

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 2010/11 Annual Report, St Kitts, 29 June 2011.

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Good evening fellow citizens of the Eastern Caribbean Currency Union.

This evening I am pleased to present the report on the performance of the Eastern Caribbean Central Bank for the financial year 2010/2011.

The purpose of this report is two-fold:

1. First, it is in-keeping with the transparency and accountability requirements of the Eastern Caribbean Central Bank Agreement Act 1983.
2. Second, the operations of the ECCB have a direct impact on the lives of all citizens of its member countries. It is therefore important that the public is provided with information on the operations of the Bank and the challenges it faces as it continues to pursue its mandate of maintaining the stability of the Eastern Caribbean currency and the region's banking system.

The size and nature of the economies of the Eastern Caribbean Currency Union (ECCU) render them particularly vulnerable to external shocks and natural disasters. This is the stark reality that the ECCB faces as it seeks to strengthen the region's financial structure in response to the impact of the global economic and financial crisis.

The external shocks which confronted the region over the past year have been manifested through the lingering effects of the global economic and financial meltdown. The global economy has been recovering from the recession of 2008/2009, but at a slow rate. Moreover, increases in oil ECCB Member and commodity prices, a significant weakening of the recovery process or a second round recession are possible downside risks given the prevailing uncertainty in the international economy.

In the United States of America, one of the region's main trading partners, stimulus interventions contributed to an estimated 2.8 per cent growth in GDP in 2010. However, the country continues to grapple with high unemployment and the economy continues to perform below capacity. This is particularly evident in the following areas:

- The very high level of sovereign debt and the stalemate between the major political parties on raising the legal debt ceiling and addressing the fiscal issues;
- The difficulties in the housing and real estate markets which are having a marked and negative impact on the pace of the recovery;
- The high level of unemployment which is now at approximately 9 per cent; and
- The significant impact of these factors on consumer spending which is the main driver of the American economy.

The European Union constitutes the largest single trading bloc in the international economy and has the second most important currency, the Euro. The Eurozone is being faced with very difficult financial issues as the peripheral states struggle to stave off default on their debts. Issues of a fiscal and banking nature are having a major impact on Europe with repercussions on the global capital markets. We are monitoring the situation in Europe very carefully as there must be lessons to be learnt from another currency union, especially the largest one in the international system.

Japan is the third largest economy in the world and the recent natural disasters and the resulting nuclear meltdown have had effects beyond its borders. Major impacts have been felt on the international money and capital markets and on the supply chain of inputs into the important electronics and auto industries. In addition, insurance premiums are rising and this is particularly critical in the Caribbean area as we begin another hurricane season.

The political upheavals in the Middle East and North Africa are having a marked impact through the rise in price of the most important internationally traded commodity, oil.

The emerging markets particularly China, the world's second largest economy, India and Brazil, which have been driving growth in the global economy, are taking steps to restrain their economies due to a significant increase in inflation. These factors make for great uncertainty in the international economic system and the possibility of a lower growth performance than projected.

In the ECCU, economic activity declined by 1.8 per cent in 2010, a slower rate compared with 5.4 per cent in 2009. Weak external demand and a reduction in domestic investment contributed to the decline which resulted in the continued contraction of activity in the construction and transport and communications sectors. Construction, which is one of the main contributors to growth in the ECCU, contracted by 21.8 per cent due to a decline in inflows of foreign direct investment.

In October 2010, two of the ECCU member countries, Saint Lucia and St Vincent and the Grenadines, suffered severe damage to their economic infrastructure due to the passage of Hurricane Tomas. This has resulted in a further weakening of their economies.

These international events and natural disasters have brought the vulnerabilities of the region's economies and financial structures into sharp focus. In response to these prevailing challenges and setbacks, the Bank, guided by its mandate, intensified its efforts to maintain financial and monetary stability and confidence in the ECCU financial system.

ECCB's performance

The international financial downturn has impacted the Bank's performance for the 2010/2011 financial year. The Bank realised a net income of \$22.6m a decrease of \$14.5m over the previous year's income of \$37.1m. This was due to the decrease in interest income on the Bank's investments in a declining interest rate environment.

As at 31 March 2011, the Bank's total assets amounted to \$2.8b an increase of \$256.1m when compared to the previous year. This was mainly due to inflows of grants and loans to member governments from international institutions.

Monetary stability

At the end of the financial year, the foreign reserve backing of the currency was 95.53 per cent, well above the legal benchmark of 60.0 per cent and the operational benchmark of 80.0 per cent. The level of foreign exchange reserves measured in months of imports was above the IMF benchmark of 3 months.

In an effort to ensure that its risk tolerance level was preserved in uncertain market conditions, the Bank rebalanced its customised benchmark to a two-year duration. The Bank also conducted a review of its reserve management custodian to ensure the continued safety of its foreign reserve assets.

In collaboration with De La Rue, the authorised printers of the EC banknotes, the Bank hosted an Expert Witness Training Course. The course was designed to provide law enforcement officers in the ECCU with the skills to assist the Bank in its quest to reduce the circulation of counterfeit EC notes and to increase the prosecution of offenders.

