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SOME EFFECTS OF ADJUSTMENT ON THE FINANCIAL SECTOR IN SURINAME

Rakesh Adhin
and
Frits Konigferander
Central Bank of Surinam

JACK TAR VILLAGE
FRIGATE BAY
ST KITTS

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Mr. Rakesh Adhin & Mr. Frits Konigferander *)
Central Bank of Suriname

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*) The authors are staff members of the Central Bank of Suriname. Views expressed in this paper, however, are theirs and do not necessarily reflect those of the Bank.

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1. INTRODUCTION

The Structural Adjustment Programme of Suriname was officially approved of in November of 1992 by Parliament. Some measures in the area of adjustment were, however, taken even before this date. Typically, the reason for the implementation of the adjustment programme was bad macroeconomic management. A decade of monetary financing of government deficits (1983/93) had caused a massive expansion of the monetary base leading to high inflation, loss of output, balance of payments deficits and a strongly overvalued Surinamese guilder.

Though financial markets in Suriname are not yet well-developed, there have been some changes recently, including the introduction of a stock exchange (1994) and the issue of Central Bank gold certificates (1995). The stock exchange was established as an initiative of a large insurance company that acknowledged the economy's need for a more efficient allocation of funds, while the Central Bank began her open market type operations to restore confidence in the national currency by offering a real interest, thereby reducing the pressure on the exchange rate.

This paper deals with some effects adjustment policy has had on the financial sector in Suriname. First, the focus will be on the monetary and exchange rate policies as formulated in the adjustment programme, since these policies most directly affect the financial sector. Next, the financial institutions and instruments will be briefly reviewed, and finally, the main effects of adjustment measures on three financial subsectors will be looked at.

2. THE ADJUSTMENT PROGRAMME

2.1 Monetary Policy

The monetary policy issues and main supporting measures in the context of the adjustment programme are/were:

- **Reduction of monetary overhang**

- use of counterpart funds from balance of payments support[1] for reduction of government debt with the Central Bank , official external debt and Central Bank forex losses;
- sale of state-owned land and property.

- **Credit monitoring and control**

Public

- issue of government bonds to finance the budget deficit;
- elimination of monetary financing of the government budget;
- a realistic arrangement for the reduction of government debt with the Central Bank;

Private

- quantitative and qualitative (selective) credit control;
- special guidelines for credit supply through external funding to productive sectors.

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[1] Suriname is still entitled to some US$ 0.6 billion of Dutch development aid, to be received as balance of payments support during the adjustment programme.

● Open market and interest rate policy

- issue of Central Bank paper to mop up excess liquidity;
- a realistic interest rate policy based on development goals.

● Legislation

- revision of existing banking laws;
- introduction of additional banking laws.

2.2 Exchange Rate Policy

The exchange rate policy issues and main supporting measures in the context of the adjustment programme are/were:

● Introduction of a new forex market

- revision of the existing, highly restrictive, foreign exchange law;
- introduction of a new exchange rate for the bauxite sector;[2]
- legalization of the parallel exchange market;
- exchange rate management through interventions.

● Revision of transfer procedures

- new rules for transfers for overseas study;
- new rules for profit repatriation of foreign-owned companies;

[2] The bauxite sector is traditionally the largest earner of foreign exchange in Suriname.

- new rules for the transfer of re-insurance premiums;
- formulation of instructions with respect to unsettled export proceeds and outstanding debt.

- Surrender of export proceeds
  - gradual switch from the old fixed rate to the managed rate.

- Unification of the exchange rate
  - phasing out of the multiple exchange rates;[3]
  - introduction of a flexible exchange rate.

- Balance of payments support
  - continuation of aid through an interbank system to defend the national currency.[4]

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[3] During the multiple exchange rate regime (1992/94) a total of seven exchange rates were operational; six fixed rates and one flexible rate.

[4] Earlier (1992/93), balance of payment support was allocated through foreign exchange auctions on the basis of a list of selected import items.

3. THE FINANCIAL SYSTEM

3.1 Financial institutions

The banking system of Suriname is comprised of the Central Bank and six commercial banks. The two largest commercial banks are privately owned by or in affiliation with Dutch banking groups (ABN-AMRO), while the government is the sole or majority owner of the four smaller ones.

