

Financial Interconnectedness in the Caribbean

Challenges for Financial Stability

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International Monetary Fund*

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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

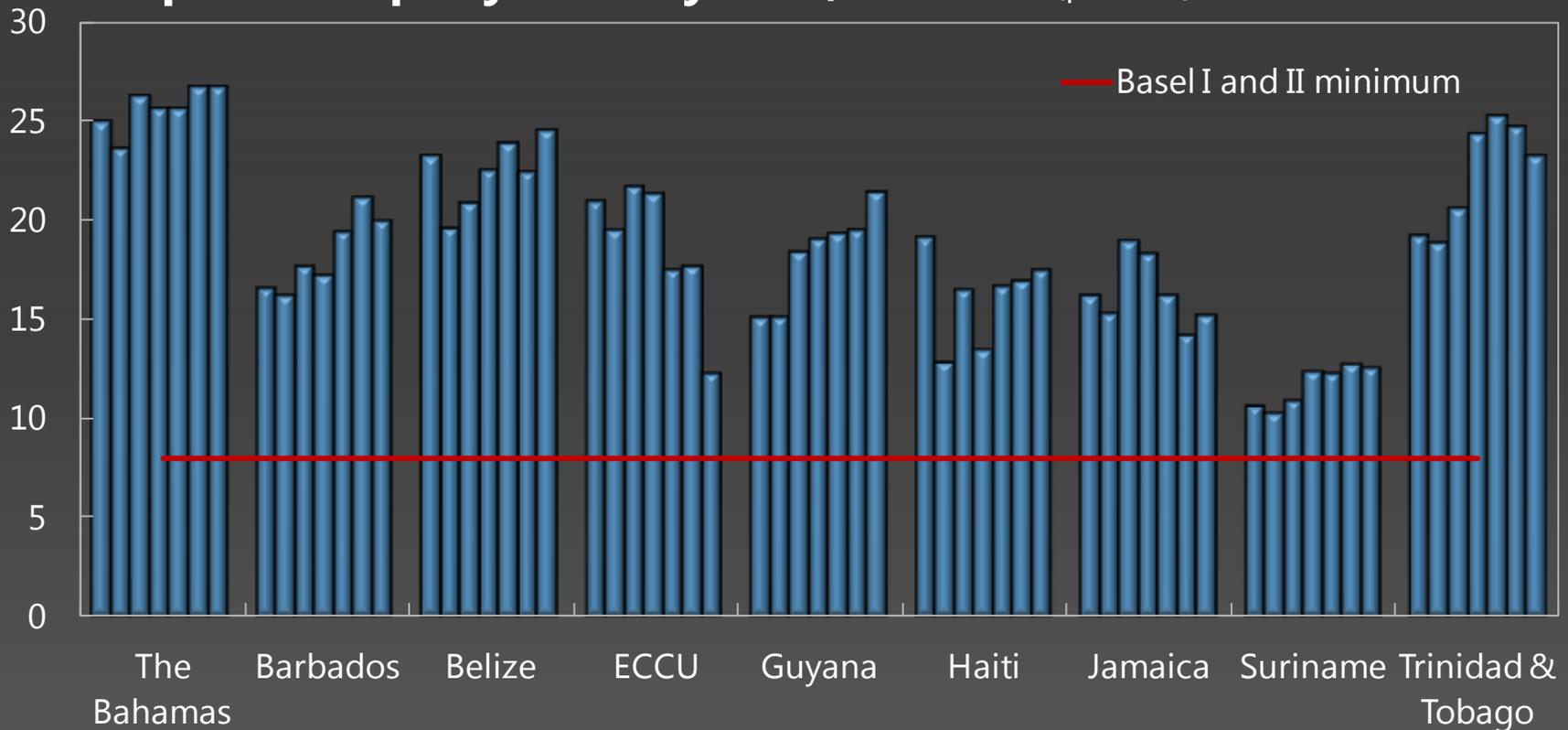
- Why Worry?
 - Fragilities
 - Potential Financial Contagion Channels
- Caribbean Regional Financial Project
- Conclusions

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- **Why Worry?**
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Bank capital generally high (but falling in some jurisdictions)

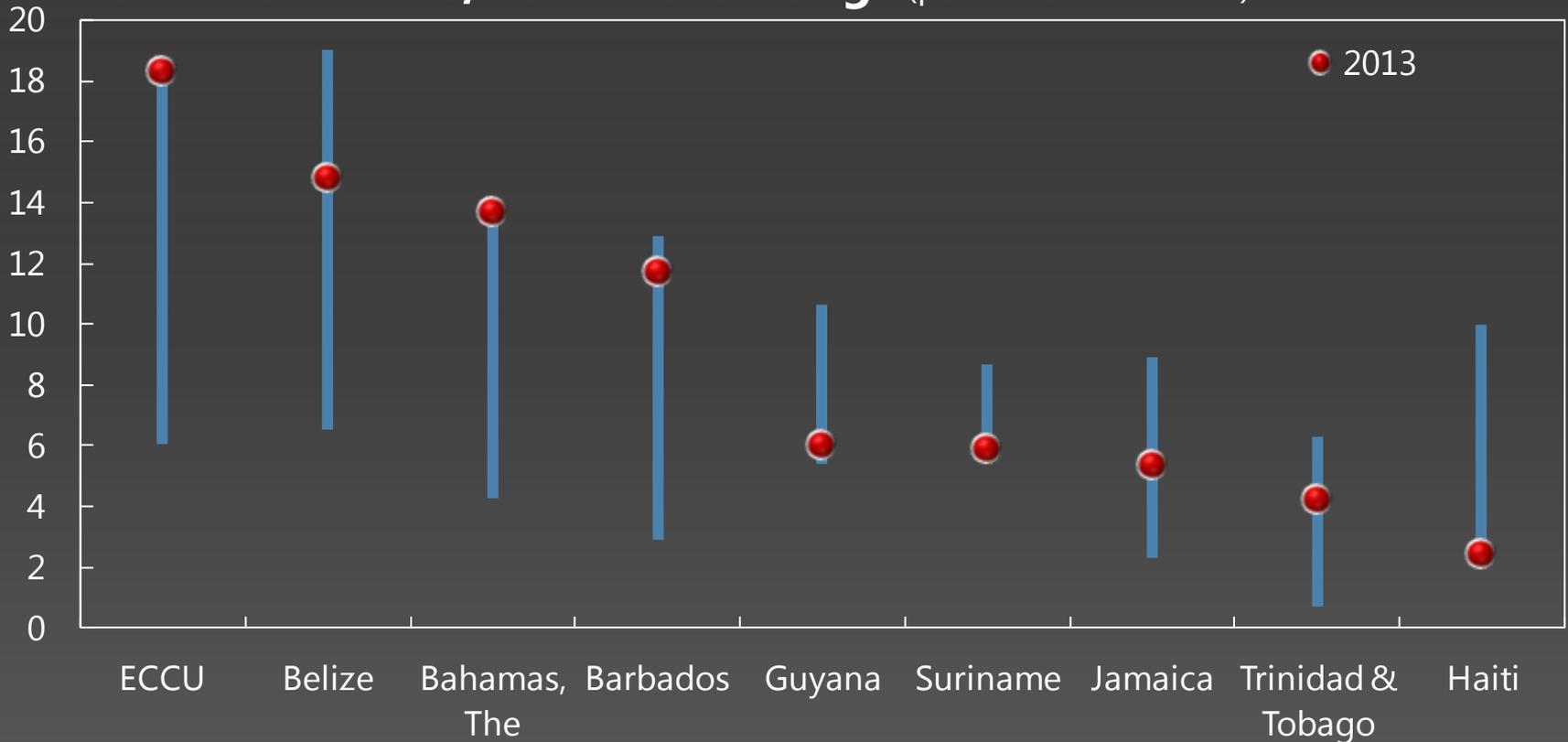
Capital Adequacy Ratio by Year, 2007-13 (percent)



Source: National authorities.

