FINANCIAL STABILITY IN THE CARIBBEAN REGION*:*

MAIN FINDINGS FROM THE DRAFT REGIONAL FINANCIAL STABILITY REPORT

FINANCIAL STABILITY, INTERCONNECTEDNESS AND RISK ASSESSMENT IN THE CARIBBEAN

Port-of-Spain, Trinidad and Tobago

March 19 – 20, 2015

OVERVIEW

1. Definition of Financial Stability
2. Structure of Regional Financial Stability Report (RFSR)
3. Main Findings of Draft Report on Financial Sector Risks and Financial Stability
   a. Structure of Financial System
   b. Macroeconomic Imbalances and their Impact
   c. Micro Prudential Indicators
   d. Initiatives to Strengthen Stability

FINANCIAL STABILITY

"… a condition in which the financial system – intermediaries, markets and market infrastructures – can withstand shocks without major disruption in financial intermediation and in the effective allocation of savings to productive investment."

European Central Bank

STRUCTURE OF RFSR

- **Chapter 1: Overview of Financial Stability in the Caribbean**
- **Chapter 2: Global and Regional Macro-Financial Environment**
- **Chapter 3: Structure of the Caribbean Financial System**
- **Chapter 4: Performance of Financial Institutions**
- **Chapter 5: Interconnectedness and Financial Stability**
- **Chapter 6: Policy Initiatives for Maintaining Financial Stability**

SCOPE

- RFSR covers, from a regional perspective, developments in Barbados, Belize, ECCU, Guyana, Haiti, Jamaica, Suriname, The Bahamas and Trinidad and Tobago;
- The data cut-off is 2013;
- Focus on banking and insurance sectors
  – Data gaps with respect to insurance.

Characteristics of Caribbean Countries - Population, Total Area and Type of Economy

Country	Population	Total Area (km²)	Type of Economy
Anguilla	15,358	91	Consumer Service Export (Tourism)
Antigua and Barbuda	88,710	443	Consumer Service Export (Tourism)
The Bahamas	342,877	13,940	Consumer Service Export (Tourism)
Barbados	273,331	430	Consumer Service Export (Tourism)
Belize	307,000	22,966	Goods Export (Agricultural products and oil)
Dominica	67,757	751	Consumer Service Export (Tourism)
Grenada	104,487	344	Consumer Service Export (Tourism)
Guyana	754,493	214,970	Mixed - Goods Export/Consumer Service Export (Tourism)
Haiti	10,700,000	27,750	Mixed - Agricultural Products/ Consumer Service Export (Tourism)
Jamaica	2,741,052	10,991	Mixed - Goods Export/Consumer Service Export (Tourism)
Montserrat	5,934	40	Consumer Service Export (Tourism)
Saint Kitts and Nevis	52,402	260	Consumer Service Export (Tourism)
Saint Lucia	174,267	617	Consumer Service Export (Tourism)
St. Vincent and the Grenadines	109,333	389	Consumer Service Export (Tourism)
Suriname	524,636	163,270	Mixed – Goods Export (Energy and bauxite/alumina)
Trinidad and Tobago	1,341,465	5,130	Goods Export (Energy)

STRUCTURE OF FINANCIAL SYSTEM

- The financial sector in the Caribbean is
  - large relative to the size of the economies (131 % of GDP);
  - dominated by banks whose assets account for 91% of GDP ;
  - dominated by foreign banks which account for about 60% of banking system assets;
  - experiencing growth in non-bank financial institutions (NBFIs);
  - financial institutions often serve as repository of funds of other institutions;
  - at embryonic stage as it relates to rating agencies and credit bureaus and lacks vibrant debt and equity markets.

Structure of Financial System: Number of Institutions

	Barbados	Belize	ECCU	Guyana	Haiti	Jamaica	Suriname	The Bahamas	Trinidad & Tobago	Caribbean
Banks	6	6	40	6	9	7	9	8	8	99
Local	0	1	14	3	7	1	8	3	2	39
Foreign	6	5	26	3	2	6	1	5	6	60
Credit Unions	35	12	61	25		44	26	25	131	359
Insurance Companies	30	13	158	15		15	13	15	37	296
Other	7		31	1		40			22	101
	78	31	290	47	9	106	48	48	198	855

BANKING SECTOR

- The size of the banking sector varies quite significantly across jurisdictions. The Bahamas has the largest banking system, equivalent to 150 per cent of its GDP, while Jamaica is at the other extreme, with a banking sector equivalent to just under 50 per cent of its GDP;
- Four largest banking groups account for 75% of assets;
- Canadian branch/ subsidiary operations exist in most jurisdictions;
- High level of indigenous banks in the ECCU area.

