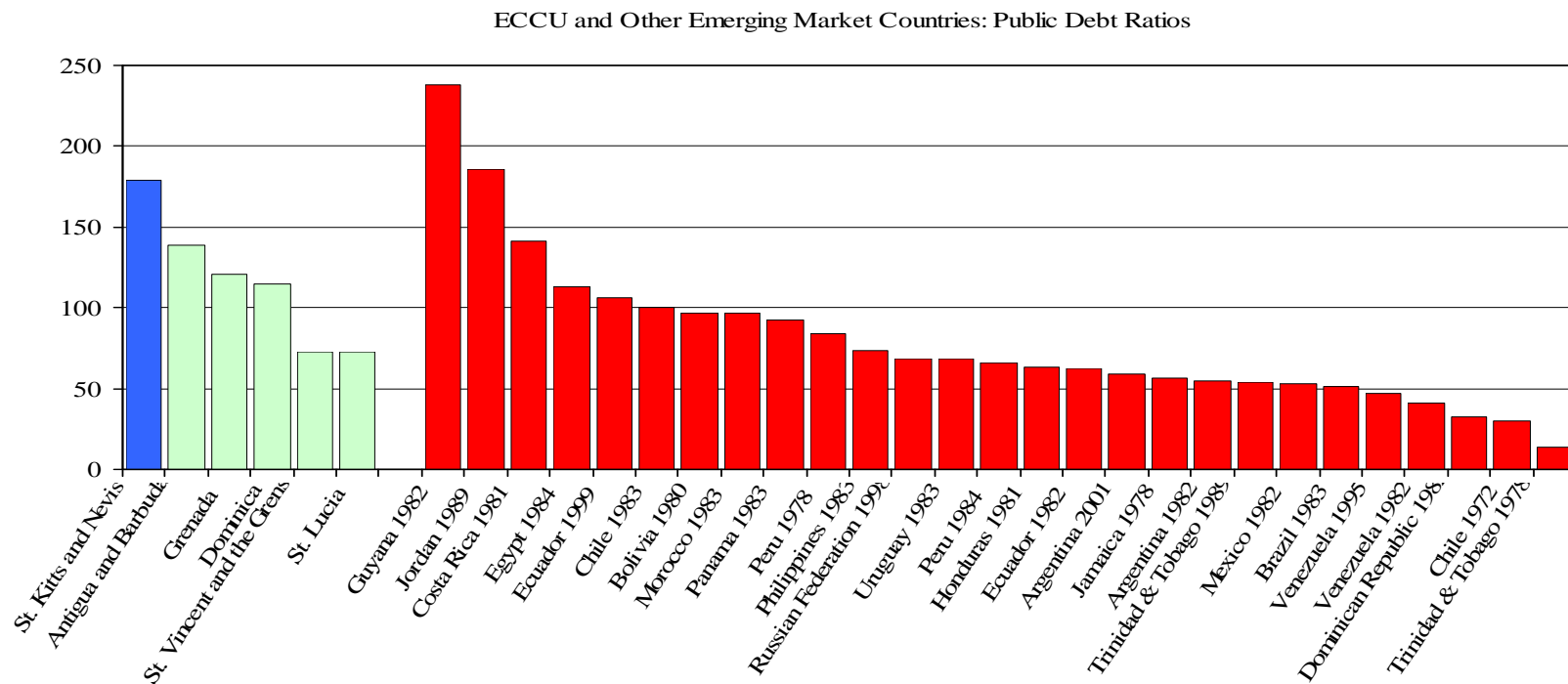


Impact on Fiscal sustainability

- The ECCU countries are among the highest debtors in the world.
 - Investment has been mainly for infrastructure
 - Amongst the most vulnerable in the world
 - The debt service to revenue ratio has become more onerous in recent years due to:
 - more of the debt contracted on commercial terms.
 - Revenue growth relatively subdued due to tax concessions
 - The increase in food prices and oil prices in 2007 & 2008

