Jwala Rambarran: Prospects for Caribbean economies and opportunities for the financial services sector – the catalytic potential of diaspora bonds

Remarks by Mr Jwala Rambarran, Governor of the Central Bank of Trinidad and Tobago, at the Annual Meeting of the Caribbean Association of Banks (CAB), Montego Bay, Jamaica, 15 November 2012.

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At the outset, I thank the Caribbean Association of Banks (CAB), formerly the Caribbean Association of Indigenous Banks, for inviting me to speak at its first conference under the CAB name and brand, and to deliver the keynote address on the relevant sub-theme "Prospects for Caribbean Economies and Opportunities for the Financial Services Sector."

Over almost four decades, CAB (through its previous incarnation) has played an important role in sensitizing Caribbean leaders to regional and global financial policies that are likely to impact our banking and financial services industry. Indeed, I commend CAB for spearheading the effort to alert Caribbean policymakers to the implications of the Foreign Account Tax Compliance Act (FATCA), an issue that revolves around tax transparency and the fight against cross-border tax evasion, and has the potential to affect every Caribbean person or entity with any interest in U.S. financial assets.

At a time when closer partnership across the region's financial sector is becoming even more relevant, I look forward to CAB remaining a strong, respected voice and advocate for financial institutions in the Caribbean.

Ladies and Gentlemen, the Caribbean is gradually recovering from a deep recession caused by the global economic crisis, which originated in the United States some five years ago and has since spread to the Euro zone. Given the Caribbean's close trading and investment ties to North America and Europe, the region experienced sharp contractions in key sectors such as tourism, energy and alumina, a virtual sudden stop of foreign direct investment, and weaker flow of remittances.

Some Caribbean countries have approached the International Monetary Fund (IMF) for financial support to weather the crisis. Others have delayed or resisted the implementation of harsh austerity measures, preferring to rely mainly on fiscal stimulus to kick start growth, which, in turn, is elevating the risk of debt distress.

The twin constraints of low growth and high debt are weighing on economic prospects for the Caribbean, and the state of affairs in the Eastern Caribbean is not too encouraging.

So, this morning, I want to talk about three things:

- First, some of the key risks and challenges to global growth occupying our attention which have implications for the pace and strength of the economic recovery in the Caribbean;
- Second, current growth and financing challenges facing the Caribbean; and
- Third, propose an innovative financial solution that can help to strengthen regional economic growth, transformation, and development.

Global growth prospects

Ladies and Gentlemen, let me begin with a brief overview of global growth prospects. Sadly, the news is not so good. Downside risks continue to dampen the outlook.

As you may be aware, financial markets remain the Achilles' heel to a global recovery which has suffered several setbacks over most of 2012. Prospects for stronger world growth are hampered mainly by the seemingly unhurried approach of policymakers across both sides of the Atlantic to resolve both the sovereign debt crisis in the Euro Area and the fast approaching U.S. “fiscal cliff” and possible breach of the U.S. debt ceiling.

The economic situation in Europe remains challenging given rising fears about Spain and about a black swan scenario in which Greece exits the Euro zone. Weakness seems to be spreading from the periphery to the core of the euro area, as even Germany has not been immune. Lack of broad-based agreement among European governments on a progressive path towards a more complete monetary union is also worsening the situation.

Across the Atlantic, the re-election of President Obama took place against a slow recovery of the U.S. economy from a deep recession, even as the “fiscal cliff” and breach of the U.S. debt ceiling loom dangerously near. The U.S. Congressional Budget Office has warned that an automatic fiscal withdrawal in 2013 could push the U.S. economy back into recession, unless legislation is adopted to prevent it.

More recently, concerns have arisen about the significant economic losses caused by the devastation from Hurricane Sandy, which battered states along the U.S. Eastern seaboard as well as islands in the Caribbean. Hurricane Sandy is expected to initially depress U.S. economic activity, but then support it over time as reconstruction commences.

Monetary policy has been easing across the world economy and is likely to remain very accommodative to softer economic conditions. The European Central Bank recently announced its Outright Monetary Transactions programme, which helped to temporarily calm market sentiment. The U.S. Federal Reserve adopted a new round of quantitative easing in September 2012 where it was announced it would continue “Operation Twist” until the end of the year, and extend its low-interest rate guidance from late 2014 to mid-2015.

Other central banks in the advanced economies have either cut policy rates or postponed interest rate hikes. Many central banks in emerging market and developing economies have postponed anticipated monetary tightening, and some have cut policy rates, including in the Caribbean.

