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Stabilisation and Financial Adjustment in Guyana

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STABILISATION AND FINANCIAL ADJUSTMENT IN GUYANA

1.0 INTRODUCTION

During the second half of the 1970's and 1980's, Guyana experienced unfavourable macroeconomic conditions. The underlying imbalances came to the fore in the mid 1980s as flows of financial foreign assistance declined substantially. The authorities responded to these developments by resorting to external and domestic commercial bank borrowing to finance increasingly large budget deficits. The easing of credit stance, large fiscal deficit and a number of large devaluations, resulted in a rise in inflation that reached 120 per cent in 1989. Moreover, negative economic growth with real GDP declining by an average of 3 per cent per year and high interest rates in World markets had caused the debt burden to reach unsustainable proportions, and Guyana's external vulnerability to be exacerbated.

Table 1 illustrates the crisis situation at the end of the 1980's. The external debt exceeded annual GDP by nearly fivefold, internal payment arrears had accumulated to over US$500 million and official international reserves declined below one month of imports.

Table I
Selected Economic Indicators

	1980-85	1986	1987	1988	1989	1990
GDP Growth	-2.9	0.0	0.6	-3.0	-4.8	-6.0
Inflation	18.7	7.9	28.7	40.0	120.0	85.0
External Debt/GDP	1.7	2.5	3.9	3.4	5.1	-
BOP Deficit/GDP	-130.9	-136.6	-152.0	-69.3	-187.0	-193.7
Exchange Rate (G$ per US$)	3.2	4.3	9.8	10.0	27.2	39.5
External Debt Stock (US$M)	700.0	1035.6	1117.4	1233.5	1391.9	1820.1
Domestic Debt Stock (G$M)	2828.0	6100.0	6810.0	7078.0	9267.0	
Gross International Reserves (US$M)						
Import Cover	7.9	8.6	8.9	4.0	14.1	26.6
Debt Service Ratio	2 wks	2 wks	2 wks	1 wk	3 wks	4 wks

Source: Bank of Guyana Annual Reports (various years)

To address the rapidly growing imbalances, Guyana adopted in mid 1988 a market-oriented Economic Recovery Program (ERP), supported by arrangements with the IMF, structural adjustment and sectorial loans from the World Bank, balance of payments support from bilateral creditors in the form of new loans and debt relief through restructuring arrangements. Key policy elements of the program have been prudent demand management policies to reduce internal and external imbalances and wide ranging structural reforms to increase aggregate supply.

The financial system, being crucial in promoting growth through mobilising savings, allocating capital, facilitating transactions, and easing risk management, was subject to intensive reforms aimed at improving its structure and efficiency. This paper analyses financial sector policies under structural adjustment adoption by Guyana since mid 1988, to identify its strengths and remaining vulnerabilities, and discuss policy measures that would enhance financial intermediation in the context of the challenges associated with liberalisation and globalisation. The structure of the paper is as follows: Section II provides an overview of financial sector reforms from 1988 through 1997. Section III assesses the impact of the sector's reform. Section IV discusses challenges for the future. Section V provides some concluding remarks.

2.0 Financial Sector Reform

The financial system consists of a small but wide range of banks and non bank financial institutions. The Bank of Guyana is the apex of the financial system. Seven commercial banks (four domestic and three foreign owned banks) with a network of thirty (30) branches dominate the financial system, holding 73 per cent of the total financial assets at end 1997 (see Table II). The non-bank financial sector comprising insurance companies, credit unions, the new building society, trust companies and a mortgage bank accounts for the remaining 27 per cent of financial assets.

