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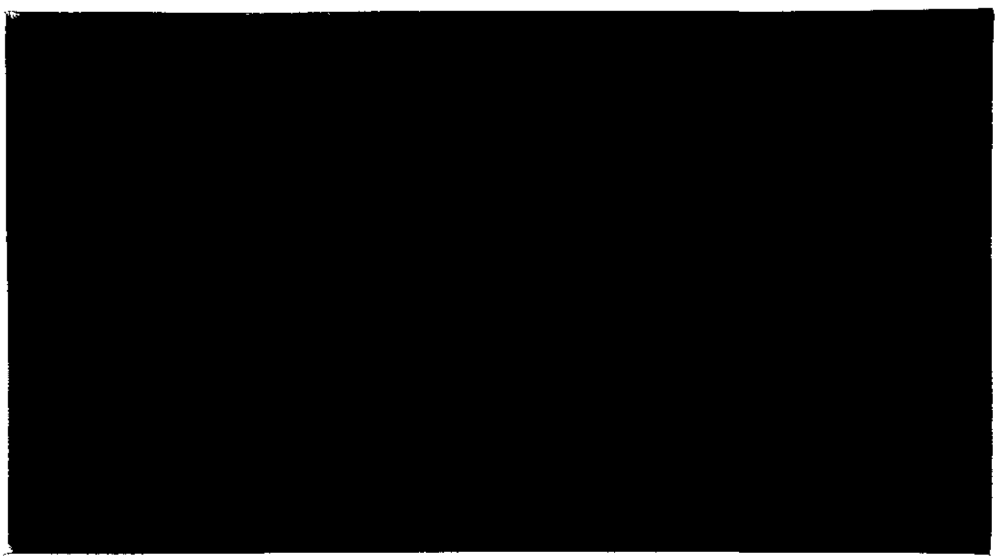

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THE EVOLUTION OF FINANCIAL SERVICES IN THE CARIBBEAN AND ITS IMPLICATIONS FOR MACROECONOMIC STABILITY

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I. Introduction

The purpose of this paper is to highlight some of the key recent trends in the activities of banks and other financial institutions in the Caribbean region,[1] and discuss some broad, preliminary observations regarding the implications of some of these activities for macroeconomic management and financial sector regulation and stability. Our interest in this topic derives, in part, from our ongoing work on financial sector issues in the Caribbean, and is related also to further research which we plan to undertake on the operational aspects of monetary and credit policies in selected countries in the region. In addition, the topic is relevant to the debate on the financial sector aspects of economic integration in the Caribbean, and we hope that this paper will help stimulate the debate.

The role of financial institutions in the Caribbean has been a subject of much discussion and analysis. A large part of the discussion has focussed on the role of foreign banks; changes in the ownership structure of financial institutions, including the indigenization of banks during the 1970s and 1980s; bank profitability and interest rate spreads; and the recent pickup in mergers and consolidations. More recently, the discussion has centered on the origins and resolution of financial crises (particularly in the case of Jamaica), financial sector regulation, and the supervision of offshore financial services. The subject of how the recent behavior of financial institutions has affected macroeconomic policy and management and financial sector supervision has received less attention. However, notable contributions in this area have come from Worrell and from Zephirin and Seerattan.

We place our discussion of the growing size and complexity of Caribbean financial institutions in the context of the important advances which governments in the region have made during the second half of the mid-1990s in achieving faster rates of economic growth, and stabilizing their economies—despite various external shocks. Against this background, our review of the recent changes in the financial systems points to the growing complexity of the environment facing governments and central banks as they endeavor to conduct effective monetary, external, and regulatory policies. It also points to the need to take fuller account of the region-wide and international activities of financial institutions in the design and monitoring of these policies. The paper should be viewed as a work-in-progress, hence some of the observations and conclusions are best regarded as tentative. However, we believe that the issues raised in the paper have become increasingly relevant for policymakers throughout the region who are interested in the role and future of the financial sector, and how financial sector activities and innovation could affect economic stability.

[1] This paper will focus on the English-speaking member countries of the IMF.

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The paper is structured as follows. Section II presents a brief review of the recent economic developments in the Caribbean, while Section III describes some of the key recent changes in the region's financial system. In Section IV we consider some macroeconomic and regulatory implications of those changes. Some tentative conclusions are outlined in Section V.

II. RECENT ECONOMIC PERFORMANCE OF CARIBBEAN COUNTRIES [2]

Economic performance was broadly satisfactory for most Caribbean countries during the second half of the 1990s (Table 1). The Bahamas and Barbados have experienced a steady recovery from a recession in the early 1990s. Although slower than in the previous decade, moderate real growth rates have characterized the economies of Belize and the member countries of the Organization of Eastern Caribbean States (OECS)[3]. Also, after a prolonged period of decline during the 1980s, Guyana and Trinidad and Tobago experienced steady economic growth during the 1990s. In Jamaica, the sustained decline in output since the mid-1990s seems to be on the verge of being reversed, as interest rates have come down in response to the country's strategy of continuing to strengthen the fiscal position and rehabilitating the financial sector.

Countries in the region have also been successful in reducing inflation to single-digit rates. For some (The Bahamas, Barbados, and Belize, as well as in the quasi-currency board arrangement managed by the ECCB), much of this performance has been due to long-established currency pegs to the U.S. dollar, supported by generally sound fiscal policies. Exchange rate stability has also been an important factor in bringing down inflation in Guyana, Jamaica, and Trinidad and Tobago which operate under managed floating (Tables 2-3).

Success in stabilization of the economy has been accompanied in some countries by progress in structural reforms, including:

- consolidating the fiscal position through tax reforms and a strengthening of revenue collections, in some cases through the introduction of a value added tax. Some countries have begun to develop on a regular basis medium term fiscal plans incorporating targets for government savings and debt;

- privatizing or restructuring state-owned enterprises and public utilities;

- in the area of monetary and credit policies, shifting away from direct controls in favor of increased reliance on indirect instruments such as open market operations. Concurrently,

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[2] For a more detailed review of economic developments in recent years, see Hilaire, and IMF (2000) forthcoming.

[3] The OECS comprises Antigua and Barbuda, Dominica, Grenada, Montserrat, St. Kitts and Nevis, St. Lucia and St. Vincent and the Grenadines. The countries share a common central bank—the Eastern Caribbean Central Bank (ECCB).

regulatory reserve and liquid asset requirements have been reduced in some countries where initial levels were high;

- developing further equity and debt markets by improving the regulatory framework, and establishing closer links among markets in the region; and

- liberalizing trade regimes under the aegis of the Caribbean Community (CARICOM). In particular, considerable progress has been made in reducing intra-regional trade barriers.

Prospects for sustained growth and social progress will depend to a large extent on consolidating the achievements made in stabilizing regional economies, and adjusting to the decline in traditional industries (bananas, sugar, and bauxite) by attracting investment in other areas such as tourism, manufacturing, construction, and financial and other services.

Except for Jamaica, which experienced a major crisis during the mid-1990s, the financial services sector has played an important role in the region's economic performance (Figures 1-8).[4] In The Bahamas, the sector contributes about 14-15 percent of GDP, accounts directly for about 5 percent of the employed labor force, and grew steadily (3-4 percent a year in real terms) during the 1990s. In Trinidad and Tobago, where the sector's contribution to GDP is also about 15 percent, financial services have experienced rapid growth in recent years, and branches or subsidiaries of its financial institutions now play an important role in most Caribbean countries. For other countries, including members of the ECCB, financial services—including offshore finance—have become increasingly important, with the sector's contribution to GDP ranging from 3 percent to 12 percent.[5] Part of this development has reflected offshore finance—as evidenced by the large claims of international banks on several Caribbean countries (Table 4). In the Section below, we focus on the key recent changes in banking and other financial services in the region, and consider their implications for economic management and the regulation of the financial sector.

III. RECENT CHANGES IN THE FINANCIAL SYSTEM

The recent changes in the structure and activities of financial systems in the Caribbean region are best viewed as the latest in a series of changes that began during the 1970s and 1980s. In summary, the changes which occurred during that period, and continued into the first half of the 1990s comprised the establishment of indigenous (often state-owned) banks and other

[4] Trinidad and Tobago experienced difficulties in its financial sector (mainly nonbanks) in the mid-1980s, and The Bahamas, Barbados, Guyana and the ECCB region have all experienced failure or difficulties in small banks.

[5] These ratios may well be underestimated, because of the way in which the contribution of the offshore financial services is calculated. In some countries, for example, the contribution is measured only by changes in employment.

financial institutions—mainly development banks and mortgage finance institutions; the liberalization of financial systems; and (except in ECCB countries) the gradual transfer of ownership of banks and other financial institutions from foreign (mainly British and Canadian) interests to private domestic shareholders or to the state.