The remaining financial sector consists of a National Development Bank; a Mortgage Bank; finance companies (7); insurance companies (12); pension funds (28); provision funds (8); and credit unions (33). In addition, six bank and five non-bank cambios operate in the foreign exchange market since June of 1993, while a modest stock exchange became operational in January of 1994.

With the exception of the stock exchange, all mentioned institutions are subject to financial supervision by the Central Bank. Additionally, the commercial banks are subject to monetary supervision.

3.2 Financial instruments

The financial instruments in Suriname are: demand deposits, savings deposits, time deposits, foreign currency deposits, government bonds and Central Bank gold certificates. Demand deposits are non-interest bearing since credit expansion on the basis of these accounts is not allowed under the current credit arrangement with the commercial banks. Foreign currency deposits were introduced following the partial liberalization of the foreign exchange regime. The Central Bank gold certificates are denominated in grams of gold (U.S. dollar value of the gold as quoted in London multiplied by the official exchange rate) at a 5% annual interest. The interest received in Surinamese guilders therefore varies with changes in the international price of gold and the exchange rate.

4. ADJUSTMENT: MEASURES AND MAIN EFFECTS

4.1 Money and Credit

- Issue of government bonds

In 1990 and 1992 government bonds were issued with maturities of five years. Because of the then present monetary overhang there were no noticable effects on domestic credit conditions. Thus, these bond issues did not affect the level of domestic interest rates.

- Financial regulation

In January of 1995 new international solvency directives were adopted. According to these directives the target standard ratio of capital to weighted risk assets should be 8%, of which the core capital element should be at least 4%. Capital consists of core capital, supplementary capital and deductions from capital. Core capital, consisting of equity capital and disclosed reserves, should be a certain proportion of supplementary capital. The directives also include transitional arrangements for a period of three years at the end of which banks are obliged to meet the target standard of 8%. In Suriname, the ratios for the transitional period are: 1st year: 5%, 2nd year: 7,5% and 3rd year: 8%.

- Quantitative credit control

Also in January of 1995, penalties were introduced to deter banks from exceeding their credit ceilings. First, a part of the bank's reserves, equal to the amount overshooting its ceiling, will be blocked at the Central Bank. Second, the bank will be charged interest on this blocked amount at a rate that lies two percentage points above its highest lending rate. At most, credit expansion may be equal to the sum of the increases in: capital and reserves, long-term deposits (long-term time deposits + 90% of savings deposits + other long-term liabilities) and 75% of short-term time deposits. In addition, remaining amounts under the credit ceiling at the year's end are added to the credit ceiling during the next year. Increases in bank investments, however, bring down the credit ceiling with the amount newly invested.

- Issue of Central Bank paper

In March of 1995 the Central Bank gold certificates were introduced. Denominated in grams of gold and yielding an annual 5% gold-linked interest, this instrument is devised to reduce monetary overhang and to push up the, in real terms, highly negative domestic interest rate level. The latter objective was especially achieved, since the commercial banks shortly afterwards increased their deposit rates to more realistic levels, thereby reducing capital flight. Since the gold certificates can be cashed on demand, they are a close substitute to foreign currency deposits with the advantage that residents do not need to have foreign currency to acquire them.

4.2 Foreign Exchange

- Foreign exchange auctions

From October of 1992 until July of 1993 Suriname received balance of payments support from the Netherlands. These treaty funds were allocated through auctions and intended for imports of the productive sectors. The subsequent auction rates were not as desired because of speculation on whether the balance of payments support would be continued or not after the auctions. As a consequence, the auction rates showed a rising trend. A side-effect of the auctions was, however, the rise in nominal interest rates due to the additional demand for credit to finance these imports.

● Foreign currency deposits

Following the partial liberalization of the foreign exchange regime in June of 1992, foreign currency deposits were added to the existing financial instruments in April of 1993. The commercial banks, however, re-invest these deposits abroad which, in the past, led to a lack of foreign exchange and pressure on the exchange rate.