Non-Performing loans elevated, rising in some jurisdictions

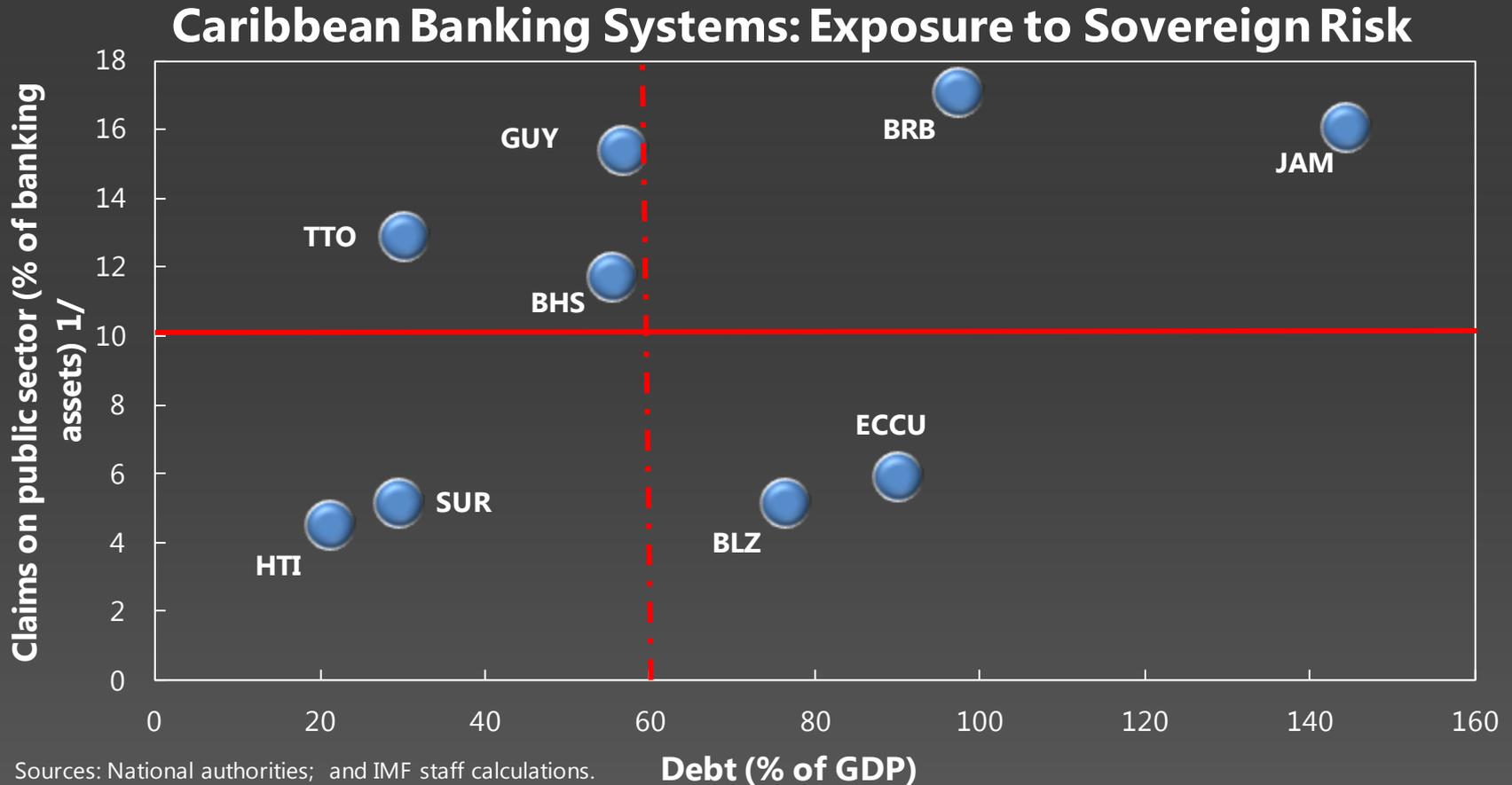
Caribbean NPLs, 2007-2013 Range (percent of total loans)



Sources: National authorities; and IMF staff calculations.