Table II
Percentage Distribution of Assets of Financial Institutions in Guyana

	1980	1985	1990	1995	1997
Commercial Banks	63.9	73.9	64.2	71.6	73.3
Non-Bank Financial Institution	36.0	26.1	35.8	28.4	26.7
Building Society	5.3	5.8	4.7	7.3	7.7
Trust Companies	1.6	2.0	2.2	5.5	5.6
Insurance Companies	14.6	9.6	15.4	9.5	7.9
Life	9.0	7.1	13.1	6.8	5.5
Non-Life	5.6	2.4	2.3	2.8	2.4
Pension Schemes	8.8	3.5	4.1	6.0	5.5
Mortgage Bank	1.9	1.0	0.3	0.1	0.0
Development Bank[1]	3.8	4.2	9.1	0.0	0.0
Total Assets	100.0	100.0	100.0	100.0	100.0

Source: Bank of Guyana

Guyana's banking system is quite concentrated, with the two largest banks accounting for 65 per cent of the total bank assets. The main sources of commercial bank funding are deposits held by the public which represent 85 per cent of total liabilities at end June, 1998. Credit facilities to residents (both the private and public sector) represent the largest share of assets (see Table III). Investment in treasury bills accounts for 26 per cent of the share of commercial banks assets.

[1] In 1995 the Development Bank was merged with the state owned Guyana National Cooperative Bank.

Table III
Composition of Commercial Banks Assets and Liabilities

	1980	1985	1990	1995	1997
Assets					
Foreign Sector	58989	34665	2408519	3798211	3497458
of which balance due from banks abroad	45616	28384	2318333	2559528	2152522
Public Sector	450938	1665196	4878244	15540327	19644894
of which securities	216432	816471	4075721	14814142	18024933
Private Sector Loans and Advances	195800	520075	4108696	20656770	42920893
Bank of Guyana	125861	627948	1802424	10326443	13315475
of which deposits	43760	99191	691206	9355904	11720910
Other including non-banks	92726	228290	1104867	7256504	9912009
Total Assets	**924314**	**3076174**	**14302750**	**57578255**	**89290729**
Liabilities, Capital and Reserves					
Foreign Sector	55599	62737	862399	2883269	4963726
of which balance due to banks abroad	23043	1192	545294	278596	782677
Public Sector Deposits	51249	152694	1971186	4695213	9631037
Private Sector Deposits	562766	1410607	7042765	39634076	52116931
Non-Banks Fin. Insti. Deposits	59151	155409	1436619	1827478	3777663
Other Liabilities	195549	1201759	2192970	3146354	3747309
Capital and Reserve		92968	796811	5391865	15054063
Total Liabilities	**924314**	**3076174**	**14302750**	**57578255**	**89290729**

Source: Bank of Guyana

2.1 Prereform financial sector

Until the end of the 1980's, Guyana's financial system was characterised by selective credit allocation and interest rate controls. Credit was increasingly directed to specific industries, sectors and public sector corporations while interest rate restrictions were in the form of interest rate ceiling. These policies were motivated by the social aspect of banking i.e. to guard against increases in interest rates and to provide low-cost funding to priority sectors. These policies achieved their objectives. However, they restricted monetary policy to direct controls and changes in the minimum liquid assets and reserve requirements. In addition, financial institutions and markets had either deteriorated or failed to develop. Accounting systems were lax, disclosure was poor and surveillance weak. An unstable financial system with a defective regulatory framework made commercial

lending very risky with banks burdened with portfolios dominated by unproductive and nonperforming assets. The operational efficiency of the banks was highly unsatisfactory.

2.2 Financial Sector Reforms: 1988-1997

Guyana has been undertaking reforms of its financial sector as part of a broader macroeconomic adjustment program and structural reform since 1988. Key elements of the reform were aimed at improving the efficiency of the financial system and enhancing competition among institutions; strengthening the prudential framework; and developing and deepening financial markets.

2.2.1 Policies to improve efficiency and competition in the financial sector

The central features of these reform measures comprised the removal of restrictions on interest rates, credit and foreign exchange transactions and the use of indirect instruments of monetary policy. In mid-1991, the Central Bank introduced a competitive bidding process for treasury bill auctions. The bank rate and the rediscount rate were determined in relation to the market determined treasury bill rate for 91 day bills. The frequency of treasury bill auctions increased to bi-weekly auctions in 1995 and then to weekly auctions in February 1996.

