COMMERCIAL BANK ASSET BEHAVIOUR
IN
ECCA AREA COUNTRIES

by

Eustace Liburd
Research Department
East Caribbean Currency Authority

Paper prepared for delivery at the Eleventh Annual Conference of the Regional Programme of Monetary Studies, St. Kitts, October 29 - 31, 1979. The views expressed do not purport to reflect those of the East Caribbean Currency Authority.

COMMERCIAL BANK ASSET BEHAVIOUR IN ECCA AREA COUNTRIES[1]

Commercial banking in the ECCA Area as in many developing countries is dual in structure. The dualistic nature of the system derives from the ownership and control structure of the banks. Dominant in the system are six foreign-owned and controlled banks which operate forty branches, while in the second group are the newly established locally-owned and controlled (indigenous) banks numbering eight and operate from ten branches. The indigenous banking sector may in turn be sub-divided into three fully or largely publicly-owned banks and five banks that are fully or largely privately-owned and controlled.

This paper attempts to analyse and evaluate the performance of the asset portfolio of the above banks during the period 1970 - 1978. It is necessary however to appreciate at the outset that the banks operate in an environment that is largely free of regulation in respect to their asset portfolio decisions; the legislation establishing the Monetary Authority (ECCA) did not provide for the imposition of restrictions like reserve requirements or other policy instruments to constrain bank portfolio.[2]

PERFORMANCE CRITERIA

A review of the literature on the performance of commercial banks

1558

in the English speaking Caribbean will invariably reveal the following criticisms:[3]

(1) The preference by banks for self-liquidating short-term loans and their traditional reluctance to broaden the scope of their services to accommodate loans of a medium or long term nature.

(2) Their lending policies which tend to favour loans to the distributive trades and personal loans sectors which tend to lead to a drain of scarce foreign exchange for the purchase of imported consumer goods and the relative neglect of the manufacturing and agricultural sectors.

(3) The sizeable holdings of overseas balances often reflected in excessively high levels of liquidity.

In evaluating the performance of the commercial banks' asset portfolio cognisance will be given to the foregoing criticisms. Certain ratios will usefully be employed, namely:

(i) Ratio of medium and long term loans to total loans.

(ii) Ratio of loans to the various sectors to total loans.

(iii) Ratio of liquid assets to total assets.

(iv) Ratio of liquid assets to total deposits.

(v) Ratio of external balances to total deposits.

(vi) Ratio of investments to total assets.

In identifying the above ratios it is not intended to suggest that these are the only relevant indices for the measurement of commercial banking performance in the ECCA area, they however, highlight sensitive areas of the banks' operations. The aspects of operations which will be analysed are liquidity structure, loan policy, investments and interest rate policy.

LIQUID ASSET STRUCTURE

The liquid assets of the banks as can be identified, consist of currency, balances with ECCA and balances due by banks or branches abroad.[4] Table 1 shows the composition of these assets. Excluded from the estimates are balances with local banks and holdings of local Treasury Bills. It is probable that the former were mainly items in the course of collection while the latter are not usually considered by the banks as liquid assets as they are expected to roll them over at maturity.

Traditionally the ECCA area banks have maintained a high proportion of their assets in a liquid form. The bulk of these assets were often held in the form of foreign balances and therefore could be of little benefit to the development of the area's economy. In 1970 for instance, foreign balances accounted for $61.6m out of total liquid assets of $71.7m. The non-availability of local liquid assets as an alternative to cash, a non-earning asset, has been advanced as an explanation for the banks' holding of large foreign balances. In recent years however the situation has changed markedly, the ratio of liquid asset to total assets has been falling and foreign balances constitute a substantially smaller proportion of liquid assets.

It has already been noted that there is no legal cash reserve requirement for banks operating in the ECCA area, as a result during the period 1970-1975 the banks maintained lower cash ratios than those maintained by banks in countries where such requirement are in operation.

