Regional Financial Stability Report

PRESENTED AT THE LAUNCH OF RFSR

Central Bank of Barbados

Barbados
10 March 2016
Overview

1. Why RFSR?

2. Structure of Regional Financial Stability Report (RFSR)

3. Main Findings of Regional Financial Stability Report
   I. Macro Imbalances
   II. State of Regional Financial System
      a. Size of System
      b. Overview of Financial System Risks
      c. Summary of Financial Stability Indicators
      d. Systemic Risk
      e. Cross- Border Contagion
   III. Policy Issues.
Genesis...

- Deepening of financial integration across the region means that national regulators need to take account of developments in regional countries;

- CL Financial collapse;

- Recognition of need to enhance framework and methodologies for regional financial surveillance.
How?

• A Project on Financial Risk Assessment in the Caribbean
  ▫ Promoted by Committee of Central Bank Governors;
  ▫ Funded by Inter American Development Bank;
  ▫ Managed by Caribbean Centre for Money and Finance;
  ▫ Facilitated by staff of regional central banks and a hired consultant.
Aims of Project…

Project aims were to:

1. Develop and upgrade methodologies (including financial soundness indicators and early warning systems) for the overall assessment of financial stability in the Caribbean region;

2. Assist with the preparation and upgrading of national Financial Stability Reports (FSR); and

Impact...

- The impact of the project includes
  - Reduced data gaps on financial stability indicators;
  - Improved capacity of regional technicians in treating with financial stability issues as a result of increased access to relevant training;
  - An increase in the number of countries now able to prepare their own reports.
Outcome...

- Complements national financial stability reports;
- Sensitises financial stability stakeholders of issues relevant to stability of financial system in the region;
- Provides guidance to policy makers on the building blocks to defuse financial tensions;
- Identifies need for financial sector reforms.
Structure of RFSR...

- **Chapter 1:** Overview of Financial Stability in the Caribbean.
- **Chapter 2:** Global and Regional Macro-Financial Environment.
- **Chapter 3:** CARICOM Financial Systems.
- **Chapter 4:** Performance of Financial Institutions.
- **Chapter 5:** Assessment of Contagion Risk in the Caribbean.
- **Chapter 6:** Policy Initiatives for Maintaining Financial Stability.
Main Findings Of Report...
State Of Financial System...

Financial Sector is:

• Vulnerable to Macro-Imbalances;
• Vulnerable to exogenous shocks;
• Dominated by the banking sector;
• Increasingly interconnected; but
• Stable.
Macro Imbalances

- The Region faces macro imbalances including low growth, high fiscal deficits, balance of payment deficits and a high level of sovereign indebtedness:

  ▫ This combination prevents CARICOM countries from employing effective counter-cyclical measures in the face of the adverse impact from the global economic downturn.
  ▫ These imbalances are of course not helped by the region’s vulnerability to hurricanes and other natural hazards.
  ▫ These developments have invariably had a negative impact on some countries’ credit ratings.
Real GDP Growth of CARICOM Economies

- The post-2008 period has been characterized by slower growth for most CARICOM countries relative to the period before the international financial and economic crisis.
  - Commodity-based producers have consistently outperformed the services-based economies.
  - Forecasts for 2015 suggest that growth dynamics in the region will be characterized by the convergence of performance across commodity and services-based economies.
Many Caribbean countries lack fiscal space.

- They had pre-existing vulnerabilities which intensified in the wake of the international financial and economic crisis.
- The overall fiscal balance as a percentage of GDP for the region improved slightly from -4.5 per cent in 2013 to -4.1 per cent in 2014.
Sovereign Indebtedness in CARICOM (% of GDP)

- The Caribbean region is relatively highly indebted.
  - Indebtedness was fairly static, moving from 66.1 per cent to 65.9 per cent of GDP between 2013 and 2014.
  - External debt is on average slightly more than half of total debt
  - The foreign exchange servicing of this debt component (payment of interest plus principal/total export earnings) is somewhat more onerous for the services-based economies.
Regional economies have chronic external current account deficits. 

- This vulnerability intensified in the post-crisis period, with the services-based economies registering bigger imbalances relative to their commodity-based counterparts.