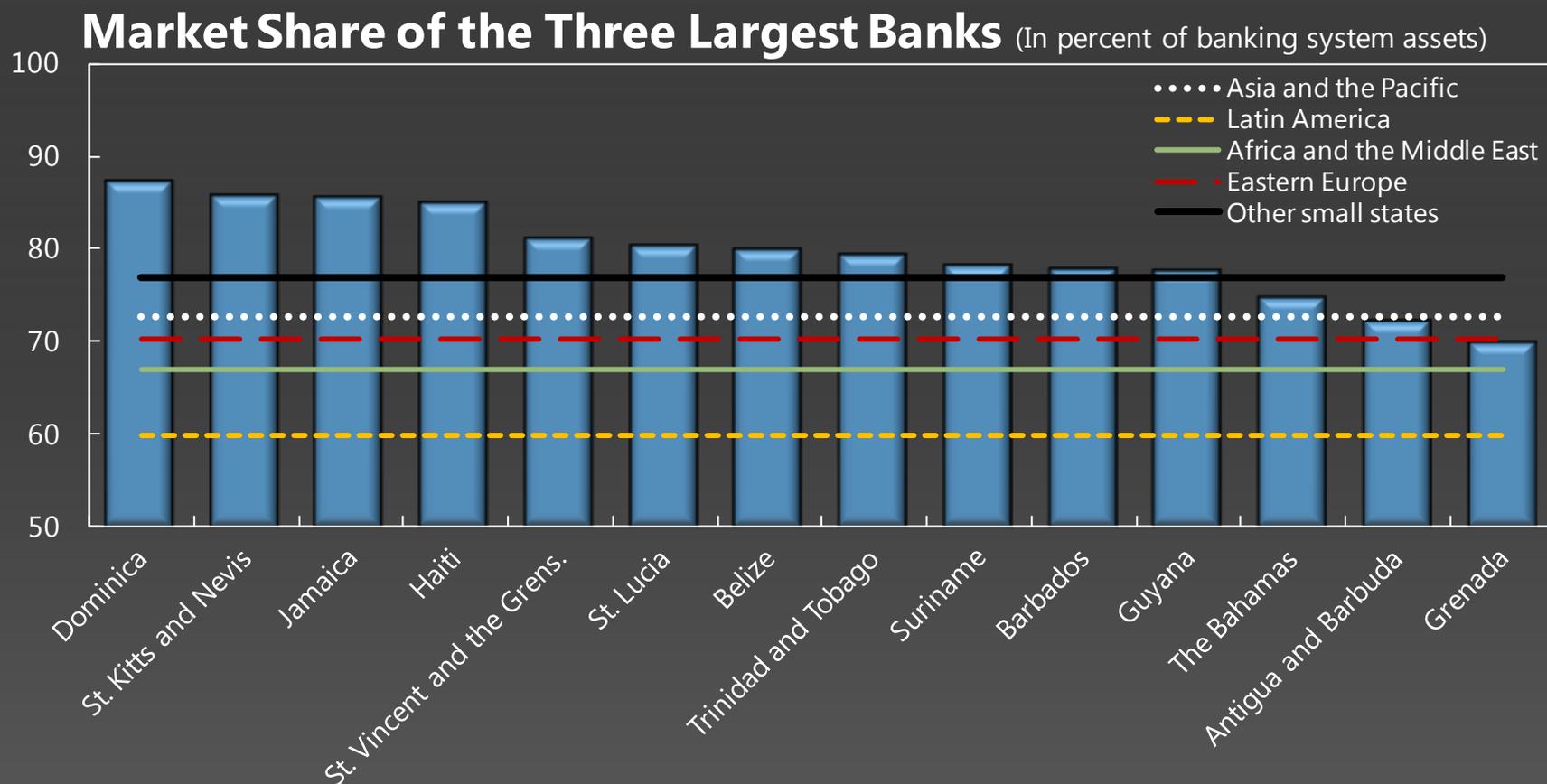
Exposures to public sector

(Especially in countries with highly indebted sovereigns)



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

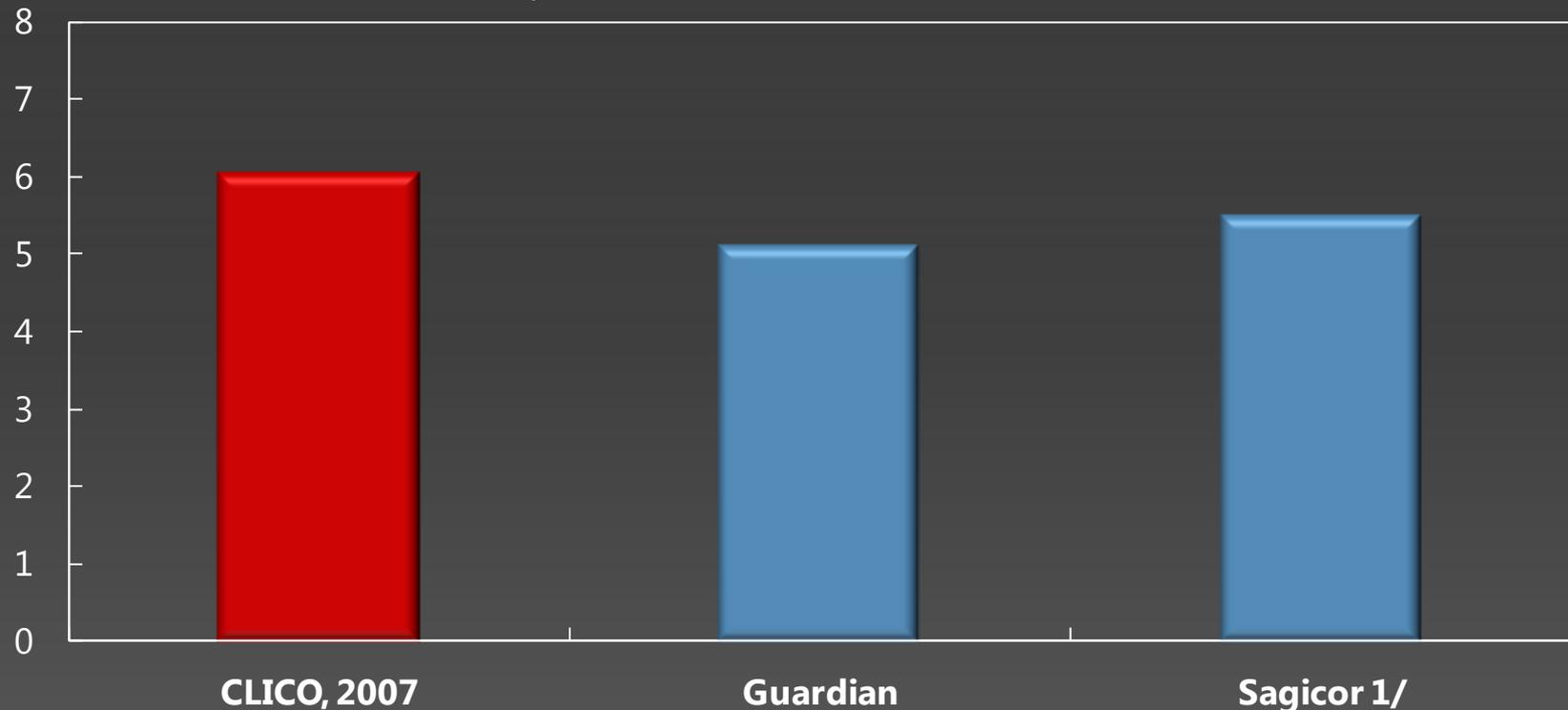
High market concentration



Sources: National authorities; Bankscope; banks' annual reports; and IMF staff calculations.