NON-BANKING SECTOR

- Credit Unions are becoming increasingly important with assets amounting to 7 per cent of regional GDP but their importance varies widely among countries. The largest credit union sectors as a share of GDP are in the small markets of Dominica (39 per cent of GDP) and Montserrat (36 per cent of GDP).

- Penetration ratio for credit unions is over 50% in at least 7 countries and over 40% in two others. The average penetration ratio is above 16% which compares favourably except with North America.

- The insurance sector is dominated by regional conglomerates, and its assets account for about 17 per cent of regional GDP. The largest insurance sectors are in the Bahamas, Barbados, Jamaica and Trinidad and Tobago.

- Other types of institutions include building societies (mainly Jamaica) and finance companies (mainly Trinidad and Tobago).

EQUITY MARKET

- Vibrant stock markets do not exist across the region as evidenced by
  - Low level of listed stocks in jurisdictions where stock exchanges exist.
  - Low volatility and turnover ratios of listed stocks.
- Market capitalisation varies among jurisdictions.
- High incidence of cross-border listing but low level of price convergence.
- No observed impact on financial stability.

BOND MARKET

- Market dominated by government securities
  - Insurance companies and pension funds traditionally demanded these instruments.
- Concern about government debt restructurings
  - recent IMF programmes have sought to mitigate potential impact of these restructurings on financial institutions and hence on financial stability.

SYSTEMIC RISK

- **Systemic risk** is important in the Caribbean.
  - certain banks and insurance companies are large enough to each account for a very significant share of the sector's assets and liabilities in the national domain, such that a collapse could imperil the integrity of the financial system, with dire consequences for depositors, policy holders, shareholders and other stakeholders.

SYSTEMIC RISK

Systemic risk is of further concern because

- a collapsing Systemically Important Financial Institution (SIFI) may have conglomerate style ownership and network arrangements with firms in other financial and real sectors, thus generating a transmission of risk to these entities.

– there is almost invariably a regional dimension in that the SIFI has subordinates in some other CARICOM countries e.g.

    - Republic Bank
    - Guardian; and
    - Sagicor.

CREDIT RISK

- Banks remain the main source of private sector financing across regional economies.
  - Partial data suggests that credit/GDP ratio has risen since 2008 and was higher in tourism dependent economies than commodity based economies.
  - Credit growth has been modest.
- Significant asset concentration in exposures particularly to export services sectors;
- Increasing exposure to real estate for direct lending and collateral;
  - Inadequate data on real estate price indices.
- The absence of significant equity and bond markets heightens credit risk as a financial stability issue.

MACROECONOMIC IMBALANCES

- Growth
  - Subject to exogenous shocks
  - Tourism based economies badly impacted by effects of global financial crisis
  - Unemployment
- Fiscal imbalance
  - Revenues unable to match expenditures for social programmes and infrastructural development
- Debt
  - High incidence of debt has created need for adjustment measures
- Foreign exchange payments gap
  - Foreign investment
  - Imports
  - Exports

SOVEREIGN RISK

- **Sovereign risk** is of concern to banks and other institutional investors in certain Caribbean countries, owing to the level of government indebtedness and the difficulties these countries have in servicing both the domestic and foreign components of the debt.
  - in recent years, at least three countries have technically defaulted and/or restructured and been in receipt of IMF assistance.
  - comparing 2013 debt figures with those for 2012, shows that the degree of indebtedness continues to increase for both the commodity and services based economies, especially with respect to domestic debt.
  - the risk posed by distressed governments' defaults or debt exchanges to the balance sheets of institutional investors may be equally matched by a related lack of business confidence and adverse effects on the level of economic activity.