LIQUID ASSETS & LIQUIDITY RATIOS OF ECCA AREA BANKS

(EC$ MILLION)

Year	(1) Cash	(2) Balance with ECCA	(3) Total (1 + 2)	(4) Due From Abroad	(5) Total Liquid Assets (3 + 4)	(6) Cash Ratio %	(7) Liquid Asset Ratio %	(8) Liquid Assets/ Total Assets %	(9) Loans/ Deposit Ratio
1970	5.7	4.4	10.1	61.6	71.7	5.6	39.8	30.6	70.6
1971	5.9	2.6	8.5	61.4	69.9	4.0	33.2	25.8	74.8
1972	6.9	8.9	15.8	44.3	60.1	6.4	21.3	18.9	85.1
1973	6.8	2.9	9.7	35.0	44.7	3.5	15.9	12.7	87.8
1974	7.3	10.4	17.7	48.6	66.3	5.6	20.8	16.3	86.8
1975	7.8	37.0	44.8	79.2	124.0	11.6	32.1	25.4	76.9
1976	9.3	119.4	127.7	41.5	170.2	27.9	36.9	28.3	66.5
1977	12.1	100.6	112.7	33.6	146.3	22.5	29.3	22.7	71.6
1978	14.9	93.0	107.9	35.7	143.6	19.0	25.3	19.9	76.2

Based on Average Monthly Data

SOURCE: ECCA

As was observed by McLean [2] it does not however mean that the banks are holding inadequate reserves and thereby failing to achieve an optimal balance between risk and expected income in their portfolios. Rather, the currency arrangement that then existed whereby ECCA was bound to buy and sell sterling for immediate delivery in London, at a fixed rate, facilitated the banks holding of low cash balances as balances held with banks abroad could then be operationally treated on the same level as cash reserves. Consequently, there was no need for the banks to adhere to the kind of cash and liquidity ratios maintained by banks abroad. Moreover, the then existing financial arrangement enabled the banks' London Offices to perform the role of lender of last resort to local branches at little cost to themselves.

The banks' cash ratio changed markedly in 1976 through large inflows of funds to the area, intermediated by the banks, starting in late 1975 and gaining momentum during the first six months of 1976. The inflow was occasioned by the then weak and depreciating position of Sterling which gave rise to public uncertainty regarding the alignment of the EC dollar. **The bulk of the** funds that flowed into the area were deposited by the banks with ECCA and the gross foreign assets of the Authority were swollen from \$120.7m at the end of 1975 to \$220.8m at the end of June 1976. When the traditional EC dollar link with sterling was shifted to a link with the U.S. dollar in July 1976, the gross foreign assets of the Authority subsequently fell to \$173.4m at the end of 1976. Since 1976 the banks cash ratio has remained high relative to the legal reserve requirements normally impose in other countries.

That a substantially greater proportion of liquid assets are now being held locally, derives from two important amendments to the ECCA Agreement. (1) ECCA with the approval of participating governments now has the authority to determine the parity of the EC dollar and (ii) it can now determine the terms and conditions under which it is prepared to buy and sell foreign currencies.

These two amendments introduced new elements of risks for banks holding external assets as ECCA is no longer bound to buy and sell sterling or any other foreign currency at a predetermined and guaranteed rate, also with the approval of participating governments ECCA can now vary the exchange rate of the EC dollar. Since the banks' liabilities are in EC dollars they find it prudent therefore to hold a greater proportion of their liquid assets locally.

Finally, the loans to deposits ratio is a fairly good indicator of liquidity in ECCA area banks. During the years 1972-1974 this ratio attained its highest level and as is to be expected, it coincided with low points in the liquid assets, and liquid assets to total assets ratios; since then the banks have been relatively liquid.