The Caribbean has been dominated by large insurers

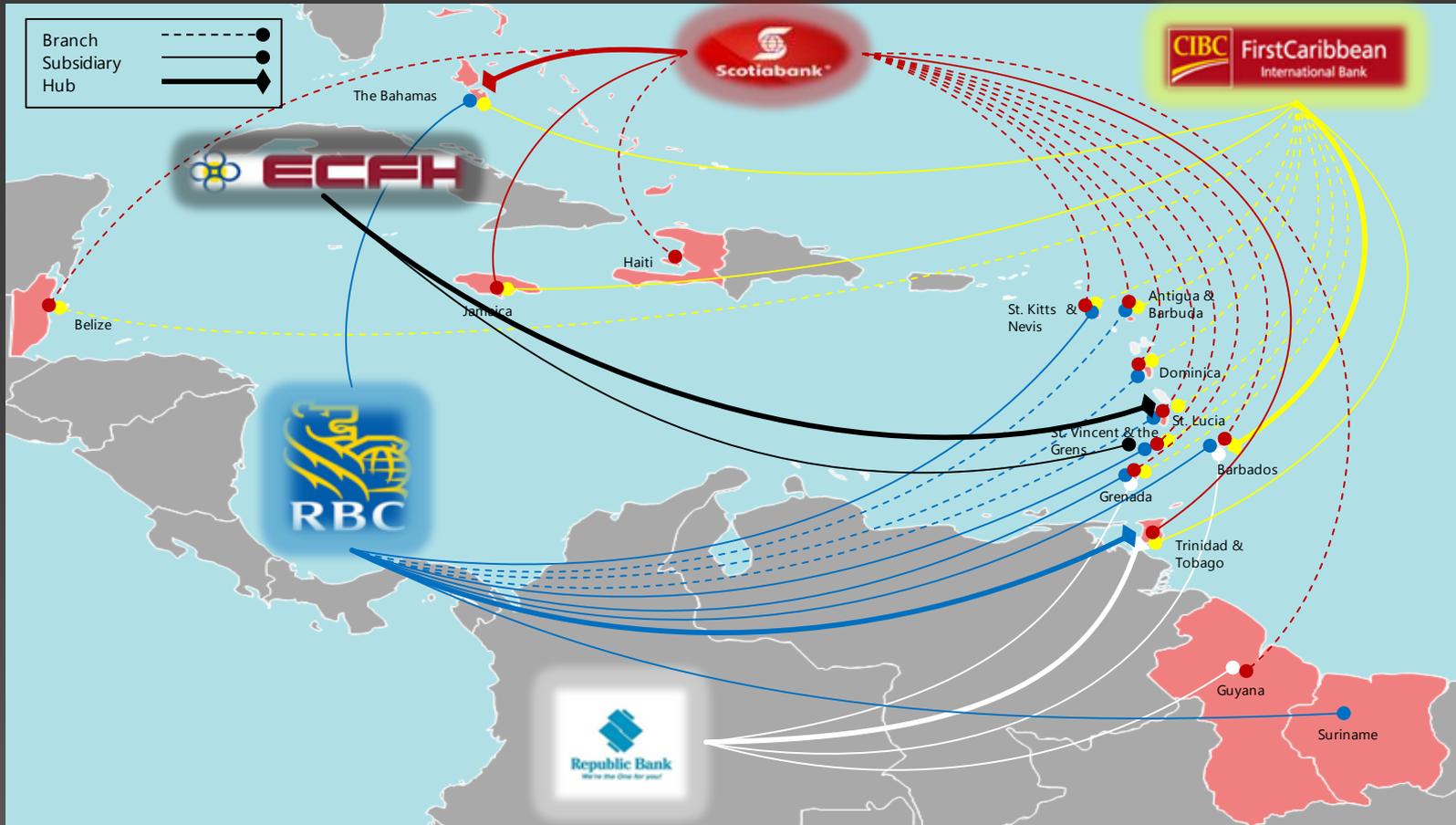
Total Assets, 2013 (percent of total Caribbean GDP)



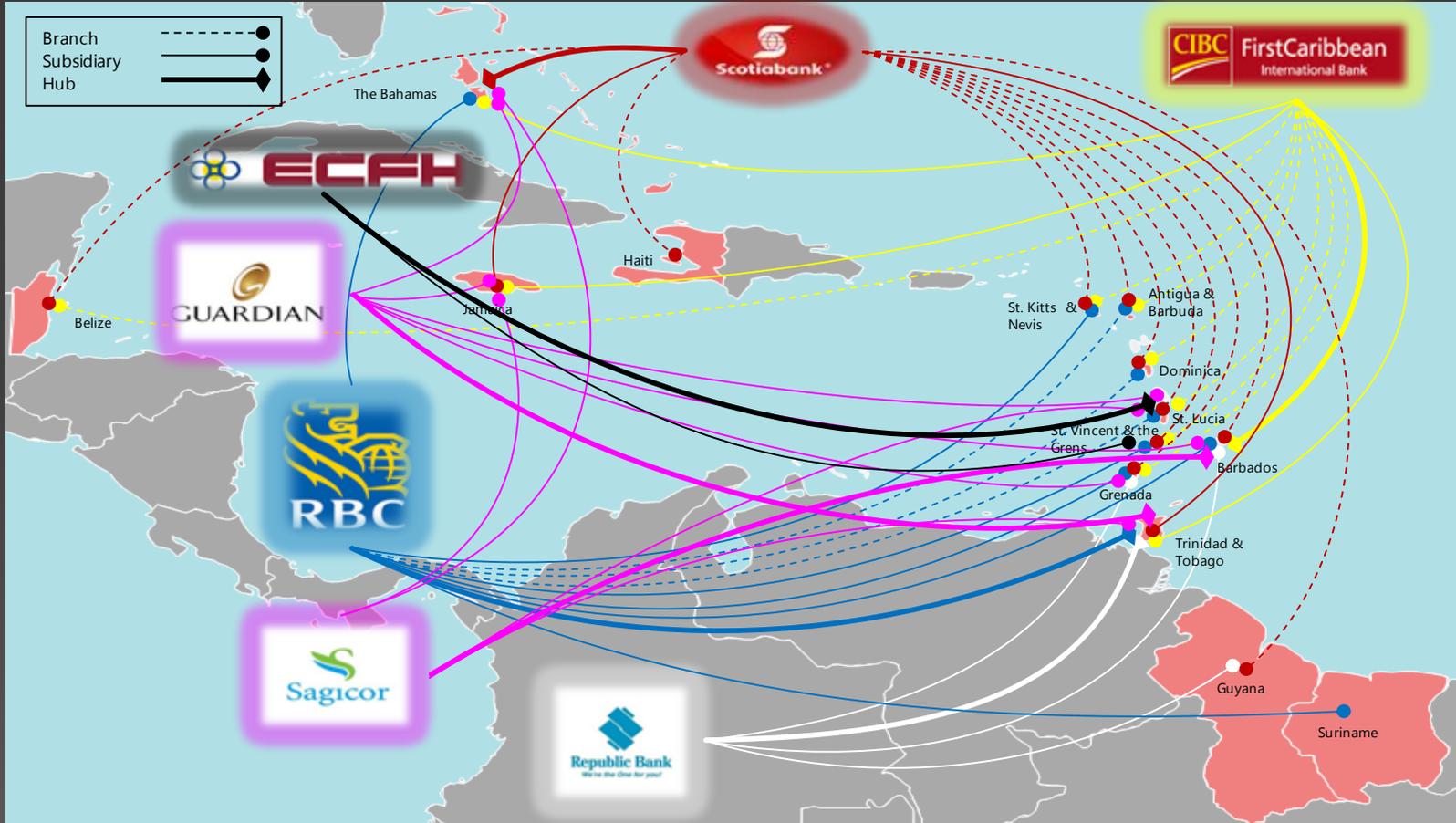
Sources: Annual reports; and IMF staff estimates.

1/ Excludes Sagicor USA.