Since the earlier changes are documented elsewhere[6], in this paper, we focus on the main changes which have taken place during the 1990s (see Box). Among the most prominent were:

the further concentration of banks and other financial institutions, mostly through mergers and acquisitions;[7]

the marked increase in cross border activities of financial institutions, including the financing of public sector capital projects and the private sector;[8]

the continued convergence of banking and insurance, combined with the proliferation of non-traditional and off balance sheet activities such as investment/mutual fund and trust management,[9] securities underwriting, and stockbroking;

the growing importance of nonbank financial institutions, especially insurance companies, consumer finance houses, credit card operations, merchant banks, and commercial paper brokers;[10]

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[6] The liberalization of financial systems consisted mainly of the removal of administrative interest rate and credit controls. The changes which took place during the earlier decades are summarized well in Clarke and Danns, McBain, and Zephirin and Seerattan, and Central Bank of Trinidad and Tobago.

[7] In Jamaica, the largest three banks account for 88 percent of total bank deposits; for Trinidad and Tobago and Guyana, the comparable ratios are 81 percent, and 72 percent, respectively.

[8] The Canadian banks operating in the region have been active participants in cross-border lending for several years. Also, Trinidad and Tobago institutions have been playing an increasing role in this area in recent years. One financial holding company, the Royal Bank of Trinidad and Tobago (RBTT), controls thirty companies in seven countries. Most of the growth in assets of RBTT in the period ended March 2000 (61 percent) reflected the expansion in overseas operations, and one third of the bank's earnings derived from these operations. The group recently concluded negotiations with the Jamaican authorities for the sale of that country's third largest bank, Union Bank.

[9] This includes the offer for sale of U.S. dollar-denominated mutual funds.

[10] For Trinidad and Tobago, the share of nonbanks' assets in the total assets of the financial system rose from 20 percent in 1980 to about 40 percent in 1999.

Selected Developments in the Financial System in the Caribbean: 1997-2000

Banking sector

- Transfer to the Bank of Nova Scotia of most of the deposit-like financial instruments of three intervened insurance companies in Jamaica.
- Purchase by Republic Bank Limited of Trinidad and Tobago of the majority shares in the National Bank for Industry and Commerce of Guyana.
- Purchase by the Royal Bank of Trinidad and Tobago (RBTT) of all the shares of the First National Bank of Aruba,
- Establishment by Republic Bank Limited of Trinidad and Tobago of offshore banking and insurance subsidiaries in Barbados and the Cayman Islands.
- Establishment of subsidiaries in the ECCB area by two of the largest banking groups in Trinidad and Tobago (RBTT and Republic Bank Limited), partly in anticipation of the establishment of a Regional Securities Market.
- Acquisition by Banks (D.I.H) Limited, a large manufacturing group based in Guyana of majority shares in CitizensBank (Guyana) Limited.
- Completion of negotiations between the RBTT Group and the Jamaican authorities for the purchase of Jamaica's third largest bank, Union Bank.

Non bank activities

- Purchase by the Guardian Holdings Group—which has a strategic alliance with the RBTT group—of the insurance portfolio of three intervened insurance companies in Jamaica.
- Purchase by RBTT Financial Holdings of a cement company in Jamaica.
- Acquisition by Barbados Mutual Life of a majority shareholding in Island Life Insurance Company of Jamaica.
- The initiation of listings of large regional companies on more than one of the stock exchanges in the region; for example, shares in RBTT Holdings are listed on the Barbados Stock Exchange.
- The marked growth in the activity in the secondary market in Jamaica of commercial paper brokers. The largest broker, Jamaica Money Market Brokers, has discussed plans for the expansion of its operations to Trinidad and Tobago.

the increased recourse to debt and equity issues (in local currency and U.S. dollars, and in domestic, regional, and international markets) by public and private sector companies, including financial institutions; and

the incorporation into financial groups of companies carrying out non-financial activities.

These developments are fully consistent with recent trends in financial sector activity worldwide that have brought a number of benefits, but also increased risks to macroeconomic policy and the regulation of financial institutions.[11] In the Caribbean, financial institutions have contributed to economic growth through the intermediation of resources between countries facing liquidity shortages and those with surpluses, which has helped smooth out fluctuations in capital flows and economic activity that could lead to pressures on interest and exchange rates. For example, financial institutions have helped meet the financing requirements associated with hurricane damage, preparations for Y2K, and urgent infrastructure needs. Financial institutions have also helped promote savings by making available a wide array of domestic, regional, and global instruments. In addition, the growing integration of the region's financial systems has allowed greater diversification of banking risks and portfolios, and helped strengthen and modernize the financial sector in countries in which banks were small and inefficient. Moreover, the large financial institutions in the region are generally characterized by experienced management, good track records in profitability, and high international credit ratings. At the same time, however, the recent activities of financial institutions have made macroeconomic management and financial system supervision more complicated. These complications are discussed in the section below.

IV. POLICY IMPLICATIONS OF RECENT FINANCIAL SECTOR DEVELOPMENTS

We group the policy implications of recent financial institutions' activities into four broad categories: (a) monetary and credit policies, (b) fiscal and public debt policies, (c) balance of payments and external financing policies, and (d) financial system regulation.

A. Monetary and credit policies

It is often suggested that the scope for monetary policy in the Caribbean is severely constrained owing to the prevalence of fixed exchange rate regimes, the absence or

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[11] For a summary of recent global trends among financial institutions, and their regulatory implications, see Balino and Ubide, and Mishkin (1998). On September 24, 2000, G-10 ministers noted that the wave of global mergers and acquisitions in the financial sector was creating institutions that were larger and more complex than in the past, with implications for, *inter alia,* financial risk, monetary policy, and payments and settlements.

ineffectiveness of capital controls, underdeveloped capital markets, and collusion by a few dominant banks. This may well be true over the long run, but in the context of the authorities' short term (i.e. up to one year) operational framework, central banks' purchases and sales of government paper and foreign exchange, repurchase agreements, changes in liquidity and reserve requirements, special deposits, and movements in benchmark interest rates indeed influence liquidity conditions, the cost of bank loans, the nominal exchange rate, and ultimately, spending decisions and expectations.[12]

In most countries in the region, the main objective of monetary policy is to achieve low rates of inflation. For some (The Bahamas, Barbados, Belize, and the ECCB members), the fixed exchange rate peg to the U.S dollar, supported by sound fiscal policies and a high level of international reserves in the central bank, provides the basis for helping ensure that the inflation rate does not deviate much from that in United States. Regarding fiscal policy, The Bahamas, for example, has announced its intention to achieve balance in the central government finances, while the ECCB places limits on its loans to governments. Sound public finances, together with the instruments described above help support strong international reserve positions and confidence in the exchange rate peg. For countries with flexible exchange rates (Guyana, Jamaica, and Trinidad and Tobago), steps toward a prudent fiscal stance have been accompanied by a more aggressive use of open market operations, repurchase agreements, and special deposits aimed at mopping up liquidity. Also, the authorities in these countries have intervened in the foreign exchange markets to smooth out temporary movements in the exchange rate that do not reflect fundamental changes in competitiveness, but which could result in marked fluctuations in inflation and increased uncertainty.

Notwithstanding a role for monetary policy, we observe that there has been a further weakening of the fragile transmission mechanism for monetary policy resulting from the activities of nonbanks (including their offer of an increasingly wide array of savings instruments and loans), and the cross-border operations of regional and international banks. For the monetary authorities, key operational tasks such as the short-term forecasting of the growth of private sector deposits and related instruments, credit expansion, cross-border capital flows, and countries' net external positions have become more difficult. Since important policy decisions. (changes in interest rates, targets for open market operations, and interventions in the foreign exchange market) are often based on these forecasts, policy making has become increasingly challenging.

Some examples of a weakening of the link between policy actions and economic effects include the following:

attempts by central banks to mop up liquidity or restrain the growth in credit through the sale of government paper, higher reserve requirements, or increased interest rates are offset by

[12] Some evidence of the influence of monetary policy on economic activity in the Caribbean is presented in Watson (1999).

capital inflows originating in the head offices of banks, in banks' branches or subsidiaries in other countries, or by external borrowing by financial institutions not supervised by the central bank. The inflows are not necessarily triggered by inter-country interest rate differentials, but by corporate decisions based on each bank's region-wide distribution of liquidity and risk, as well as by perceived business opportunities;[13]

policies to ensure adequate loanable resources in banks are stymied by shifts in resources from banks to other institutions (such as mutual funds, money market funds, and equity or debt issues), or abroad; and

central banks' efforts to ensure stable conditions in foreign exchange markets could be compromised by foreign exchange outflows on the part of financial institutions that are driven by the institutions' own corporate strategy. This would occur, for example, when financial institutions purchase shares in entities abroad, or lend in foreign currency to those entities.[14]

Central banks have responded to these developments by undertaking more active open market-type operations and interest rate policies, as well as by broadening the scope of existing instruments to capture the activities of nonbanks. For example, in 1998, the Central Bank of Trinidad and Tobago instituted new regulations which required that deposit-like instruments (called "fund raising instruments") be subject to reserve requirements. Other countries, like Jamaica, have taken steps to reduce the levels of reserve and liquid asset requirements in banks and other deposit-taking financial institutions—thereby reducing the scope for regulatory arbitrage. Such attempts to "catch up" with the constantly evolving activities of financial institutions are unlikely to be successful. Based on the experience of other countries, attempts to control the amount of liquidity in the financial system are likely to become increasingly difficult with further progress toward integration in the Caribbean region, and between the region and the rest of the world, as well as with the continued advances in the speed of transactions and the sophistication of financial and information technology.