The Indigenous Banks

The dualistic structure of commercial banking in the area has been noted. The indigenous banks have tended to operate with higher cash ratios than do their foreign counterparts. The liquidity ratios of the indigenous banks are presented in Table II. The fact that they are new entrants into the banking field, means that they are obliged to be that more concerned to maintain the confidence of depositors and to do so they must hold an adequate degree of liquidity in their asset portfolio. Also, unlike the branches of the foreign banks, the indigenous banks must rely largely on their own resources to meet the claims inherent in their deposit liabilities. These factors may in part account for the higher liquidity.

TABLE II

Indigenous Banks Liquidity Ratios

	Cash Ratio	Liquid Asset Ratio	Liquid Assets/ Total Asset Ratio	Loans/Deposits Ratio
1975	12.3	27.9	20.3	77.6
1976	31.9	34.5	25.8	63.9
1977	26.9	37.8	30.7	53.2
1978	20.2	27.8	22.0	56.3

Based on Average Monthly Data

SOURCE: ECCA

Net Foreign Balances

The banks have been criticised for the intermediation of local savings abroad on the pretext that local opportunities did not exist for the investment of liquid funds. The ratio of net balances held abroad to local deposits in Table III below is intended to indicate the degree of intermediation.

TABLE III

ECS Million

Year	Due From Abroad	Due to Abroad	Net Due From Abroad	Net as % Deposits
1970	61.6	31.6	30.0	16.7
1971	61.4	36.0	25.4	12.0
1972	44.3	44.7	- 0.4	- 0.2
1973	35.0	37.1	- 2.2	- 0.8
1974	48.6	45.5	3.1	1.0
1975	79.2	51.2	28.0	7.2
1976	41.5	43.4	- 1.9	- 0.4
1977	33.6	37.1	- 3.5	- 0.7
1978	35.7	35.1	0.6	0.1

Based on Average Monthly Data

SOURCE: ECCA

The table shows that in 1970 and 1971 the banks employed a substantial amount of funds abroad; as investment opportunities improved in the area during 1972 - 1974 net balances abroad became negative, (note that during this period the loans to deposit ratio exceeded 85%). The net amount of funds held abroad were again high in 1975 but were subsequently reduced as a result of the sterling crisis of 1976, and the amendments to the ECCA Agreement referred to earlier.

BANK LENDING

Commercial banks influence output and employment in the economy, by applying the proceeds raised from depositors to developmental and other projects. The distribution of commercial bank loans between consumption and investment goods, or among different kinds of investment determines to a significant degree the pattern of growth in the economy. The lending policies of commercial banks are therefore of crucial importance to the development of any country but particularly so in a developing area like that of ECCA where financial markets are underdeveloped.

The banks in the ECCA area all identify the same kinds of criteria in their lending policies. They determine creditworthiness by the financial capacities of the borrower as revealed by his past record and future prospects; the feasibility of the project, where applicable, is given close attention. Collateral is generally in the form of titles to land or other property, though in many cases the guarantee of a person known to the bank is acceptable.

The loan policies of the foreign banks are established at their Head Offices for the guidance of branch managers. The banks report that there are no limits to the type of loans the branch may make but demand for loans in excess of established limits has to be referred to Head Office. The loan limit of a particular branch is determined by the branch size and the experience of the manager.

Growth in Lending

Bank loans outstanding increased at an annual average rate of 16.5% over the survey period. There were however alternating periods of rapid and sluggish growth coinciding with fluctuations in economic activity. Three distinct phases are discernible. During the first phase, 1970 - 1973, conditions in the economies were buoyant and bank loans expanded at an annual average rate of 24.8%, with loan expansion outpacing the growth in deposits. All major sectors benefitted from the expansion of credit and there were no significant changes in the pattern of credit allocation. The second phase, 1974 - 1976, coincided with a slowdown in economic activity and credit expanded at the vastly slower rate of 7.5%. During this period, greater emphasis was placed on the manufacture of light articles as part of the development strategy for the area and this was the only sector to show any significant growth in credit allocation, while credit to the tourism and construction sectors declined. Phase three, 1977 - 1978, saw a revival in the economic fortunes of the area and loans expanded at an annual average rate of 18.7%. Loans to manufacture continued to grow rapidly and so did loans to the personal sector. Most other sectors showed modest growth in loan expansion except agriculture where loans declined.