Cross-border bank operations have led to strong interconnectedness in the Caribbean banking system

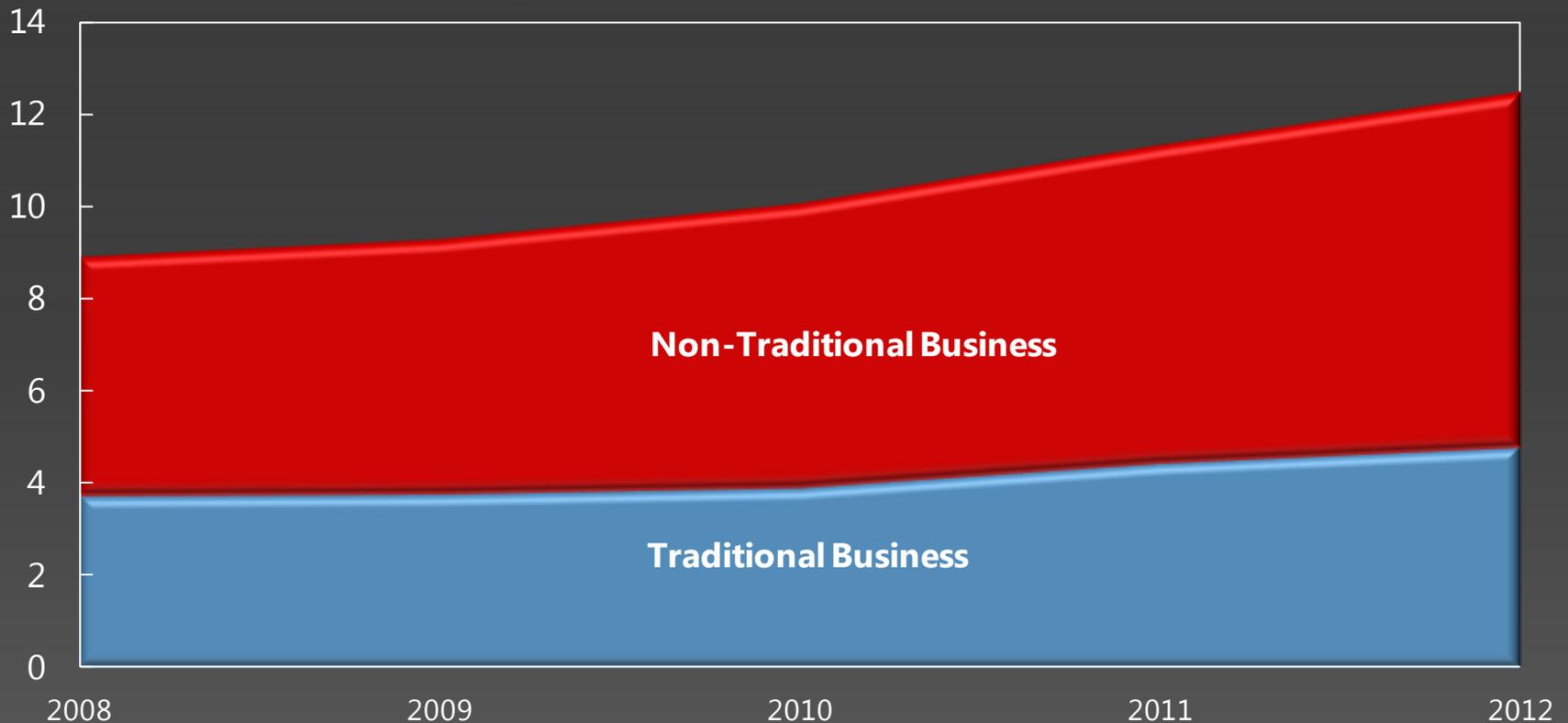


Cross-border bank operations have led to strong interconnectedness in the Caribbean banking system



Does the expanding non-traditional life segment present risks to financial stability?

Trinidad and Tobago, Life Insurance Sector (TTD billion)

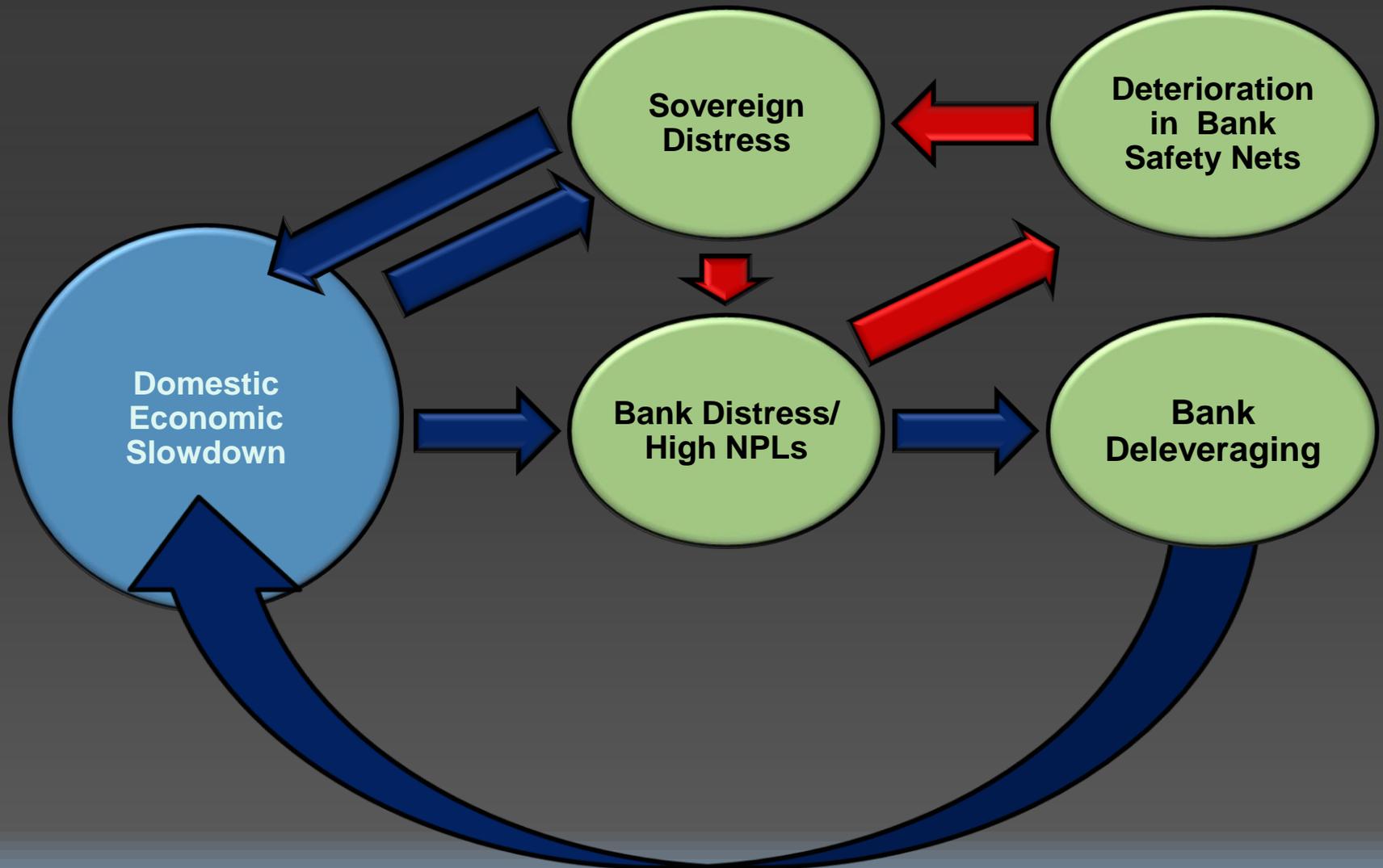


Source: Central Bank of Trinidad and Tobago Financial Stability Report, 2012.