- Weakness in this area is ameliorated somewhat by the level of external reserves and capital flows, especially FDI, particularly in commodity-based producers.
Total Assets of Financial System: Per cent of GDP (2014)

<table>
<thead>
<tr>
<th></th>
<th>BHS</th>
<th>BRB</th>
<th>BLZ</th>
<th>ECCU</th>
<th>GUY</th>
<th>HTI</th>
<th>JAM</th>
<th>SUR</th>
<th>TTO</th>
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<tr>
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<td>22.5</td>
<td>15.4</td>
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<td>5.3</td>
<td>0.1</td>
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<td>34.7</td>
<td>6.9</td>
<td>12.0</td>
<td>7.7</td>
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<td>20.7</td>
<td>8.5</td>
<td>29.4</td>
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<td>52.2</td>
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<tr>
<td>Total</td>
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<td>191.0</td>
<td>90.4</td>
<td>47.3</td>
<td>130.6</td>
<td>67.5</td>
<td>115.6</td>
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</tr>
</tbody>
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Sources: National central banks for Caribbean countries; World Council of Credit Unions, International Monetary Fund
Financial System Risks...

- **Credit Risk** manifest itself in three ways:
  - Non-performing loans
    - Increased incidence since 2009 but some moderation in 2014 from 12.6% to 10.3%;
    - Incidence greatest in services-based economies.
  - Credit growth
    - Credit to GDP ratio has slowed;
    - No concern of excessive leverage, especially in services-based economies.
  - Credit Concentration
    - Need to continue to monitor real estate activity.
Financial System Risks...

**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 some countries have had in servicing both the domestic and foreign components of the debt.

- In recent years, Caribbean economies have undertaken fiscal adjustments intended to improve fiscal and debt sustainability and mitigate the risk of default.
Financial System Risks...

**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.
- Four countries have significant exposures to foreign currency deposits but banks have a positive net open position.
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.

- 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. The contagion effects may, in certain circumstances, produce a considerable degree of panic.

- there is almost invariably a regional dimension in that the SIFI has subordinates in some other CARICOM countries.
Stability Indicators

The key financial system stability indicators are reflected in:

- Favourable capital and liquidity ratios in the banking sector;
- Stable capital and earnings in insurance sector;
- Adequate capital levels in the credit union sector;
- Modest credit to GDP gaps;
- Containment of Contagion risks;
- Encouraging individual country stress tests that suggest the financial system is resilient and able to withstand significant shocks.

But

- NPLs in service-based economies are a source of concern;
- Profitability in the banking sector has declined.
Financial Stability Indicators

Regulatory Capital to Risk Weighted Assets (per cent)

Liquid Assets to Total Assets (per cent)
Systemic Risk Assessment...

• Using credit-to GDP ratios over 1990-2014, it was noted that
  • Credit-to-GDP ratios vary across the region;
  • Countries with lower levels of credit to GDP are exhibiting higher growth rates in credit, suggestive of a convergence process;
  • Services-based economies are registering negative credit-GDP gaps;
  • Credit cycle measures do not appear to have a strong regional component;
  • Credit to GDP gaps track global crisis with a one to two-year lag but gaps for consumer and business credit appear to be more contemporaneous.
Credit-to-GDP

The bar chart on the left shows the credit-to-GDP percentage for various countries, including Suriname, Guyana, Trinidad and Tobago, Jamaica, Barbados, Belize, USA, ECCU, and EUR. The countries are listed from left to right along the x-axis, with the percentage decrease from top to bottom on the y-axis. Suriname has the highest credit-to-GDP ratio, followed by ECCU and EUR. The countries with the lowest credit-to-GDP ratios are Barbados, Belize, and USA.

The scatter plot on the right illustrates the real annual credit growth against the credit-to-GDP ratio. The countries are plotted as points, with Suriname having the highest credit-to-GDP ratio and the lowest real annual credit growth. The regression line indicates a negative correlation, with the equation y = -1.055x + 49.744 and R² = 0.1133.
Assessing Channels for Cross-Border Contagion...