ECCU and Public Debt

Public debt-to-GDP ratios: Among the highest in the world



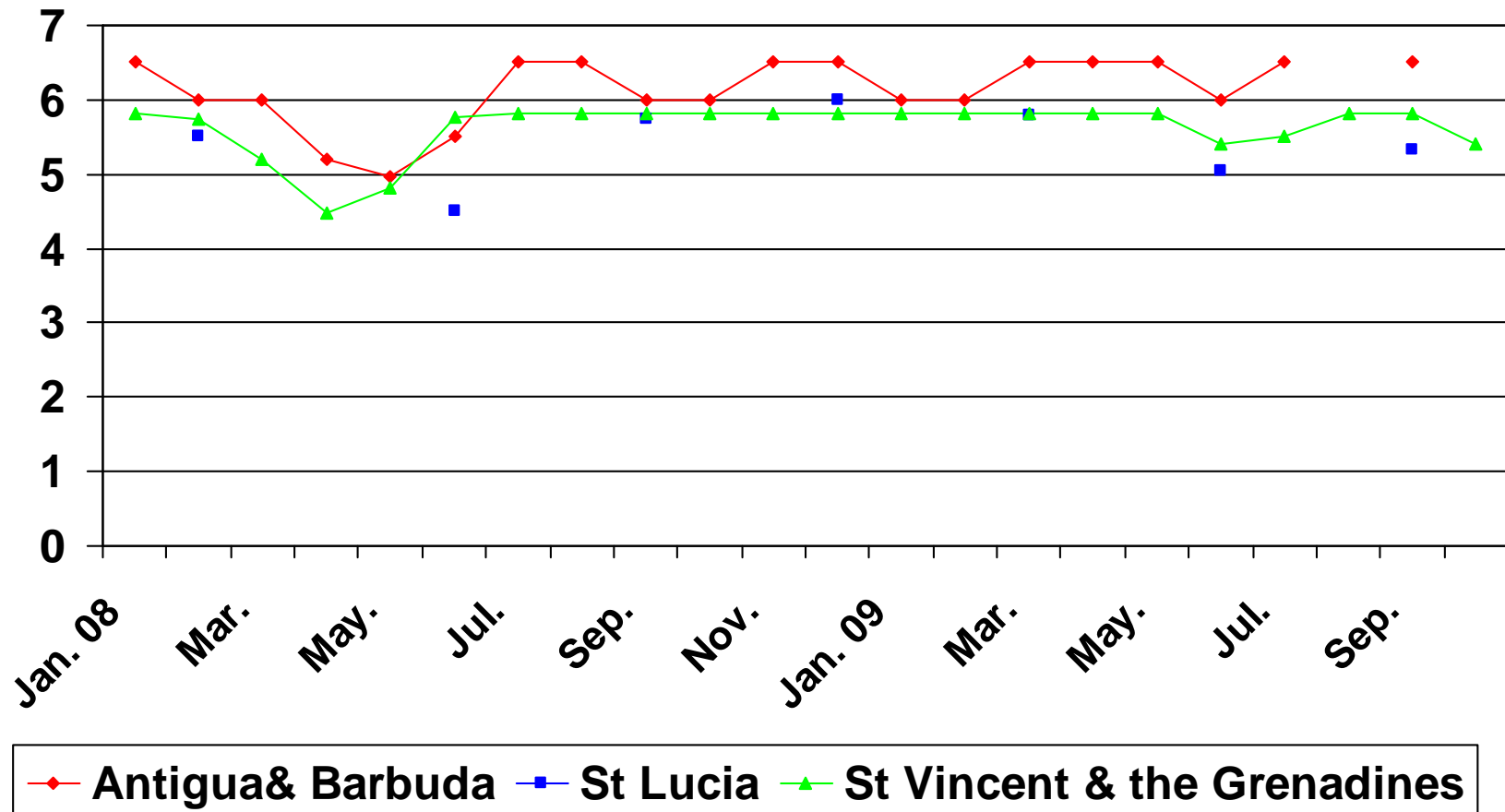
Sources: ECCU country authorities; WEO; and Reinhart, C.M., K.S. Rogoff, and M.S. Savastaro, 2003, "Debt Intolerance," NBER Working Paper No. 9908.