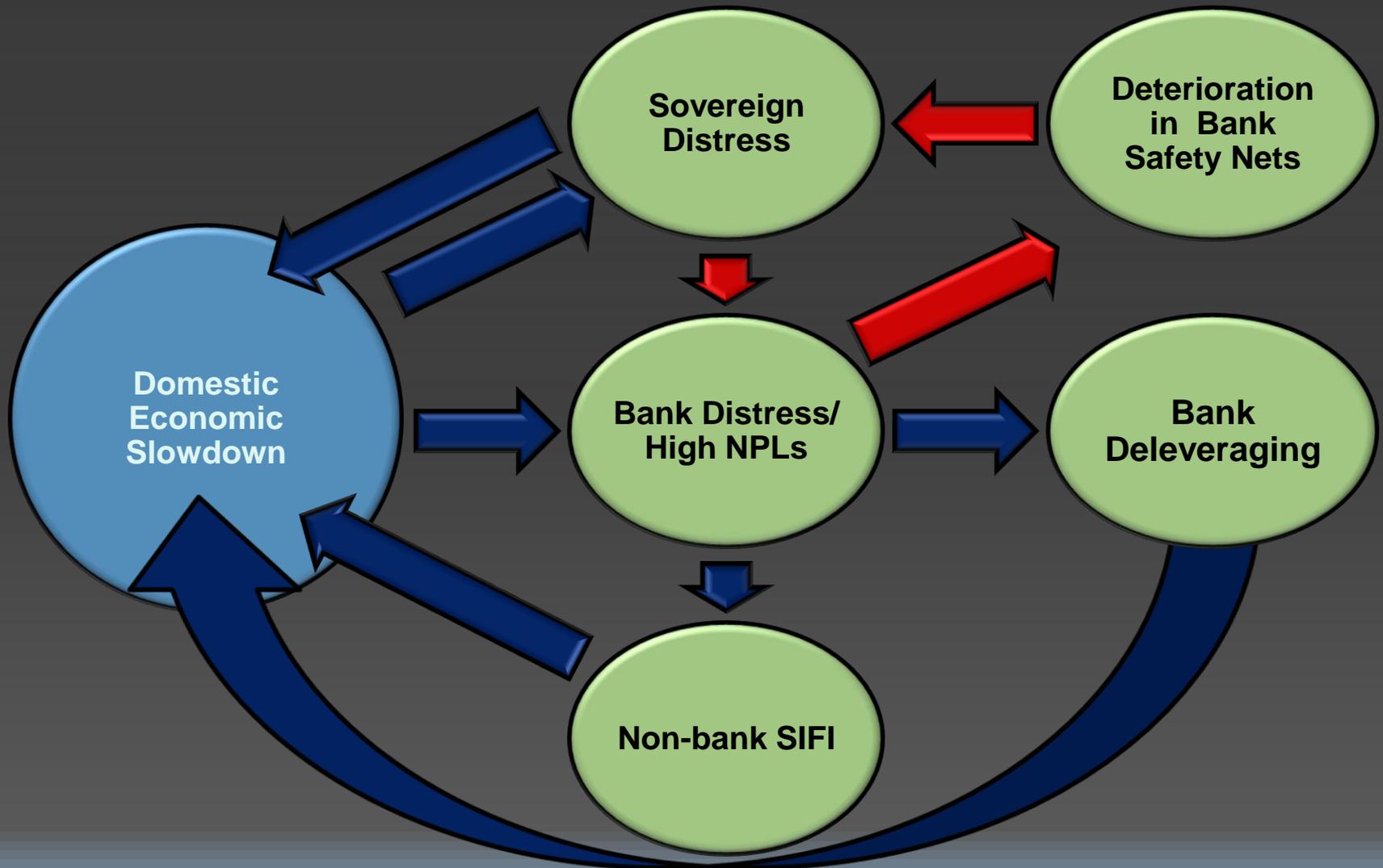
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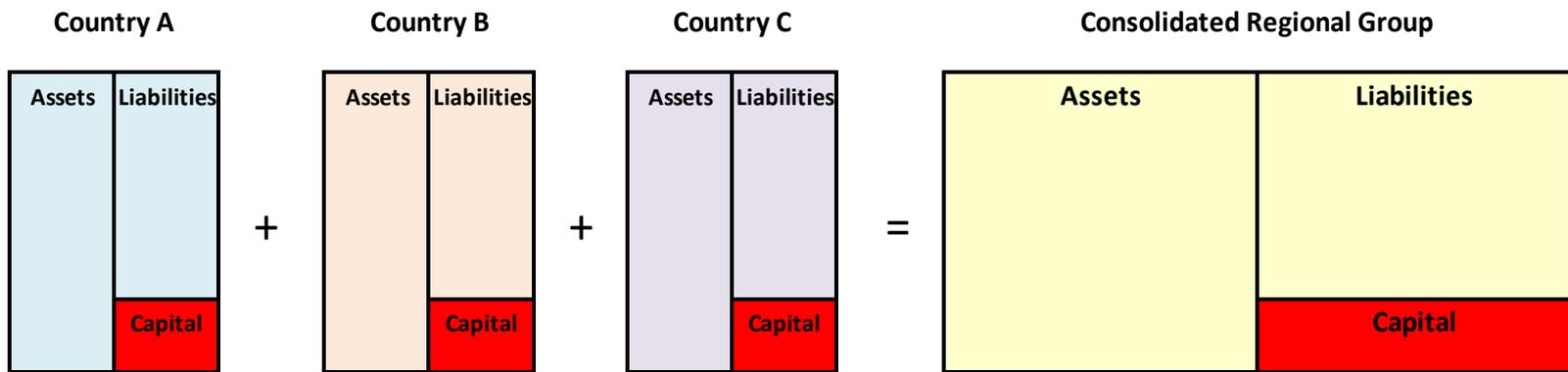
Are there adverse feedback loops?