- Banks and insurance companies have significant cross-border claims in excess of ten percent.
- Of total cross-border claims, 32 per cent were inter-regional and 68 per cent extra-regional.
- With respect to cross-border sovereign exposures, none of the financial sectors in the region had greater than ten per cent of total assets exposed to sovereign assets based on positions at end-June 2013.
- Banks and insurers displayed significant regional bias with 63 per cent of their exposure concentrated in regional sovereign holdings.
- Global sovereign exposures were primarily to the United States (34%) with Trinidad & Tobago having the largest exposure to that country of 3.1 per cent.
Despite representing small exposures relative to total assets at end-June 2013, regional sovereign cross-border claims of banks and insurers were more significant than inter-institutional exposures as evidenced by the directional network of regional gross cross-border claims where the five largest exposures in United States dollar terms are to regional sovereigns as highlighted.
The structure of the regional cross-border network also appears to be incomplete with Belize, Suriname and Haiti showing limited interconnectedness with the rest of the region at end-June 2013.

In contrast, Barbados, Jamaica and Trinidad & Tobago have a greater clustering of exposures compared to the rest of the region.
Regional Financial Stability Architecture ... 

• The financial stability architecture refers to the set of institutions, laws, conventions, data systems and executive decision making protocols which work together to monitor, report and implement policies to maintain regional financial stability.

• A regional financial stability architecture should involve inter alia:
  – Institutions - regional committee(s) or new institution(s) with a specific mandate for regional financial stability e.g. Regional Financial Stability Coordinating Council (RFSCC);
  – Monitoring and reporting systems – RFSR;
  – Decision making frameworks – executive protocols for intervention at the regional level;
  – Liquidity mechanisms or financial safety nets arrangements;
  – Laws – to give force for cross-border information sharing and regulatory action;
  – Accountability mechanisms for executive action which require use of public funds.
Regional Financial Stability Architecture ...

- The CARICOM Group of Central Bank Governors is a natural regional forum which could serve as the basis for a wider regional committee that could sit at the apex of the CFSA.
- The existence of regional regulatory associations (CGBS, CAIR and CGSR) which can help to promote consensus on regional financial stability issues.
- Improvements in the national financial stability architectures in the region
  - The creation of dedicated financial stability units;
  - Improved institutional capacity through training and data development;
  - The formation of national financial stability committees;
  - The setting up of regional supervisory colleges;
  - MOUs to facilitate information sharing between different jurisdictions;
  - The publication of financial stability reports (FSRs).
- Long standing efforts to develop the regulatory and supervisory systems
  - Update of financial legislation;
  - Strengthening of regulatory and supervisory frameworks;
  - Increased harmonisation of laws;
  - Implementation of consolidated supervision.
Regional Financial Stability Architecture ... 

The committee of CARICOM central bank governors would:

• Receive periodic reports, including the regional financial stability report.
• Advise the Council of Finance and Planning generally on systemic regional risks.
• Devolve into sub-committees of relevant governors (SCOG) to form in association with the relevant supervisory authorities a regional crisis management group (RCMG) if there are cross-border implications.
• The RCMG, under the *chairmanship of the governor of the home country* of a problem institution, will coordinate the actions necessary to resolve the situation.
Possible Regional Financial Stability Architecture ...

- Regulators of NBFIs that are not central banks may have to be included at the level of the committee of central bank governors in a broader oversight committee.
Macro-prudential Policy

• The key elements of a plan to formalize the design of a macro-prudential policy framework across the region should relate to:
  • Goals and tools: macro-prudential policy should have a sufficient range of instruments available to be introduced in order to mitigate or prevent the development of systemic risks.
  • Powers and governance arrangements: to set macro-prudential policy and support operational independence of the decision-making process.
  • Examination of the transmission mechanism: the macro-prudential policy must have the capacity to study the transmission mechanism of the instruments in order to better understand their impact and assure better selection and more precise calibration of the tools.
  • Accountability: the macro-prudential policy authority should publish its macro prudential policy governance framework, including tools designated to correct deviations from operating macro prudential targets.
THANK YOU FOR YOUR ATTENTION

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