Note: Figures for the ECCU countries are public debt ratios as a percent of GDP in 2004. The remaining columns list middle income countries that underwent an adverse credit event during 1970–2001, as identified by Reinhart, et al. (2003), with the figures referring to public debt as a percentage of GNI in the year of the event.

Money and Capital Markets

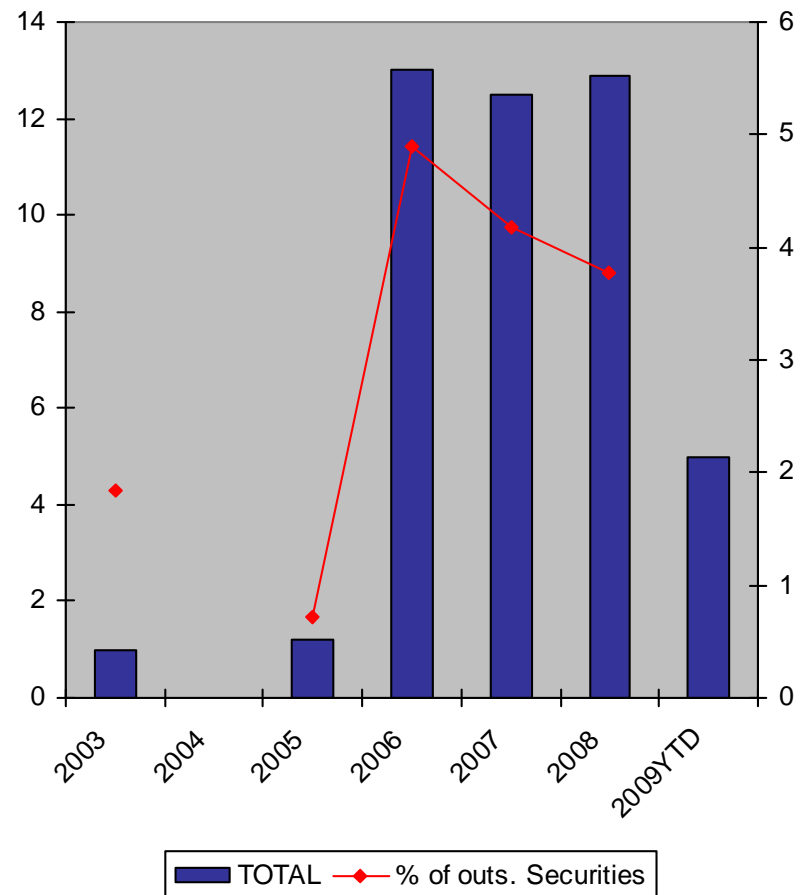
- The Governments and the ECCB have been making efforts to develop money and capital markets in the ECCU:
 - To improve access to financing for the private sector and the public sector
 - Increase opportunities for savings by residents
 - Provide greater opportunities for financial institutions to manage their risk
- The Authorities moved towards an integrated market for Government securities in 2001. Bigger market
- Securities are dematerialised (electronic records only) at the stock exchange

RGSM interest rates (Jan. 08 to Oct. 09)