Beyond these concerns, I want to mention two downside risks in a world economy that has become quite interdependent and interconnected. First, economic prospects are moderating for the major emerging market countries, raising concerns about their ability to provide much-needed support to a weaker global economy. With slowing export demand partly due to contagion effects from the European sovereign debt crisis and their economies adjusting to policy tightening conducted over 2010–2011, growth in Brazil, Russia, India, China and India is expected to be lower in 2012 and 2013.

Second, commodity prices are projected to remain high during 2012–13, given geopolitical tensions and supply constraints. Escalating tensions in the Middle East could set off a prolonged surge in oil prices, hitting global growth and metal and food prices. The impact of the unprecedented severe drought in the United States and dry summer in Russia, Ukraine and Kazakhstan is yet to be fully reflected in global food prices, and threatens the health and well being of millions of people, particularly in the Sahel and Eastern Africa regions.

In its October 2012 World Economic Outlook, the IMF revised downwards its near-term forecasts for world economic growth to around 3 ¼ percent in 2012, rising slightly to just over 3 ½ percent in 2013, which are somewhat lower than earlier estimates in April. Projections for growth in the United States have been trimmed slightly, with a larger downward revision for the Euro area.

Economic growth and financing challenges in the Caribbean

Ladies and Gentlemen, this brings me to my second point – economic growth and financing challenges in the Caribbean against this unsettled global backdrop. In the rest of my discussion, please note that all references to the Caribbean refers to members of the

Caribbean Community (CARICOM), all of which, with the exception of Belize and Guyana, are island economies that form part of the archipelago of the Caribbean Sea.

At the outset, we must recognize that the Caribbean region has important strengths on which it can build to better meet its economic challenges. These strengths include political stability, strong investor protection frameworks and healthy observance of the rule of law.

More importantly, the Caribbean appears to be gradually recovering from the global crisis, even though the region was not sufficiently prepared to deal with such a protracted external shock. After posting a cumulative contraction of around 3 percent in 2009–2010, and modest growth of just over 1 percent in 2011, the Caribbean is expected to grow by close to 2 percent in 2012, and strengthen to about 2 ½ percent in 2013.

The tourism intensive economies still face headwinds from the lukewarm recovery in employment in North America and Europe. By the end of 2011, tourist arrivals from the United States to the main Caribbean markets had declined by 3 ½ percent from 2007 levels, when the global crisis originated. Tourist arrivals from Continental Europe, which accounts for nearly one-quarter of the Caribbean tourism market, were more than 10 percent lower in 2009 than in 2007. Although Canada accounts for one-tenth of Caribbean tourism flows, it was the only main market to show substantial growth in tourist arrivals since 2007.

The islands of Jamaica and St. Lucia are experiencing a faster pick up in tourist arrivals while Barbados and Belize are seeing some degree of stabilization. St. Vincent and Grenadines, the Bahamas, Grenada and Antigua and Barbuda continue to experience falling tourist arrivals relative to 2007.

Despite the recent pickup in tourist arrivals, the Jamaican economy appears to be moving back into recession. According to the Planning Institute of Jamaica (PIOJ), the Jamaican economy contracted by under a ¼ percent (year-on-year) in the second quarter of 2012, following a flat performance in the previous quarter.

Barbados continues to experience sluggish economic growth. Following an expansion of nearly 1 ½ percent (year-on-year) in the first quarter of 2012, Barbados' economy contracted by 2 percent in the second quarter of 2012. The Government of Barbados is on a privatization drive and has outlined plans to sell 30 percent stakes in the government-owned Grantley Adams International Airport, the Barbados National Oil Company, and the Barbados Port Authority.

Prospects seem somewhat better for the commodity exporters in the Caribbean (Belize, Guyana, Suriname and Trinidad and Tobago), where output is expected to grow by an average of 2 ¾ percent in 2012, before rising to 3 ¾ percent in 2013. Belize has weathered the global crisis relatively well compared to its Caribbean peers, with a moderately positive economic outlook. Large public and private investments are anticipated to underpin Suriname's favourable economic outlook. Guyana's economy remains resilient, with medium-term growth projected at an impressive 5 percent in the context of continued implementation of the Low Carbon Development Strategy. High prices for key commodity exports, particularly for gold and oil, are expected to also support growth in Suriname and Guyana.