Financial stability

During the year, the Bank's efforts to ensure the safety and soundness of the ECCU financial system were concentrated on enhancing its regulatory, supervisory and monitoring frameworks. These initiatives included:

- The drafting of enabling legislation for the credit union and insurance sectors for passage by member governments;
- The implementation of the necessary apparatus for information-sharing and integrated supervision and regulation of the system;
- Development of a framework for the introduction of a repurchase facility to enhance liquidity support to commercial banks;
- Development of a liquidity monitoring and forecasting model;
- Working with the commercial banks to establish the ECCU Automated Clearing House (ACH); and
- Working with the Office of the Superintendent of Financial Institutions in Canada to adopt an advanced model of financial regulation.

Throughout the year, the Bank accelerated its efforts to mitigate the fallout from the global economic and financial crisis by restructuring and strengthening the financial sector. The Bank, in collaboration with member governments and with the support of the World Bank, continued the efforts to establish the Resolution Trust Corporation (RTC) to restructure and recapitalise financial institutions and manage troubled assets.

The Bank also provided support to the Ministerial Sub-Committees of the Monetary Council on banking, insurance, credit unions and international financial services in addressing and implementing solutions to the challenges in these sectors. During the year, a Ministerial Sub-Committee on Debt was appointed to facilitate timely decision making by the Council in respect of issues related to debt, growth and development in ECCU member countries.

The ECCB also played a pivotal role in the smooth transition of the Bank of Antigua Limited to the new entity, the Eastern Caribbean Amalgamated Bank Ltd (ECAB).

The Bank hosted the 89th Meeting of the Committee on International Monetary Law of the International Law Association in November 2010. It was the first time that the ECCB was hosting this high level meeting, which included committee members from the European Central Bank, the Federal Reserve Bank of New York and central banks from across the globe.

Monetary and capital market developments

In the area of money and capital market development, the Bank continued the preparations for the operationalisation of the Eastern Caribbean Enterprise Fund Limited (ECEEF) and the OECS Distribution and Transportation Company Limited (ODTC).

The ECEEF will provide capital, financial advisory services, technical assistance and general financial services to promote the growth of business ventures in the region, while the ODTC will serve as a third-party logistics company to facilitate trade across the OECS.

Throughout the year, the Bank continued to provide technical support to the member governments in accessing financing on the Regional Government Securities Market. The average weighted interest rate on 91-day Treasury bills declined from 5.69 per cent to 4.93 per cent. Hence, participating governments were able to lower their debt servicing costs on those instruments.

As part of the ECCB's mandate to facilitate the balanced growth and development of its member states, the Bank piloted the Entrepreneurship Module of its Savings and Investment Course in St Kitts and Nevis. The 10-month module provided the participants with the rudiments of conceiving a business idea, creating a business plan and setting-up and managing a business from a theoretical and practical standpoint. The course will be launched in the other seven member countries during the year.

Policy advice

In the policy sphere, the Bank supported the work of the Commissions on Tax Revenue, Pensions and Public Expenditure, established by the Monetary Council to develop efficient revenue and expenditure systems throughout the ECCU. In addition, the Bank, with the support of the Caribbean Regional Technical Assistance Centre (CARTAC) and the International Monetary Fund (IMF), hosted a mini boot camp for technical officers from member governments to facilitate the development of fiscal targets and systems for reporting and monitoring the targets.

The ability of ECCU member governments to assess, manage and service debt is critical to financial stability in the region and to achieving and sustaining their public sector debt target of 60.0 per cent of GDP by 2020.

Throughout the year, the Debt Management Advisory Services Unit (DMAS) at the ECCB continued to work closely with the Debt Management Units in the member countries to build their debt management capabilities and to address the deficiencies in their debt management strategies.

The Bank facilitated the establishment of a Task Force on Debt, Growth and Development to examine the prospects for economic growth in the ECCU and to recommend a path for stimulating and sustaining growth in the current high debt situation.

The Task Force is a collaborative effort involving the ECCB, the ECCU member governments, the OECS Secretariat, the Caribbean Development Bank, the World Bank, the IMF and the International Financial Corporation (IFC).

The Bank continued to play a critical role in implementing the various elements of the ECCU Eight Point Stabilization and Growth Programme. As the ECCU prepares for the transformation phase of the restructuring of its economies, starting in 2013, the ECCU Eight Point Stabilisation and Growth Programme must be consolidated into a strategic action plan with clearly defined and measurable goals.

This programme, together with the arrangements under the OECS Economic Union, provides the framework and guidelines for creating the necessary fiscal space and scope, reducing risk, effectively assessing and mitigating challenges and building resilience to external shocks in order to facilitate sustainable development.

The way forward

The year 2012 will be critical as the ECCU strives to consolidate its efforts to strengthen its economies and position itself to take advantage of the opportunities from the anticipated global economic recovery. The policy priorities for the Bank would therefore be to:

- Strengthen the framework for the early identification of risk and resolution of problems at weak financial institutions;
- Continue to explore appropriate monetary policy tools and the enhancement of market intelligence to influence money and credit conditions and to inform policy development;

- Continue to work with member governments to identify and remove legal impediments to the establishment of a single financial space;
- Build on the power of collective action by assisting member governments in the articulation and adoption of a macroeconomic transformation programme for ECCU member countries consistent with the objectives of the OECS Economic Union and the ECCU Eight Point Stabilisation and Growth Programme; and
- Encourage member governments to modernise the public sector in order to enhance efficiency and provide the requisite technical and administrative capacity to achieve the region's economic objectives.

The challenge for the Bank in these difficult times is to continue to support the strong dollar policy as set out by the Monetary Council and to establish the environment for the future growth and development of the region.

Thank you and good night.