● Free foreign exchange market

The establishment of a free market in foreign exchange in June of 1993 in fact legalized the parallel exchange market. Subsequently, licensed foreign exchange dealers, the so-called non-bank cambios, were permitted to enter the exchange market. The commercial banks also run cambios and some of the larger banks extend loans in foreign currency. Cambios are, however, only allowed to buy and sell foreign exchange. They have to report on a daily basis to the Central Bank, which in turn publishes the official exchange rate -the weighted average exchange rate (or 10-20% less) of all cambio dealings- the following day.

● Gold purchases in U.S. dollars

In April of 1995 the Central Bank began to purchase industrial gold in foreign currency on the local market. Since the gold industry is one of the fastest growing sectors in Suriname at the moment, the "gold dollars" were instrumental in the process of stabilizing the exchange rate.

• Foreign exchange market intervention

Since May of 1995 the Central Bank has been intervening in the forex market. The effect has been a substantial appreciation of the Surinamese guilder vis-a-vis the U.S. dollar in recent months. For example, at the time of the first intervention the exchange rate on the parallel market was Sf 750 per US$. Currently, the parallel market rate is around Sf 412 per US$ and, as a consequence, we have had negative inflation rates in the past few months. The end of year inflation for 1995 is estimated at below 50%, compared to the 590% inflation rate of last year.[5] The challenge commercial banks are now faced with is to adjust their lending rates to the lowered inflation rate.

4.3 Insurance

• Inflation tax on life insurance

Although adjustment measures do not directly affect insurance companies, some measures do fuel price inflation (e.g. unification of the exchange rate or removal of price subsidies on essential goods), which in turn affects the insurance business in a negative way. It can therefore be stated that cost push inflation, as a initial side-effect of adjustment, has a negative effect on the performance of, especially, life insurance companies. In Suriname, many insurants cancelled their life insurance policies due to the heavy inflation tax in recent years. Insurance companies, however, manage to operate by covering insurance losses through alternative investment policies. In addition, insurance policies in foreign currency have been introduced.

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[5] In 1994 the main source of money creation was a balance of payments surplus. However, insufficient foreign exchange was again made available for imports, which contributed to the already massive depreciation of the national currency in that year.

5. CLOSING REMARKS

Since Suriname is a small open economy exchange rate depreciations are very rapidly translated into domestic inflation. However, due to money illusion of the public and the lack of competition in the banking sector real interest rates have been negative since 1989, which in turn led to capital flight and even higher inflation. Although the Central Bank has no formal policy to regulate interest rates the introduction of its gold certificates, yielding a 5% real interest rate, implicitly set a floor rate for the commercial banks.

After the balancing of the budget, the biggest challenge for the monetary authorities was to stabilize the exchange rate. Incidentally, neither the balance of payments support nor the cambios, but the foreign exchange market interventions of the Central Bank, proved to be the most succesful instrument to stabilization. Since foreign exchange intervention has its limits, it is encouraging to notice that confidence in the Surinamese guilder is beginning to restore. It seems that the vicious circle of inflation and capital flight has finally been broken, but at this stage it is yet too early to tell.