The Sectoral Distribution of Loans

An analysis of the sectoral distribution of loans presented in Table IV reveals that the banks' portfolios throughout the survey period were still heavily weighted in favour of the personal loans and distributive trades sectors. It is to be noted however, that on average approximately 50 per cent of personal loan allocation was made in favour of house and land purchase. The personal loans and distributive trades sectors together accounted for between 42% and 47% of bank loan allocation. In marked contrast, loans to the agricultural sector has never exceeded

7.7 per cent of total allocation and this ratio declined to 5.3 per cent at the end of the period. Similarly the ratios of loans to the tourist and construction industries have also been declining. The most encouraging feature of loan allocations, in terms of the criticisms levelled at the banks, has been the loans to the manufacturing sector. The ratio of loans to this sector rose from 5.7 per cent to 10.4 per cent. Of the other major sectors only loans to Government and Statutory Bodies showed any significant increase in share allocation. The ratio of loans to this sector rose from 9.6% to 12.3% and reflects partly the increasing cost of government and partly their greater participation in the productive sectors of the economy.

That a relationship ought to exist between C.E. & G.D.P. is arguable

It is of interest to relate the structure of bank loans to the observed behaviour of sectoral Gross Domestic Product (GDP) estimates contained in Table V1, and the often stated strategy of the area governments that development must be based on agriculture, (with emphasis on food production), tourism, the manufacture of light articles and a lessening of dependence on imported consumer goods. The information presented in the table on loan allocations does not reflect the development strategy described above. As previously indicated the proportion of loans allocated to agriculture and tourism has been declining and at the same time loans to the distributive trades and personal loans sectors which are associated with high levels of imports have been rising. Also, loan allocation to the crucial sectors of agriculture, manufacture and

TABLE IV

ANALYSIS OF ECCA AREA BANKS' LOANS & ADVANCES

PERCENTAGE DISTRIBUTION

	1970	1971	1972	1973	1974	1975	1976	1977	1978
Agriculture	7.7	7.5	7.7	7.7	7.3	7.3	7.7	4.8	5.3
Manufacturing	5.7	6.3	5.9	5.4	4.7	6.8	8.8	9.4	10.4
Distributive Trades	22.0	22.2	21.3	21.6	21.0	22.0	21.0	22.6	18.5
Tourism	9.5	9.9	10.7	9.6	9.4	7.9	7.7	7.2	6.8
Transport	3.5	3.9	4.1	4.4	5.5	5.5	4.8	4.9	5.8
Public Utilities	2.2	2.5	2.6	2.4	1.8	1.2	1.4	1.5	1.4
Building & Construction	10.4	9.6	10.4	9.6	10.2	10.0	8.5	7.0	7.2
Govt. & Statutory Bodies	9.6	10.4	10.7	12.1	13.0	12.9	13.0	13.2	12.3
Personal Loans	20.9	20.0	21.6	23.0	21.0	20.4	21.6	24.5	25.0
Other Advances	8.5	6.7	5.0	4.2	6.1	6.0	5.5	4.9	7.3
Total Loans & Advances	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Based on Average end of Quarter Loans Outstanding

SOURCE: ECCA Economic & Financial Review

TABLE V

INDEX OF LOANS AND ADVANCES OUTSTANDING

(1970 = 100)

	1970	1971	1972	1973	1974	1975	1976	1977	1978
Agriculture	100	120	166	193	204	220	241	173	232
Manufacturing	100	136	172	183	180	281	375	467	618
Distributive Trades	100	125	160	190	207	235	230	289	285
Tourism	100	129	186	196	214	193	196	213	242
Transport	100	138	194	246	340	366	331	394	569
Public Utilities	100	140	194	208	174	124	151	188	215
Building & Construction	100	115	167	180	214	226	198	191	236
Govt. & Statutory Bodies	100	103	136	181	217	231	241	285	319
Personal Loans	100	124	171	213	218	228	245	330	406
Other Advances	100	158	167	163	269	280	270	274	500
Total Loans & Advances	100	124	166	194	217	234	241	282	340