On credit policy, some research in the United States and anecdotal information in the Caribbean would seem to point to a concern that as bank concentration increases, the

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[13] These offsetting flows have been a longstanding feature of the activities of international banks in the region, however, with the liberalization of the capital account and the increased regional scope of operations of large nonbank financial institutions, the volume of these flows has increased significantly.

[14] In recent years, monetary and exchange rate policy has also been complicated at times by the absence of co-ordination between treasuries and central banks in the timing and nature of government debt operations. Close collaboration in this area is essential to avoid unplanned pressures on domestic liquidity or the exchange rate that could be caused by, for example, the uncoordinated issue or redemption of government paper in domestic or foreign currency.

environment for bank credit to small firms becomes more restrictive (see Mishkin, 1998). First, large banks are perceived to be less interested than small ones in processing and extending small loans, so that *access* to bank credit becomes more difficult. Second, large banks are often regarded as less tolerant toward delays and other related problems in the servicing of small loans, and are more likely to foreclose on small debtors.

B. Fiscal policy

In some countries, domestic and cross border loans to the public sector by large regional banks or branches of international banks have permitted a more expansive fiscal stance than otherwise would have been possible.[15] This is particularly the case for those countries which do not have ready access to international capital markets, such as those in the ECCB area. Some of these loans have financed, for example, government office buildings and sports facilities (in Dominica, Grenada, and St. Lucia), and housing projects in Belize. For governments, the main advantages of this form of financing have been the often more rapid pace of loan preparation, negotiation, and disbursement than is possible from regional or multilateral development banks or bilateral donors—which allows countries to respond faster to national priorities, such as improving the infrastructure and creating jobs—and the avoidance of the conditionality that is often attached to those loans. However, reliance on this type of financing could lead to a number of risks, including:

the temptation to forego the feasibility studies and procurement procedures that accompany loans from official or multilateral agencies—which, in turn, could lead to a deterioration in the overall quality of public investment programs;

a shift in the debt structure toward more commercial debt and higher debt service costs[16];

the incurring of contingent commitments through government guarantees of loans to finance projects carried out by the private sector; and

the postponement of urgently needed reforms in the public sector, including privatization and enterprise reforms.

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[15] Expansionary fiscal policies have also been facilitated (for example in Dominica, St. Kitts and Nevis and St. Vincent and the Grenadines) through loans from state-owned banks to the central government or to loss-making public enterprises. In some cases, these loans have been funded by the deposits of the national insurance schemes.

[16] In Grenada, one large project financed by a large Trinidadian bank cost about US$29 million, or close to 10 percent of GDP. The additional debt servicing costs associated with recent commercial bank loans for infrastructure projects are equivalent to about 1 percent of GDP.

As the structure of the financial sector in the Caribbean continues to shift away from foreign ownership, central banks and governments are likely to be called upon more frequently to support financial institutions or to assume the role of lender of last resort (LOLR).[17] As a result, weaknesses in bank behavior and performance in the region increasingly could be expected to have fiscal implications. Since the advances in macroeconomic stability which the region has achieved in the past decade have been due mostly to sound fiscal policies, a weakening of fiscal performance stemming from government or central bank support to the financial sector could threaten this achievement. Moreover, for countries with long established fixed pegs to the U.S. dollar (including the ECCB countries), the failure of one or more of the large financial institutions—accompanied by a sharp rise in demand for U.S. dollars, or the fiscal shock stemming from government support of such institutions, could be expected to adversely affect the credibility of those pegs.

C. Balance of payments and the external debt

For a number of countries in the region, large and lumpy foreign investment flows as well as cross-border activities of financial institutions have resulted in an increase the size and volatility of capital flows. For some countries with fixed exchange rate pegs (The Bahamas), such developments have been associated with marked fluctuations in investment and output. In countries with flexible exchange rates, the increased volatility has obliged central banks to intervene more frequently in the foreign exchange market to smooth out large and disruptive fluctuations in the exchange rate. However, unplanned interventions could, in turn, derail the central banks' targets for international reserves, which, if sustained, could raise concerns about the stability of the exchange rate.

In recent years cross border activities of financial institutions—including direct lending, equity transactions, secondary market transactions in government securities, and the sale of regional and international mutual funds—have made it increasingly difficult to identify the size and nature of capital flows on the part of the private sector.[18] As a result, key indicators, such as the stock of private sector debt and its maturity structure, the main lenders

[17] This was demonstrated in Trinidad and Tobago in the mid-1980s, in Guyana, and in the wake of the Jamaican financial sector crisis in 1994-95. In earlier years, when regional banking systems were dominated by branches of international banks, the lender of last resort function was performed by the headquarters of those banks.

[18] One indicator of this difficulty has been the large size of the errors and omissions in the balance of payments. Over the period 1994-98, these have averaged 3.3 percent of GDP in Jamaica, about 4 percent of GDP in Trinidad and Tobago, and 7 percent of GDP in The Bahamas.

and borrowers, are often not monitored, with the risk that the authorities could be unaware of emerging difficulties in the private sector until a crisis develops.[19]

D. Regulatory implications

As noted above, the absorption by large financial institutions of the operations of smaller ones could help strengthen the financial systems in some countries.[20] However, **activities of the large institutions have also helped reveal a number of shortcomings in the regulatory framework in the region.**[21] Principal among these are:

the absence of consolidated supervision of financial groups;

the unevenness of the regulatory framework as between banks and nonbanks in each country, and among the countries within the region;

the remaining legal limitations throughout the region that do not permit the sharing of information among supervisors and financial institutions;[22]

inadequate disclosure requirements on the financial performance of banks and nonbanks;

poor monitoring of the operations of large nonbanks;

the possibility that large, dominant financial institutions that are not effectively supervised on a consolidated basis could engage in risk taking that could weaken the region's financial systems;

the risk that financial institutions could become so large that governments conclude that they are "too big to fail";

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[19] Under new IMF guidelines on surveillance, member countries are being asked to report quarterly external debt data for the government, central bank, the banking system, and other sectors.

[20] In Singapore, the authorities note that the entry of foreign banks has pushed the local banks to upgrade their information systems and risk management.

[21] See Zephirin and Seerattan for an earlier listing of these weaknesses.

[22] The existing legislation prevents the ECCB from sharing information with other regulatory agencies. The Bahamian government has recently indicated that it will be introducing legislation that will oblige its regulators to co-operate with regulators in other jurisdictions.

the risk that a crisis in one jurisdiction could spread to other countries, and that corporate strategic decisions by large banks could affect liquidity and credit conditions in small countries which host affiliates of those institutions; and

the increased risk of collusion by large financial institutions.[23]

An important risk that should be included for those countries with significant offshore activity, but an undeveloped regulatory framework, is that of the possible co-mingling of offshore with onshore activities. In the region, this type of risk appears likely in some member countries of the ECCB where supervision of the offshore sector is not carried out by the central bank, but by units in the ministries of finance which are small and understaffed. Co-mingling could result in the spillover into the domestic banking system of difficulties that originate in the offshore bank, taking the form, for example, of a large and rapid withdrawal by an offshore entity of its deposits in a domestic institution.[24]

Efforts have begun to address these weaknesses, but much work is needed. New legislation needs to be drafted and approved, legislation that is outdated and made irrelevant by new banking and information technology needs to be revised, work on harmonization of the regulatory framework, including for deposit insurance, within the region should be accelerated, and disclosure standards should be broadened to meet the emerging international standards. In organizing themselves to meet the new challenges in the financial system, Caribbean regulators may have to consider seeking technical assistance from regional and international institutions while they recruit and strengthen their in-house capacity. The IMF and the World Bank have indicated to governments in the region their willingness to help regulators conduct a variety of assessments in the context of the Financial Sector Assessment Program (FSAP). These assessments would, *inter alia,* identify risks and vulnerabilities of financial systems, determine technical assistance needs, and help prioritize policy response.[25]

V. CONCLUSIONS

There is little doubt that the rapid growth of the financial systems in the Caribbean in recent years has brought significant new opportunity and challenge to the region. The opportunity derives from the several benefits which accrue to the region from the operation of

[23] Concern about collusion by large banks in small countries is not unusual; see for example Karunasena, and Vassallo. The minimum deposit rate in some Caribbean countries is often justified as a protection against possible oligopolistic practices of large banks.