While the above measures helped to strengthen monetary control and increase the role of market forces in the financial system, monetary policy continued to rely on direct instruments of monetary control in the form of reserve requirements on commercial banks because of excess liquidity in the financial system. In mid-1991, reserve requirements on demand deposits were increased from 6.0 to 11.0 per cent and on savings and time deposits from 4.0 to 9.0 per cent. In April 1994, the reserve requirements went up further from 11.0 per cent of demand deposits and 9.0 per cent of savings and time deposits to 16.0 and 14.0 per cent respectively. The ratio has remained at the same level since then, but the scope of reserve requirements has been extended to include licensed non-bank depository institutions as well as the definition of reserves to include foreign currency deposits to provide a level playing field for all licensed depository financial institutions. The liquid asset ratio has remained at 25.0 per cent of the banks demand deposits and 20.0 per cent

of time deposits since May 1991. The scope and reporting period have been changed to reduce administrative cost.

In the external sector, measures included the abolition of exchange control and the establishment of a market determined exchange rate system. In 1990, both bank and non-bank foreign exchange markets (cambios) were allowed to operate. Partial convertibility of the Guyana dollar was introduced during the same year. Under the new system, two markets - the official and the cambio market co-existed. In February 1991, the exchange rate in the two markets was unified whereby the official rate was determined weekly based on the average free-market rates for the preceding week. In 1993, the Central Bank began inter-bank cambio market operations to achieve a closer integration of the official and cambio markets. In 1995, the Exchange Control Act was abolished.

A critical element of financial development is the payment system which has been a neglected area. However, steps have recently been taken to improve the payment system. At the retail payments level, cheque clearing is projected to be automated by the end of the year.

Reducing the role of the state in the financial sector is seen as critical to improve competitiveness and efficiency. At the end of 1997, government ownership of financial entities was reduced to 25 per cent of the end-1993 asset value of the group of banks the government owned at that time. This was achieved through the sale of all government shares in the Guyana Bank for Trade and Industry and the National Bank of Industry and Commerce.

2.2.3 Policies to strengthen the prudential framework and bank supervision

Concomitant with the relaxation of structural regulations was a step up of prudential regulations. This was brought about through the enactment of the Financial Institutions Act (FIA) in March 1995. The legislation requires all institutions carrying on banking and financial business to be licensed by the Bank of Guyana and centralises the surveillance responsibility over all licensed financial institutions on the Central Bank.

The improvement of supervision of financial institutions is primarily to promote the transparency of the status of financial institutions, to increase consumer protection and to ensure the safety and soundness of the system. The prudential requirements emphasise capital adequacy and asset quality. Capital adequacy requirement in line with internationally accepted standards has been implemented. In addition, commercial banks are required to follow the guidelines on the calculation of risk assets that the Bank of Guyana adopted from the Bank for International Settlements (BIS) guidelines.

The FIA also addresses issues of large exposures, limits on investment in non-bank companies, liquidity ratio, minimum capital for the setting up of a bank, licensing of new banks, insider lending, prohibited operations, loan classification, provisioning and other regulations that would limit risk and concentration of ownership of financial institutions. In addition to the FIA, a revised Central Bank Act, designed to increase the independence of the Central Bank is to be tabled in parliament. The off-site surveillance and on-site inspection of banks were strengthened.

2.2.3 Policies to develop and deepen financial markets

Money market and long term debt securities are thin and secondary markets are almost nonexistent. To encourage the latter development, the interbank market has been supported by the provision of the enabling framework recently announced by the Central Bank. Similarly, the government recently began preparing the necessary legislation for the establishment of capital markets. Notwithstanding, there are virtually no capital account restrictions.

3.0 Effects of Financial Sector Reform

The impact of the reform is difficult to assess since developments in the financial system have been driven by other factors that include the macroeconomic environment and developments in emerging and other markets. In addition, data and informational inadequacies constrain conclusive comments on the effects of the reform. Nevertheless, an assessment of the impact will focus on areas where tangible results of reforms have been witnessed: the efficiency in

intermediation, monetary management and quality of banks' loan portfolio.

Reforms have caused the range of financial services to expand considerably, especially in the form of deposits and credit instruments with the liberalisation and maintenance of positive real interest rates. Time and savings deposits increased sharply from G$3.8 billion in 1989 to G$18.4 billion in 1992 and to G$46.9 billion in 1997. As a per cent of broad money, quasi-money increased from 62 per cent in 1989 to 70 per cent in 1992 and to 73 per cent in 1997. This indicator suggests that reasonable interest rates, more branches, better service and more diversified savings instruments have contributed to a deepening of the financial system which raised aggregate savings.