Based on Average of End of Quarter Loans Outstanding

SOURCE: ECCA

TABLE VI

ECCA AREA - SECTORAL ORIGIN OF GDP

AT FACTOR COST

Percentage Distribution

	1970	1971	1975	1976	1977
Agriculture	22.1	21.8	20.3	19.7	19.6
Mining & Quarrying	-	-	0.7	0.8	0.8
Construction	13.3	13.9	7.1	7.1	6.5
Manufacturing	5.1	3.7	8.4	7.3	7.4
Distribution	14.2	13.5	13.0	12.8	13.0
Tourism	5.6	7.0	5.3	5.9	6.9
Transport & Communication	3.6	3.5	6.5	7.1	7.4
Public Utilities	-	-	1.9	1.6	1.7
Public Administration	20.4	20.2	16.0	17.1	17.2
General Services *	15.7	16.4	20.8	20.6	19.5
	100.0	100.0	100.0	100.0	100.0

* Includes Ownership of Dwellings & Financial Services

SOURCE: World Bank Reports.

tourism does not reflect their importance as contributors to GDP. Combined loan allocations to these three sectors in 1977 totalled 21.4% while the contribution to GDP amounted to 34.0 per cent. The allocation of loans to these sectors therefore continues to be unsatisfactory. The loan performance of the banks in these key sectors is further analysed below.

Agriculture

It was noted above that the ratio of agricultural loans to total loans has been declining, so too has been the share of GDP attributable to agriculture. However, the sector still remains the single most important contributor to GDP. Traditionally, the bulk of bank credit extended to agriculture went to export agriculture, namely, sugar cane planting in the Leeward Islands and tree crops in the Windward Islands. While these traditional exports have continued to attract a significant proportion of agricultural credit it has been noticeable that their share has declined somewhat and the proportion of agricultural credit going to food crops and livestock has increased in recent years. It is clear however that the level of bank credit extended to agriculture does not reflect the sector's importance to the economies. The view is held in some circles that the major constraint on the level of lending to agriculture is due to inadequate demand. Bankers report receiving few applications for loans even though in some instances special incentives in the form of lower interest rates and technical advice have been offered, The small number of applications probably reflects therefore, the still depressed state of non-traditional agriculture.

Manufacture

In 1970 the proportion of GDP attributable to manufacture amounted to 5.1 per cent, since then the sector has grown at an annual rate of 18.7 per cent to account for 7.4 per cent of GDP in 1977 and the loan expansion rate averaged 28.5 per cent per annum over the survey period; the highest for any sector.

Despite the high level of credit expansion, the manufacturing sector is still relatively small. Applications for credit have been infrequent and bankers report that the problems encountered by prospective small manufacturers in obtaining financing are made more difficult as the banks face greater risks in financing new products, that are sometimes intended for markets that have not been fully assessed. But Bourne [1] has suggested that very often, the training received by many credit managers does not equip them to undertake the dynamic credit management required in new ventures dis-similar to those of which they are accustomed.

There are however two inhibiting factors to the development of manufacturing in the area, which are probably more inhibitive than finance and which probably account for the low level of applicants for credit; they are, insufficient know-how and a lack of entrepreneural skills.

Tourism

The tourism sector grew steadily during the period 1970 - 1973, and increased its contribution to GDP. This period was followed by a slump in the industry, starting in 1974 and lasting until 1976, due largely to the economic recession in North America. A significant recovery was made in 1977 when the industry accounted for approximately 7 per cent of GDP.