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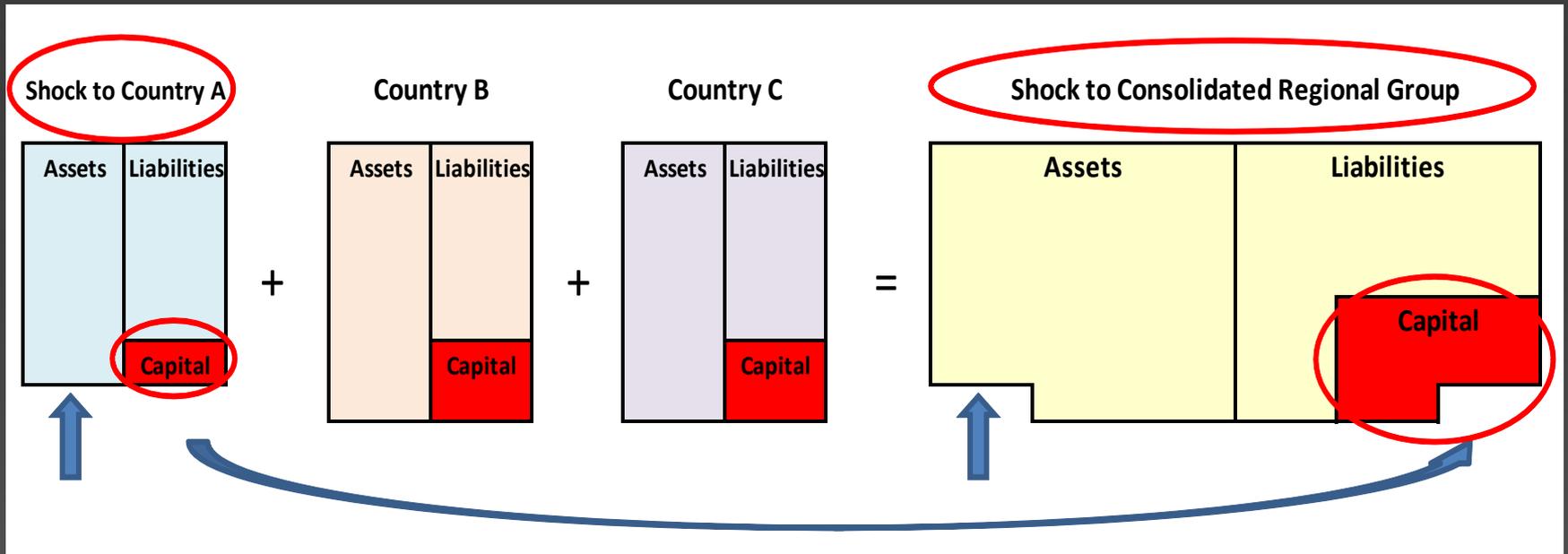


Hypothetical Contagion Channel Via Regional Bank Group Structure



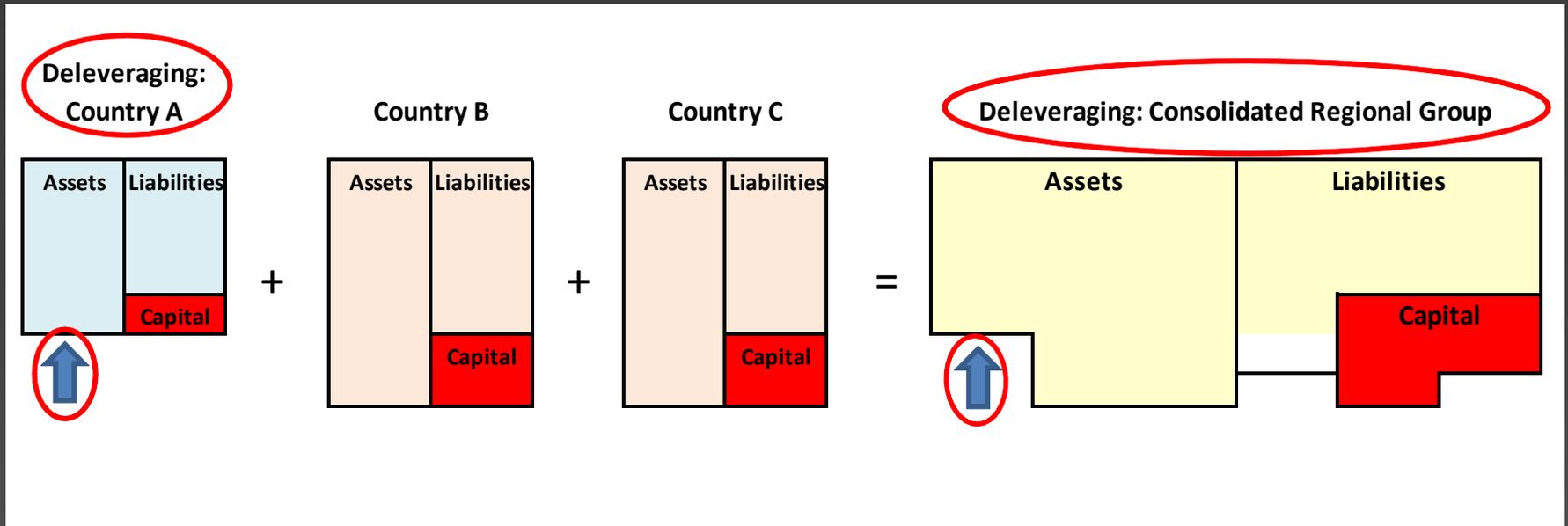
Step 0 (initial condition)

Hypothetical Contagion Channel Via Regional Bank Group Structure



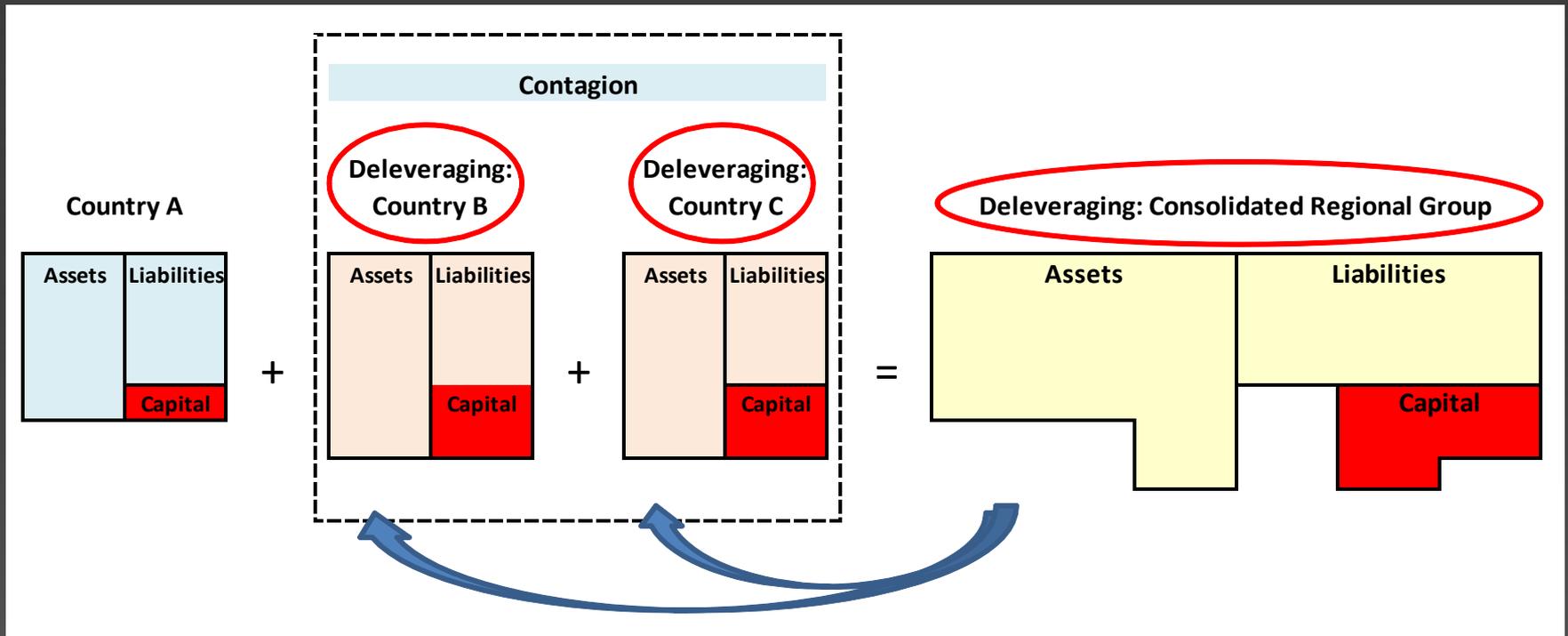
Step 1: Losses in subsidiary imply losses in consolidated capital of the regional group