In contrast to the quasi liquid assets to M2 ratio (see Table IV), the standard financial depth indicator of the ratio of money stock to GDP declined substantially after 1989. It fell from 114.5 per cent in 1988 to 68.1 per cent in 1990 but increased to 72.3 per cent in 1997. In the 1990-1997 period, the ratio has remained relatively stable except for a sharp decline in 1991. Similarly, the ratio of financial assets to GDP, which declined from 162.0 per cent in 1988 to 96.0 per cent in 1989 to 84.0 per cent in 1997, remained relatively stable over the 1989-1995 period with the exception of 1991. The decline in these ratios is attributed to the large devaluations of the Guyana dollar between 1989 and 1991 which resulted in considerable expansion of nominal GDP. Specifically in 1989, the Guyana dollar was devalued by 70 per cent to G$33 per US$1. In 1990, the Guyana dollar was further devalued from G$33 per US$1 to G$45 per US$1. In 1991, the Guyana dollar was again devalued from G$45 to G$101.75 per US$1. The use of intermediate monetary targets during the period of macroeconomic stabilisation, has helped to create a consistent framework within which the financial sector can grow further.

Table IV
Selected Monetary Indicators (1985-1997)

Year	Broad Money M2 % GDP	Deposit % GDP	Finan-cial Assets % GDP	Credit to Private Sector % GDP	Quasi Money (G$ Million)	Quasi Money % M2	Real Deposit Rate[1]	Real Lend-ing Rate[2]	Infla-tion Rate	Interest Rate Spread[3]	Aver-age Money Multip lier
1985	115.6	109.2	181.8	31.1	1215.4	64.5	-3.1	-0.1	15.1	...	
1986	122.7	117.5	201.4	36.5	1453.6	65.1	4.1	7.1	7.9	...	
1987	105.2	117.5	155.3	32.3	1859.9	62.0	-16.7	-13.7	28.7	...	
1988	114.5	127.0	161.9	43.9	2462.6	59.8	-28.0	-25.0	40.0	5.5	
1989	68.2	78.3	96.2	27.8	3809.3	61.5	-87.8	-84.0	120.0	6.6	
1990	68.1	77.9	97.0	29.7	5982.9	63.6	-56.9	-54.0	85.0	4.9	
1991	48.4	56.7	71.4	19.8	10256.9	63.1	-41.1	-36.8	70.3	9.0	3.2
1992	64.6	76.1	87.9	21.5	18355.0	70.3	4.0	11.7	14.2	13.1	2.5
1993	67.4	75.9	89.7	20.7	23991.8	71.9	2.2	8.8	8.7	8.7	3.1
1994	61.9	63.7	86.0	27.8	26849.3	68.6	-3.3	3.8	16.1	9.8	3.2
1995	67.3	66.5	90.8	28.2	35332.7	71.6	4.7	11.0	8.1	9.9	3.2
1996	70.0	73.0		44.1	41543.1	72.1	4.5	12.5	4.5	10.73	2.7
1997	72.3	78.4		50.5	46930.5	73.0	4.2	12.8	4.2	10.93	2.8

Source: Bank of Guyana's:
Statistical Abstract (Dec 1994, Mar 1998)
Annual Report (1991, 1997)

... Not available
1/ Commercial Banks' three month time deposit rate
2/ Average prime lending rate
3/ Weighted average lending rate less average savings rate

As regards credit dispensation (see Table V), since 1989, the bulk of commercial bank credit has gone to the private sector. Not only has the credit growth been significant in absolute terms, but the ratio too has improved. The share of credit to the private sector rose from 39.0 per cent in 1985 to 88.0 per cent in 1992 to over 94 per cent between 1993 and 1997. With fiscal adjustment, the public sector, which was the largest borrower, became a net depositor to the banking system. The increase in private sector credit indicates that the banks have been diversifying their loan portfolio and looking out for new loan accounts. The sectoral distribution of the stock of private sector credit however shows that credit to business enterprises, including agriculture, manufacturing, mining and

services, has declined from 85.0 per cent in 1989 to 83.0 per cent in 1992 and to 80 per cent in 1997. The share of credit to households has, however, gone up from 13.3 per cent in 1989 to 20 per cent in 1997.