[24] Recent newspaper reports have indicated that the Grenadian authorities are investigating the possible domestic ramifications of the failure of an offshore bank—First Bank International.

[25] The Government of The Bahamas has announced that it has asked the IMF to conduct an assessment of its financial sector.

large, internationally recognized banks and other financial institutions, characterized by diversified ownership, experienced management, and strong financial performance. These benefits include access to increased resources from within and outside the region as well as to a wider array of financial services and instruments.

However, the size of these institutions, the participation of some in large conglomerates that comprise a wide range of banking and other interests, and their regional and international scope of operation have combined to complicate macroeconomic management and financial sector supervision. On the macroeconomic side, the challenge for governments is how to sustain the progress made in stabilizing their economies during the 1990s at the same time as the operations of large financial institutions could induce a further weakening of monetary policy, a relaxation of fiscal discipline, and marked increases in public and private sector debt. In meeting these challenges, governments may have to consider options to make liquidity management more effective. This could require not only the development of mechanisms that would make open market operations more efficient, but perhaps also selective and temporary controls over potentially disruptive capital inflows. It will also be essential to stick to sound fiscal policies aimed at raising domestic savings and containing the growth of debt. More generally, as the role of financial institutions and markets becomes more pervasive, current and reliable information on economic developments and policies will essential for their smooth functioning. In this connection, it will be important for governments and central banks to communicate more clearly and frequently to the public their macroeconomic policy objectives, the measures being implemented to achieve them, and the progress being made in meeting the goals. Greater transparency in economic policy would contribute to reducing the fluctuations in markets and the instability that are often associated with inadequate information on government policy.

Addressing the shortcomings in the regulatory framework for the financial system in the region is an enormous task that will require prompt actions to bring operations of large nonbank institutions and financial conglomerates, cross-border transactions, and public disclosure requirements in line with international standards. In view of the growing size of the regional financial sector, its potential effects on macroeconomic stability, the steady increase in the degree of linkage among the separate financial sectors in the region, and the high cost of potential crises, these tasks should qualify for high priority among the policy issues to be addressed in the Caribbean.

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Table 1. Selected Caribbean Countries: Real GDP Growth
(Annual averages; in percent) 1/

	1981-85	1986-90	1991-95	1996-99
Antigua & Barbuda	6.9	6.5	1.9	4.0
The Bahamas	3.3	2.4	-0.4	3.2
Barbados	-0.4	2.3	-0.5	2.8
Belize	0.1	9.6	4.3	2.8
Dominica	5.2	5.6	1.6	1.9
Grenada	5.3	5.8	2.0	4.5
Guyana	-3.4	-1.7	7.1	3.0
Jamaica	2.3	3.8	1.1	-0.7
St. Kitts & Nevis	4.9	6.6	3.9	3.4
St. Lucia	5.4	8.3	3.5	1.6
St. Vincent & the Grenadines	5.9	6.8	2.6	2.8
Trinidad & Tobago	-3.6	-2.2	1.4	3.7
OECS Economies 2/	5.6	6.6	2.6	3.0

Sources: IMF, Recent Economic Developments Reports; and WEO database.

1/ Measured as the growth rate for the period divided by the number of years considered.
2/ Unweighted average.
2/ Measured as standard deviation of annula growth rates during each period.

Table 2. Selected Caribbean Countries: Inflation.

(Consumer price index inflation, in percent) 1/

	1981-85	1986-90	1991-95	1996-99
(Countries with fixed exchange rates pegged to the U.S. dollar)				
Antigua & Barbuda	3.2	5.8	2.4	2.0
The Bahamas	5.8	6.1	3.3	1.3
Barbados	7.3	4.3	2.9	2.6
Belize	5.1	2.6	3.8	1.0
Dominica	4.8	5.0	1.8	1.5
Grenada	6.6	2.8	2.8	1.6
St. Kitts & Nevis	4.0	2.5	2.4	4.5
St. Lucia	3.3	4.3	4.5	2.3
St. Vincent & the Grenadines	4.7	4.1	2.9	1.5
Unweighted average	5.0	4.2	3.0	2.0
(Countries with flexible exchange rates)				
Guyana	28.0	34.6	34.6	6.0
Jamaica	22.2	19.1	89.5	9.2
Suriname	8.5	30.2	1,197.6	52.8
Trinidad and Tobago	14.3	11.8	7.5	4.5
Memorandum Item: United States	5.3	4.5	2.9	2.4

Sources: IMF, Information Notice System; and Recent Economic Developments Reports.

1/ Measured as the inflation for the period divided by the number of years within the period.

Table 3. Caribbean Countries: Consolidated Public Sector Balances
(Overall balances after grants, in percent of GDP)

	1994	1995	1996	1997	1998	1999
Antigua & Barbuda	-5.4	-7.4	-3.8	-8.2	-4.6	-5.4
The Bahamas	0.5	-0.2	-1.6	-3.1	-2.3	-1.7
Barbados 1/	2.8	2.1	-1.8	-0.7	-0.5	0.4
Belize 1/	-5.6	-2.7	-2.2	-4.2	-6.0	-5.6
Dominica 2/	-2.9	-1.0	1.4	-1.1	-2.6	-4.1
Grenada	-1.6	1.6	-1.3	-4.9	-5.7	-3.8
Guyana	-1.1	-2.1	1.2	-3.0	-4.8	-1.0
Jamaica 1/	3.7	2.5	-5.7	-10.9	-12.0	-9.4
St. Kitts & Nevis	1.4	2.3	-3.9	-0.7	-6.7	-7.3
St. Lucia	0.7	1.8	2.2	1.3	3.1	4.9
St. Vincent & the Grenadines	-3.2	1.2	1.6	-1.5	0.4	-0.1
Suriname 3/	-2.5	1.1	2.3	-5.2	-11.1	-4.2
Trinidad & Tobago	3.0	1.4	0.5	-1.2	-3.3	-3.5

Sources: Recent Economic Developments Reports; and Fund staff estimates.

1/ Fiscal year begins on April 1.
2/ Fiscal year begins on July 1.
3/ Central Government and Central Bank Operations.

Table 4. Consolidated International Claims
of BIS Reporting Banks on Caribbean Countries
(as of June 2000)

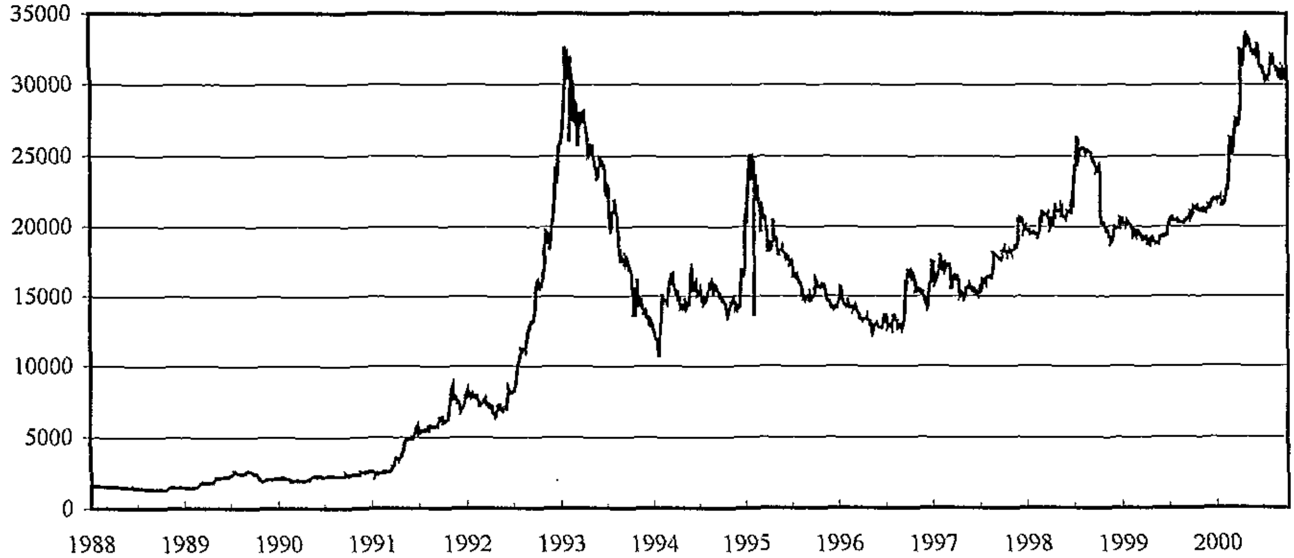
	U.S. dollar millions	Percent of GDP
The Bahamas 1/	18,711	383.4
Barbados 1/	1,989	76.9
Belize	1,363	181.5
Dominica	71	24.8
Grenada	50	13.7
Guyana	83	11.1
Jamaica	1,224	15.4
St. Lucia	100	17.1
St. Vincent & the Grenadines	603	190.6
Suriname	130	15.7
Trinidad & Tobago	1,817	25.5
Memorandum Items:		
Argentina	67,004	23.2
Brazil	61,844	9.9
Mexico	61,177	10.9
Venezuela	13,685	11.9

Source: Bank for International Settlements.