Lending to tourism reflected the fluctuations in demand for the service and after fairly rapid growth in the period prior to 1974, the rate of loan expansion fell thereafter as excess hotel room capacity increased during the slump. This led to a cessation of new construction in the industry and the share of loan allocation fell. A further explanatory factor in the declining ratio of loans allocated to tourism may be the beneficial role of foreigners who own a substantial part of the industry and provide their own sources of finance.

The Indigenous Banks

One of the reasons for the establishment of indigenous banks, particularly the publicly owned banks was the desire for a different and new approach to credit evaluation and credit provision to vital sectors of the economy. It was not intended that the banks experiment in the granting of unsound advances, but rather to recognise that it was more important that projects are viable, that loans are sound, than that they are consumer credit loans, short term business loans or loans to provide medium or long term capital. In other words feasibility of the project should take precedent over the type of the loan.

The Indigenous banks loan allocation performance is presented in Table VII. The information reveals that, as in the case for all Area banks the personal sector dominates allocation. In 1976 such loans accounted for as much as 50 per cent of the total but then fell to 29 per cent by 1978. The very high proportion of personal loans in the earlier years is probably a reflection of their recent entry into the banking field. In some respects their performance has been more favourable in terms of the established criteria than is the case for expatriate banks. For instance, the proportion of loans made to agriculture was higher by an amount in excess of 6 percentage points. Loans to the distributive trade sector was substantially lower, though the indigenous banks' late entry and the long established external links of the expatriate banks may be a factor. Advances to Government and Statutory Bodies constitute a significant proportion of indigenous banks' loans and may be indicative of their role in the financing of the Governments' investment programmes. The indigenous banks loans record in the manufacturing and tourism sectors is somewhat of a disappointment.

TABLE VII

Analysis of Indigenous Banks' Loans & Advances
Proportionate Distribution %

	1975	1976	1977	1978
Agriculture	14.4	12.8	12.2	11.4
Manufacture	1.1	1.9	2.1	3.6
Distributive Trades	8.7	8.1	8.8	5.0
Tourism	2.3	2.8	1.5	3.6
Transport	0.3	0.5	0.5	1.4
Public Utilities	0.0	0.6	0.6	1.8
Building & Construction	9.7	8.7	6.1	14.3
Govt. & Statutory Bodies	14.4	10.5	20.4	22.7
Financial Institutions	0.1	0.3	0.7	0.6
Personal Loans	46.1	50.0	43.6	29.2
Other	2.9	3.8	3.5	6.4
	100.0	100.0	100.0	100.0

Based on Average of end of Quarter Data

SOURCE: ECCA

Medium and Long Term Loans

An aspect of credit allocation that deserves comment in the context of the economic development of the area is the provision of long term loans by the commercial banks. While it has been stated that banks consider it their prime function to make short-term loans, throughout the 1970's a significant proportion of ECCA area banks' loans (in excess of 30%) have been of the medium and long term variety. Table VIII provides data on the proportionate distribution of long term loans outstanding with an original maturity of three or more years.[5] The data reveal that the personal loans sector which includes mortgage lending for housing is the major recipient of bank long term credit. Loans to Governments and Statutory Bodies and to tourism also feature prominently over the years.

While the distribution of long term loans appear generally to be more favourably allocated than total loans to the more directly productive sectors the ratio of long term loan allocation to agriculture is still surprisingly low.

