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ECLAC SUBREGIONAL HEADQUARTERS FOR THE CARIBBEAN

FOCUS

Magazine of the Caribbean Development and Cooperation Committee (CDCC)

ECONOMIC PERFORMANCE AND POLICIES IN THE CARIBBEAN



ISSUE I / JANUARY - MARCH 2015

ABOUT ECLAC/CDCC

The Economic Commission for Latin America and the Caribbean (ECLAC) is one of five regional commissions of the United Nations Economic and Social Council (ECOSOC). It was established in 1948 as ECLA to support Latin American governments in the economic and social development of that region. Subsequently, in 1966, the Commission established the subregional headquarters for the Caribbean in Port of Spain to serve all countries of the insular Caribbean, as well as Belize, Guyana and Suriname, making it the largest United Nations body in the subregion.

At its sixteenth session in 1975, the Commission agreed to create the Caribbean Development and Cooperation Committee (CDCC) as a permanent subsidiary body, which would function within the ECLA structure to promote development cooperation among Caribbean countries. Secretariat services to the CDCC would be provided by the subregional headquarters for the Caribbean. Nine years later, the Commission's widened role was officially acknowledged when the Economic Commission for Latin America (ECLA) modified its title to the Economic Commission for Latin America and the Caribbean (ECLAC).

Key Areas of Activity

The ECLAC subregional headquarters for the Caribbean (ECLAC/CDCC secretariat) functions as a subregional think tank and facilitates increased contact and cooperation among its membership. Complementing the ECLAC/CDCC work programme framework are the broader directives issued by the United Nations General Assembly, which constitute the Organization's mandate. At present, the overarching articulation of this mandate is the Millennium Declaration, which outlines the Millennium Development Goals.

Towards meeting these objectives, the secretariat conducts research; upon request, provides technical advice to governments; organizes intergovernmental and expert group meetings; helps to formulate and articulate a regional perspective within global forums; and introduces global concerns at the regional and subregional levels.

Areas of specialization include trade, statistics, social development, science and technology, and sustainable development, while actual operational activities extend to economic and development planning, demography, economic surveys, assessment of the socioeconomic impacts of natural disasters, climate change, data collection and analysis, training, and assistance with the management of national economies.

The ECLAC subregional headquarters for the Caribbean also functions as the secretariat for coordinating the implementation of the Programme of Action for the Sustainable Development of Small Island Developing States. The scope of ECLAC/CDCC activities is documented in the wide range of publications produced by the subregional headquarters in Port of Spain.

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FOCUS: ECLAC in the Caribbean is a publication of the Economic Commission for Latin America and the Caribbean (ECLAC) subregional headquarters for the Caribbean/Caribbean Development and Cooperation Committee (CDCC).

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Produced by ECLAC

Printed by Caribbean Print Technologies (CPT)
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Director's Desk

ECONOMIC PERFORMANCE AND POLICIES IN THE CARIBBEAN



This edition puts focus on recent economic performance and policies in the Caribbean, acknowledging that ongoing challenges notwithstanding, macroeconomic indicators across the subregion are improving. Four articles will address respectively the prospects for growth, the fiscal situation, the performance of balance of payments and monetary policy and their impact.

The discussion on growth points to a number of positive and negative trends. Welcome developments include improved performance in major export markets, reduced oil prices and low inflation, all of which are giving rise to positive growth. Regional growth rates, which were estimated at 1.8 per cent in 2014, are projected to be 2.2 per cent in 2015. Less welcome trends indicate that, given the fall in commodity prices, primary commodity producers in the Caribbean may likely face a period of difficulty marked by lower foreign exchange earnings, lower government revenues, reduced fiscal space and higher unemployment.

While increased demand in major export markets will improve the subregions' trade balance, particularly in tourism markets, a number of ongoing challenges to growth will persist. The reality is that tourism services are relatively expensive in the Caribbean, and as a result the region has begun to lose market share in this highly competitive sector. In addition, falling labour productivity and rising unit costs continue to limit



Photo courtesy ECLAC

Ms. Diane Quarless, Director, ECLAC subregional headquarters for the Caribbean

the export competitiveness of the subregion across most sectors. It is also recognized that low growth occasions higher unemployment especially among the youth. While some governments have responded with "make work" programmes, these are not sustainable. A number of recommendations are made to enhance growth. Among these is the need to improve the business environment and to introduce labour market reforms that not only protect workers' rights but also improve worker productivity.

As regards fiscal policy, debt levels remain high, having risen slightly for both goods- and service-based economies in the wake of the global crisis. Furthermore, while the fiscal deficit has declined for the goods producers, it has increased for service

producers. This was due to high pre-crisis commodity prices on the one hand, and low tourism receipts on the other. While the debt may have stabilized, it was still high at 71 per cent pre-crisis and 69.5 per cent post-crisis. Given the evidence that debt levels in excess of 60 per cent tend to squeeze growth, Caribbean debt ratios continue to be clearly in an unacceptable range.

The external debt, which was 63 per cent of total debt, absorbed 11 per cent of exports of goods and services over the period 2009-2013 and some 23 per cent of government revenue. In response, governments have been scaling back on public capital expenditure and are constrained to expand social security programmes. With respect to the balance of payments, there is evidenced need for short term adjustment as the deficit on the current account is large and there is much reliance on foreign direct investment and remittances to close the gap. While the latter has been relatively stable, the former has been volatile and could be a challenge if a high share of profits is repatriated out of the region. In addition, anticipated benefits have not occurred, such as technology transfer to local firms and increased complementarity with the domestic private sector.

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A GROWTH AGENDA FOR THE CARIBBEAN

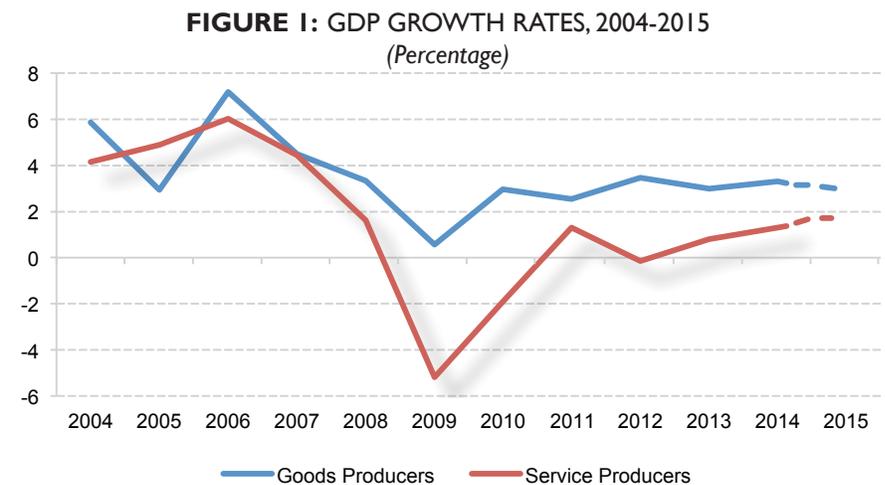


Low growth and stagnant employment remain fundamental challenges to sustainable development in the Caribbean. The barriers to growth and employment creation are here examined, with a view to identifying strategies to energize both over the short and medium term.