Secondary market for Government securities

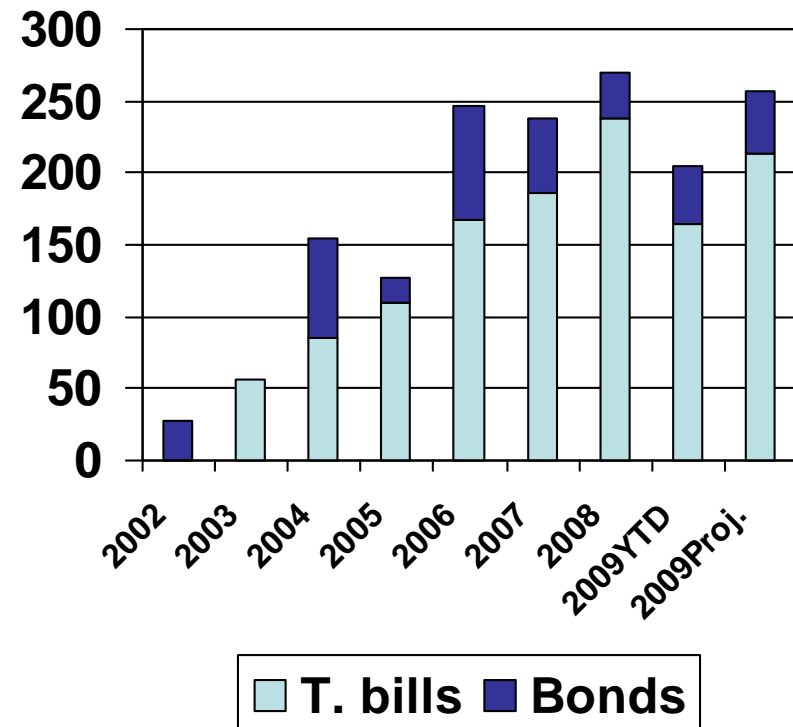
- Activity on the secondary market has fallen off.
- Investors normally buy and hold.
- Greater education and awareness needed



Primary market for Government securities

- Since the financial crisis:
 - The Market's appetite for long term bonds has diminished.
 - Investors have favoured issuers with stronger fiscal positions
 - Rates have not declined as sharply as US treasury rates
 - However, Governments have not moved to dollarise their domestic debt.

Value of Securities issued on the RGSM (US\$m)



SUCCESS FACTORS AND SCORECARD

NO	SUCCESS FACTOR	SCORE
1	All member countries using the market	Only 5 so far
2	Issuing short term bills on a monthly basis	Only 1
3	The RGSM as the major source of short term funding	Only 1
4	Raising a reasonable percentage of capital expenditure from long term bonds	Only 1
5	Issuing along the yield curve	Limited issuance
6	Raising funds in local currency	Very good. Only 3 of the 175 issues have been in non EC\$

SUCCESS FACTORS AND SCORECARD (2)

NO	SUCCESS FACTOR	SCORE
1	Large number of investors	Low
2	Wide range of investors – type	Fairly good. However, missing small savers and collective investment schemes
3	Wide range of investors - geographical	Still narrow

SUCCESS FACTORS AND SCORECARD (3)

NO	SUCCESS FACTOR	SCORE
1	Active secondary market	Still low as a percentage of outstanding issues
2	Government securities serve as a benchmark for interest rates	To some extent
3	At least 3 active brokers	Possibly only 2
4	Continuous pricing by brokers	No
5	Cross border activity	Still below par