1558

ANALYSIS OF ECCA AREA BANKS
LONG TERM LOANS OUTSTANDING

	1970	1971	1972	1973	1974	1975	1976	1977	1978
Agriculture	5.2	8.8	8.6	8.6	10.9	11.8	9.7	4.5	6.4
Manufacture	5.2	9.6	7.5	6.5	3.7	7.6	9.8	11.5	12.2
Distributive Trades	9.1	7.6	12.5	15.6	12.6	11.9	9.2	10.6	5.9
Tourism	19.2	15.3	17.0	10.9	9.4	9.5	9.1	9.1	10.1
Transport	1.1	1.4	2.3	1.2	1.7	1.9	1.4	1.9	3.0
Public Utilities	3.6	2.0	3.2	3.0	1.7	2.0	2.4	1.2	1.5
Building & Construction	10.9	13.5	9.2	8.0	8.2	8.5	9.3	7.3	8.0
Govt. & Statutory Bodies	22.1	18.3	14.9	14.9	17.3	13.9	12.1	18.2	14.4
Personal	16.3	20.5	22.2	25.5	26.9	27.4	27.8	32.2	32.2
Other Advances	7.3	3.0	2.6	5.8	7.6	5.5	4.2	3.5	6.3
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Based on End of Year Data

SOURCE: ECCA Economic & Financial Statistics Publications

INVESTMENTS

Banks consider it their primary function to make loans and their investment activities are therefore subsidiary to their lending activities. In the ECCA area the banks investments have been consistently less than 10% of total assets. Table IX presents the information on the banks investments.

TABLE IX

Area Commercial Banks Investments

EC$ Million

	(1) Total Investment	(2) Investment in Local Govt. Securities	(3) Ratio of (2) to (1) %	(4) Ratio of (1) to Total Assets %
1972	19.6	12.3	62.8	6.1
1973	16.4	10.7	65.2	4.7
1974	23.4	17.0	72.6	5.7
1975	30.7	21.0	68.4	6.3
1976	57.8	24.9	43.1	9.6
1977	54.9	24.8	45.2	8.5
1978	66.4	28.5	42.9	9.2

Based on Average Monthly Data

SOURCE: ECCA

Their investment portfolio includes local Treasury Bills, Government debentures, and 'other investments'. Public issues of Treasury Bills have only been offered by Governments in recent times. Dominica, the frist to do so, offered its first issue during the financial year 1970/71 followed by St. Vincent 1972/73, Grenada and St. Lucia 1973.74 and finally Antigua and St. Kitts 1974/75. Montserrat does not offer a public issue of Treasury Bills. In the table, Treasury Bills and debentures are lumped together as the data base did not provide for their separation. It was also not possible to capture the extent to which 'other investments' are local or foreign.

Usually, banks invest in Treasury Bills to provide them with liquidity and at the same time to earn a return. Most ECCA area banks however do not view their investments in Treasury Bills as liquid as they are expected to roll them over at maturity. Rather they are viewed as long term investments, that yield a quarterly return. The ratio of investment in Government securities to total investment declined over the survey period.

LENDING RATES

The Prime rate is the only lending rate available, this may however be regarded as an indicator of the movement of the level of lending rates. In fact, in quoting interest rates to borrowers, banks sometimes specify a certain percentage in relation to the prime rate.

The main factor influencing the level of lending rates is the cost of deposits. The high spread between deposit rates and lending rates in the area has been a cause of some concern particularly for its effect on savings. Banks maintained a spread of approximately 6 percentage points between the savings rate and their prime lending rate for most of the period 1974 to 1978, while the spread between the six-month time deposit rate and the prime rate varied from 2 to 6 percentage points depending on the banks liquidity position. Given the high rate of inflation of recent times, lending rates do not appear to be excessive. It seems however that real deposit rates have been negative, particularly since 1976. Table X contain data on average interest rates at the end of the period.

Finally, McLean [2] working with data on interest rates for the nineteen-sixties, suggested that there was a high degree of association between these rates and the United Kingdom rates. At that time lending rates for the area were consistently higher than the U.K. bank rate. It appears that the high level of association no longer exists as for most of the period between 1974 and 1978 lending rates in the area were lower than the U.K. bank rate, and tended more to reflect the banks' local liquidity positions.