The Trinidad and Tobago economy is yet to experience a full and steady recovery. Preliminary estimates from the Central Bank suggest that real GDP declined further by just over 3 ½ percent in the second quarter of 2012, following a relatively flat performance in the first quarter of 2012. The contraction in output was mainly attributed to longer-than- expected plant maintenance operations carried out by energy sector companies as well as prolonged strike action at Trinidad Cement Limited.

Available information for the third quarter of 2012 shows that cement supplies have normalized, while there are signs of a revival in production levels of natural gas and petrochemicals. Overall, the Central Bank projects real GDP growth for the Trinidad and

Tobago economy to be in the order of 1 percent in 2012, and possibly accelerating to close to 2 ½ percent in 2013.

Meanwhile, Haiti is projected to expand by close to 4 ½ percent in 2012, accelerating to 6 ½ percent in 2013, reflecting increased earthquake reconstruction efforts.

Ladies and Gentlemen, although the Caribbean appears to be on a recovery path, persistently large external current account and fiscal deficits as well as high public debt constrain stronger regional growth prospects.

In the Eastern Caribbean, external current account deficits are widening again due to higher oil and food imports and weak exports. Grenada, St. Kitts & Nevis, and St. Vincent & the Grenadines are expected to run sizeable external current account deficits, averaging more than 20 percent of GDP during 2012–2013. Further increases in oil and food prices would put further pressure on the already aggravated external current account positions of Caribbean economies. Oil imports, for example, account for more than half of all imports in the tourism-dependent economies.

Trinidad and Tobago is the only country in the Caribbean that consistently maintains a surplus on its external current account due to its position as an energy-exporter. Excluding energy exports, however, Trinidad and Tobago runs a significant non-energy trade deficit. Most of the Caribbean's external imbalances are financed by foreign direct investment (FDI) which, although regarded as the most stable source of international capital, declined sharply during 2007–2011 but is now showing some signs of revival. Official flows, including from the IMF, are also helping to finance the region's external imbalances. Antigua and Barbuda and St. Kitts and Nevis are receiving financial assistance from the IMF in the context of Standby Arrangements, while Grenada and Haiti are under the Extended Credit Facility. In addition, Dominica received IMF financing in early 2012 under the Rapid Credit Facility.

As many of you are aware, Jamaica is actively negotiating a new IMF program. The Government of Jamaica hopes to conclude a new Standby Agreement with the IMF by the end of 2012. Some of the outstanding issues revolve around Jamaica's tax and pension reform, and the need for cuts in the public sector payroll.

Financing through concessional loans from the Petrocaribe Energy Cooperation Agreement with Venezuela is also helping to buffer the impact of high oil prices for some Caribbean countries. Nonetheless, there are concerns about the capacity of these countries to repay the debt that is building up from the Petrocaribe agreement.

Remittances have become a fairly stable source of non-traditional external financing for many Caribbean countries. In fact, the Caribbean is among the larger recipient of remittances in proportion to its GDP. For countries such as Haiti (21 percent), Jamaica (16 percent) and Guyana (13 percent), remittances represent a lifeline, contributing to smoothing household consumption, easing balance of payments pressures, and financing domestic investments.

Progress at fiscal consolidation is weak, with fiscal fatigue and a growing resistance to austerity measures evident across some Caribbean countries. In 2012, the region's overall fiscal deficit is expected to deteriorate by an average of 1 percentage point to 4 ½ percent of GDP. Some degree of fiscal consolidation is anticipated in 2013, with the overall fiscal deficit narrowing by close to 1 ½ percentage points to just below 3 percent of GDP. Even Trinidad and Tobago, which had achieved strong fiscal surpluses since 2002 owing to the buoyancy of energy prices, began running fiscal deficits from 2009, and is not expected to return to fiscal balance until 2016.

Ladies and Gentlemen, public debt persists at extraordinarily high levels in the Caribbean. The region's gross public debt climbed rapidly from 65 percent of GDP in 1998 to a peak of almost 100 percent of GDP in 2002, before falling to a still elevated 80 percent of GDP in 2012. The accumulation of public debt was even faster in the Easter Caribbean, moving from just over 60 percent of GDP in 1998 to a high of almost 120 percent of GDP in 2004, before falling to 95 percent of GDP in 2012.

Generally, a public debt ratio of over 50 percent of GDP is considered high. By this measure, only three countries – Haiti, Suriname and Trinidad & Tobago – are expected to have low debt in 2013. Another six countries are projected to have heightened debt vulnerabilities, averaging in the range of 50 to 90 percent of GDP, in 2013. These are the Bahamas, Belize, Dominica, Guyana, St. Lucia and St. Vincent and the Grenadines.