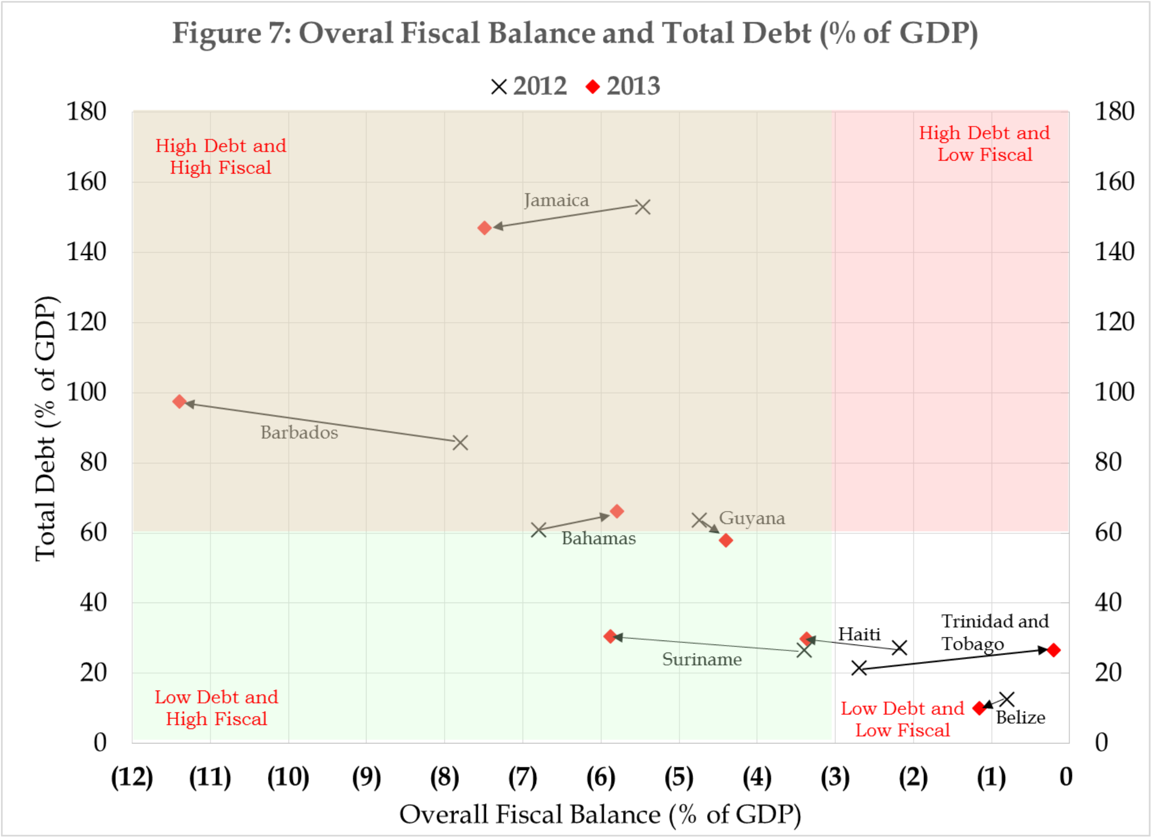

Figure 7: Overal Fiscal Balance and Total Debt (% of GDP)
2012
2013
180
160
140
120
100
80
60
40
20
0
Total Debt (% of GDP)
High Debt and
High Fiscal
High Debt and
Low Fiscal
Low Debt and
High Fiscal
Low Debt and
Low Fiscal
Jamaica
Barbados
Bahamas
Guyana
Suriname
Haiti
Trinidad and
Tobago
Belize
(12)
(11)
(10)
(9)
(8)
(7)
(6)
(5)
(4)
(3)
(2)
(1)
0
Overall Fiscal Balance (% of GDP)

Commodity-Type Economies	2012	2013	% Increase
Commodity Producers			
Domestic Debt to GDP	15.5	16.8	8.4
External Debt to GDP	21.8	21.5	-1.4
Total Debt to GDP	37.3	38.3	2.7
Services-Based Producers			
Domestic Debt to GDP	53.2	58.5	10.0
External Debt to GDP	21.5	22.7	5.6
Total Debt to GDP	74.7	81.2	8.7
Overall Average			
Domestic Debt to GDP	34.4	37.7	9.6
External Debt to GDP	21.7	22.1	1.8
Total Debt to GDP	56.1	59.8	6.6