TABLE X

Commercial Banks Interest Rates

		DEPOSIT RATES				
		Savings	Three Month	Six Month	Prime Lending	U.K. Bank Rate
1974	March	4.2	7.8	8.5	10.5	12.5
	June	4.2	8.0	8.5	10.5	11.75
	September	4.3	8.0	8.4	10.5	11.50
	December	4.4	7.9	8.4	10.7	11.5
1975	March	4.3	7.9	8.4	10.6	10.0
	June	4.1	7.5	8.0	10.4	10.0
	September	3.6	7.0	7.3	10.4	11.0
	December	3.5	6.6	7.2	10.3	11.25
1976	March	3.4	5.6	6.4	10.3	9.0
	June	3.3	4.0	4.3	10.0	11.5
	September	3.0	3.9	-	9.6	13.0
	December	3.0	3.8	-	9.0	14.25
1977	March	2.9	3.5	-	8.8	9.50
	June	2.8	3.5	-	8.6	8.00
	September	2.8	3.5	3.6	8.6	6.00
	December	2.8	3.5	4.2	8.6	7.00
1978	March	2.8	3.8	4.5	8.5	6.5
	June	2.8	4.0	4.5	8.7	10.0
	September	2.7	4.0	4.4	8.7	10.0
	December	2.8	4.0	4.4	8.7	12.5

Simple Average of end of Period Rates for All Banks

SOURCE: ECCA

Possibility of banks fixing spread.

SUMMARY

This paper has attempted to evaluate the performance of the asset portfolio of ECCA area commercial banks during the 1970's. In doing so cognisance was taken of the traditional criticism levelled at banks in the area. The analysis reveals that in many respects marked changes have occurred in the composition of banks assets to the benefit of the area.

The liquid asset behaviour of the banks has changed markedly. Cash ratios rose significantly and the proportion of liquid assets held abroad have been substantially reduced. The fact that a greater proportion of liquid assets are now held locally is attributable to two amendments to the ECCA Agreement which make it more risky for the banks to hold overseas balances. A downward trend in the liquid asset ratio has been noticeable as the loans to deposits and investments to total assets ratios have risen relative to the levels of the 1960's.

The pattern of economic growth influenced both the rate of expansion and distribution of loans. Over the survey period as a whole, loans expanded at an average rate of 16.5%. In terms of share distribution the personal loans and distributive trades sectors remained dominant, absorbing just under half of allocations. The outstanding feature of credit allocation has been the growth in credit to the manufacturing sector which averaged 28.5% per annum. The banks record in terms of the maturity of their loans has also been satisfactory; a significant proportion in excess of 30% has been for a period of three or more years. Of major disappointment though, given their importance to the area economies, have been the declining ratios of loans to agriculture and tourism. In the case of agriculture, demand factors deriving from the depressed state of non-traditional agriculture is perhaps a contributing factor.

Finally, in contrast to the 1960's when ECCA area interest rates were determined to a large extent by rates in the U.K., in the 1970's they tend more to reflect local liquidity conditions.

FOOTNOTES

(1) Barbados was a participant in the ECCA Agreement until 1973. However the data used and the views expressed do not apply to Barbados.

(2) Various governments have imposed levies on deposits ranging from ½% in Montserrat to 10% in Grenada.

(3) See for instance Bourne [1], McLean [2] and Thomas [4].

(4) It was not possible for instance to capture from the data base any liquid assets included in the banks investments.

(5) The reporting procedure employed required the banks to report loans of up to three years maturity and loans over three years maturity. It was therefore not possible to capture loans of one to three years maturity which could be considered medium term.

REFERENCES

[1] BOURNE, Compton, "The Political Economy of Indigenous Banking in Guyana" in Economic and Social Studies, Vol. 23 No. 1 March 1974, ISER, U.W.I., Jamaica.

[2] MCLEAN, A. W. A. "Money and Banking in the East Caribbean Currency Area" ISER, U.W.I. Jamaica 1975.

[3] MILLER, Nugent "Organization and Structure of Commercial Banking in Jamaica", ISER, U.W.I. Jamaica, 1971.

[4] THOMAS, C.Y. "The Structure Performance and Prospects of Central Banking in the Caribbean" ISER, U.W.I. Jamaica, 1972.