RECENT GROWTH PERFORMANCE

It is now well recognized that continuous technological upgrading and sustained economic growth based on improved productivity are necessary conditions for sustainable development. Falling productivity and a lack of technological capacity are key factors hindering sustainable Caribbean growth. In addition, the lack of diversification makes the economies vulnerable to negative external shocks.

An examination of the growth performance of the subregion in relation to the goods and service producers reveals a very slow recovery after the global financial crisis of 2008. Figure 1 shows that economic recovery after the crisis has been slow and growth has not returned to levels experienced in 2007-2008. The recent post-crisis period has been characterised by asymmetries within the region, with service producers¹ growing at a slower rate than goods producers. In 2014,² the growth rate was estimated at 1.8 per cent for Caribbean economies, 3.3 per cent for goods



Source: Economic Commission for Latin America and the Caribbean (ECLAC) on the basis of official figures. The dotted lines represent estimates.

producers and 1.3 per cent for service producers. In 2015, the growth rate is projected as 2.2 per cent for Caribbean economies: 3 per cent for goods producers, in light of depressed commodity prices, and 1.9 per cent for service producers.

It is reasonable to conclude that there is need for economic diversification and strategies to capture a higher share of regional and global value-added.

THE INTERNATIONAL ENVIRONMENT AND ITS IMPACT ON GROWTH

A number of developments will affect the region's growth performance in varying degrees over the short and medium term.

First, the improving performance of the developed economies, especially the United States and Europe, will help fuel the demand for Caribbean exports.

Secondly, lower oil prices will likely help improve productivity through falling unit costs and improved capacity utilization. At the same time, however, these improvements will also benefit similar countries. Given the importance of energy

¹ The service producers are Anguilla, Antigua and Barbuda, Barbados, Dominica, Grenada, Jamaica, Montserrat, Saint Kitts and Nevis, Saint Lucia, and Saint Vincent and the Grenadines. The goods producers are Belize, Guyana, Suriname, and Trinidad and Tobago.

² Simple average.

security, countries benefiting from the Petrocaribe deal may have to reassess their options in the event of any change in this arrangement. In addition, considerably lower prices will also provide lesser incentives for Caribbean countries to pursue the agreement.

Figure 2 shows the payment amounts deferred under the Petrocaribe agreement after the up-front cost for oil has been accounted for. It demonstrates that the opportunity cost of such deferrals is greater when oil prices are high.

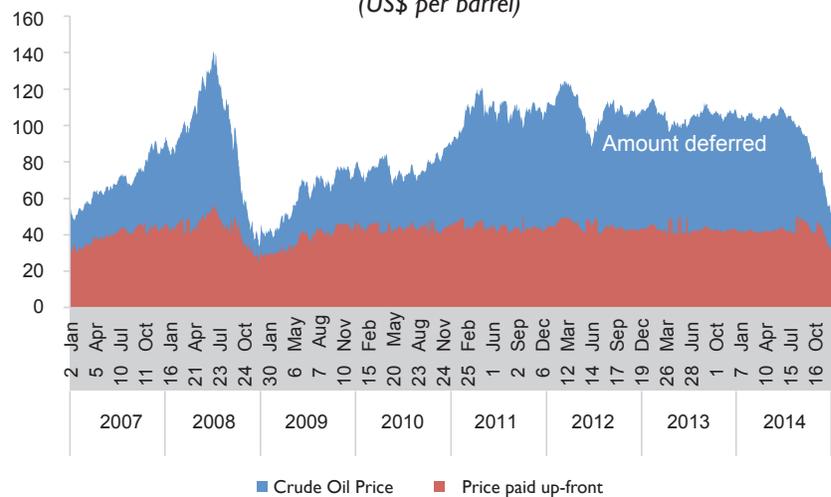
For the non-tourism based economies, such as Belize, Guyana, Suriname and Trinidad and Tobago, falling commodity prices could also negatively impact their foreign exchange earnings and output.

Thirdly, the normalization of relations with Cuba will likely affect the tourism sector in the Caribbean. Cuba, which has enjoyed some of the highest levels of tourism investment in the Caribbean over the last 15 years, could become even more attractive once the need for infrastructure upgrading is addressed.

This could impact the tourism trade of other Caribbean islands through increased competition and through expanded scope for joint ventures with Cuba in areas such as pharmaceutical development, research and development in agriculture, and creative industry marketing.

Overall, two important

FIGURE 2: PETROCARIBE FINANCING: UP-FRONT AND DEFERRED COST (US\$ per barrel)



Source: OPEC, PDVSA, author's calculations³

considerations emerge. First, the model of development of the last two decades, based on abundant factor endowments, is no longer able to deliver – in a competitive environment – high growth rates. Second, even with an improved external economic environment, the decline in labour productivity will not allow for strong and sustained growth.

LOW GROWTH AND HIGH UNEMPLOYMENT

Low growth rates and high unemployment, especially in the service based economies, can be linked to poor tourism performance.

Although average stop-over arrivals for the Caribbean have been growing for the last five years along with nominal visitor expenditure, they have been growing at a slower rate than in other regions. The Caribbean's share of the global tourism market fell from 2.5 per

cent of the global market in 2000 to 2 per cent in 2013.⁴ According to the World Travel and Tourism Council,⁵ the Caribbean tourism industry's contribution to GDP has the 10th lowest long-term growth prospects among 12 international regions.

After the global financial crisis of 2008, investment in tourism development in the Caribbean stalled. While investment has returned to its pre-crisis levels, the number of flights to the islands has not.⁶ Improving airlift, especially from markets such as China and Latin America, is key to the subregion's tourism growth.

With respect to unemployment, although data in the region is sparse, rates are high for most countries where information is available. In 2013, unemployment rates ranged from 3.7 per cent in Trinidad and Tobago (a figure which masks some degree of disguised unemployment),

▶ (continued on page 13)

³ Calculated using Petrocaribe's financing schedule

⁴ Lafranboise, Nicole, NkundeMwase, Joonkyu Park and Yingke Zhou. 2014. "Revisiting Tourism Flows to the Caribbean: What is Driving Arrivals?" WP/14/229.

⁵ World Travel and Tourism Council. 2014. "Travel and Tourism Economic Impact 2014" – Caribbean.