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SURINAME

Statistical Profile

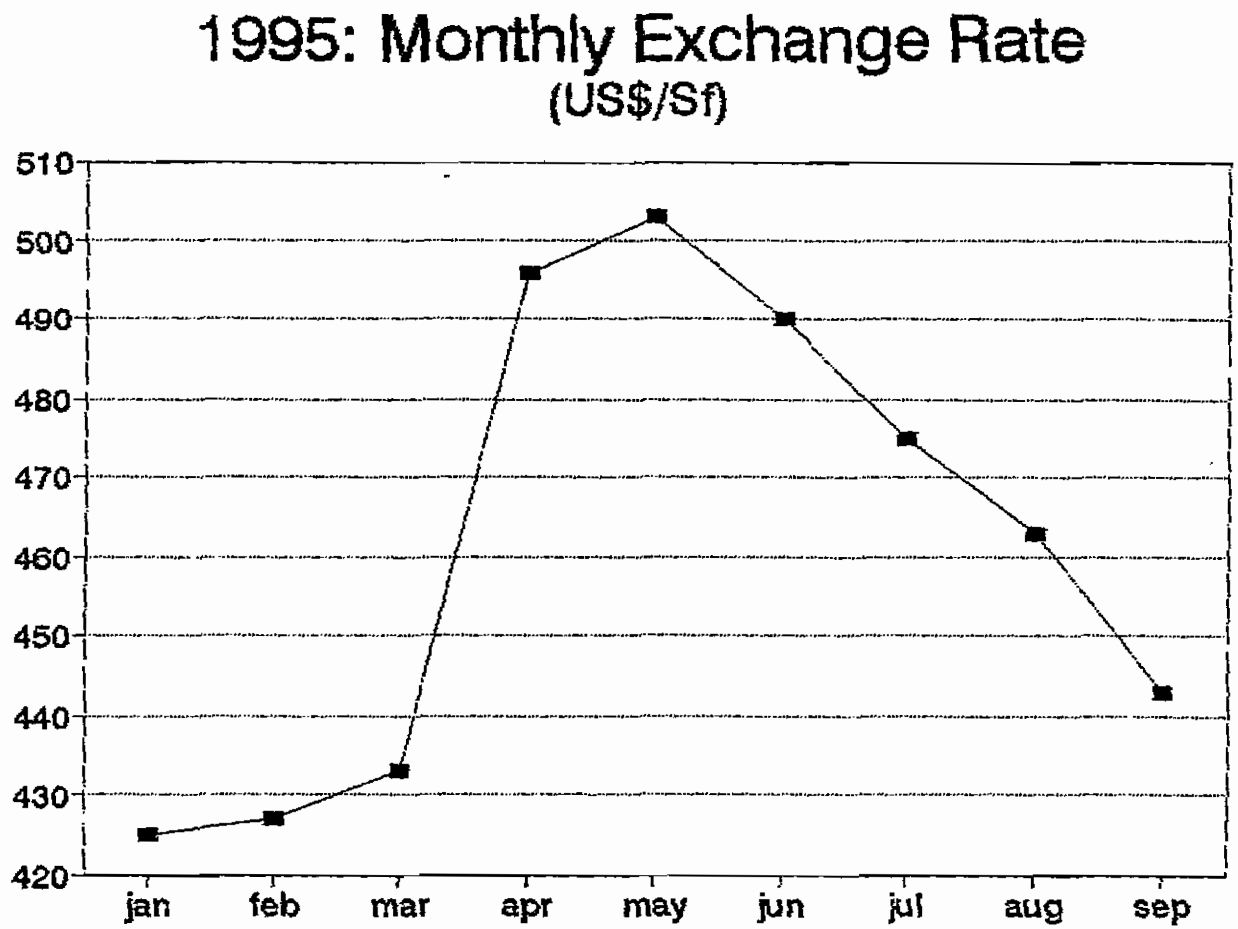
	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994p
Real Gross Domestic Product (GDP) 2					(Average Annual Growth Rates)					
Total GDP	2.0	0.8	-6.2	7.8	4.2	0.1	3.5	5.8	-4.5	-2.2
Agriculture, Forestry and Fishing	1.4	-2.6	5.5	-0.5	-2.4	0.9	18.6	1.1	3.9	-2.0
Mining and Quarrying	18.6	13.4	-17.7	43.8	6.6	-1.9	1.4	5.5	10.5	14.3
Manufacturing	6.5	2.7	-22.3	11.9	1.5	0.9	-3.2	0.9	-4.1	0.7
Construction	-11.3	7.3	-17.3	-1.7	-10.3	-13.7	-2.2	18.9	-28.1	0.0
Central Government					(As a Percent of GDP)					
Current Revenue	29.9	31.0	29.0	29.3	31.2	32.1	27.7	22.8	12.6	26.5
Current Expenditures	48.5	55.2	53.0	49.0	44.8	37.8	45.0	39.5	37.4	47.9
Current Saving	-18.6	-24.2	-23.9	-19.7	-13.5	-5.7	-17.3	-16.7	-24.8	-21.3
Fixed Investment	3.0	2.2	1.1	1.8	3.2	3.1	1.0	2.1	3.4	5.6
Deficit or Surplus	-21.4	-26.0	-24.8	-21.3	-14.0	-5.7	-16.9	-10.8	-7.9	0.1
Domestic Financing	20.6	25.6	24.5	20.9	16.7	3.8	17.1	8.5	7.7	0.1
Money and Credit					(As a Percent of GDP)					
Domestic Credit	91.2	115.9	132.1	137.1	142.0	126.8	126.7	113.1	65.0	...
Public Sector	53.3	75.5	94.7	101.8	102.8	86.2	84.3	71.9	38.9	...
Private Sector	37.8	40.4	37.4	35.3	39.2	40.6	42.4	41.2	26.2	...
Money Supply (M1)	39.5	60.3	68.0	74.2	75.3	69.8	67.8	57.9	36.5	20.0
					(Percent per Annum)					
Interest Rate 3	3.2	2.7	2.4	2.2	2.3	2.6	2.5	2.7	2.7	...
Prices and Salaries					(Average Annual Growth Rates)					
Consumer Prices	10.9	18.7	53.4	7.3	0.8	21.7	26.0	43.7	143.5	368.6
Real Wages	-7.1	-10.9	-32.2	-3.2	8.0	-15.9	-7.5	-14.7	-37.3	-28.2