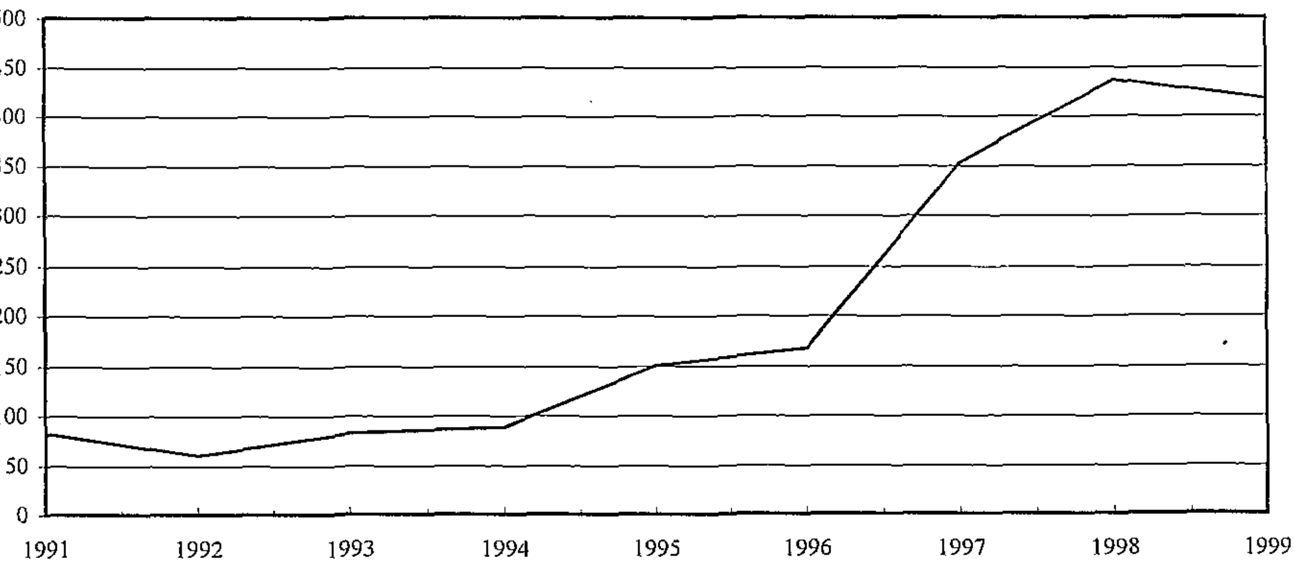
1/ Banking centers according to BIS classification.

Figure 1: Jamaica and Trinidad & Tobago: Stock Exchange Index

Jamaica

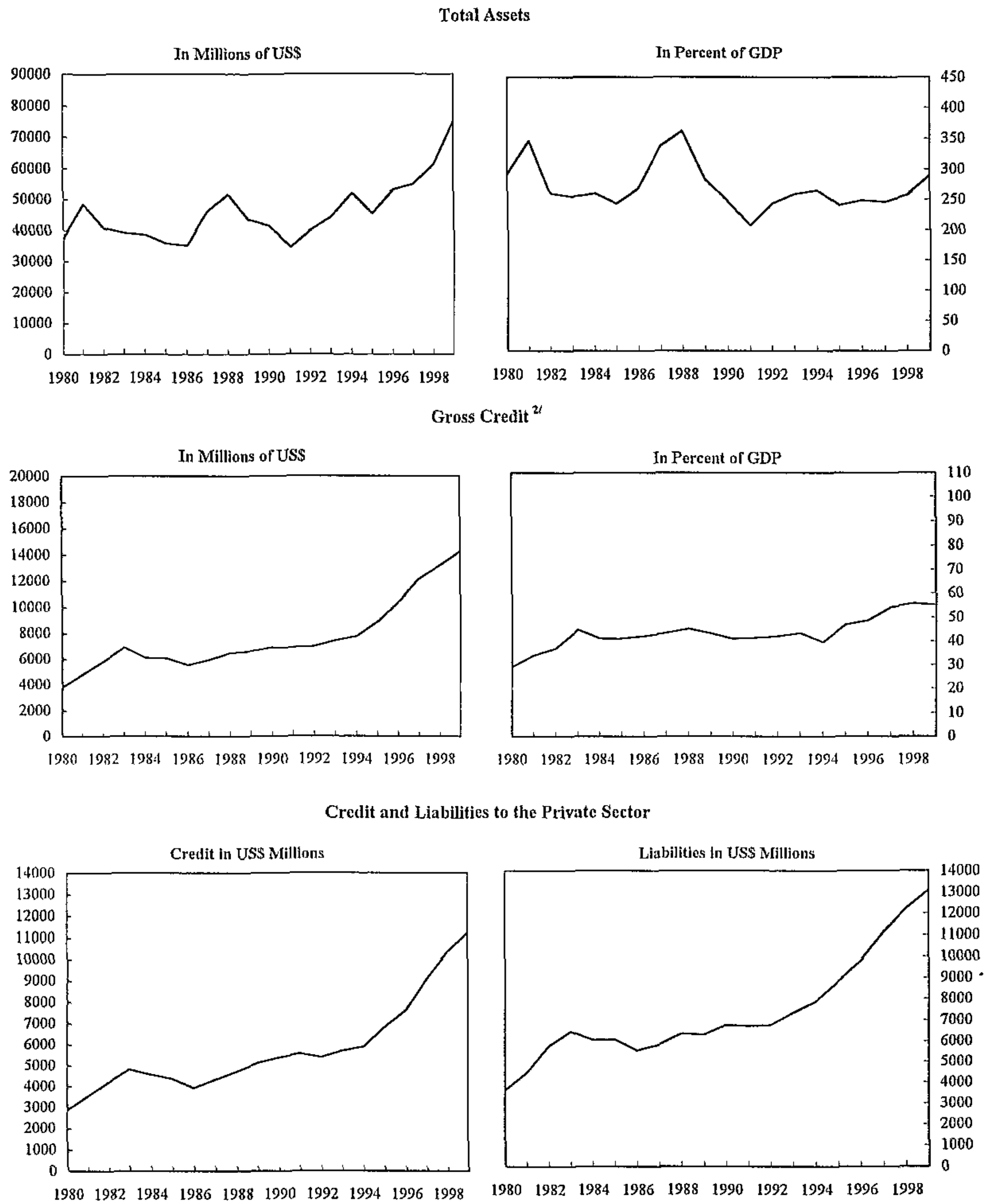


Trinidad & Tobago



Sources: Jamaican Stock Exchange; Stock Exchange of Trinidad & Tobago.

Figure 2. Selected Caribbean Countries: Trends in the Banking System 1/



Source: *International Financial Statistics.*

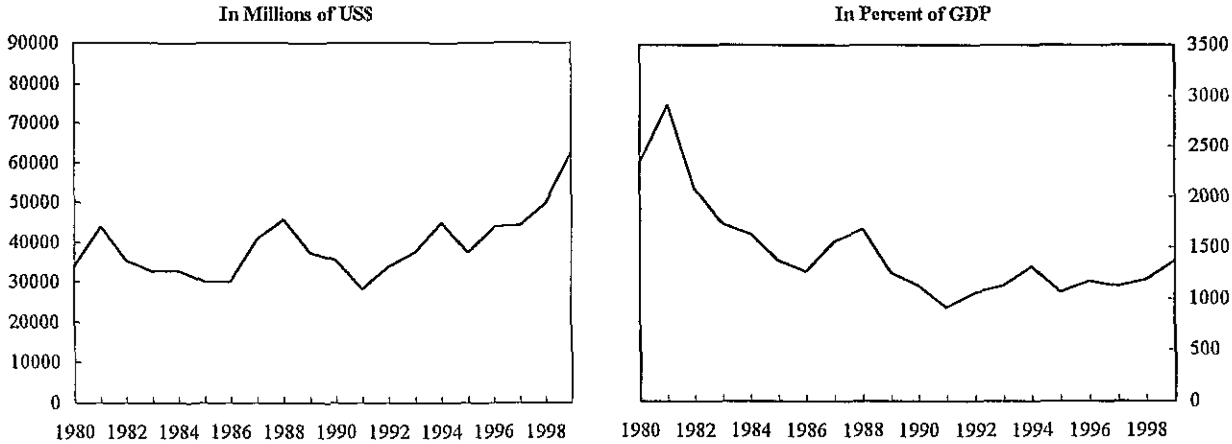
Selected Caribbean countries include: Antigua and Barbuda; The Bahamas; Barbados; Belize; Dominica; Grenada; Guyana; Jamaica; St. Kitts and Nevis; St. Lucia; St. Vincent and the Grenadines; and, Trinidad and Tobago.