Four countries in the Caribbean will continue to accumulate exceptionally high public debt, averaging in excess of 90 percent of GDP in 2013: Jamaica (140 percent), St. Kitts & Nevis (139 percent), Grenada (109 percent), and Antigua & Barbuda (93 percent).

The dramatic rise in Caribbean debt partly reflects a shift in the composition of regional external financing flows away from aid, grants and other concessional flows to an expansion of private capital, especially expensive commercial borrowing. It also reflects the growing inability of Caribbean governments to generate high enough primary fiscal surpluses to stabilize debt.

The gravity of the Caribbean's debt situation is generating debt restructuring or credit events in a few countries. In April 2012, St. Kitts and Nevis concluded an orderly debt exchange offer on US$150 million out of the US$750 million subject to its global debt restructuring exercise, and which saw its bondholders and external commercial creditors accept deep haircuts. Progress has been made in respect of the debt/land swap with domestic creditors.

Belize missed a semi-annual coupon payment due August 2012 on its US$544 million dollar bond, widely known as the "super bond" but made a partial payment in September when the 30-day grace period ended. Nevertheless, this prompted Standard & Poor's Ratings Services (S&P) to classify the foreign currency rating on Belize as "selective" default, one step below a full default. Belize is negotiating a debt exchange offer with bondholders but no consensus has been reached as yet on proposed new terms.

In October 2012, Grenada made its overdue coupon payment on its US$193 million bond due 2025 before expiry of the 30-day grace period which the country was given when it missed the scheduled September payment. Standard & Poor's subsequently downgraded Grenada's credit rating to "selective" default, but following the payment upgraded Grenada's status to CCC+, still below the previous level.

Although the financial system in the Caribbean has a strong presence of Canadian banks, which has helped to limit the contagion impact of the global crisis, financial stress still exists across the region.

Credit quality, particularly for indigenous banks, has deteriorated in light of the downturn, coupled with weak oversight and low loan provisioning ratios. High exposure to sovereigns (including to those that have recently restructured or about to restructure debt) requires regional central banks to keep closer oversight and stand ready to intervene, if necessary.

On the nonbank side, almost four years after the collapse of the insurance subsidiaries of the CL Financial Group, resolution has been uneven. In Trinidad and Tobago, the recent launch of the CLICO Investment Fund (CIF) has brought some closure to the settlement of claims due to CLICO policyholders, but has come at considerable cost to the state. Contingent liabilities associated with the resolution in Trinidad and Tobago have reached an estimated one-tenth of GDP. In Barbados, the resolution is still pending. In the Eastern Caribbean Currency Union (ECCU), where insurance claims exceed 17 percent of GDP, part of the insurance subsidiary is being sold, and a fraction of the claims are pending a regional resolution.

With predominantly fixed exchange rate regimes in the CARCIOM region (10 out of 14 countries) inclusive of a currency board arrangement for the Eastern Caribbean, devaluation is not an option for Caribbean countries to support their weakening external positions. Barbados, in particular, remains vehemently opposed to such an action, which it considers ill-conceived and will not correct fundamental economic problems facing small, middle-income Caribbean countries.

The Caribbean region as a whole, therefore, needs to explore innovative sources of financing to contain the onerous public debt overhang, regain fiscal stability and strengthen economic growth.

Diaspora bonds – an innovative financing solution

Ladies and Gentlemen, beyond managing the near-term risks associated with the global crisis, the Caribbean region must continue to address its fundamental economic issues over the medium term, paying particular attention to the legacies of the crisis. In this regard, I firmly believe that Caribbean policymakers will need to adopt innovative financing solutions in support of the region's economic growth, transformation and development.

Many of you may be aware that the Caribbean has a large, highly educated diaspora pool. Using a well-established World Bank methodology and adopting a narrow but useful definition of the diaspora as those born in the country but presently living outside of the country, the stock of the Caribbean diaspora is estimated at around 3.5 million people or more than one-fifth of the region's population.

The annual savings of the Caribbean diaspora is estimated at over US$10 billion or more than 15 percent of the region's GDP. Most of these savings are invested in the host countries of the diaspora, especially in the United States, Canada and the United Kingdom. Diaspora savings, therefore, represent a potential alternative source of long-term funding for the Caribbean.

