Financial Interconnectedness in the Caribbean

Challenges for Financial Stability

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*The views expressed here are those of the authors and do not necessarily represent those of the IMF or IMF policy.
Agenda

• Why Worry?
  – Fragilities
  – Potential Financial Contagion Channels

• Caribbean Regional Financial Project

• Conclusions
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Bank capital generally high (but falling in some jurisdictions)

Capital Adequacy Ratio by Year, 2007-13 (percent)

Source: National authorities.
Non-Performing loans elevated, rising in some jurisdictions

### Caribbean NPLs, 2007-2013 Range (percent of total loans)

- ECCU
- Belize
- Bahamas
- Barbados
- Guyana
- Suriname
- Jamaica
- Trinidad & Tobago
- Haiti

Sources: National authorities; and IMF staff calculations.
Exposures to public sector
(Especially in countries with highly indebted sovereigns)

Sources: National authorities; and IMF staff calculations.
1/ Includes central, state, and local governments.
High market concentration

Market Share of the Three Largest Banks (In percent of banking system assets)

Sources: National authorities; Bankscope; banks' annual reports; and IMF staff calculations.
The Caribbean has been dominated by large insurers.

Source: Annual reports; and IMF staff estimates.

1/ Excludes Sagicor USA.
Cross-border bank operations have led to strong interconnectedness in the Caribbean banking system.
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Does the expanding non-traditional life segment present risks to financial stability?

Trinidad and Tobago, Life Insurance Sector (TTD billion)

Source: Central Bank of Trinidad and Tobago Financial Stability Report, 2012.
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Are there adverse feedback loops?

- Domestic Economic Slowdown
- Sovereign Distress
- Bank Distress/High NPLs
- Deterioration in Bank Safety Nets
- Bank Deleveraging
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- Domestic Economic Slowdown
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- Non-bank SIFI
Hypothetical Contagion Channel Via Regional Bank Group Structure

Step 0 (initial condition)
Hypothetical Contagion Channel Via Regional Bank Group Structure

Step 1: Losses in subsidiary imply losses in consolidated capital of the regional group.
Hypothetical Contagion Channel Via Regional Bank Group Structure

Step 2: Subsidiary sheds assets. Is this delevering enough to restore capital ratio of the group?
Hypothetical Contagion Channel
Via Regional Bank Group Structure

Step 3: If not, parent may decide to delever at other regional subsidiaries to restore capital ratio of the group
Contagion through “Common Owner”
Channel: simulation results

Contagion Scenario 1/

Sources: National authorities; Bankscope; banks' annual reports; and IMF staff estimates.
1/ Deleveraging in response to losses of 15% of total loans in selected bank affiliates in the trigger country.
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The Caribbean Regional Financial Project (CRFP)

• Project Aims:
  – Phase I – Analysis
    • Collect inter-sectoral exposure data
    • Map financial interconnections
    • Assess financial contagion risks
  – Phase II - Policy
    • Crisis prevention and management

• Project status:
  – Data collection underway
  – Expected Phase I completion: mid-2015

Note: Luxembourg’s importance as a conduit.
Interconnectedness map example: cross-border funds
Source: “Understanding Financial Interconnectedness”, IMF, 10/4/10
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Broad Policy Priorities: A Systemic Perspective

- Harmonize/strengthen prudential regulations and standards
- Bring non-bank financial institutions into regulatory perimeter
- Introduce consolidated supervision
- Enhance regional safety nets and resolution frameworks
- Identify and fill data gaps, including on interconnections
- Strengthen regional cooperation and information sharing
Challenge: How do we ensure that those responsible for financial stability are taking a high-level, systemic perspective?

Because when you’re looking at the problem from ground level, you can’t always see the dangers.