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Equipping The Bahamian Economy For Sustained Growth And Development

Remarks for the 18th Annual Grand Bahama Business Outlook Conference

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Introduction

I congratulate the Counsellers for hosting these annual economic forums which bring much needed focus to both regional and national economic issues. The Central Bank has always welcomed the opportunity to participate and sponsor these events. Today I would like to concentrate my more substantive emphasis on the placement of monetary and financial sector policies in our medium and long range aspirations. To put the topic into context, I will recap recent year's economic performance.

The Economy

The Bahamian economy has been challenged since the onset of the great recession in 2008. In Grand Bahama, difficulties have been pronounced a bit longer, with Hurricanes Frances and Jean being the critical markers for the stalling tourism momentum.

Since the start of the recession, The Bahamas has experienced a rise in unemployment from a low point near 7 percent to a peak above 15 percent, and more recently incremental reduction closer to the 14 percent range.

Yet the economy has grown over most of the years since 2008. In fact, compared to other tourist-reliant, English speaking economies in the Caribbean, the expansion in The Bahamas has been stronger. The comparative employment figures may not bear this out because, regionally, The Bahamas has sat more on the upper end of the unemployment rate spectrum. This, in my view, reflects a Bahamian private sector that has a more dominant position in the economy. On average, public sector employment mattered more in the other regional economies and therefore their unemployment rate rose less than The Bahamas'. However, their costs were more acute in terms of the deficits experienced and the comparative increase in public debt.

The Bahamas also experienced deterioration in domestic financial sector ratios, with a rise in delinquencies for consumer loans, mortgages and commercial debt, as borrowers absorbed the fallout from weaknesses in the jobs market. Already, with the modest growth in the economy, there are signs of incremental resolution to the loan servicing difficulties. However, this is remains a very high-risk environment, with soft credit growth and with banks continuing to holding very significant amounts of liquidity.

Looking to the future, growth is still only on a mild trajectory. This is enough impetus to support continued gradual improvement in credit quality. The foreign reserves of the Central Bank are also on a stable to mildly improving trend, as is the characterization of conditions to support gradual tapering in the public debt burden.

Beyond this forecast, the agenda will have to feature interventions to elicit more robust growth, for an even more desirable pace of employment gains. This would also favour stronger credit conditions and a more accelerated resolution of problem loans. The work on the National Development Plan (NDP) can set the stage for this transformation. Some of the strategies that we will adopt for the NDP will have their greatest impact in the medium to longer-term, influencing particularly how The Bahamas develops a more skilled workforce that provides the foundation for greater economic diversification.

In the near-term, stronger growth prospects will have to be exploited from within the existing economic structure—particularly tourism.

We also need to begin to anticipate how fiscal consolidation will impact the financial sector and investment environment. Fiscal consolidation in an expanding economy will challenge the investor to find more private outlets for their funds, as the scope to profit from public sector securities will abate. The alternative of bank deposits, would not sit well for the model of personal credit financing pursued by local banks. Getting more of these resources into productive use will require further development of private sector debt markets, the stock exchange and more ambitious venture capital fund activities.

Central Banking

The Central Bank by virtue of its role and placement within the financial sector sits in the midst of any economic transformation that lies ahead, and must be poised as an enabling force in such trends. This relates among other things to how the institution delivers on its mandate to

- Promote financial stability
- Uphold the reputation of The Bahamas as a well regulated financial centre
- Promote modernisation of the payments system
- Contribute to and inform the dialogue on exchange controls
- Inform the dialogue on consumer financial protection

It also requires an examination of whether in our economy monetary policy can be a direct contributor to sustainable growth, that is compatible with our desire to maintain a stable currency.

Exchange Controls

It would not be prudent for the Central Bank to recommend to the government any outright elimination of exchange controls. This mechanism regulates the access to and use of foreign exchange for both investment and non-investment purposes. It ensures that the Central Bank is able to accumulate the foreign reserves that provide the support for the fixed parity of the Bahamian dollar relative to the US' currency. By law, residents cannot be prevented from purchasing foreign currency to pay for foreign goods and services—or for current account transactions, as these would be called in the language of trade. Controls are administered to ensure that when foreign exchange is requested, the purpose of the intended use can be verified. The convenience for the public today is that these approvals are mostly administered over-the-counter by commercial banks. The only binding constraint is that there are dollar limits, which have been successively relaxed over the years, on what sales commercial banks can approve without prior reference to the Central Bank.