⁶ Lafranboise, Nicole, NkundeMwase, Joonkyu Park and Yingke Zhou. 2014. "Revisiting Tourism Flows to the Caribbean: What is Driving Arrivals?" WP/14/229.

FISCAL DYNAMICS IN THE CARIBBEAN BEFORE AND AFTER THE CRISIS



This analysis of the fiscal performance of the Caribbean before and after the recent global crisis is presented here as a precursor for considering a few measures to tackle high deficits and debt in the region. It argues that the existing fiscal imbalance was aggravated by the crisis and that the fiscal challenge remains a major constraint to macro-stability and growth, despite debt restructuring in the most constrained economies.

FISCAL PERFORMANCE BEFORE AND AFTER THE CRISIS

Although the fiscal deficit for the Caribbean as a whole averaged 2.9 per cent of GDP before the crisis (see Figure 1), this average masked the fact that Belize, Grenada, Guyana, Jamaica and Saint Kitts and Nevis had deficits averaging over 6 per cent of GDP, leading to sharp growth in debt. The deficit of the service producers¹ (3 per cent) was marginally higher than that of the goods producers² (2.8 per cent). The deficit among these economies was also driven by the carryover from the adjustment of the late 1990s, when some economies undertook important capital expenditures, including cruise ship ports and site development, to transition from agriculture to tourism-based economies. Fiscal deficits and mounting debts were also exacerbated by rehabilitation and

reconstruction expenditure in the wake of a series of hurricanes in countries of the OECS and Jamaica.

Deficits among the goods producers were only marginally lower at 2.8 per cent of GDP before the crisis. Growth in these economies, averaging over 5 per cent, was partly bolstered by public investment in infrastructure, which contributed to the deficit.

The pre-crisis pattern changed after the crisis, with the deficit declining to 1.9 per cent of GDP for the goods producers, while increasing marginally to 3.2 per cent of GDP for the service producers. Growing fiscal imbalance among service producers stemmed from a slump in tourism demand, owing to recession in major export markets and fiscal stimulus to cushion the fall-out in employment and incomes. Meanwhile, fiscal outcome in the goods producers was bolstered by the hike in commodity prices driven by the supercycle that saw oil prices

almost quadrupling, metals tripling and food doubling between 2003 and 2013.³ The increase in the deficit was fuelled by higher current spending as capital spending declined from 5.9 per cent of GDP before the crisis to 5.4 per cent of GDP after the crisis. This is an adverse development, as it suggests lower expenditure on capital investment, which is necessary to boost future growth.

FISCAL FLEXIBILITY IN THE CARIBBEAN

Government expenditure tends to be higher and more inflexible in small economies such as those of the Caribbean.⁴

This makes it difficult for these economies to build up fiscal buffers to cushion the impact of economic downturns. The degree of fiscal flexibility provides an indicator of the fiscal space that countries possess to counter recessions and other economic shocks. It measures the level of discretionary spending available to governments. Fiscal

¹ The service producers consist of Anguilla, Antigua and Barbuda, The Bahamas, Barbados, Dominica, Grenada, Jamaica, Montserrat, Saint Kitts and Nevis, Saint Lucia and Saint Vincent and the Grenadines.

² The goods producers consist of Belize, Guyana, Suriname and Trinidad and Tobago whose economic structure is based mainly on production and trade in goods.

³ Gruss, Bertrand (2014) "After the Boom- Commodity Prices and Economic Growth in Latin America and the Caribbean", IMF, WP/14/154

⁴ IMF (2013) Macroeconomics Issues in Small States and Implications for Fund Engagement".

flexibility⁵ in the Caribbean is relatively low, even by the standards of other small economies at similar levels of development. The indicator has averaged 35.7 (out of a maximum of 100) in the last decade, showing that the Caribbean is characterised by fiscal rigidity rather than flexibility.

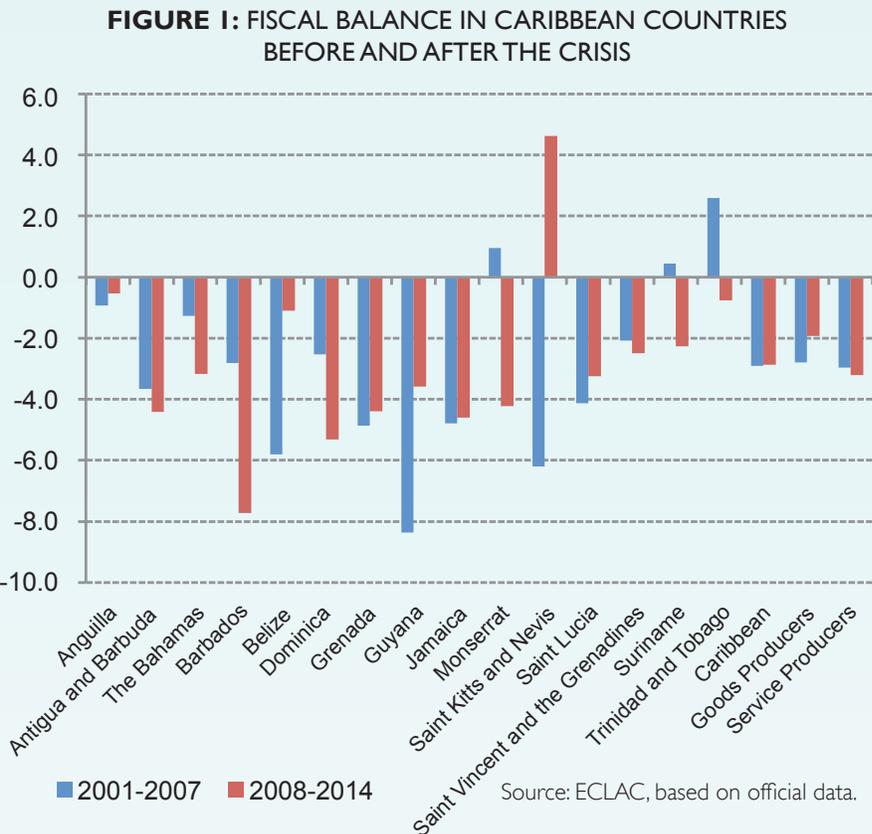
Furthermore, the indicator fell to 34.7 after the crisis, as increased fiscal space in the goods producers, owing to the boom in commodity prices, was offset by increased rigidity in service producers, which were buffeted by lower tourism receipts. The recent slump in fuel prices is a mixed blessing for the region, as it has negatively affected fuel exporters, while providing important fiscal space for fuel importers.

PUBLIC DEBT AND DEBT SERVICE COSTS

Public debt has decreased marginally from 71 per cent of GDP before the crisis and 69.5 per cent after the crisis.

However, this masks the fact that 8 out of 15 Caribbean countries had debt-to-GDP ratios in excess of 75 per cent in 2014. Among these were some of the most heavily indebted small states in the world, including Antigua and Barbuda, Barbados, Jamaica and Saint Kitts and Nevis.