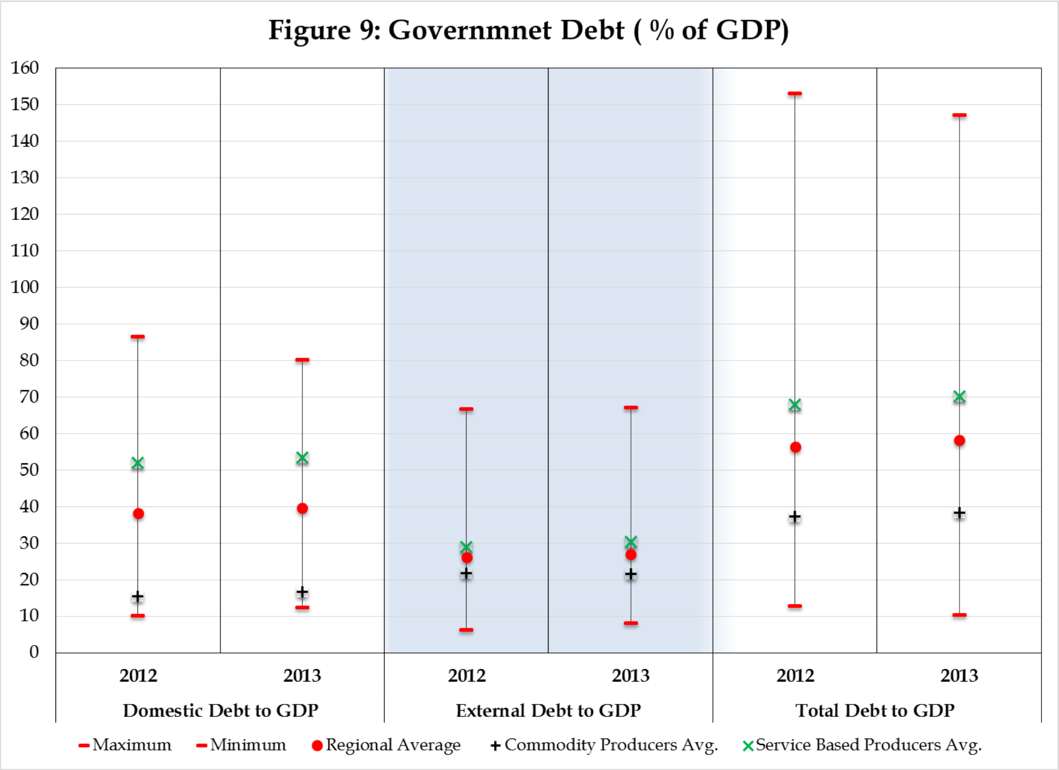

Figure 9: Governmnet Debt (% of GDP)
160
150
140
130
120
110
100
90
80
70
60
50
40
30
20
10
0
2012
2013
2012
2013
2012
2013
Domestic Debt to GDP
External Debt to GDP
Total Debt to GDP
Maximum
Minimum
Regional Average
Commodity Producers Avg.
Service Based Producers Avg.

FOREIGN EXCHANGE RISK

- **Foreign exchange risk** obtains at the level of operation and management of both the financial institutions and the economy as a whole.
- For the financial institutions, currency mismatch between assets and liabilities could pose a threat to their balance sheets if exchange rates (especially for the US dollar) move in an unexpected direction in non-pegged economies.
  - This does not seem to directly constitute a serious problem for financial institutions in the Caribbean countries, since the currency of some countries is pegged and the currency of the floating rate regimes is for the most part carefully managed so as to remain within a certain range.

FOREIGN EXCHANGE RISK

- At the national level, a latent but persistent threat is that the foreign exchange earnings of Caribbean countries may not match the demand for foreign exchange, given the high income elasticity of demand for imports. Since the advent of the global financial and economic crisis,
  - The services (particularly tourism) oriented economies have been experiencing some pressure on their foreign exchange reserves.
  - With respect to the commodity-based economies, similar problems began to be experienced in the second half of 2013.

