EASTERN CARIBBEAN CENTRAL BANK
2008 ECCU ECONOMIC REVIEW

Presented by Sir K Dwight Venner, Governor, ECCB
ECCB Headquarters, St Kitts and Nevis, 29 January 2009

Good evening citizens of the OECS.

We meet at a time when the international economy and community is at an historic turning point. Current events have and will continue to affect all countries including those in the OECS and the Eastern Caribbean Currency Union.

This evening my presentation will focus our attention on three main themes:

1. The depth, breadth and ramifications of the current crisis;
2. Its specific impact on the countries of the Currency Union; and
3. The responses being constructed at the national and regional levels.

The financial and economic crisis which is now unfolding has been declared by the International Monetary Fund as the worst that the global economy has faced in 60 years.

This crisis was preceded by two others, the energy crisis during which the price of a barrel of oil rose from approximately US$55 in January 2007 to a peak of US$147 in July 2008, and a food crisis in which the prices of basic commodities such as rice and wheat rose by 144% and 67% respectively, over the period January 2007 to July 2008.

These two crises exerted severe external shocks to our domestic economic systems and had negative impacts on our balance of payments.

The current financial crisis which has now affected the real economy in the advanced countries will pose an even greater threat to our fragile economies. This crisis is a result of three basic factors.

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1. Major global macroeconomic imbalances between the United States as a major debtor country and large surpluses in China, the East Asian countries, and major oil producing countries.
2. The sub prime lending operation which saw loose regulation and imprudent lending backed up by innovative financing, leading to major failures in the banking industry.
3. The failure of bank regulators to properly oversee the institutions under their supervision and that of financial institutions to institute proper risk management systems.

Households and firms in the United States acquired significant levels of debt during the credit boom which is now being reflected in bankruptcies, lay offs and unprecedented levels of unemployment and hardship.

Household debt in the US, just to give an example, accelerated from 98% of disposable income in 2000 to 136% in the current period.

Many large and historical financial firms have had to close their doors, for example, Lehman Brothers and Merrill Lynch; stock markets have lost tremendous value (approximately thirteen trillion dollars in the case of the US); firms have had to lay off thousands of workers; consumer and business confidence has fallen and the credit markets have dried up.

All of the major industrial countries have officially declared themselves to be in recession and even China has had to scale down its growth projections from double digits to 8%.

Globalisation and the increased interdependence of the global economy have dictated that no country will escape the effects of this crisis.

It is clear, therefore that 2009 will not be an easy year as the crisis continues. Its impact and ramifications have been so massive that most analysts and institutions are not prepared to forecast when it will bottom out and the recovery likely to begin.

There are, however two factors which give a sense of optimism.

First, after being in denial and hoping that the crisis would go away, the industrialised countries have begun to address the issues frontally.

Second, the inauguration of the 44th President of the USA, Barack Obama. The reason here is quite straight forward, what is required to turn the economy and the financial system around is confidence and credibility, and the hope is that a new and popular administration will be able to do that.

What does this mean for us in the OECS? We need to go through a reality check now that Christmas and New Year celebrations are over, and come soberly face to face with this crisis, which we must address through clear and objective reflection as we ponder our current circumstances and our future prospects.

The bottom line of our reality is that we have small, open and vulnerable economies which are largely dependent on what happens in the rest of the world.

The facts are that we have experienced a secular decline in our economic growth over the last three decades. The 1980s could be described as our Golden Age when growth averaged 6% based on the export of bananas, tourism receipts, foreign direct investment flows and foreign aid. In the 1990s growth fell to an average of 3% as most of the receipts from these activities fell.

Following the events of 9/11, in 2001, the rate of growth fell in most countries to between 1% and 2%, rebounding in 2006 and 2007 due to the hosting of the Cricket World Cup and now is trending downwards again with the advent of this crisis.

Given our openness and integration into the global economy, the channels of transmission of this crisis into our economies are through the real sector and the financial sector.
In the real sector there are three areas in which we are affected:

- Tourism;
- Foreign Direct Investment; and
- Remittances.

Tourist arrivals and expenditure have fallen, and the bookings going forward are not promising. Tourism is now our major foreign exchange earner and the challenge we now face would be if the recovery in the international economy does not come in 2009, we would then face two weak back to back tourist seasons.

This would have, in the absence of vigorous counter measures, a very depressing effect on our economies.

Foreign Direct Investment has shown significant declines, manifested in the slowing down or outright stoppage of major real estate and tourism projects.

These stoppages will have an impact on construction with its significant employment possibilities and on the capacity of the tourist industry, through the number of rooms and properties available to add to the current stock.

In the case of remittances, hard data is not easy to come by, but available information would seem to suggest that there is some slowdown in this area.

The other channel of transmission, the financial sector, is being affected through the availability of lines of credit and correspondent relationships with foreign banks which are now having difficulties of their own.

In the circumstances outlined above, we now have to come up with both short term and long term responses to these challenges.

Our governments have been addressing these matters with some urgency, and their first responses can be found in the Budget Addresses delivered in December 2008 or by the statements made by those whose budgets did not fall in this period.

As a Currency Union, there have been consultations at this level including the Ministers of Tourism, Ministers of Finance and representatives of the Banking Sector.