1/ Includes deposit money banks and other banking institutions.

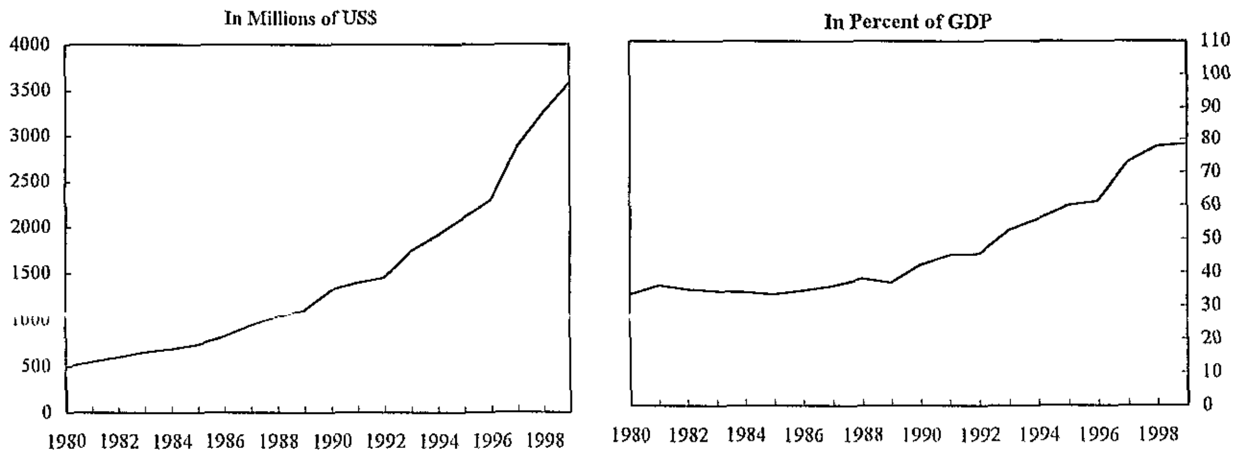
2/ Includes claims on government and other public institutions, private sector, and nonbank financial institutions.

Figure 3. The Bahamas: Trends in the Banking System 1/

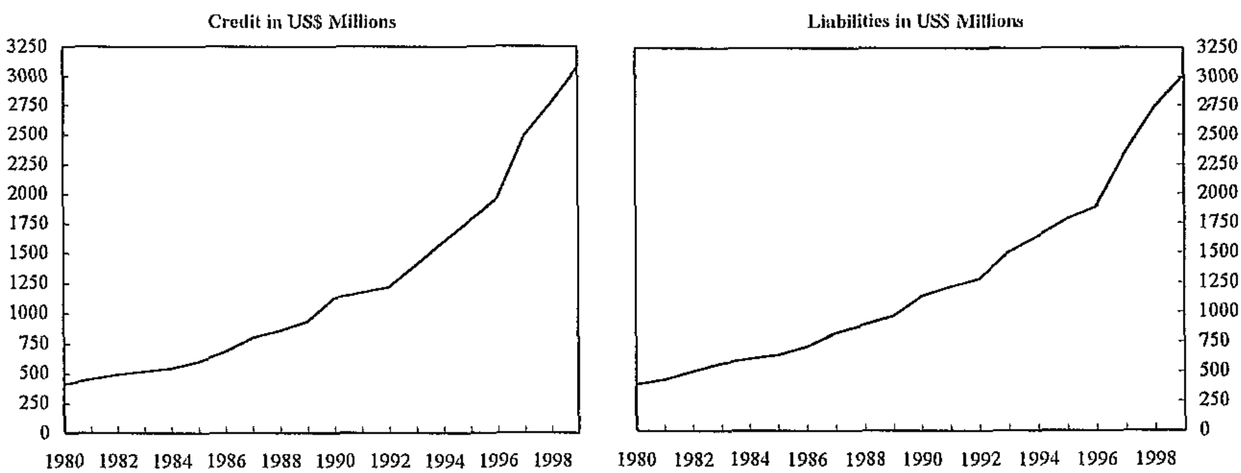
Total Assets



Gross Credit 2/



Credit and Liabilities to the Private Sector



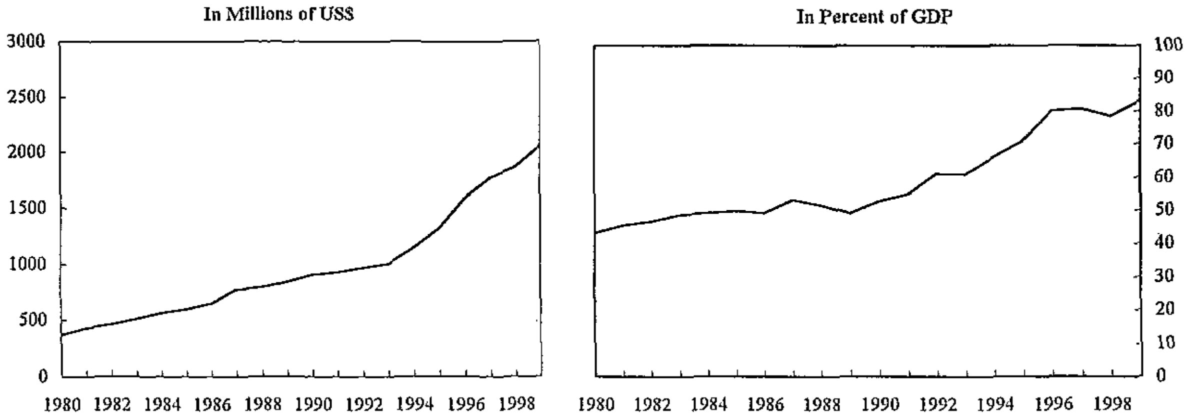
Source: *International Financial Statistics.*

1/ Includes deposit money banks and other banking institutions.

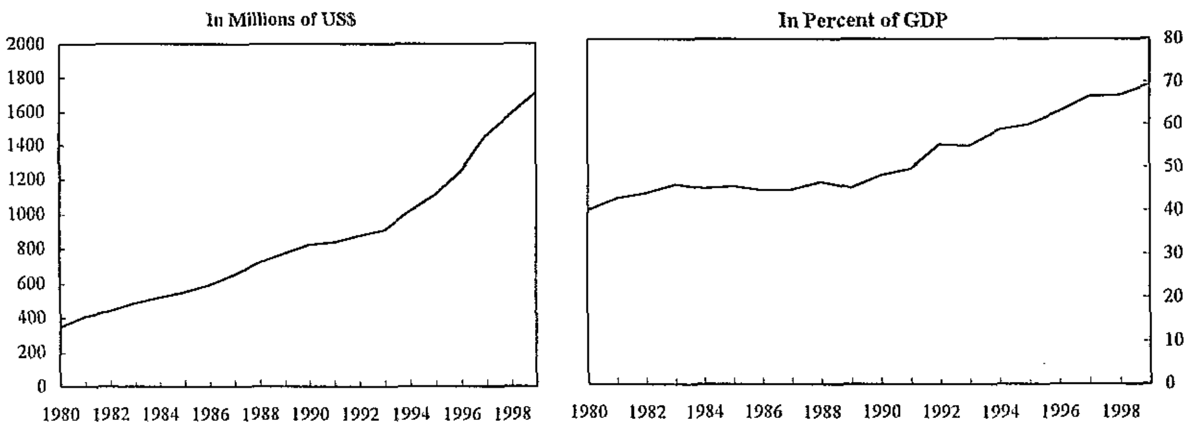
2/ Includes claims on government and other public institutions, private sector, and nonbank financial institutions.

