

## **Sir K Dwight Venner: Recent financial and economic developments in the Eastern Caribbean**

Presentation by Sir K Dwight Venner, Governor of the Eastern Caribbean Central Bank, on the ECCB 2005/06 Annual Report, St Kitts, 28 June 2006.

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### **Rationale**

I am using this medium to report to you on the performance of the Eastern Caribbean Central Bank because as the sole issuer of the EC currency, the Central Bank's work touches the lives of all citizens in the eight member countries.

The aim of my presentation is, therefore, to enable a wide cross-section of persons throughout the region to have a better understanding of what the Bank does to ensure that you have a strong, stable currency.

### **The Bank's objectives**

The Bank's major objectives are monetary and financial stability, both of which are important elements in the process of economic development.

Monetary stability allows consumers and investors to conduct their business with confidence in the purchasing power of the EC dollar. In this regard, the Bank's monetary policy focus is to maintain the value of the EC dollar to the US dollar at the rate of 2.7 to 1.

To sustain this, the Bank is required, by law, to hold foreign exchange reserves equivalent to 60 per cent of the currency in circulation and other demand liabilities.

Financial stability, that is, financial markets, operating in a sound financial system allows all of us to deposit our savings and increase our investments, knowing that our assets are safe.

The system is only as safe and sound as the banks within it, therefore the ECCB regulates and supervises commercial banks to ensure that they operate within prescribed guidelines.

At the same time, as part of the effort to increase investment opportunities, the Bank is encouraging the development of new money and capital markets.

### **The Bank's operating environment**

The ECCB is one of only four multi-state central banks in the world. As the Monetary Authority in a collective arrangement, the Bank is required to work very closely with the member governments to ensure that the fiscal infrastructure required for safeguarding the value of the currency remains in place.

The economies of these same countries are intrinsically bound by virtue of the shared currency, and developments in any one economy may affect the entire Eastern Caribbean Currency Union. This means that the governments of these countries must also collaborate very closely on an ongoing basis.

The ECCB's governance structure facilitates this collaborative process, since the institution's highest decision making body, the Monetary Council, is made up of the ministers of finance from the eight countries.

As Council members, they provide directives and guidelines to the Bank on monetary and credit policy issues. As elected representatives, accountable to the people and with cabinet and legislative responsibilities in their respective countries, the ministers spearhead implementation of the requisite legislative arrangements and fiscal policies to ensure that the financial system remains safe and the EC dollar remains stable.

It is within this framework that the operations of the Bank are conducted, with due consideration being given to various factors in the economies of the member states, as well as in the wider external environment.

### **The external environment**

Major considerations during the course of the year were:

- First, the sharp upturn in the prices of fuel and petroleum products, with accompanying hikes in the costs of transportation, electricity, imported building materials as well as domestically produced goods and services.

This resulted in an increase in the inflation rate in ECCU countries to 4 per cent in 2005, up from 2.6 per cent in 2004.

- Second, growth in the currency union of approximately 5 per cent, compared with 3.9 per cent in 2004, driven largely by increased construction activity, in preparation for the Cricket World Cup 2007.
- Third, a weakening in the tourism sector in 2005, and
- Fourth, the rising interest rate environment existing in the United States.

Against this backdrop, let us now look at the performance of the Bank during the 2005/2006 financial year.

### **The Bank's performance**

I am happy to report that the Bank achieved its main objectives of monetary and financial sector stability.

The exchange rate peg of the EC dollar was maintained, and the foreign reserve backing of the currency stood at 96 per cent at 31 March 2006, well above the statutory requirement of 60 per cent.

In the area of financial sector stability among the initiatives undertaken were:

- The drafting of new prudential guidelines and regulations, aimed at strengthening its regulatory capacity and financial sector risk management in the Eastern Caribbean Currency Union;
- Refinement of the risk assessment model used as the basis for an early warning system. The model is used to stress-test institutions and the financial system, and
- Reducing the vulnerability of banks to credit risk by mandating the reduction in the tolerable limit for non-performing loans from 10 percent to the international benchmark of 5 per cent.