Exchange Rates					(Guilders per Dollar)					
Market Rate 4	2.8	3.8	6.0	4.6	7.8	9.6	10.1	14.7	47.3	186.0
					(Index 1990 = 100)					
Real Effective	54.4	76.4	93.0	68.6	85.1	100.0	84.7	90.6	115.8	101.3
					(Index 1980 = 100)					
Terms of Trade	89.6	92.0	90.9	88.9	131.8	103.5	87.7	76.5	87.6	96.9
Balance of Payments					(Millions of Dollars)					
Current Account Balance	-11.6	-22.4	74.8	62.5	162.9	34.6	-75.8	11.0	44.5	104.5
Trade Balance	26.6	33.0	64.5	118.9	218.3	91.5	-1.1	68.4	84.4	122.9
Exports of Goods (FOB)	336.1	337.1	338.8	358.4	549.2	465.9	345.9	341.0	298.3	324.0
Imports of Goods (FOB)	309.5	304.1	274.3	239.4	330.9	374.4	347.1	272.5	213.9	201.1
Service Balance	-35.3	-54.4	8.3	-61.9	-73.3	-83.8	-86.5	-83.4	-61.3	-46.4
Unrequited Transfers	-2.7	-1.0	2.0	5.7	17.9	26.9	11.9	26.1	21.4	28.0
Capital Account Balance	14.5	1.1	-50.6	-65.9	-172.9	-15.0	32.4	-48.5	-23.0	-40.6
Non-Monetary Sector	10.2	-10.5	-53.8	-86.6	-185.0	-20.0	32.6	-21.5	-29.1	-50.4
Private	9.8	-12.1	-56.4	-94.1	-191.5	-18.3	27.5	-27.7	-31.1	-52.0
Government	0.4	1.6	2.6	7.5	6.5	-1.7	5.1	6.2	2.0	1.6
Monetary Sector	4.3	11.6	3.1	20.8	12.0	5.2	-0.2	-27.1	6.1	9.8
Change in Reserves (- Increase)	8.5	40.0	9.4	5.2	0.1	-10.3	43.9	12.0	-8.3	-28.2
Errors and Omissions	-11.4	-18.7	-33.6	-1.8	9.9	-9.4	-0.5	25.4	-13.2	-35.7
External Public Debt					(Millions of Dollars)					
Disbursed Debt	52.3	67.1	75.9	96.6	117.7	125.5	157.0	206.1	207.5	...
Debt Service Actually Paid	3.4	5.9	6.4	...	...	...	...	...	...	...
					(In Percent)					
Interest Payments Due/Exports of Goods and Non-factor Services	0.6	0.7	0.7	0.7	0.6	1.6	2.0	1.5	1.4	1.0