In my respectful view, diaspora bonds represent an innovative financing mechanism for the Caribbean region to target a previously untapped investor base. Diaspora bonds offer the huge Caribbean diaspora community a chance to help their country of origin while also providing an investment opportunity. Both Israel and India have successfully tapped their respective diaspora for funding. Since then other countries with significant diaspora populations such as South Africa, Sri Lanka, Ghana, Kenya and the Philippines have either issued or announced plans to issue these financial instruments.

Ladies and Gentlemen, almost a decade ago Jamaica considered tapping into the wealth of its diaspora but unfortunately did not proceed with this bold initiative. Permit me to use the example of Jamaica to demonstrate its suitability to pioneering diaspora bonds as an innovative financing solution.

As we all know, Jamaica has one of the highest rates of skilled migration in the world and must have access to more stable and less costly financing to achieve meaningful public debt sustainability.

Some of the more important considerations that the Jamaican government must contemplate before issuing a diaspora bond are the size and wealth of its diaspora; the compactness or dispersion of that diaspora; level of patriotism; integrity and stability of its legal system; and the potential for full subscription of the bond itself. In Jamaica's case, several of these requirements augur favorably for policymakers to seriously explore issuing a diaspora bond.

Using the same World Bank methodology, the annual savings of the near 1 million Jamaican diaspora is estimated at around US$3 billion. Put another way, the savings of Jamaica's diaspora can finance more than two-fold Jamaica's external current deficit. Effectively, a substantial pool of low-cost savings exists which the Jamaican government can mobilize in pursuit of its economic development strategy.

Simply identifying and targeting the Jamaican diaspora, however, will not ensure the success of the bond issue. These bonds must be properly structured and distributed to make them attractive to the Jamaican diaspora, even though they do have a more intimate understanding of the economics and politics of their country of origin than non-Jamaican investors.

Lingering concerns about investing in Jamaica, whose sub-investment grade credit rating is under pressure, can be mitigated through a partial risk guarantee of these diaspora bonds from either the World Bank, or the International Development Association (IDA), or the Multilateral Investment Guarantee Agency (MIGA). Such a guarantee structure would not only catalyze additional private financing for Jamaica, but might also raise the rating on the diaspora bonds to investment grade.

A 5 percent tax-free U.S. dollar interest rate, for example, could attract a large number of Jamaican investors who are getting close to zero interest rate on their bank deposits. Not only Jamaicans, but also foreign individuals interested in helping Jamaica are likely to be interested in these bonds. That would further expand the pool of potential investors in Jamaica's diaspora bonds. Marketing of such diaspora bonds in the U.S. would, however, require a temporary exemption from U.S. SEC regulations.

Unlike borrowing from the multilateral financial institutions or international capital markets with fixed terms and conditions, a diaspora bond can be structured with greater flexibility. One example of this flexibility would be the option to pay the interest in Jamaican dollars rather than in U.S. dollars. This may relieve an investor from having to remit funds on a periodic basis to assist families and relatives in Jamaica and from having to incur high money transfer fees. On the government side, there will be little or no pressure on the Jamaican currency to service debt interest payments.

Finally, Jamaica's diaspora bonds can offer investors the opportunity to do – good‖ in their country of origin, especially if targeted to finance specific projects in which the Jamaican diaspora has a special interest. These projects can range from non-traditional economic areas targeted under the government's medium strategy, to infrastructure projects in Jamaica's bauxite, mining, and tourism sectors, and to specific education, health and poverty alleviation initiatives.

Conclusion

In conclusion, Ladies and Gentlemen, the problems facing the Caribbean region are too deep-rooted to be solved with traditional policy measures. Innovative solutions are needed to contain the onerous public debt overhang, regain fiscal stability and strengthen economic growth. Diaspora bonds represent a new instrument in the policy arsenal.

It is disheartening however that despite the impressive size of the potential market for Caribbean diaspora bonds, no country in the Caribbean has actually issued a diaspora bond. A number of factors may explain this outcome. Perhaps the most important factor is that many regional governments are either completely unaware about diaspora bonds, or even if they have some awareness they are often deterred by the complexities of bond instruments.

I, therefore, encourage the CAB to fully consider the significant opportunities that could accrue to the region's financial services sector from the issuance of diaspora bonds. I also encourage CAB to develop an education program that would sensitize its members and regional governments to the feasibility of tapping into the wealth of its diaspora.

We must begin to champion the change we wish to see in the economic growth, transformation and development of our Caribbean region.

I do wish you fruitful deliberations during the rest of your meeting.

I thank you.