Recognising, however, the existence of gaps within the regulatory infrastructure, the Bank continues to collaborate with member governments to establish single regulatory units in each member territory to oversee financial institutions not regulated under the Banking Act.

The Bank established a Payment System Council to research, consult, and advise on payment system policy, in an effort to make the system in the Eastern Caribbean Currency Union more effective, efficient, reliable and secure.

One of the benefits from this will be that, in any of the Bank's member countries, you can have ready access to your accounts through the use of debit and credit cards.

There were also positive developments with respect to the Bank's money and capital market development programme during the year. Among these was the increase to five, in the number of governments participating in the Regional Government Securities Market, following the issue of treasury bills by the Government of Antigua and Barbuda. These five governments have benefited from a reduction in their cost of borrowing, while the public is now able to invest in a larger pool of investment instruments.

With respect to the Eastern Caribbean Securities Exchange, the listing of two prominent regional companies, Grace Kennedy Limited of Jamaica and FirstCaribbean International Bank Limited of

Barbados, is evidence that the efforts of the Bank to promote the Eastern Caribbean Securities Exchange as the CARICOM Exchange, are beginning to bear fruit.

As part of the effort to promote business development and to infuse an entrepreneurial spirit in the region's youth, the Bank collaborated with private and public sector partners to introduce the Junior Achievement programme in St Kitts and Nevis. Successful programmes are already operating in Grenada and Saint Lucia under the auspices of other interested parties in those countries. The Bank intends to work with partners in the other currency union countries where the Junior Achievement programme does not yet exist, to ensure that it is implemented.

Recognising the importance of public understanding and involvement in the economic development thrust, the Bank continued to expand its public education and awareness programme throughout the year.

Among the initiatives targeting school children, the media and the public were:

- A savings and investments course, which has now been implemented in Grenada, St Kitts and Nevis, Montserrat and Anguilla;
- Media round table discussions in all of the ECCB member countries.
- Press Briefings, following Monetary Council meetings, which have been aired on radio and television in member countries.
- Regional interactive discussions on the economic performance of currency union countries, and
- The opening of the OECS/ECCU Exhibition Centre with a mission to promote an understanding of the people, culture, history and economies of the OECS.

As the countries of the region move into the Caribbean Single Market and Economy, public understanding of the financial and economic issues which govern the arrangement will be imperative.

During the year, the Bank restructured its operations, in an effort to improve its effectiveness and efficiency. A significant part of the restructuring effort was the establishment of a Statistics Department. This signals the increased importance being placed by the Bank on assisting member countries to gather relevant statistics in order to improve decision-making for economic development and improvement in the standard of living.

The ECCB's financial objective for 2005/ 2006 was expenditure reduction, in an attempt to keep expenditure in line with income earned on foreign reserve assets.

I am pleased to say that this objective was achieved notwithstanding the unfavourable performance of the US bond market in an increasing interest rate environment, which had an adverse effect on the Bank's portfolio of foreign reserves.

Operating income of \$64 million exceeded the budgeted amount by more than \$11 million. On the expenditure side, total expenditure of \$51 million was less than budgeted by just over \$1 million.

The conservative expectation for income, coupled with strict expenditure management controls, contributed to a higher than anticipated operating profit of just under \$13 million.

At 31 March 2006, the Bank's total assets stood at just over \$1.8 billion, a decline of 2.3 per cent when compared to the position last year. This decline, reflected in a contraction in the foreign reserves, was due primarily to foreign payments made by the Bank on behalf of member governments and commercial banks in the ECCU.

All in all, however, I am pleased to report that 2005/2006 was a successful and profitable year for the Bank.

The current financial year 2006/2007 will bring new challenges for the Bank and its member countries. We must persist in our joint efforts in the years ahead as we work to strengthen our own economic union.

This is necessary if the Bank is to continue to fulfil its mission to maintain the stability of the EC dollar and to ensure the safety and soundness of the banking system, for the benefit of the people of the Eastern Caribbean Currency Union.