Money & Credit

Chart 5.1: Excess Liquidity

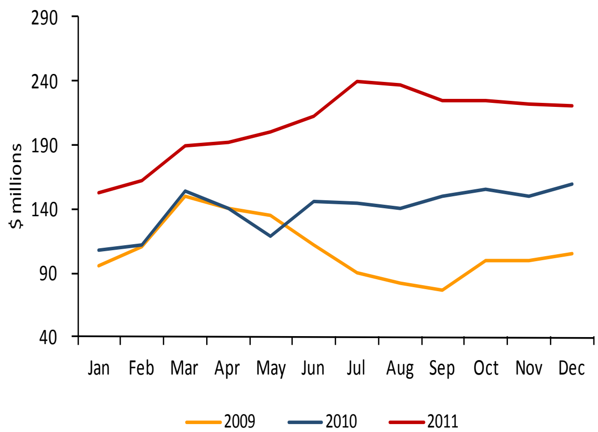
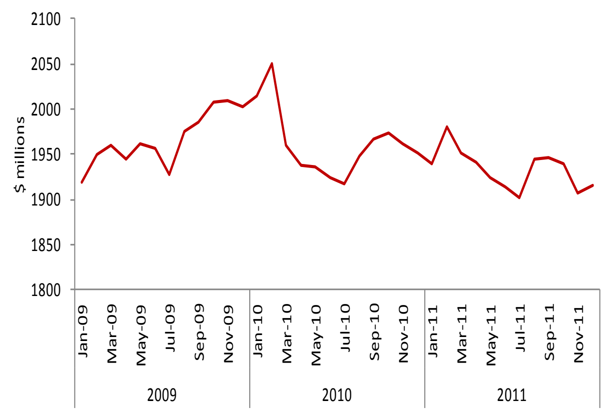


Chart 5.2: Net Domestic Credit



Bank liquidity continued on an upward trend, as robust growth in net foreign assets associated with a further improvement in the current account of the balance of payments coincided with sluggish credit demand. By year-end, the excess statutory liquid asset holdings of the banks had increased by 38.1% and stood some 46.8% in excess of the legal requirement. Excess cash balances were also 54.8% above the required level and significantly above the long term trend. The Central Bank consequently continued its efforts to bring interest rates more in line with current market and economic conditions by reducing commercial banks' costs and increasing their flexibility in liquidity management. On 1 February, the interest rate on loans granted to domestic commercial banks in its capacity as lender of last resort was lowered from 18.0% to 11.0% per annum. The mandatory securities requirement was also progressively reduced from 6.5% to 0.0% of average deposit liabilities and on 1 October, the minimum interest rate on savings deposits was further lowered from 3.5% to 2.5%. These policy changes set the stage for more aggressive loan marketing efforts by commercial banks accompanied by a downward trend in their lending rates.

Notwithstanding this, net credit contracted for the second year in a row as a modest up-turn in new loan disbursements was eclipsed by the writing off of some $45.0mn worth of non-performing loans in the banking system, the latter being part of the programmed effort to clean up and strengthen the balance sheets of some commercial banks. A $23.5mn contraction in net financing to Central Government accompanied decreases in credit to the private sector and statutory bodies of $5.2mn and $0.8mn, respectively. In the case of the Government, its increased reliance on Central Bank overdraft financing was eclipsed by growth in its deposits due to heightened receipts from oil production, loan disbursements and proceeds from the sale of BTL shares. Funds derived from the latter were notably being held in a special account pending the reaching

Chart 5.3: Private Sector Credit and Money Supply
(Annual Percentage Growth)