Table V
Commercial Banks Credit Allocation (1995-1997)

Year	Banking System Net Dom. Credit[1] (G$Million)	Private Sector (G$Million)	Public Sector (G$Million)	Credit to Private Sector as % GDP	Private Sector Share of Total Credit	Business Ent. Share of Private Sect. Credit	Household Share of Private Sect. Credit
1985	1411	557	848	28.4	0.39	0.75	0.25
1986	1009	663	334	29.8	0.66	0.76	0.24
1987	1355	943	398	28.1	0.69	0.74	0.26
1988	2145	1559	580	37.7	0.73	0.84	0.16
1989	3219	2519	688	24.4	0.78	0.86	0.13
1990	4914	4109	791	26.0	0.84	0.84	0.16
1991	7092	6620	403	17.0	0.93	0.85	0.15
1992	9896	8680	903	18.6	0.88	0.83	0.17
1993	11277	10207	544	17.3	0.91	0.79	0.20
1994	15076	13799	221	18.2	0.92	0.77	0.23
1995	22190	20657	479	23.4	0.93	0.74	0.26
1996	37162	35864	284	36.2	0.97	0.83	0.17
1997	44540	42921	221	41.0	0.96	0.80	0.20

Source: Bank of Guyana Annual Report (1997)
1/ Includes Non-Bank Financial Institutions

The key element of reform from the point of view of monetary management has been the transition to indirect instruments of monetary policy, largely at present through the regular auction of treasury bills. This has resulted in an improvement in the capabilities of the Bank of Guyana to regulate more effectively the growth in money and credit, through a market mechanism. The absorption of excess liquidity through the issue of treasury bills, has brought about better control and management of the money supply, as evidenced by the relative stability of the money multiplier

during the 1992-1997 period. The auction mechanism is helping to create competitive market conditions, by compelling banks to critically examine their funds management practices and the manner of pricing their deposits and loans.

Banks have emerged as the largest holders of treasury bills. The share of treasury bills in the asset portfolio of banks has gone up from 35.0 per cent in 1991 to 59.0 per cent in 1997. This has been largely due to the high yielding and riskless investment character of treasury bills. It is important to note that the auctioning of treasury bills for sterilisation purposes, which has improved the management of liquidity, has resulted in a high interest expenditure to the government of approximately G$25.0 billion during 1991-1997.

The greater freedom to acquire foreign exchange combined with a market-determined exchange rate has enhanced the availability of foreign exchange to the country. The volume of all foreign exchange transactions has grown considerably. Total recorded transactions increased from US$329 million in 1991 to US$1.29 billion in 1997. The cambio market accounted for US$946.5 million or 73.4 per cent of total foreign currency transactions. While the foreign exchange market remains shallow, there has been an increase in the volume of interbank foreign exchange trading which reached almost US$14 million in some recent quarters. Within this total the central bank has been very active. The cambio spread between purchases and sales rates and among banks and non-banks has been decreasing as shown in Table VI.

While partial internal financial and economic convertibility enhanced the transparency of intermediation of foreign exchange in the economy, efficiency is constrained due to the lack of full financial market flexibility because complete internal convertibility, i.e the legal right of residents to acquire and maintain domestic holdings of certain assets denominated in foreign currencies has not been granted. It is argued that complete internal convertibility may lead to currency substitution or dollarisation and consequent loss of revenue from seigniorage and inflation tax. Also, the authorities ability to conduct monetary policy may be substantially weakened because the foreign currency component of total money supply cannot be directly controlled and hence, the ability to

control inflation.

