The Global Financial Crisis, its effect on Belize and suggestions on how the business sector can stimulate the economy

Address by Glenford Ysaguirre, Governor of the Central Bank of Belize presented at the Annual General Meeting of the Belize Chamber of Commerce, Radisson Fort George Hotel, Belize City, Belize, 18 June 2009.

Salutations:

Introduction:

As you know, the global financial crisis and (to use the UN phraseology) the seemingly synchronized economic downturn has taken centre stage at this time in world current events. While the situation may have started out as a financial crisis in highly developed economies, it has since escalated into a global economic crisis with serious debilitating consequences, especially for small, open, vulnerable economies like Belize. (Focus now just shifting to developing economies)With good reason, the crisis featured as one of the main agenda items of the recent CARICOM Heads of Government Conference held in Belize in March and the Summit of the Americas hosted in Trinidad and Tobago in April.

The epicentre of the crisis was in the US with the sub-prime mortgage market and was propagated through complex financing structures in which small developing countries like Belize do not generally participate. Ironically, our oft criticized lack of financial market sophistication, our foreign exchange controls, and our ultra conservative foreign reserves management strategy served us well on this score. They cushioned us from the initial financial tremors of the crisis in late 2008, though, unfortunately, not from the resultant real sector downturn.

As anticipated in our press release back in October 2008, the impact of this crisis on Belize and more specifically on your businesses, therefore, arises from the aftershocks on the real sector. That is, the indirect effects on international trade, of the crisis-induced recession in larger countries that are our major economic partners and the international credit crunch.

In October 2008, we had cautioned that our highest areas of vulnerability were in tourism, foreign direct investments (FDI), foreign remittances and deteriorating export commodity markets. With data now available for the first quarter of 2009 we can now confirm those predictions with a 2.2% GDP contraction.

Tourism

The performance of tourism is usually a bellwether for our economic performance. Together, visitors from the EU and US account for about 75.0% of our stay-over arrivals. For the first quarter of 2009, a period falling within the peak tourist season, stay-over tourist arrivals fell by 10.1%, and cruise ship disembarkations also decreased by 1.9%, when compared to the same period of 2008. Results were uneven across the industry. Some hotels reported being fully booked, while others indicated that their booking and occupancy rates had fallen, significantly in some cases. Counter measures employed to deal with the depressed market included layoffs, lowering operational costs and offering discounts or sales incentives. Discussions with the Belize Hotel Association revealed that the lower end hotels were starting to fare off better, as tourists sought less expensive accommodations.

Remittances

Information for the first quarter of 2009 confirmed that remittances from abroad fell by approximately 14.2%, which can be attributed to rising unemployment in the US. While the national unemployment rate for the US rose to 9.4% in May, a demographic dissection paints an even grimmer picture: the rates for Blacks and Hispanics were at 14.9% and 12.7%, respectively. Since unemployment is expected to mount in the beleaguered developed economies, we can anticipate further decline in remittances to Belize. The consequence of this trend is most likely to be reflected in the reduced spending power of those domestic households dependent on this income source. This in turn leads to reduction in your sales volumes, reduced purchases of non-essential products and services, and a shift in consumer spending to less expensive products or to more cross border shopping.

We have also seen an increase in delinquency of loans at credit unions and banks that were serviced by remittances from abroad.

Foreign Direct Investments

The likely decline in foreign direct investment inflows expected during 2009 had been surmised for reasons such as difficult access to international credit by foreign investors, loss of wealth and risk aversion to taking on new projects under the unstable international business climate.

During 2008, strong FDI inflows, particularly for large condominium projects aimed at a tourist market, were very instrumental in funding a construction boom. In the last quarter of the year, these flows had started to taper off. The picture for the first quarter of 2009, when adjusted for one off special item, shows a 15.6% decline. Small investments coming through money transfer companies were down by 24.0% and tourism related FDI dipped by $13.2mn or 57.8%. Moving on, available records on external loan disbursements to the private sector show that these amounted to only $4.3 million as compared to $75.8 million in the first quarter of 2008.