These culminated in an historic meeting between the OECS Authority of Heads of Government and the Ministers of Finance who make up the Monetary Council of the ECCB.

It was unanimously agreed that the meeting was very constructive in carrying out an objective analysis of the situation from the individual member states and currency union perspectives, and in coming up with short and medium term responses to the situation which now confronts us.

The short term responses include:

- Attempting to maintain the level of ongoing economic activity by supporting the tourism industry in their cost reduction and marketing strategies;
- Engaging in targeted public sector investment programmes to stimulate economic activity; and
- Providing efficient and effective social safety net programmes to address the needs of the poor, the indigent and the vulnerable.

With respect to the financial sector, the decision was taken to complete the regulatory framework for the entire financial system and to construct money and capital market arrangements to facilitate the provision of liquidity and investment finance.

We have been very fortunate that the Canadian banks which are the largest banks in the Currency Union, are well regulated in their home jurisdiction and have been rated number one in the world. Notwithstanding, we have been maintaining very close contact with the Bank of Canada, the Office of the Superintendent of Financial Institutions (OSFI), and the headquarters of the banks in Toronto and their senior regional representatives.

In the case of the domestic banks, they are well capitalised and we have strengthened our oversight over them.

We have established a contingency team at the ECCB, with senior and experienced staff to maintain constant oversight over the situation and develop contingency plans, should a crisis arise.

We are advising our governments to complete the establishment, with some urgency, where they have not already done so, of the Single Regulatory Units (SRUs), to regulate those institutions in the financial system which are not supervised by the ECCB. Such institutions as Insurance Companies, Credit Unions, Building Societies, Money Services Institutions, all need to be properly regulated in normal times, much less in times of crisis.

There is an old saying *"When your neighbour's house is on fire throw water on yours"*. We are therefore putting in place a regulatory framework and capability which is comprehensive, sophisticated and sensitively balanced between rules, regulations, prudential guidelines and self regulation.

The public can be assured that everything that is humanly possible is being done to preserve the safety and soundness of our financial institutions.

Discussions are on-going with the Ministries of Finance and the Broker Dealers to enhance the effectiveness of the Regional Government Securities Market to provide financing to the governments for recurrent and capital expenditure on a regular basis and at a reasonable cost.

We are also very well advanced in creating an Eastern Caribbean Enterprise Fund (ECEF) to facilitate investment in the productive sectors.

These initiatives in the financial sector are important to facilitate the transformation of our economies into highly competitive and diversified entities which can take advantage of the opportunities that will present themselves when the recovery comes.

The low growth scenarios which confront our economies are due in great measure to our small land and population size and limited technical capabilities.

The OECS Authority, in recognising this fundamental impediment, has taken the decision to move to the status of an OECS Economic Union by December 2009. There is an urgent need to create the critical minimum scale and a broader economic and financial base to achieve our economic goals.

The decision was taken to establish a transition team to address the current crisis and to align the responses with the achievement of the goal of Economic Union.

The team comprises:

- The Honourable Prime Minister of St Vincent and the Grenadines, Dr the Honourable Ralph Gonsalves;
- The present Chairman of the OECS Authority, the Honourable Tillman Thomas;
- The present Chairman of the Monetary Council, Dr the Honourable Errol Cort;
- The Director General of the OECS Secretariat, Dr Len Ishmael; and
- The Governor of the ECCB.

Other Heads of Government and Ministers of Finance are expected to assist this core group to tackle these challenges during the course of the year.

The group will coordinate and monitor the implementation of the short term and long term policy responses to the crisis which were agreed to at the Joint Meeting on the 15th and 16th of January 2009.

The meeting identified three critical sectors which could be instrumental in effecting the transformation of our national and regional economies, namely:

- Tourism;
- Construction; and
- Fisheries.

Work will start immediately by teams drawn from the national and regional public services and the private sector on strategies for carrying out this decision.

The team will also meet with regional and international countries, institutions, and private sector groups to access resources and technical assistance for implementing our short and long term responses to the crisis.

While the crisis has international origins, we have the responsibility as sovereign countries to decide on our own appropriate responses.

The Government of Singapore, in responding to the Asian crisis of 1997, stated as follows, *"We have no possibility of changing the international economic system or the prevailing conditions, but we can change ourselves and our way of doing business."*

There is an important lesson in this; we must be clear on those things over which we have control and those over which we do not. We must increase our levels of resilience and our flexibility to adapt to changing circumstances.

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This particular crisis is so deep and far reaching that it requires a concerted and strategic response by a conscious and mobilised population. This means that every segment of the population, politicians in government and opposition, public servants, the private sector, the trade unions, civic society, the professions including teachers, doctors, lawyers, engineers, accountants, nurses, police, community organisations, families and individuals must take responsibility for our current and future prospects and the goals of achieving a better standard of living and quality of life in the OECS.

In the final analysis a country must depend on its citizens to work hard, to cooperate with each other, to be objective in their judgments and to be prepared to make sacrifices for the good of their country.

In this time of international crisis each and every one of us must perform the role of citizen to the best of our abilities to ensure the welfare of present and future generations.

I end with this memorable quotation:

> *There is no "them and us"*
> *In a world this size there can only be "we"* -
> *All of us working together.*

Thank you and good evening.

K Dwight Venner
Governor, ECCB