Figure 4. Barbados: Trends in the Banking System [1/]

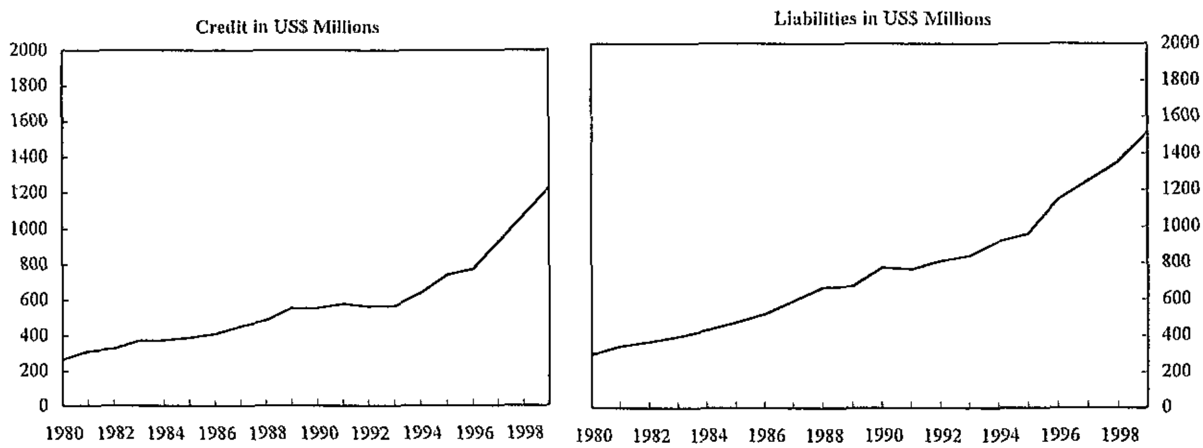
Total Assets



Gross Credit [2/]



Credit and Liabilities to the Private Sector

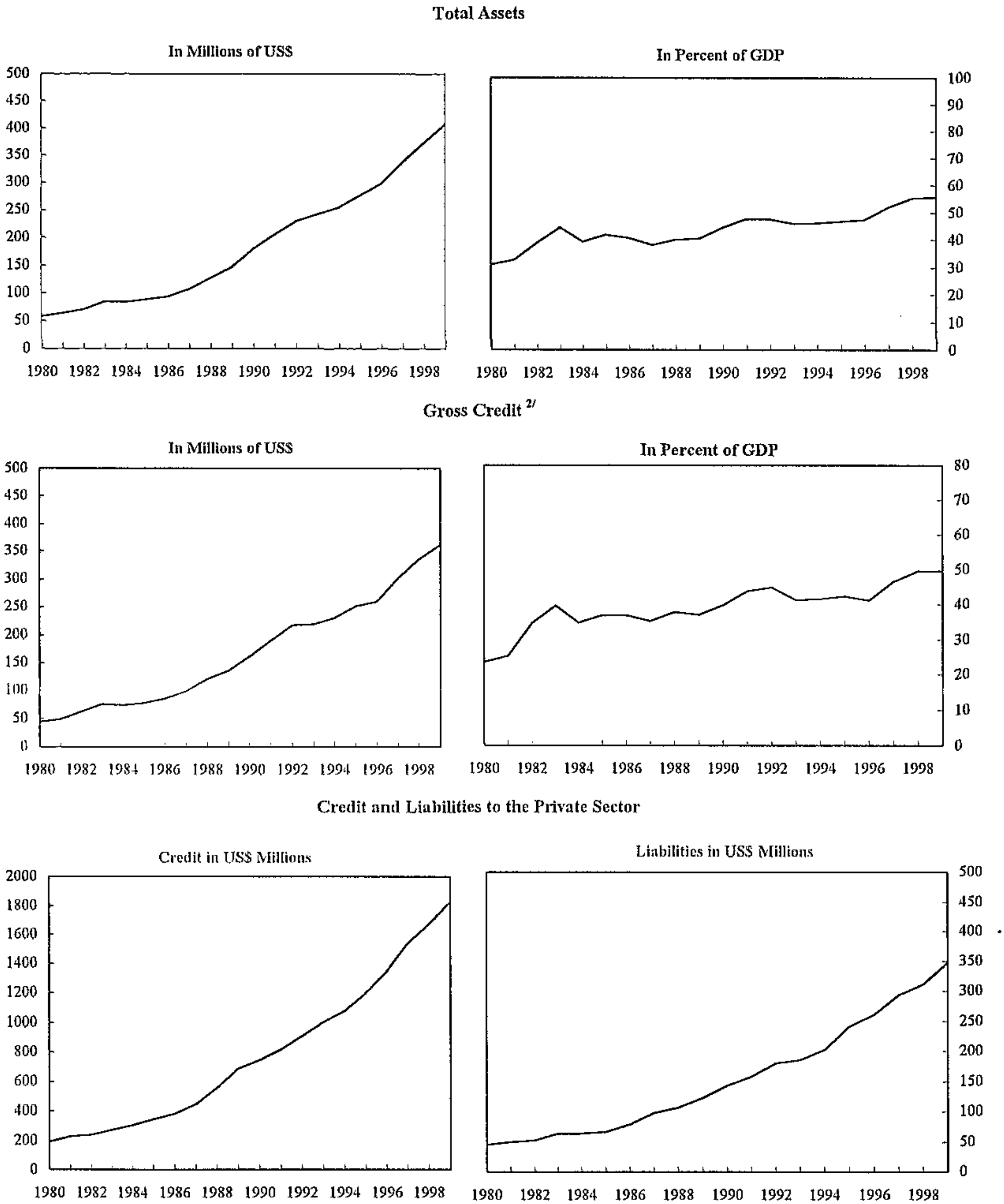


Source: *International Financial Statistics.*

1/ Includes deposit money banks and other banking institutions.

2/ Includes claims on government and other public institutions, private sector, and nonbank financial institutions.

Figure 5. Belize: Trends in the Banking System 1/

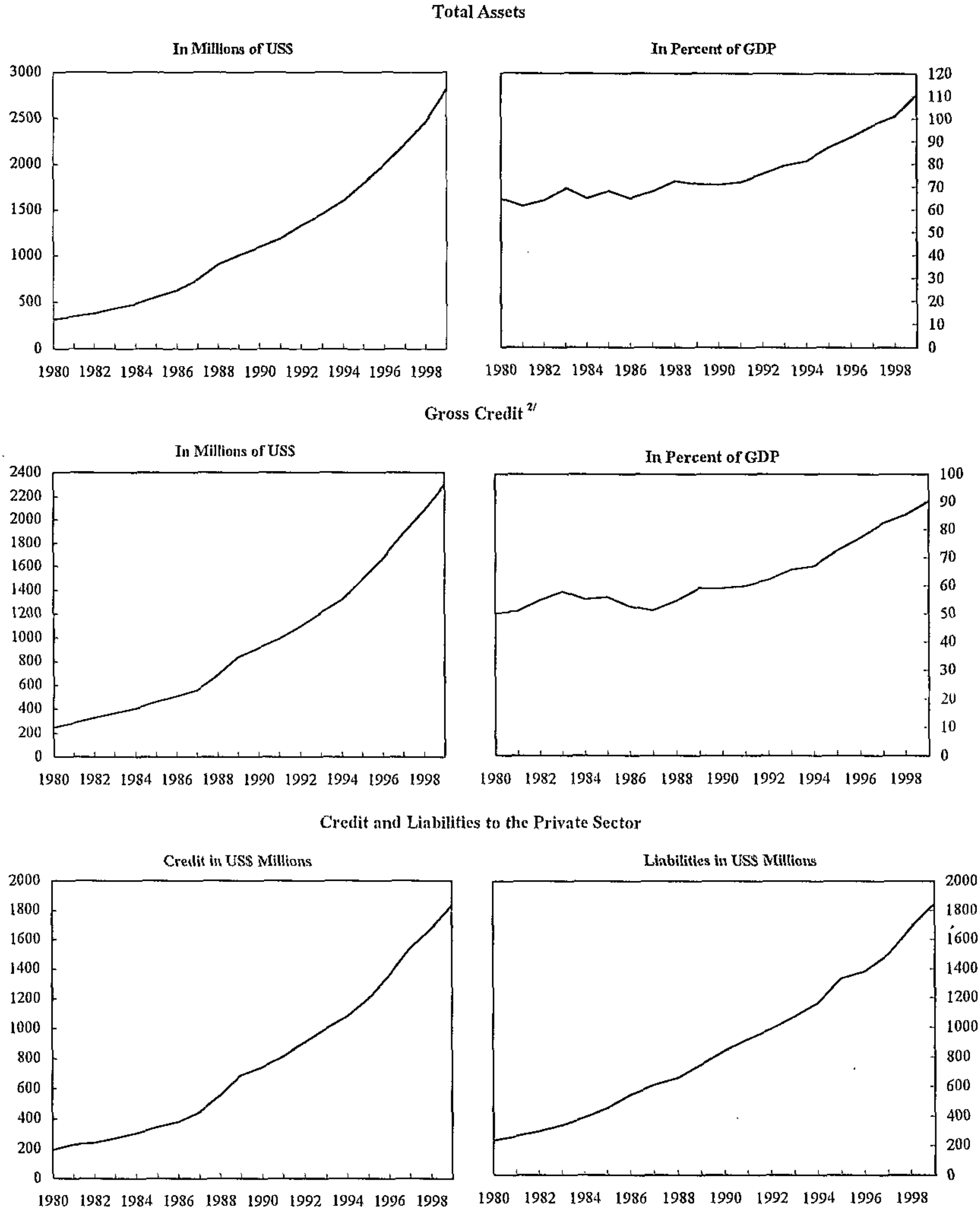


Source: *International Financial Statistics.*

1/ Includes deposit money banks and other banking institutions.