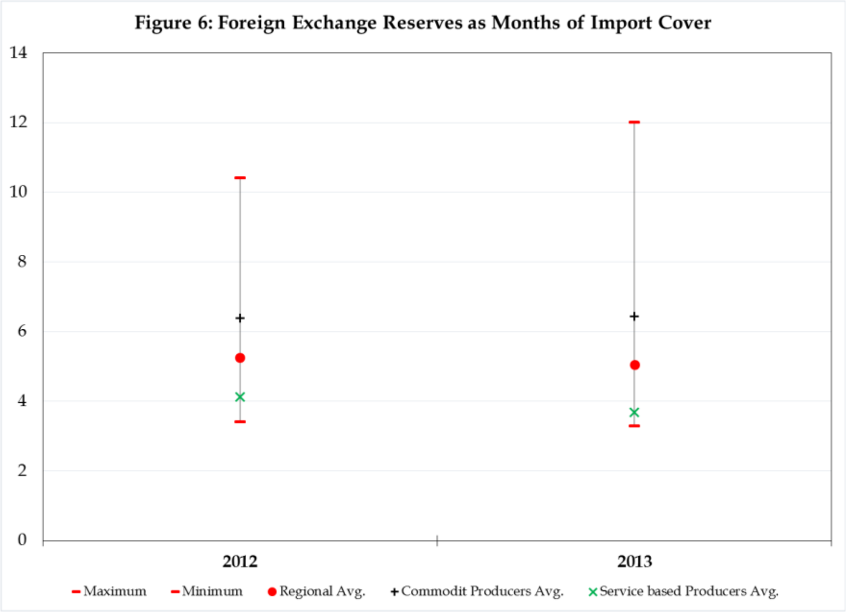
Figure 6: Foreign Exchange Reserves as Months of Import Cover
14
12
10
8
6
4
2
0
2012
2013
Maximum
Minimum
Regional Avg.
Commodit Producers Avg.
Service based Producers Avg.

MICRO PRUDENTIAL INDICATORS

- The banking system is stable as measured by
  - Capital adequacy ratios which have increased as banks shifted from private sector lending to holding more cash; and
  - Liquidity ratios which have improved, the result of increased holdings of cash .
- High levels of non-performing loans have depressed profitability.
- Non-performing loans for commodity based economies has been falling but rising significantly in at least two service-based economies.

Regional Financial Stability Averages
For Banks Pre- and Post- the Advent of the Crisis

Financial Stability Indicators	Period 2006-2008	Period 2009-2012	Periods % Difference	2012	2013
Regulatory Capital to Risk Weighted Assets	18.1	19.7	+ 8.9	19.1	20.6
Liquid Assets to Total Assets	21.1	26.9	+ 27.5	27.0	27.4
Non-Performing Loans to Total Loans	5.2	8.5	+ 63.4	8.7	8.3
Return on Equity	25.6	16.7	- 34.7	13.3	12.7
Return on Assets	2.9	1.8	- 37.9	1.5	1.6

Incidence of Non-Performing Loans (%) in Commodity and Service-Based Caribbean Economies, 2012 and 2013

Country	Commodity-Based		Services-Based	
	2012	2013	2012	2013
A	6.8	5.4	15.7	13.0
B	6.2	5.9	11.7	10.6
C	5.4	4.3	14.8	17.2
D	-	-	2.4	2.4
E	-	-	5.4	6.8
Average	6.1	5.2	10.0	10.0

STATE OF FINANCIAL SYSTEM

- Financial Sector is
  - Dominated by the banking sector
  - Vulnerable to exogenous shocks
  - Increasingly interconnected; but
  - Stable

- The Region's financial stability still bears careful watching, partly because of
  - the risks and vulnerabilities emanating from significant macro-imbalances;
  - the risks associated with its less than mature financial markets;
  - the skewed nature of the exposure to the non-financial sectors;
  - the limited degree of asset diversification in the critical banking and insurance sectors;
  - the significant weighting of systemically important financial institutions (SIFIs); and
  - the incomplete state of financial reform in the various jurisdictions.

INITIATIVES TO STRENGTHEN FINANCIAL SECTOR

- Make financial stability an explicit function of the central bank.
- Harmonise regulatory policies.
- Implement credit union reforms.
- Strengthen oversight of insurance sector.
- Strengthen framework for consolidated supervision.
- Determine strategy for dealing with SIFIs.

INITIATIVES TO STRENGTHEN FINANCIAL SECTOR

- Broaden the coverage of credit bureaus as precursor to a regional credit bureau.
- Carry out reviews of institutional investors that would minimise excessive concentration of assets or orientation of portfolios towards risky activities or assets susceptible to the development of bubbles.

INITIATIVES TO STRENGTHEN FINANCIAL SECTOR

- Insurance
  - Reinforce the power of the regulator to obtain timely, in-depth information.
  - Ensure strict adherence to statutory fund requirements.
  - Monitor product innovation.

THE END