The situation is made worse by the fact that 42 per cent of the debt is external. This not only makes it necessary for the region to earn foreign exchange to service this foreign debt, but also subjects the



countries to foreign interest and exchange rate fluctuations, which could adversely affect borrowing costs and currency stability.

Moreover, external debt service costs absorbed an average of 11 per cent of goods and services exports between 2009 and 2013, thereby reducing vital foreign exchange receipts that could have been used to import intermediate and capital goods to boost growth. Total debt service payments represented almost 23 per cent of government revenue from 2009 to 2014, limiting governments' ability to finance necessary public infrastructure and social welfare programmes. A number of Caribbean governments have committed to fiscal adjustment to contain deficits and

debt. Some countries, including Antigua and Barbuda and Jamaica, have undertaken consolidation programmes under the auspices of the IMF. This has helped to reduce debt levels. Meanwhile, Belize and Saint Kitts and Nevis benefited from debt restructuring that entailed haircuts on principal and longer maturities for their debt, thereby easing servicing costs.

WHAT CAN BE DONE ABOUT THE FISCAL PROBLEM IN THE CARIBBEAN?

Caribbean governments need a two pronged strategy to achieve sustainable fiscal positions.

First, they need to complement intensified short- to medium-term fiscal adjustment with a growth and

► (continued on page 15)

⁵ The fiscal flexibility index is defined as : $FFI = (1 - NDE/TGE) * 100$, where NDE is non-discretionary expenditure defined as outlays on wages and salaries, transfers and interest payments and TGE is total government expenditure. The maximum value of the uncorrected index is 100, reflecting total fiscal flexibility. IMF (2012) "The Challenges of Fiscal Consolidation and Debt Reduction in the Caribbean", Amo-Yartey et.al, WP/12/276.

THE PERFORMANCE OF THE BALANCE OF PAYMENTS IN THE CARIBBEAN



The components of the balance of payments that account for the largest inflows and outflows of foreign exchange for the Caribbean are:

- a) the components of the current account (i.e., the goods and services balance, current transfers and income).
 - b) foreign direct investment (FDI), which is the largest component of the capital and financial accounts.
- Focus will be given to the trends and recent developments in these components and to the steps that can be taken by countries in the subregion to improve their supplies of foreign exchange.

Caribbean economies depend in imports, which must be financed with foreign currency. Exhausting reserves of foreign currency could mean an interruption in the imports of food, fuel, durable goods and other commodities, resulting in severe disruptions of consumption and production. Furthermore, international debt is usually denominated and paid in foreign currency, which results in a significant outflow of foreign exchange. This means that outflows of foreign currency must be carefully monitored and managed.

On the whole, the supply of foreign currency for most economies in the subregion has not decreased significantly in the last decade. However, this is largely because significant current account deficits have been primarily financed by FDI, which may not be a sustainable model in the long-run.

THE GOODS AND SERVICES BALANCES

A comparison of the graphs in Figure 1 shows the goods and services balances for Caribbean countries, making clear the distinction

between goods- and service-based economies.

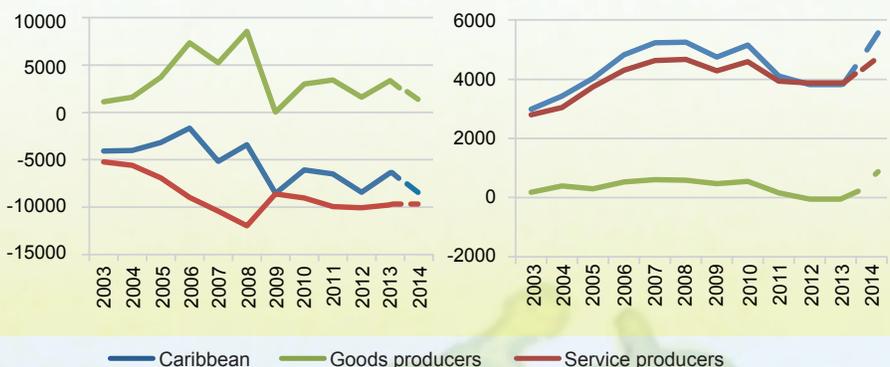
Goods producers generate significant surpluses in the goods account; this is largely driven by oil-exporting Trinidad and Tobago. In the last few years, the surplus has been relatively stable, though ECLAC estimates a significant drop in 2014 based on preliminary data, largely due to lower oil prices. Goods producers have usually had a small surplus in the services balance in the last decade, while service providers have had a very large surplus.

TRANSFER PAYMENTS AND INCOME

The second notable (though smaller) source of foreign exchange is current transfers, which consists primarily of remittances to the Caribbean.

Most remittances are received by the service producers, which includes the smallest economies in the subregion. For both goods and service producers, remittances have been increasing slightly during the last decade and were stable even during the economic turmoil of 2008 and 2009. This reinforces

FIGURE 1: GOODS (LEFT) AND SERVICES BALANCES (RIGHT) FOR CARIBBEAN ECONOMIES (United States dollars millions)



Source: ECLAC, based on official data.

Dotted lines indicate estimates.

a large body of theoretical and empirical evidence,^{1,2} which asserts that remittances (unlike exports or FDI) are counter-cyclical: they tend to increase when economic conditions in the recipient economy worsen, because remittances are partially motivated by altruism. An improved international transfer system and lower transmission costs could help to increase remittances, which, properly leveraged, provide a stable source of foreign exchange. Figure 2 shows transfer payments over time.

The final component of the current account is income, which largely consists of income earned from enterprises operating abroad. However, as the inflow of FDI to the Caribbean is much larger than the outflow, for Caribbean countries this component largely reflects outflows of earnings from foreign-owned companies. This component was negative for every economy in the subregion in 2013 and 2014.

FOREIGN DIRECT INVESTMENT

For the most part, because of a negative goods balance and negative income, most economies in the subregion have current account deficits which must be financed by surpluses in the capital and financial accounts.

By far, the largest positive component

of the capital and financial accounts for the Caribbean is FDI.