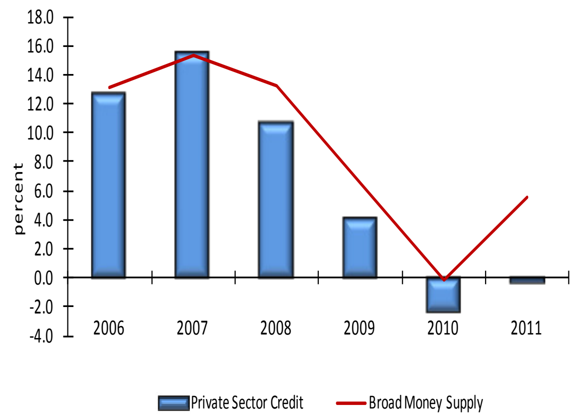


Chart 5.4: Commercial Banks' Loan Distribution

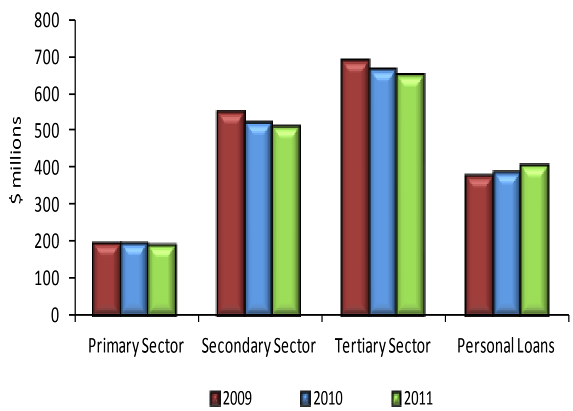
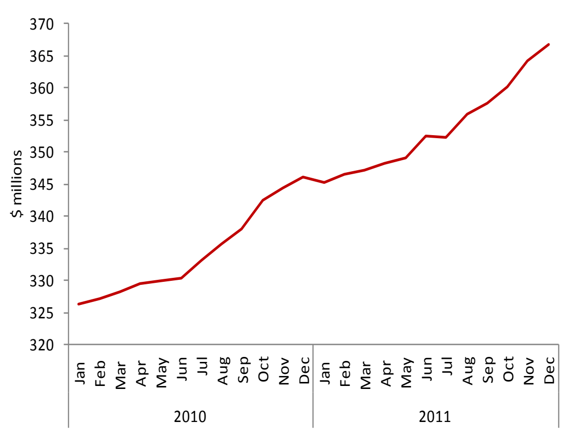


Chart 5.5: Credit Unions' Loans and Advances



of a settlement to compensate the previous owners of the telephone company.

As a result of the loan write-offs for entities involved in tourism, construction, agriculture and manufacturing, commercial bank credit declined across most sectors except for personal loans, which rose by $20.6mn, almost twice the increase over the same period of 2010. The largest decline ($12.4mn) was in the secondary sector as reductions for manufacturing and construction activities outpaced disbursements to utility providers. In the tertiary sector, repayments from merchandise distributors, transportation service providers and loan write-offs for tourism-related projects outweighed advances for real estate transactions. Meanwhile, loan activity by the five largest credit unions maintained an upward trend with a $20.8mn increase as compared to growth of $21.5mn in 2010. Most of these new loans went to finance home improvements and personal consumption.

Responding to the Central Bank's initiatives, the weighted average deposit rate fell by 196 basis points to 3.65%. Notably, the weighted average rate on time deposits declined by 205 basis points to 5.37%. Lagging somewhat, the weighted average lending rate declined by 76 basis points to 13.02% with the rates applied on residential mortgages and personal loans recording the largest reductions of 128 and 126 basis points, respectively. The slower pace of decline in lending rates largely reflected structural re-pricing rigidities of existing loan contracts since new borrowers benefitted from generally lower rates with the weighted average lending rate on new loans issued during the year falling by 257 basis points to 11.79%.

Chart 5.6: Weighted Average Deposit and Lending Rates

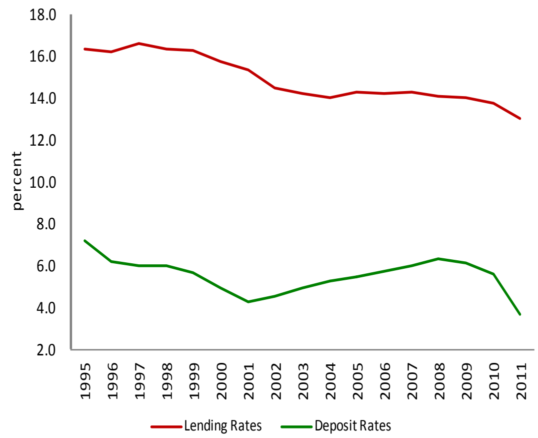
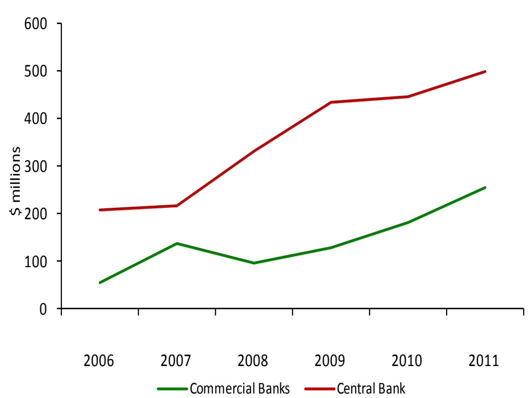