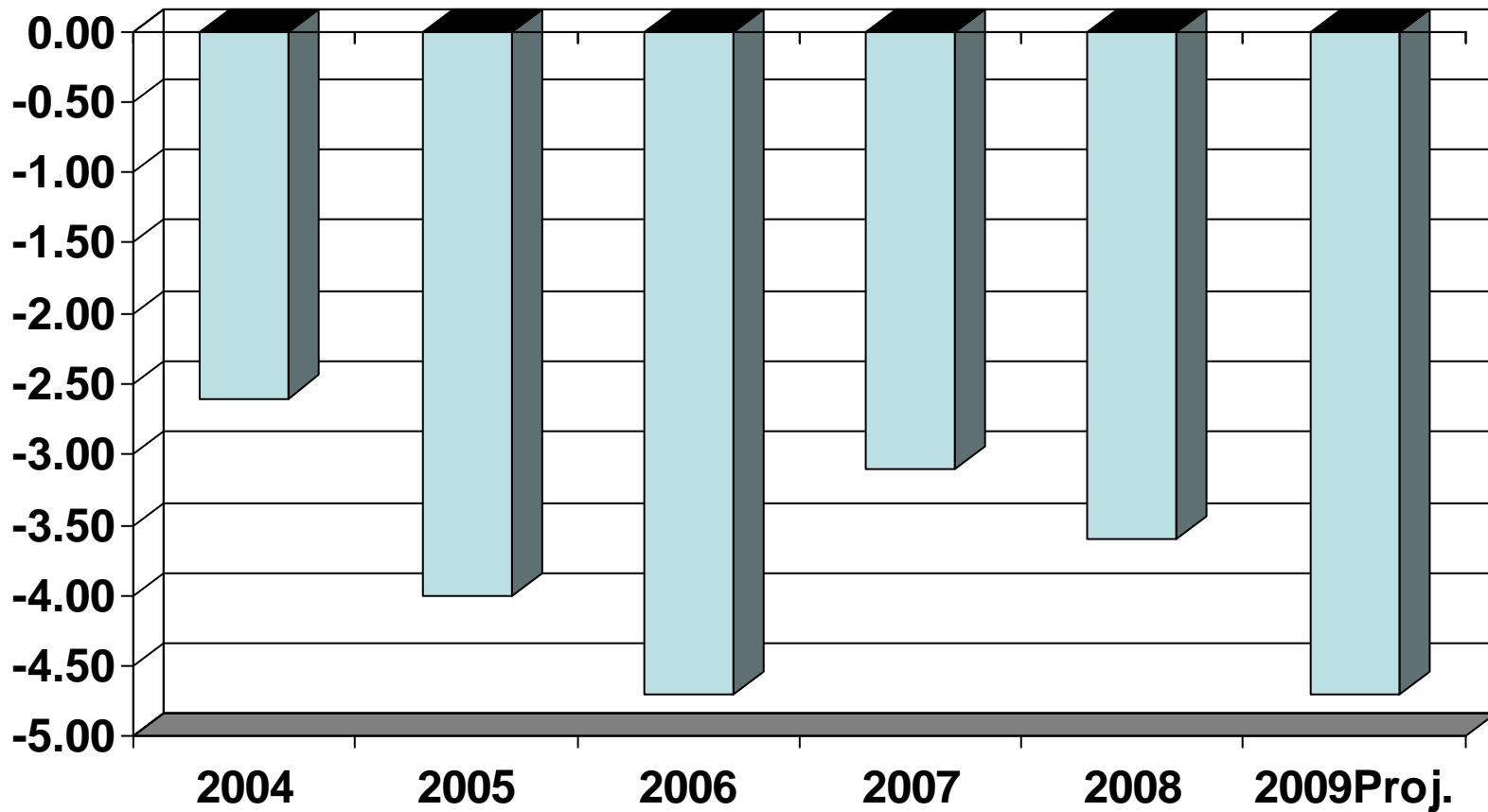
No Fiscal Space

- Limited natural resources – Countries have not benefitted from the commodity boom
- Narrow tax base
 - Already high tax efforts
- Unpopular to trim expenditure when poverty levels are high
- Personnel emoluments account for around 50% of expenditure.
- High per capita income means no access to IDA funds

Response by authorities to crisis

- Initial reaction – hopeful, as banks held no toxic assets in their portfolios.
- Realisation of indirect impact on ECCU.
 - Slowdown in foreign investment projects
 - Increase in unemployment
- Should Governments adopt countercyclical policies?
- Should Governments assist foreign investors?
- Authorities developed an 8 point plan

ECCU Primary balance



ECCU Eight (8) point plan

1. Suitably adapted financial programmes
2. Fiscal reforms
3. Improved Debt management
4. Public Sector Investment Programmes
5. Social Safety net programmes
6. Financial Safety net programmes
7. Amalgamation of indigenous commercial banks
8. Rationalisation, development and regulation of the insurance sector

ECCU and Public Debt

...leading to increasing levels of debt

ECCU: Evolution of Public Debt
(in percent of GDP)