Table VI
Exchange Rate (1991-1997)
(Guyana Dollars Per US$)

	1991	1992	1993	1994	1995	1996	1997
Buying	117.27	123.97	125.89	137.64	140.28	138.25	140.51
Selling	119.80	125.91	127.82	140.14	143.42	141.84	143.28
Spread	2.53	1.94	1.93	2.50	3.14	3.59	2.77
A. Bank Cambio Exchange Rate:	**1994**		**1995**		**1996**		**1997**
Buying	136.56		139.22		137.55		141.02
Selling	139.60		143.61		142.36		144.00
Mid Rate	138.08		141.42		139.96		142.51
B. Non-Bank Cambio Exchange Rate:							
Buying	138.76		141.30		139.32		140.43
Selling	140.71		143.42		141.41		143.00
Mid Rate	139.74		142.36		140.37		141.72
Spreads							
Bank	3.04		4.39		4.81		2.98
Non-Banks	1.95		2.12		2.09		2.57

Source: Bank of Guyana

Financial intermediation costs have not shown significant positive adjustment with the liberalisation of interest deposit and lending rates, often used as a proxy for efficiency of financial intermediation remains large because of a lack of flexibility in bank interest rates, although in the recent period narrowing of the spreads has been observed. This spread went up from 4.94 per cent in 1990 to 13.18 per cent in 1992 and declined to 12.9 per cent in 1997. The large spreads reflected administrative costs, loan loss provisioning, taxes, after tax profit margin and required reserves. Administrative costs is the major contribution to the spread, accounting for over 50 per cent of the total spread. It stands out across all banks, though for the small private banks, it is far more

significant, averaging more than 75 per cent of their individual spread. The high administrative costs of these banks is partly explained by financial innovation, in the form of computerisation, ATM machines and debit card facilities undertaken by these banks. A consequence of financial innovation is the employment of qualified staff which resulted in a higher wage bill, thereby contributing to the high administrative cost. In addition, the fact that these banks do not have branches, except for one, their average fixed costs have been higher as their scale and scope of operation have been limited, thereby increasing intermediation cost.

Financial results of banks (Table VII) show that returns on equity and on assets, have fallen during the 1991-1997 period. The ratio of net profit to equity (ROE) declined from 53.5 per cent in 1991 to 27.7 per cent in 1993 and further to 8.4 per cent in 1997. Similarly, the ratio of net profit to asset (ROA) also declined from 9.1 per cent in 1991 to 4.0 per cent in 1993 and to 2.4 per cent in 1997. The decline in profit is explained by falling earnings. The ratio of operating income to assets declined from 21.3 per cent in 1991 to 10.7 per cent in 1997 while the operating expenses to assets ratio declined from 14.5 per cent in 1991 to 8.4 per cent in 1997. Moreover, the ratio of total operating expenses to total operating income increased from 68.3 per cent in 1991 to 72.5 per cent in 1993 and to 77.9 per cent in 1997. Provision for bad loans and narrow opportunities to invest excess resources also had an impact on bank profits. In 1991, the ratio of excess reserves to total deposits which was 1.03 per cent declined to 0.16 per cent in 1994 but increased sharply to 3.41 per cent in 1995. The relatively large ratio in 1995 is explained in part by the removal of interest earning on (the) special deposit (scheme) at the central bank at end 1994.

Table VII
Commercial Bank Performance Indicators (1991-1997)

Percent	1991	1992	1993	1994	1995	1996	1997
Net profit to equity - ROE	53.5	37.4	27.7	27.7	16.5	11.5	8.4
Net profit to asset - ROA	9.1	5.0	4.0	3.9	2.9	3.2	2.4
Operating income to assets	21.3	16.7	14.6	13.9	14.1	12.2	10.7
Operating expenses to assets	14.5	11.7	10.5	10.0	11.2	9.0	8.4
Operating expenses to operating income	68.3	70.1	72.5	71.9	79.7	79.7	77.9

Source: Bank of Guyana; Author's calculation

The inability of banks to predict long term interest rates and assess risk also explains in part banks' excess reserves, falling profits and consequently, the wide interest rate margin. Specifically, when interest rates are forecastable, then the expectation theory of the term structure implies that long term rates should always reflect actual short term rates. If interest rates are unforecastable, then there will be mismatches between long and actual short rates. These maturity gaps cause problems for financial intermediaries who typically borrow short term and lend long term. In view of this, banks are reluctant to lend in the long term.

Prudential regulations and banking supervision have been strengthened considerably in recent years. As a result, the soundness of the banking system has improved. The capital base of banks has been enhanced since 1991. The level of capital increased from G$2.1 billion in 1991 to G$5.4 billion in 1995 to G$15.1 billion in 1997. As a share of total assets, capital increased from 8.2 per cent in 1991 to 9.4 per cent in 1995 to 17 per cent in 1997. The average risk-weighted capital adequacy ratio was well above the minimum 8 per cent required after 1995.