The regulations that affect the business environment most relate to investments. For flows into The Bahamas, the controls are administered to align with the Government's National Investment Policy. Any liberalization, for example in terms of the ease of purchasing real estate, having a capital stake in Bahamian firms, the right to establish locally as partially or wholly foreign owned business, or the right outside of the Banking sector to provide secured credit to a local entity—such as where immovable property is the security—would have to evolve from the National Investment Policy, before automatic incorporation into the exchange control process. Liberalisation in these instances will therefore require focused national discussion on our posture to admit wider foreign ownership and participation in the economy. Even in these cases, the Central Bank would only recommend more access in areas that promote more net retention of foreign exchange.

There is still no appetite to invite unchecked flows across the border affecting either capital markets or the local banking sector. Such flows would have to be able to move outward as easily as they move inward. To accommodate them would require a more sophisticated regulatory framework to maintain stability within the financial sector, and much larger foreign reserve buffers for potentially large capital withdrawals. In terms of flexibility, it would also mean allowing the Bahamian dollar to float, as the ultimate regulator of the supply and demand for foreign exchange.

The capital account regime also has a bearing on local ownership and savings. In this regard there have already been positive policy trends. First, Bahamians whether directly or through institutional channels can invest in international capital markets, at the one-to-one exchange rate, using the Bahamian dollar depository receipts market. The Central Bank makes an annual allocation equivalent to up to $25 million, or no more than 5 percent of the external reserves to fund these purchases. This program has been in place since 2006 and is about to be enlarged to an annual cap of $35 million starting later this year. The National Insurance Board is accommodated through a separate annual arrangement.

The Government has also relaxed capital controls to allow Bahamians to make direct investments abroad, where it is assessed that the ventures can earn net foreign exchange for the country. An investor group can have access to up to $5 million over any three year period to establish a business outside The Bahamas, while in similar cases, a sole individual can access $1 million at the one-to-one rate. It is an outlet particularly for professionals who might qualify to hold banking, trust, other international financial services licenses. In 2016 this investor group limit, per three-year interval will be increased to $10 million. The sole individual limit will rise to $2 million.

Payments System

The Central Bank is also responsible for promoting payments systems development. From an ease of doing business perspective this speaks, among other things, to the efficiency, reliability and security of payments. Over the past decade, the Bank spearheaded the introduction of a Real Time Gross Settlement (RTGS) System, for instant settlement of local wire payments of $150,000 or more. The Bank also led the introduction of the Automated Clearing House (ACH) for smaller-value retail payments. This ACH infrastructure has significantly improved the speed of check settlements. It is facilitating direct deposits, and it is moving the domestic financial system closer to the point of customer initiated electronic payments between bank accounts. These electronic settlement options will reduce the need for use of cash in retail transactions and overtime accelerate trends which we already observe in the decline in the use of physical checks.

In another current trend, the Central Bank is introducing a formal oversight regime for e-money, which includes the stored value products in various forms, promoted by non-bank entities. This framework would increase the domestic economy's access to innovative mobile payments options. In all of these trends we are being guided by established, international best practices.

Credit Bureau

At this point in the financial sector's development, The Bahamas should also have the benefit of a functioning credit bureau, so that lenders can better assess credit worthiness and make informed decisions to tailor pricing and supply of credit to the credit score of borrowers. The Central Bank is moving in that direction, working closely with local banks and other stakeholders. The Central Bank is now finalizing the recommended legislation that the Government would be able to approve through Parliament.

Consumer Protection

As we progress towards a credit bureau, the focus rightly should also sharpen on consumer financial protection. This is not yet a well-defined or assigned responsibility within our financial system, however the Central Bank is committed to developing framework proposals that the Government can consider. Best practices internationally are that these frameworks should promote financial protection in terms of transparency, fairness of credit practices and financial literacy. Countries have taken different approaches to oversight, sometimes through standalone agencies, but often also by placing the responsibility within existing regulators. The Central Bank will consider how to make recommendations over such a range of options, mindful that in the case of The Bahamas, the outcome has to be sensitive to the acute capacity constraints from creating too many separate regulatory agencies.

Globally financial protection has been about empowering consumers to have access to information to make the best decisions on the selection of financial products. It does not universally amount to pricing regulation.

Monetary Policy

Those who study economics come to expect that central banks can lower interest rates or provide other credit stimulus to boost growth. There are, however, caveats for the Bahamian economy. The Bahamas Central Bank would need to be able to impact "sustainable" economic growth that either stimulates our capacity to earn more foreign exchange or that does not fuel demand that outstrips our capacity to earn foreign exchange. Otherwise, our stock of foreign reserves would deplete and devaluation or floating of the Bahamian dollar would be real threats. Credit expansion in The Bahamas mainly stimulates spending on imports, which have to be financed with foreign currency.