Hypothetical Contagion Channel Via Regional Bank Group Structure



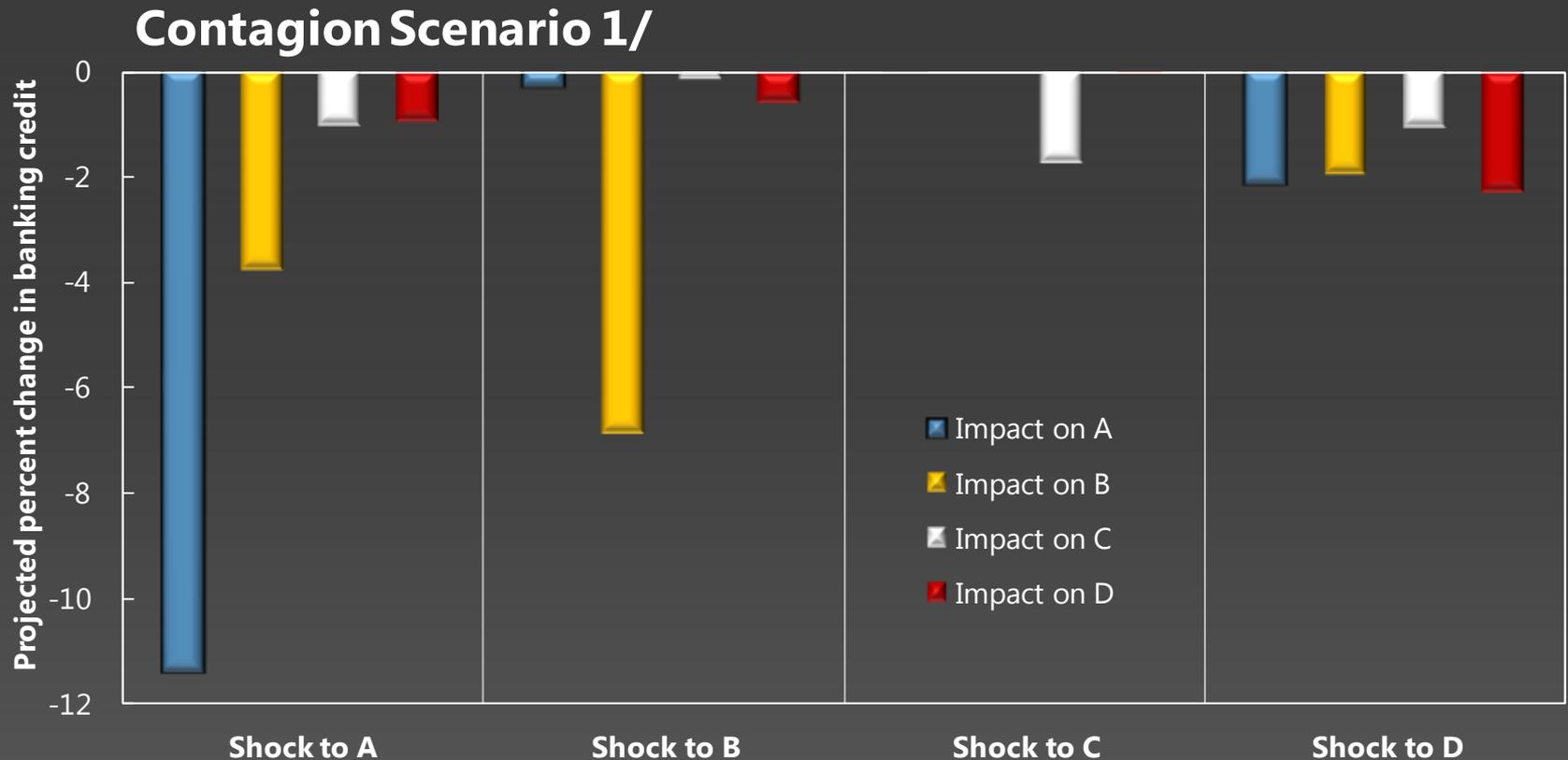
Step 2: Subsidiary sheds assets. Is this deleveraging enough to restore capital ratio of the group?

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



Sources: National authorities; Bankscope; banks' annual reports; and IMF staff estimates.

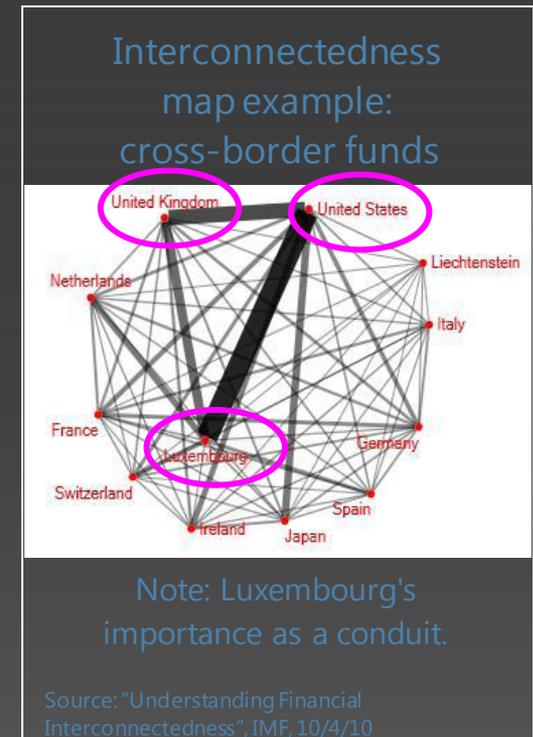
1/ Deleveraging in response to losses of 15% of total loans in selected bank affiliates in the trigger country.

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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



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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.