Non-performing loans have declined between 1992-1997. In 1997, it amounted to 14 per cent of total loan[2], much lower than the 22.7 per cent in 1995 and 40.69 per cent in 1992. Expressed in terms of total assets, there was also a decline from 10.4 per cent in 1992 to 8 per cent in 1997. The share of general provisions has decreased with a reduction in non performing loans. However, provisions as a percentage of non-performing loans have decreased from 63.5 per cent in 1992 to 51 per cent in 1997.

IV Challenges ahead in the Financial Sector

Guyana has made significant progress in enhancing the effectiveness of monetary policy and reforming its financial system. In the future, to achieve high sustainable rates of growth, the reform

[2] Net of non-performing loan of the merged Gaibank with GNCB.

efforts will have to continue to enhance the mechanism for efficient mobilisation of domestic and foreign savings and ensure their efficient allocation. In this regard, the thrust of reform efforts will have to be on financial deepening, that is, development of institutions, markets and instruments. In addition, it is crucial that a sound financial system is maintained to support the process.

Financial institutions in Guyana need to be efficient, innovative and productive in conducting their basic function of intermediation to reduce cost and tap new areas of activity to increase profitability levels. To achieve this, institutions will have to have the necessary capital strength, personnel and expertise. With adequate capital, institutions will be able to invest in information technology, training and product development. Information technology is crucial in contributing towards improvement in services, convenience, productivity and profitability and will have to assume a greater role in the financial sector and in particular the banking industry. While information technology has played an important role in the modest modernisation of financial transactions in Guyana through the electronic payment mechanism using credit cards, debit cards and ATM, one critical area is an electronic clearing house for cheques that can alleviate the long delays encountered by the present manual clearing of cheques. A national automated cheque clearing system using image-based technology is being acquired by the Bank to provide same day clearing of all local cheques nationwide.

To meet the challenges ahead and respond to the needs of a changing economy, information technology will have to be extended to other more strategic areas such as the creation of new products and services; enhancing productivity through better utilisation of resources and productive capacity; corporate planning; risk management to assess the risk exposure of financial institutions; and market analysis. Effective use of information technology, however, requires its promotion within the organisation; effective flow and use of information; the training and development of information technology skills; and the optimising of its use within the context of business volume, operating cost and improvement of consumer service.

To remain adequately sound and profitable, the institutions will need to provide continuous

training for staff at all levels. Since financial reform usually entails a portfolio shift associated with increased risks, it is important that all players understand the risks involved and acquire the necessary skills to deal with such risks. In view of this, it is imperative that banks invest in risk management that will provide for adequate assessment of borrowers' condition, collateral values, portfolio risks under various scenarios and the adequacy of provisions to absorb potential losses.

The large level of concentration of the Guyanese banking system is a source of systemic risk. While there are no legal barriers to entry in the Guyanese banking system, the small size of the market acts as an impediment to entry. There is, therefore, a need for measures to promote an expansion of the smaller banks' market share and thus stronger levels of competition in the banking system. These may include policies to enhance the smaller banks competitive edge through operational efficiency, introduction of new products and access to foreign markets. The entry of specialised banks in the corporate end of the market and in trade finance where current services are not adequately provided, may also be encouraged to provide more competition in the market.

Money market, equity markets and the interbank market need to be developed to provide additional instruments to serve the needs of both savers and borrowers, thereby providing additional avenues to mobilise and allocate resources. Given the present thrust of market oriented reform in Guyana and the continuing downsizing of government's operations through the privatisation of public enterprises as well as the emphasis on the private sector as the main engine of growth, there is tremendous potential for the development of capital markets. The establishment of a merchant bank, mostly with equity participation from foreign investment banks to tap their expertise, can play an active role in innovating and promoting new capital market instruments. The central bank could also help in the reform process by stimulating growth of markets and instruments. Authorities can develop central bank certificates and bankers' acceptances orders to permit the withdrawal and injection of liquidity. A viable secondary market can also be developed for government securities by changing operating procedures.