2/ Includes claims on government and other public institutions, private sector, and nonbank financial institutions.

Figure 6. Eastern Caribbean Central Bank Area: Trends in the Banking System [1/]



Source: *International Financial Statistics.*

1/ Includes deposit money banks and other banking institutions. Excludes Anguilla and Montserrat.

2/ Includes claims on government and other public institutions, private sector, and nonbank financial institutions.

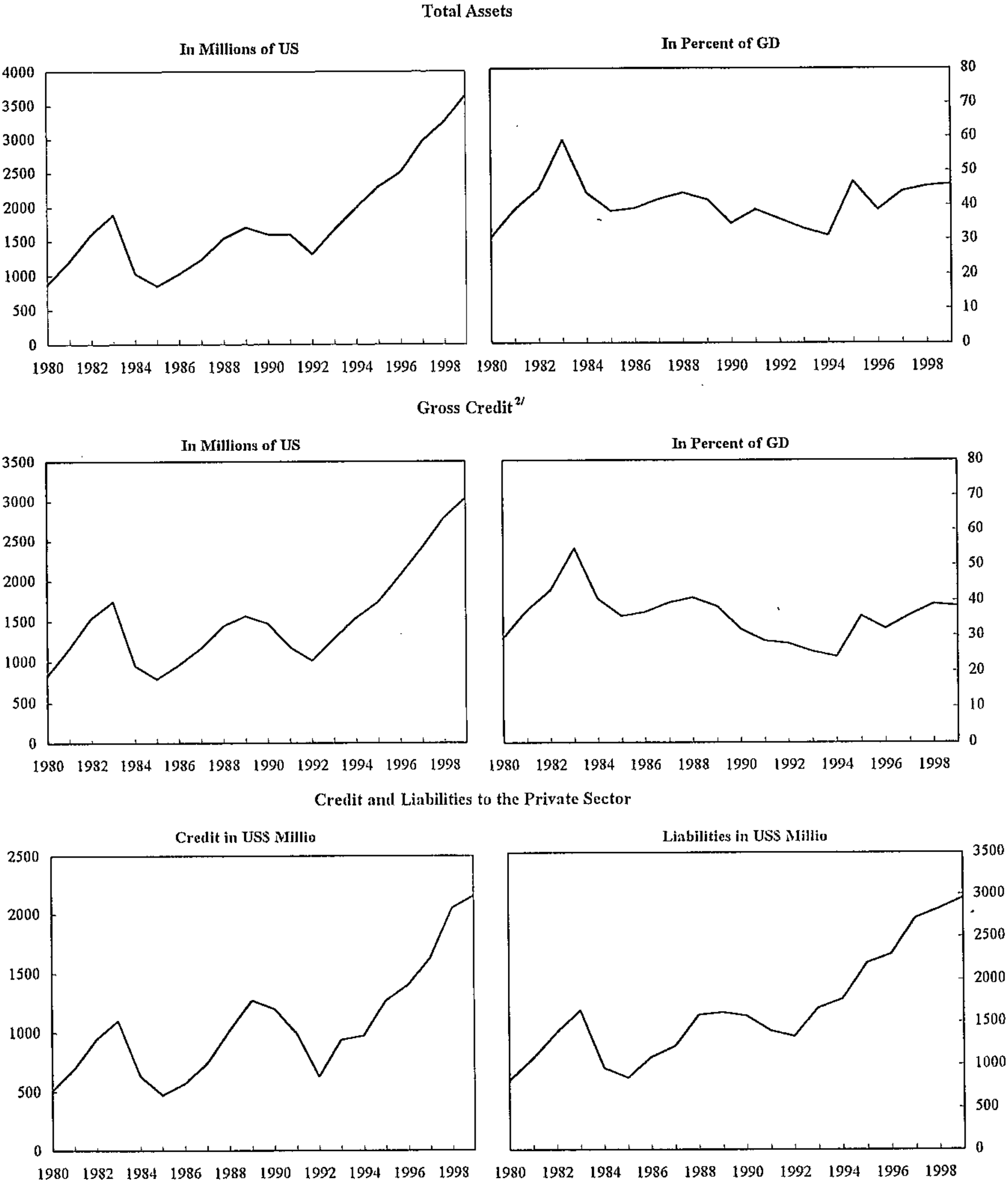
Figure 7. Guyana: Trends in the Banking System [1/]

Source: *International Financial Statistics.*

1/ Includes deposit money banks and other banking institutions.

2/ Includes claims on government and other public institutions, private sector, and nonbank financial institutions.

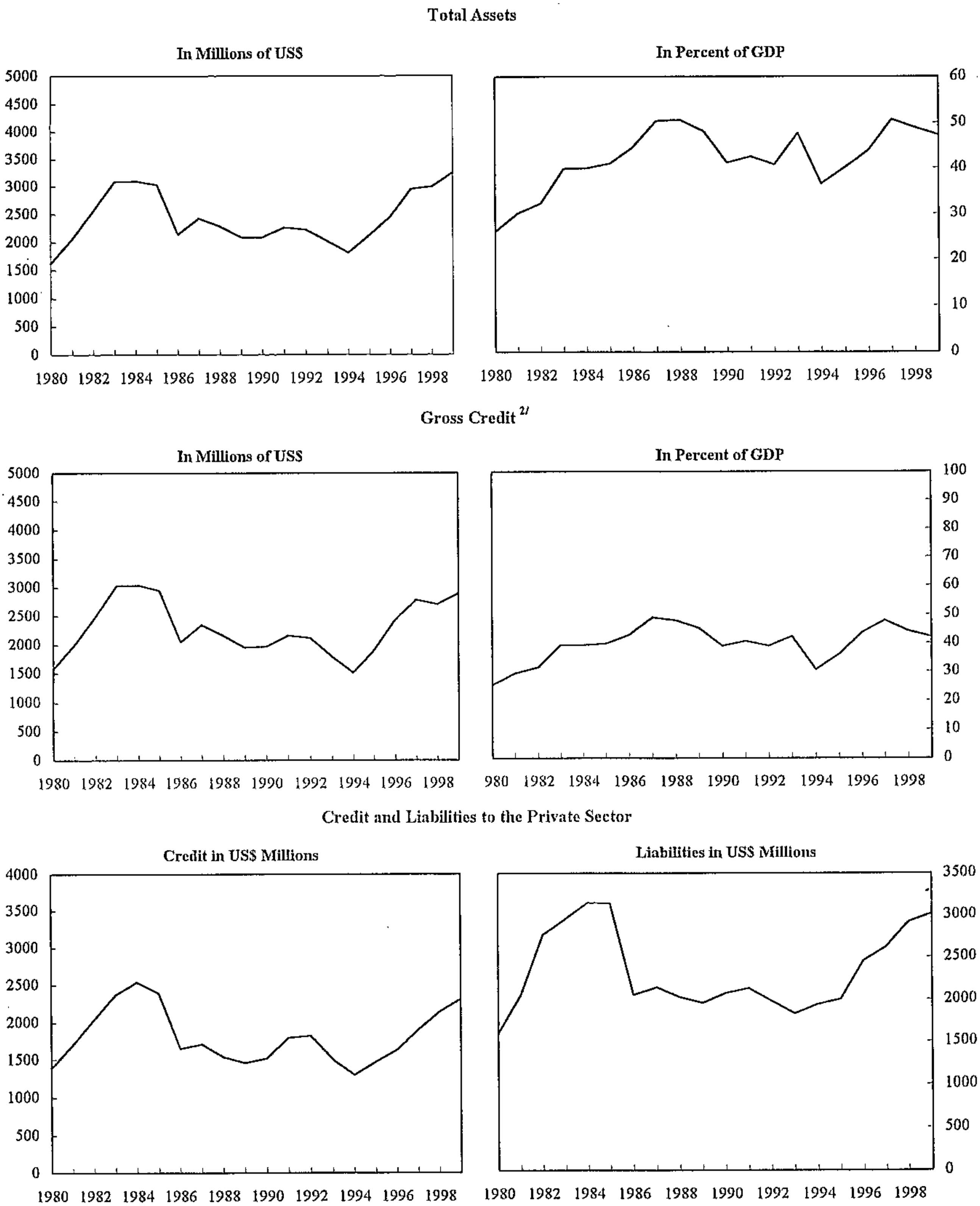
Figure 8. Jamaica: Trends in the Banking System 1/



Source: *International Financial Statistics.*

1/ Includes deposit money banks and other banking institutions.
2/ Includes claims on government and other public institutions, private sector, and nonbank financial institutions.

Figure 9. Trinidad and Tobago: Trends in the Banking System [1/]



Source: *International Financial Statistics.*

1/ Includes deposit money banks and other banking institutions.

2/ Includes claims on government and other public institutions, private sector, and nonbank financial institutions.