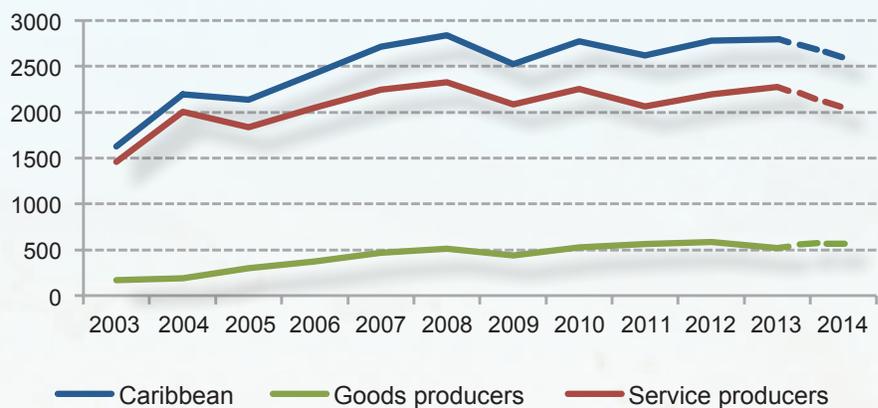
Figure 3 (page 14) shows FDI as a percentage of GDP, and for the purpose of comparison, the current account balance as a percentage of GDP.³ FDI declined quite significantly beginning in 2008, and, as a percentage of GDP, is only beginning to recover from its lowest levels since 2003.⁴ It is also interesting to note the convergence in FDI (as a percent of GDP) between goods and service producers, as investments in tourism have decreased over time relative to investments in oil and mining in resource-rich countries.

In spite of chronic current account deficits, the average balance of payments (calculated

as an unweighted average over economies) for the subregion has been in surplus for more than a decade. Nonetheless, this balance results from a deficit in the current account, which is largely financed by FDI. FDI provides an immediate influx of foreign exchange and can potentially lead to the import of new technologies, the development of human capital and economic growth.⁵ However, FDI can negatively impact the balance of payments in the long run. Earnings by foreign-owned companies are often repatriated to the parent company if the rate of return from reinvestment in the Caribbean is perceived to be less than it would be elsewhere.⁶ This represents a long-run drain on the current account.^{7,8}

► (continued on page 14)

FIGURE 2: CURRENT TRANSFERS BALANCE FOR CARIBBEAN ECONOMIES
(United States dollars millions)



Source: ECLAC, based on official data.

¹Frankel, Jeffrey A. 2009. "Are Bilateral Remittances Countercyclical?" National Bureau of Economics Research working paper no. 15419.

²Ratha, Dilip. 2005. "Remittances: A Lifeline for Development". *Finance and Development* volume 42, no. 4.

³Calculated as unweighted averages.

⁴In these graphs data for Jamaica was not available and is not included for 2013 and 2014, which affects both the total Caribbean and the service-producers plots. Recent FDI data for Barbados is not available and Barbados is not included in FDI calculations.

⁵Read, Robert. 2007. "Foreign Direct Investment in Small Island Developing States". United Nations University Research Paper No. 2007/28.

⁶Though, capital flight is also possible with local investments.

⁷Campbell, Trevor. 2003. "Foreign Direct Investment Inflows and their Impact on Barbados' Current Account: Implications for Policy". In *Facing Globalisation: Impact & Challenges for Barbados and the Caribbean*, Harold Codrington, Roland Craigwell and Darrin Downes (eds.).

⁸ECLAC. 2014. *Foreign Direct Investment in Latin America and the Caribbean - 2013*.

MONETARY POLICY AS A PLATFORM FOR ECONOMIC RECOVERY IN THE CARIBBEAN



Caribbean economies have grappled with economic recovery during the post-crisis period 2009 to 2014. Guyana and Suriname have been notable exceptions, having achieved average annual growth of 4.2 per cent on the back of favourable gold prices. The subregion as a whole grew by an average of 0.5 per cent from 2008 to 2014, with goods-producing economies expanding annually at a rate of 2.7 per cent while service producers grew by 0.3 per cent. As a result, the Caribbean's growth was decidedly below that of the global and Latin America and Caribbean (LAC) averages of (3.2 per cent) and (2.9 per cent).

Regional economic growth is projected at 2.2 per cent for 2015 which, if attained, would mark three consecutive years of increasing economic expansion in the Caribbean. Taken at face value, this suggests that many subregional economies may have now turned the corner towards sustained, albeit sub-optimal, economic growth. This article seeks to explore the extent to which monetary policy in the subregion has provided a platform for macroeconomic stability and facilitated economic recovery. The discourse is underpinned by the theory that posits that monetary policy plays a key role in ensuring sustainable macroeconomic stability and output growth, and therefore is central to economic development.¹

SHIFT IN APPROACH TO MONETARY POLICY-SETTING

Caribbean economies have gradually transitioned from the use of direct mechanisms² of monetary control towards the implementation of monetary policy through more indirect instruments.³ The latter is primarily geared at influencing money market conditions and enhancing the role of price signals in the economy.⁴ This distinct shift has been influenced by the diminished efficacy of direct instruments in what has become an increasingly liberalized economic environment.⁵

Although authorities in the Caribbean have generally maintained a neutral monetary stance in recent years, policy setting was somewhat expansionary in 2014. This was reflected in an easing of monetary policy aimed towards stimulating economic activity. Subtle variations in the stances adopted by monetary authorities across subregional economies have invariably been

guided by the particular economic circumstances, policy challenges among member states and the individual exchange rate regime. Monetary policy interventions have, to varying degrees, sought to maintain stable exchange rates, ensure price stability and stimulate private sector investment to boost economic activity.

SLUGGISH CREDIT DEMAND IN THE FACE OF INCREASING MONEY SUPPLY AND DECLINING INTEREST RATES

Regional Money Supply

Within the Caribbean, money supply (M2) has trended upward during the post-crisis period.

However, this increased liquidity has not led to high levels of inflation across the subregion, an issue which will be examined in due course.⁶ What is more relevant here is that

¹ Goshit, Gideon G. 2012. "Indirect Monetary Policy Reforms and Output Growth in Nigeria: An Empirical Investigation". *A Journal of Contemporary Research* volume 9, no. 1.

² Direct instruments include interest rate controls, credit ceilings and direct lending.