Chart 5.7: Annual Growth in Bank Deposits

Chart 5.8: Net Foreign Assets

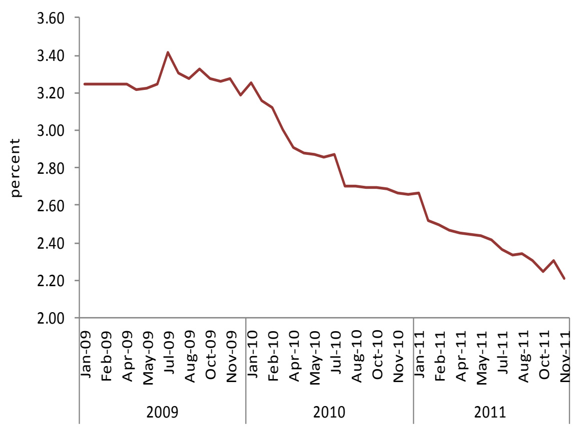


Given the slackness in credit, growth in M2 was driven by a 19.9% increase in net foreign assets. Reversing its 0.1% dip in 2010, M2 grew by 5.6% during the year. However, given the substantial build-up in their liquidity, some banks began refusing to accept new time deposit liabilities. Hence, while quasi-money declined by 4.4%, with the latter change encompassing a notable shift of $54.4mn by individuals from time to savings deposits, narrow money expanded by 18.6% with the bulk of the increase being in demand deposits, where interest rates were lower.

Notwithstanding the re-direction of their resources in order to increase loan loss provisioning and meet cash reserve requirements, the commercial banks were able to boost their foreign assets by 21.1% and reduce foreign liabilities by 53.8% due to heightened inflows from CFZ sales, tourism receipts and domestic exports. The Central Bank's foreign asset holdings also improved as foreign exchange purchases of $285.4mn outpaced sales of $233.9mn. Almost one-third of the foreign exchange receipts came from taxes and royalties on oil production, while loan disbursements, receipts from sugar exports and foreign exchange purchases from commercial banks accounted for 20.9%, 16.4% and 12.3%, respectively. Central Government accounted for approximately 75.0% of the Bank's foreign exchange outflows, most of which was allocated for external debt payments. The balance went to meet the needs of statutory bodies and commercial banks.

Activity in the Treasury bill market continued to be dominated by the commercial banks, and this was a reflection of the high levels of excess liquidity. The banks took steps to maintain their percentage

Chart 5.9: Treasury Bill Average Yield



share of available Treasury bills at approximately 83.7% over the twelve month period, even without the statutory requirement. At the end of December, their Treasury bill holdings were valued at $151.5mn, slightly higher than the amount held at the end of 2010. Against the backdrop of strong demand, the Treasury bill yield continued to drift downward over the year. The last issue for the year was rolled over at a yield of 2.21263%. This was lower than the 2.23969% registered for the previous issue and well below the 2.66172% yield recorded for the last issue of 2010.

Box 1: Monetary Policy Developments in 2011

1 January, 2011 -	The government securities' requirement was reduced from 6.5% to 5.0% of commercial banks' average deposit liabilities, while the cash reserve requirement and liquid asset ratio remained unchanged at 8.5% and 23.0%, respectively.
1 February, 2011 -	Central Bank's discount rate as lender of last resort to commercial banks was reduced from 18.0% to 11.0% per annum.
1 April, 2011 -	The government securities' requirement was reduced from 5.0% to 3.0% of commercial banks' average deposit liabilities, while the cash reserve requirement and liquid asset ratio remained unchanged at 8.5% and 23.0%, respectively.
1 October, 2011 -	The minimum interest rate on savings deposit was reduced to 2.5% from 3.5%, previously set in November 2010.
1 October, 2011 -	The Central Bank standardized the calculation of interest payable on savings deposits by mandating that interest be accrued on the closing available daily balance. In addition, commercial banks were required to publicly disclose their annual nominal and effective savings rates.
1 October, 2011 -	The government securities' requirement was reduced from 3.0% of commercial banks' average deposit liabilities to 0.0%, with the cash reserve requirement and liquid asset ratio remaining unchanged at 8.5% and 23.0%, respectively.