The Central Bank's ability to provide stimulus therefore has always depended on the relative strength of tourism and the other foreign exchange earning activities. In this context, the sustainable interventions would have to be those that, for example, finance more capacity in tourism. But this sector is still driven by foreign investment inflows that are more dependent on external financing conditions.

Monetary policy aside, we are faced with the need to have more of our local currency financial resources impact those enterprising activities that create linkages with tourism or promote local ownership in ventures that target the foreign markets. This is squarely compatible with the notion of self-sufficiency that would foster more linkages from the production side of the economy to those areas where demand is already generated, such as for food and cultural amenities. Rather than monetary policy intervention, the approaches to this challenge might also frame how our capital controls are refashioned overtime to increase access to foreign currency financing for such sustainable growth activities.

Access to Capital

More dynamic and sustainable growth must also be fueled by effective channeling of more of our existing financial savings into venture capital like outlets. This should not rest entirely under Government sponsorship, or in the hopes that Banks would change their fundamental credit model. Strictly private sector sponsored investment vehicles will be necessary to harness more of these resources for productive purposes. The obstacles to this process, whether they be deficiencies of a social, cultural or regulatory nature, need to be identified and tackled.

Financial Sector Regulation

A well regulated financial services sector will also promote growth into the future. For the international sector, where the key focus in on job preservation and job creation, the quality of prudential regulations and supervision, along with our ability to continue to cooperate and adapt in an increasingly interdependent global environment, will determine the survivability of the international sector. At the Central Bank, like in other Bahamian regulators, this task has been embraced by constant upgrading and training of staff so that the industry can evolve under regulatory standards that match global norms, in terms of safety and soundness, and effective safeguards against criminal abuse.

Since 2009, Bahamian banks (both domestic and international) have had to meet higher standard capital adequacy requirements, doubled that of the benchmarks recommended by the Bank for International Settlement (BIS). Our regulatory capacity also continues to increase in terms of how we monitor the reputation and operational risks that affect entities that are licensed to operate in The Bahamas.

Reputation and the quality of regulations also matters in terms of how we instill and maintain confidence in local institutions that provide the stable context for all economic activities.

Correspondent Banking

The interdependence that underlines our external economic environment is now being manifested in the retraction or constraining of some correspondent banking relationships on which our local and international banks rely. This is an uneasy trend particularly affecting the Caribbean, parts of Africa and the Middle East, where there are blanket perceptions of increased risk of the financial sectors being infiltrated by money laundering, terrorist financing and other illicit activities. Some of the de-risking has also been influenced by the low-interest environment that prevails in the external markets, such that being a banker to other banks is not as profitable—especially in the context of compliance costs. The loss of correspondent relationships would have serious implications for the Bahamas as it relates to routine foreign currency payments for any variety of external transactions. The Bahamas' exposure to risks is somewhat unique because of our predominance as a tourism and financial centre and as an outbound remitter of funds such as for expatriate labour, students and medical services.

A survey conducted by the Central Bank in 2015 revealed that some local, as well as international banks in The Bahamas, have had to make adjustments to safeguard their correspondent relationships. Sector wide, there is a focus on strengthening internal systems and controls, and on increasing the understanding of the underlying profile of the clients who are at least one level removed from the customers who ultimately receive the banking services.

This is high priority item for our jurisdiction. The Central Bank is working closely with our licensees to ensure they have contingencies in place for their operations. There is moreover a regional political approach now set in motion to interact with regulators and enforcement agencies in the US and other advanced countries, and to ensure that there is more constructive focus to the advocacy efforts of international institutions such as the IMF, the World Bank and the IDB.

Conclusion

I conclude now with reference to the assigned topic of my presentation which is equipping the economy for sustained growth and development. A stable, sound, efficient, and well regulated financial services sector provides the foundation for the more robust economic outcomes to which we aspire—that is, alongside, the range of considerations to improve the ease of doing business. Our growth has to be sustained from better utilization of local financial resources, carefully considered intervention to make better use of available international capital, and with the assurances of financial stability that maintain the confidence of both domestic and foreign investors. The work of the Central Bank and other financial regulators are with all of these ends in mind. Our goal is to continue to support the public dialogue on the reform oriented elements of monetary and financial sector policies.