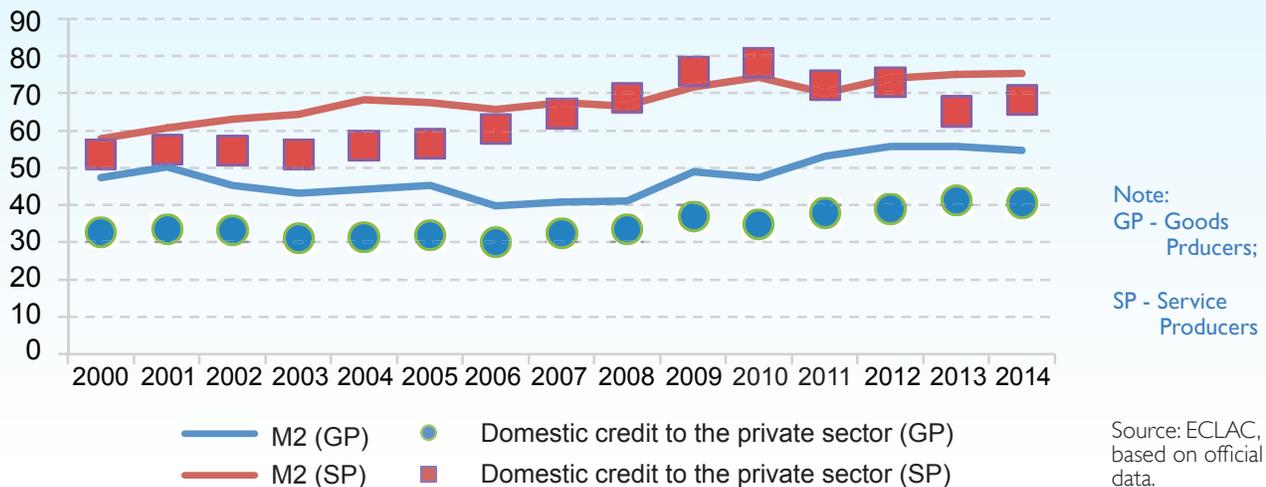
³ The main indirect instrument utilized in the subregion has been open market operations. Others include reserve requirements and lending facilities of the monetary authority.

⁴ Alexander, William E et al. 1996. "Adopting Indirect Instruments of Monetary Policy". *Finance and Development* volume 33, no. 1.

⁵ Caprio, Jr., Gerard and Patrick Honohan. 1990. "Monetary Policy Instruments for Developing Countries". World Bank working paper no. 528.

⁶ In response to this increasing liquidity the Central Bank of Trinidad and Tobago (CBTT) has adopted a more contractionary disposition, increasing the repo rate to by 25 basis points to 3.5% in January 2015. Further, in 2014 high liquidity in the banking system led banks in Belize to reduce their holdings of higher interest bearing time deposits in favour of demand and savings deposits.

FIGURE 1: M2 AND DOMESTIC CREDIT TO THE PUBLIC AND PRIVATE SECTOR, 2000-2014
(Percentage of GDP)



since most subregional economies have been operating with significant economic slack, broad money supply as a percentage of GDP has increased steadily since 2010, reaching 54.7 per cent in 2014 (Figure 1). This ratio provides a measure of the share of production-related transactions facilitated by quasi money.

Traditionally, the money supply (M2) to GDP ratio has been higher for service producers (75.4) than for goods producers (54.7 per cent), suggesting that bank credit continues to be the primary source of private sector financing in the service-based economies. As a corollary, given that M2/GDP is a measure of financial depth, this suggests that the financial systems are deeper in the services economies than in the goods producers on average. Sadly, the private sector seems largely unable to translate excess liquidity in the financial system into sustainably productive activities, especially in the export sector.

INTEREST RATES AND CREDIT DEMAND

While interest rates have

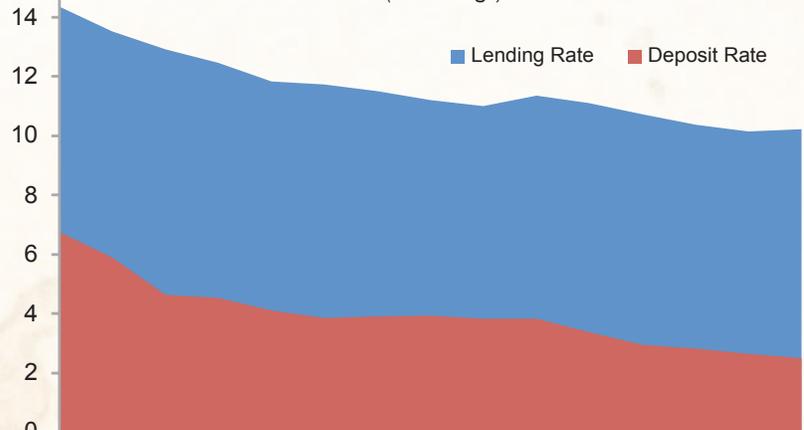
remained relatively stable across the subregion, increased liquidity in the financial sector has resulted in the falling of lending and deposit rates (Figure 2). In 2014, the average lending and deposit rate was 10.2 per cent and 2.5 per cent, respectively.

Goods producers have, on average, maintained a marginally higher lending, deposit and interest rate spread when compared to the services-based economies. The average interest rate spread, however, has fluctuated somewhat during the

post-crisis period, standing at 7.7 per cent in 2014.

Despite the declining interest rates, domestic credit to the private sector has remained relatively sluggish, contracting from 66.7 per cent of GDP in 2010 to 60.4 per cent in 2014. This suggests that investor confidence remains somewhat in the doldrums. Moreover, private sector credit declined across the ECCU, Barbados and The Bahamas in 2014. There was however a slight uptick (1.2 per cent) in lending to households within the ECCU. ▶

FIGURE 2: CARIBBEAN INTEREST AND DEPOSIT RATES, 2000-2014
(Percentage)



Source: ECLAC, based on official data.

On the other hand, Belize and Suriname both experienced growth in private sector credit, particularly to productive activity.

THE INFLATION AND EXCHANGE RATES

Despite the openness and high propensity of Caribbean economies to import, inflation driven by imports has not been an issue for the subregion within recent time.

During the post-crisis period inflation in the Caribbean remained relatively modest, declining to as low as 1.2 per cent in 2013. This soft consumer price inflation can be attributed to weak domestic demand in some economies and declining food, fuel, clothing and footwear prices in many others, particularly those of the ECCU. In 2014, due partly to the pick-up in activity and to currency depreciation in some instances, there was a slight uptick in average headline inflation (to 1.8 per cent), with goods producers (4.0 per cent) having relatively higher levels of inflation than service-based economies (1.0 per cent).

Maintaining either stable or fixed exchange rates has been a principal monetary policy objective for Caribbean economies. This is because significant exchange rate depreciation could fuel inflation while, conversely, appreciation could reduce the competitiveness of the subregion's exports. In this regard, maintaining adequate external

reserves have allowed the ECCU (US\$1.00 = EC\$2.70), Barbados (US\$1.00 = BDS\$2.00) and Belize (US\$1.00 = BZ\$2.00) to support fixed exchange rate regimes. For the subregion's other goods producers, except for Suriname, there have been varying degrees of fluctuation in the exchange rates. For example, in 2014, an oversupply of foreign exchange in the market resulted in the Guyana dollar depreciating at a slower rate (0.12 per cent) against the United States dollar relative to 2013 (0.86 per cent).⁴ The Jamaican dollar experienced a similar easing of its rate of depreciation; as import demand declined, demand for BOP financing transactions were reduced and inflows from current transfers increased.

In response to continued tightness in the foreign exchange markets throughout 2014, and in an effort to address excess demand for foreign exchange, the Central Bank of Trinidad and Tobago sold an estimated US\$1,290 million over the course of the year. This, however, caused only a slight appreciation of the currency. Suriname's exchange rate on the other hand has remained relatively stable at SDR\$3.30 = US\$1.00 in 2014, which is likely to persist in 2015.