These non-bank financial institutions and the manner in which they allocate their funds is

also linked to the development and growth of financial markets. There is little doubt that, with appropriate investment regulations, life insurance companies which hold the largest share of the assets of non bank financial institutions can play a major role in mobilising long-term financial resources as well as promoting capital market development by providing an effective demand for viable investment instruments. It is necessary, however, that the Insurance Act of 1970, which requires insurance companies operating in Guyana to keep 90 per cent of the assets of their insurance funds in local investment, be revised and the institutional capacity to enforce the Insurance Act be properly developed.

The profitability of institutions and efficient functioning of markets depend crucially on the continued existence of a sound financial system. While the central bank has legislated the banking law so as to assure depositors' trust on the soundness of the banking system and ensure strong bank governance via the Financial Institutions Act, there is a dire need to enhance its resources and skill base to enforce the law and effectively deal with the changes in the banking environment in Guyana. Institutional strengthening through the garnering of expertise and resources, training, stronger collaboration in the sharing of information between countries in the region, introduction of new accounting standards, self regulation through strengthened internal bank governance and use of external auditors can go a long way toward fostering bank soundness.

Bank soundness depends also on a conducive macroeconomic environment. It is crucial that a non-inflationary macroeconomic environment is maintained that is conducive to efficiency within the sector and for an efficient transmission of monetary policy signals to the economy. In this regard, it is important that monetary and fiscal discipline as well as a realistic exchange rate are adhered to so that relative prices are not distorted and the price system is able to perform the role of resource mobilisation and allocation on the basis of sound criteria relevant for improving investment and productive efficiency.

Monetary management as a complement of macroeconomic policy in general is another key component of bank soundness. Between 1991 and 1997, monetary control improved as a result of

the transition to indirect instruments (treasury bills) and evidenced by the substantial decline in the volatility of the money multiplier. This suggests that the bank should pursue an independent monetary policy through the conduct of open market operations, (which the Bank is working towards), where the money supply is influenced through base reserve money. This operation is very complex and requires timely and accurate data on financial sector developments, the balance sheet of the central bank and quantification of key monetary relationships. In addition, projections of the demand for and supply of currency and bank resources as well as estimates of their effect on money aggregates are crucial (Alexander, W.E., Balino, T., Enoch, C. 1995). Strengthening of the central bank technical capacity as well as investment in information technology are important for this undertaking.

It is important to note that open-market operations could not be continuously relied on, particularly when the stage of development of securities markets are thin and illiquid and where there is sustained fiscal imbalance and major capital inflow. In these situations, open market operations are extremely costly and frustrate the element of macroeconomic policy objectives, especially higher domestic interest rates (Lee, 1996). It would be desirable, therefore, for authorities to consider alternative or supplementary techniques and instruments that would provide the scope for more efficient monetary management which has been focussing on sterilisation of excess liquidity. Judicious use of direct controls altering access to central bank's refinance facility, switching government deposits between commercial banks and the central bank and using currency swap operations are some supplementary sterilisation measures.

Conclusion

The financial sector in Guyana has undergone a far reaching process of reform. Controls on interest rate and bank credits have been removed and a more market oriented approach through the indirect instruments of reserve requirements, open market type operations and discount facilities control have been implemented. The reforms have had positive effects. They have created an environment conducive to financial intermediation and a sound banking system. They enabled the economy to mobilise funds for investment and growth, as well as contributed to the development

of the private sector. Inspite of the positive developments that are taking place in the banking system, the Guyanese policy makers understand the need for further banking reform and hence, more steps to be taken to restructure the financial system.

In the future, the need to intensify financial reforms is overwhelming in view of the fact that Guyana's challenges in achieving high sustainable rates of growth depend on enhancing the mobilisation of domestic and foreign savings and ensuring their efficient allocation. Improving the operational efficiency of the financial system is crucial. Institutional developments, creation of new products for fund mobilisation and credit expansion as well as financial markets deepening are necessary. It is also imperative that macro economic policies are consistent with financial reform. Bringing the fiscal deficit under control is vital for financial stability since it is directly related to high rates of inflation which hampers the desired improvements in productive sector performance.

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