1

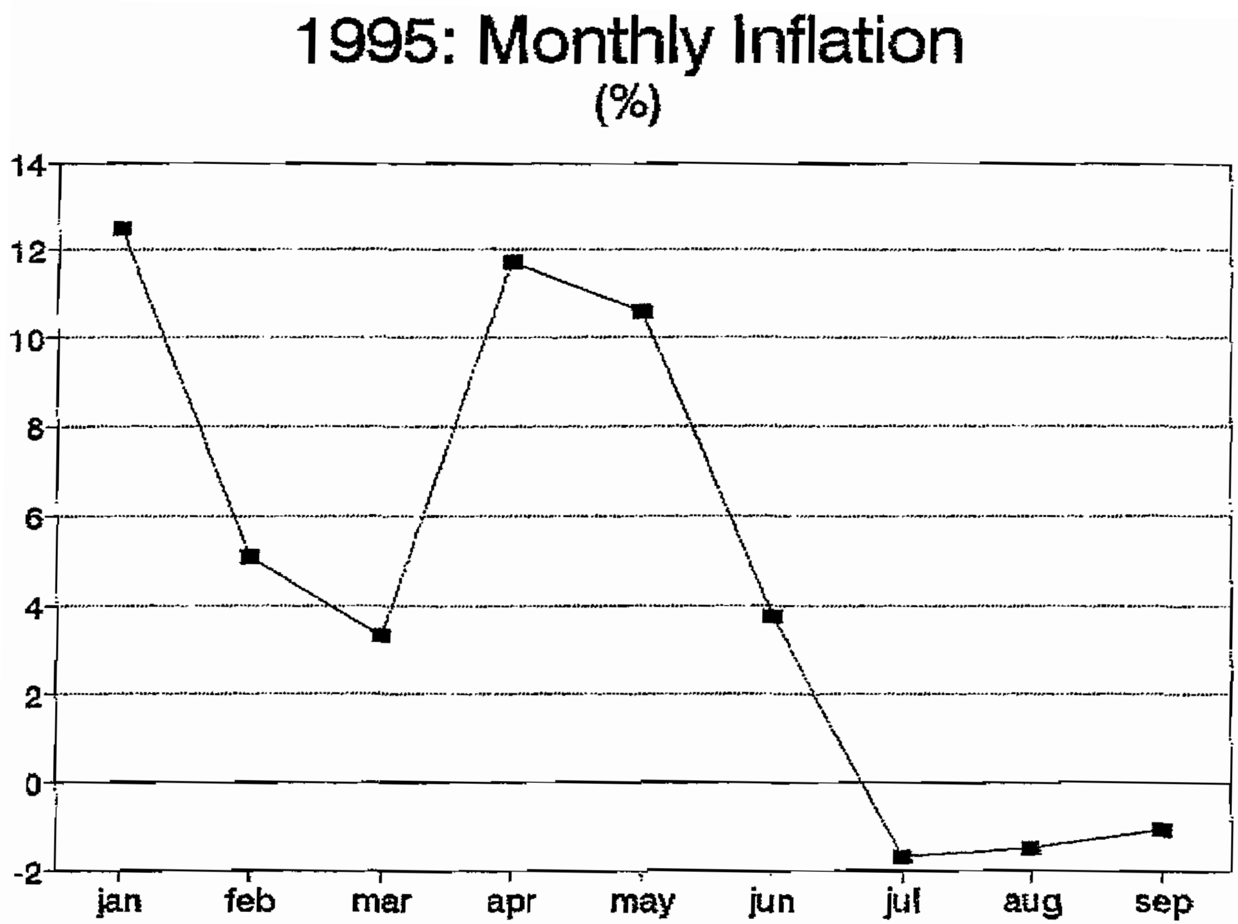
2 At factor cost.

3 Average deposit rate.

4 Average exchange rate taking into account parallel rate.



1995: Monthly Exchange Rate
(US$/Sf)
510
500
490
480
470
460
450
440
430
420
jan
feb
mar
apr
may
jun
jul
aug
sep


1995: Monthly Inflation
(%)
14
12
10
8
6
4
2
0
-2
jan
feb
mar
apr
may
jun
jul
aug
sep