OPTIMIZING THE ROLE AND CONTRIBUTION OF MONETARY POLICY TO ECONOMIC GROWTH

Although growth within the subregion continues to be below pre-crisis levels, most economies

now seem to be on an upward growth trajectory.

Furthermore, inflation and interest rates have been kept in check. However, for monetary policy to continue to provide a platform for macroeconomic stabilization and growth, it must complement fiscal consolidation and debt reduction programmes being instituted across the economies of the subregion.

More importantly, abating exchange rates pressures in some economies and stimulating growth in private sector credit and aggregate demand remain key challenges for the subregion. This suggests the need for policies to strengthen the intermediation of credit for private business investment. This can be facilitated by lowering policy rates to encourage commercial banks to reduce the loan interest rates, thereby reducing the cost of credit, and by improving the business environment to stimulate entrepreneurship. There is also a need for more innovative financing mechanisms and a more aggressive approach to deepening the financial sector as well as enhancing legal and prudential frameworks. This would go a long way in making indirect instruments more effective in driving economic growth. In addition, public-private sector partnerships should be seen as providing a useful means of redirecting excess liquidity into more value-added productive activity, thereby stimulating sustainable aggregate demand in the short- to medium-term. ■

⁴ When the Bank of Guyana intervened to pump US\$163.6 million into the system.

► (continued from page 3)

ECONOMIC PERFORMANCE AND POLICIES IN THE CARIBBEAN

Finally, we will also take a look at the monetary policy framework and its impact on domestic credit, inflation and exchange rates. This highlights the fact that despite declining interest rates, domestic credit to the private sector has contracted from 66.7 per cent of GDP in 2010 to 60.4 per cent of GDP in 2014. The much needed private investment in productive activity has thus been limited. There was a slight pickup in inflation in 2014, but this movement will not pose a threat to stability. Similarly, exchange rates remain broadly stable.

In summary, despite the slight improvement in macroeconomic performance across the subregion, a number of challenges must still be addressed if we are to promote successfully the sustainable economic development of the Caribbean. To this end, a number of solutions are offered. Of note, given the openness of the economies of the subregion, is the suggestion that public policy will need to focus on improving the environment for innovation and export business. The improvement in the ease of doing business index in some countries in recent years is a step in the right direction but much more will need to be done to remove

logistical and other barriers to trade and to facilitate cooperation among firms in the subregion.

Foreign direct investment is also an important source of financing for the subregion and policies which encourage the reinvestment of profits will help sustain growth. In addition, opportunities for public-private partnerships must be explored to help reduce private risks while generating additional resources for a fiscally constrained public sector.

Yours in FOCUS,

Diane



► (continued from page 5)

A GROWTH AGENDA FOR THE CARIBBEAN



to 32.5 per cent in Grenada. Other countries with high levels of joblessness were Jamaica with 11.7 per cent, The Bahamas with 15 per cent and Saint Lucia with 24.9 per cent. The unemployment situation is even more daunting among the youth of the subregion. Unemployment rates for this group have been above 20 per cent⁷ for most of the countries with available data in recent years, with highest rates recorded in Grenada (53.2 per cent in 2013⁸). Governments in a number of countries have been

using “make work” programmes to ease unemployment pressure, but these do not augur well for either improved labour productivity or sustainable employment.

A RECIPE FOR GROWTH

Over time, ECLAC has suggested a number of strategies to accelerate economic growth, including:

- Fiscal consolidation aimed at improving the public finances.
- Trade facilitation aimed at increasing exports.
- Blended financing to jump start the private sector.
- Labour market reforms that preserve workers’ rights while improving productivity.
- Policies to improve the technology readiness of SME’s.
- Regional integration that goes

beyond CARICOM to embrace Latin America.

While these remain relevant, at the end of the day, it is firms that will need to build export competitiveness. In addition, consideration should also be given to nurturing start-up firms and creating a business environment conducive to private sector expansion. Recent evidence about Caribbean firms relative to similar enterprises in other small economies suggests that Caribbean firms are less export oriented. They are also surprisingly more credit-constrained, and exhibit less growth than similar small- and medium-sized enterprises. The recent improvement in the ease of doing business index for many Caribbean countries may bode well for the future. ■

⁷ Parra Tornado (2014) “Unemployment, Youth and Active Labor Market Policies in the Caribbean” Manuscript, World Bank.

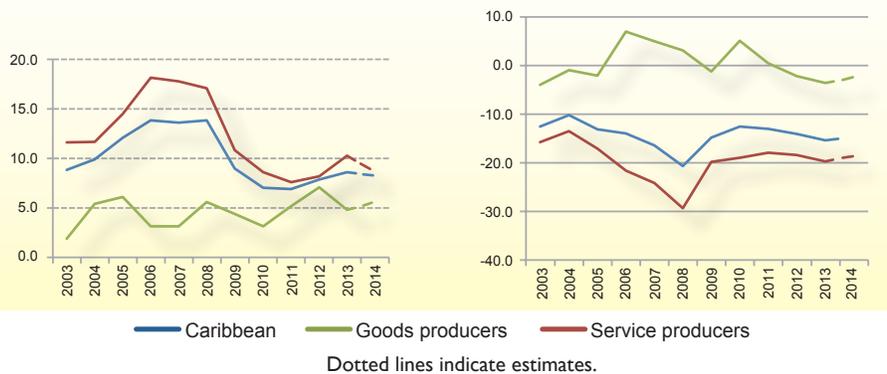
⁸ Government of Grenada Budget Statement 2015.

► (continued from page 9)

THE PERFORMANCE OF THE BALANCE OF PAYMENTS IN THE CARIBBEAN



FIGURE 3: FOREIGN DIRECT INVESTMENT (LEFT) AND CURRENT ACCOUNT BALANCE (RIGHT) (Per cent of GDP)

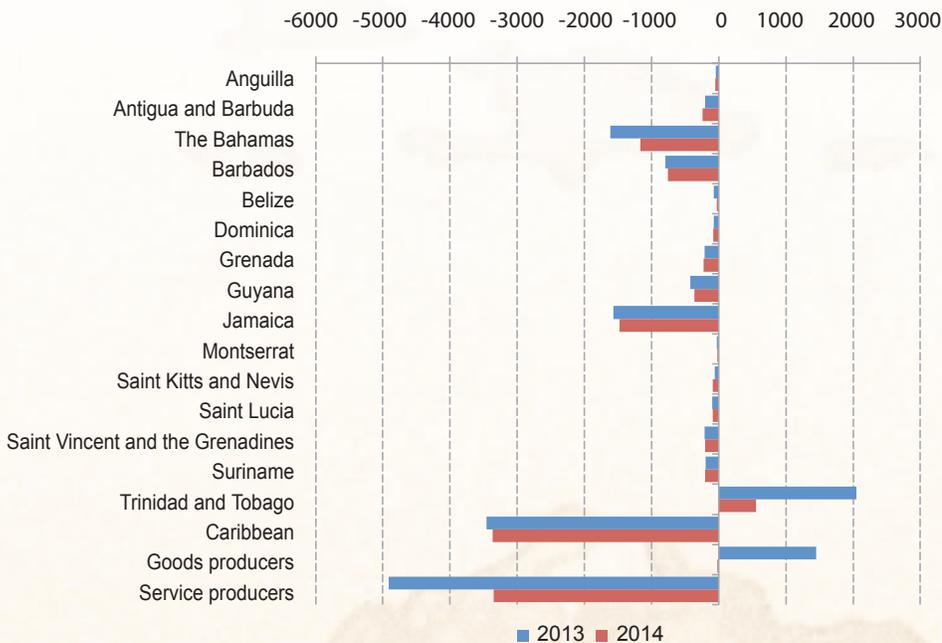


Source: ECLAC, based on official data.

Though data for 2014 remains incomplete, some preliminary projections and estimates regarding developments in the balance of payments, especially the current account, can be made.

Service producers saw a modest improvement in their current account, and preliminary data indicates improvements in their capital and financial accounts as well.

FIGURE 4: CURRENT ACCOUNT BALANCE IN 2013 AND 2014 (United States dollars millions)



Source: ECLAC, based on official data.

For goods producers, while Belize and Guyana showed modest improvements in the current account, and Suriname a marginal deterioration, Trinidad and Tobago saw a large decrease in its current account surplus, from US\$2.1 billion in 2013, to an estimated US\$554 million in 2014. This decline was largely due to lower oil prices and higher outflows of investment income.

As a whole, the Caribbean saw a small decrease in its current account deficit in 2014, with most countries showing modest improvement. Figure 4 shows the current account balances in 2013 and estimated current account balances in 2014. Most countries ran a current account deficit.

The modest improvements in the current account for many Caribbean countries are a good sign. Long-run improvements in the balance of payments will be possible only when the current account deficit is sustainably decreased; funding a current account deficit with a capital and financial account surplus is not sustainable indefinitely.

The current account deficit can be reduced in a few ways. Increased production of goods and services (including tourism services) for export will create a flow of foreign exchange. In some areas, where local capital is lacking, this may be possible only with increased FDI. However, with either FDI or local investments, measures must be taken to make the Caribbean an attractive environment for the reinvestment of profits; otherwise, increased export activity could be offset by capital flight overseas. ■

► (continued from page 7)

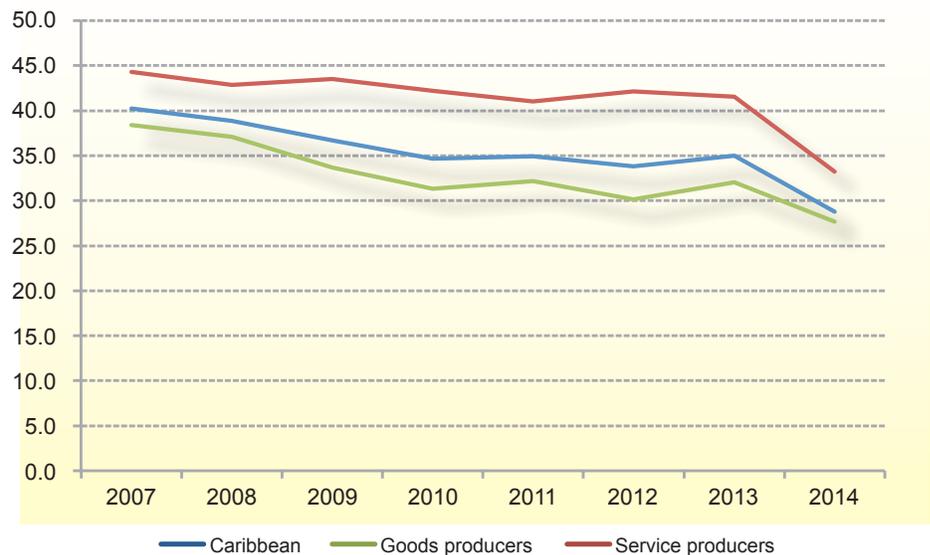
FISCAL DYNAMICS IN THE CARIBBEAN BEFORE AND AFTER THE CRISIS



competitiveness strategy. A number of the most indebted economies have adopted either IMF programmes or home-grown debt restructuring programmes. These have helped to reduce debt and servicing costs. To achieve sustainable medium-term fiscal positions, the region needs to improve and stay the course with consolidation programmes. Programmes should be strengthened by better prioritizing expenditure, reducing government consumption spending and generating primary surpluses to maintain vital capital expenditure. In addition, in line with the new financing for development arrangements, the region should put forward strategic projects in areas such as climate change adaptation, disaster risk reduction and small business start-up that might benefit from counterpart international financial assistance. This could help to ease the pressure on already strained budgets.

The growth strategy should tackle the main binding constraints to growth in the region. Two notable constraints in this regard are the limited private investment in new export-generating activities, and the weaknesses in the adaptation of technology to domestic needs and human-capital development. Productive export-based investment

**FIGURE 2: FISCAL FLEXIBILITY IN CARIBBEAN ECONOMIES
BY ECONOMIC STRUCTURE**



Source: ECLAC, based on official data.

could be facilitated by developing business incubators to address binding constraints faced by small businesses. Similar efforts should be underpinned by a reform of the incentive framework. Also, a

more robust network should be established between universities, technical institutes and business firms, to stimulate research and development. ■

UPCOMING EVENTS 2ND QUARTER 2015

24 - 25 June, 2015

Symposium on Shaping the Sustainable Development Goals within the Context of the Post-2015 Development Agenda. Radisson Hotel, Port of Spain, **Trinidad and Tobago**.

26 June, 2015

Seventeenth meeting of the Monitoring Committee of the Caribbean Development and Cooperation Committee. Radisson Hotel, Port of Spain, **Trinidad and Tobago**.

LIST of Recent ECLAC Documents and Publications

Listed by Symbol Number, Date and Title

No. L.462

May 2015

Report on the regional seminar on implementation of the SAMOA pathway

No. L.461

April 2015

Report of the second expert group meeting on opportunities and risks associated with the advent of digital currency in the Caribbean

No. L.455 rev

March 2015

An assessment of the performance of CARICOM extraregional trade agreements: An initial scoping exercise



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The Magazine of the Caribbean Development and Cooperation Committee
ECLAC Subregional Headquarters for the Caribbean

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