Suppliers Credit

While our information may be incomplete, some large exporters have indicated to the Central Bank in recent discussions that they are facing some difficulties in accessing or maintaining credit lines. This means that businesses will need to keep operations at the level that can be supported by the amount of available financing. Some renegotiation of loan repayment or suppliers' credit terms may also be necessary.

International Trade

Regarding our domestic exports, preferential markets have partially shielded banana and sugar export prices, however sluggish international demand has weakened other key commodity prices. The prices of lobster, shrimp and citrus juices have experienced double digits price declines. I the First Quarter of 2009, the total value of domestic exports was down by some 15.0% when compared to first quarter of 2008. In fact, the Central Bank is projecting about a 16.0% decline in total export value for 2009, and the current trend for the first few months seems to support this.

On the other hand, the fall in international commodity prices as well as the winding down of capital-intensive investments, has led to a reduction in the import bill. During the first quarter, imports fell by 17.4%, with the largest contraction occurring in fuel due to lower acquisition costs. In the CFZ, the depreciation of the peso has reduced Mexicans' purchasing power and the effects are being felt in a slowdown in sales volume.

Inflation

On the upside, falling international prices especially for fuel led to a cooling of inflation to 1.5% for the first few months of 2009.

And then of course there is CLICO

The current status of the domestic branch of the Colonial Life Insurance Company (CLICO) was externally induced and was not due to deficiencies in Belize's regulatory oversight. The Supervisor of Insurance has procured an order from the courts to place the CLICO branch here under provisional judicial management. Fortunately, the Belize branch is better positioned than the other CLICO branches in the Caribbean because of its mandatory statutory reserves, and quick action by the regulators to freeze assets.

The Domestic Financial System

The Central Bank's regulatory responsibility is to foster monetary, financial and exchange rate stability. I therefore, naturally, must speak on our domestic financial system.

The Central Bank's response to the global financial crisis has been the immediate implementation of a programme of enhanced regulatory oversight for all financial institutions under our supervision, including credit unions, in order to ensure their safety and soundness. We continue to monitor closely the asset quality, capital adequacy and liquidity of these institutions as the critical prudential measures.

Capital Adequacy:

Capital adequacy base ratio of the commercial banks in Belize averages 18% over the past three years. This indicates a generally strong level of capitalization that is capable of withstanding portfolio write offs that would be associated with the economic slowdown. The international BASLE II benchmark is set at 8.0% and the Bank and Financial Institutions Act (the BFIA) requires 9%. Consequently, our banking system continues to exceed the international criteria for basic capital soundness, and the Central Bank will remain diligent in ensuring that banks continue safe and sound management practices.

Liquidity:

The Banks and Financial Institutions Act and Exchange Control Regulations have prevented those destabilizing, volatile short-term foreign inflows from entering our banking system. Instead, the lending activity of our local banks depends mostly on domestic deposits from residents, so domestic liquidity has not been affected by the international credit crunch. In fact, excess liquidity at the end of 2008 was 43.6% higher than its starting position in January 2008. During the first quarter of 2009, excess liquidity rose even further, following the customary seasonal pattern in which liquidity builds up in the first part of the year. Rather than a liquidity crunch, the Central Bank is presently tasked to monitor closely a liquidity build-up; and I will talk more about that later.

We recently conducted internal stress tests for capital adequacy, liquidity and bad debt coverage and I am comforted by the report that indicates a sufficient level of capitalization to withstand any recession-induced increases in bad debt.

The Official Reserves

Briefly, while I am happy to inform that our international reserves at the end of May stood at some US$180 million, the highest levels they have been in more than four years, they are still relatively low and only cover some 3 months of imports. Ideally, we would like coverage for at least six months. The Central Bank holds these reserves primarily in interest bearing deposits and short-term government backed instruments with foreign central banks and top ranked commercial banks. Since the start of the crisis, we have seen a marked declined in international interest rates that will reduce CB earnings significantly.

Nonetheless, the Central Bank has further enhanced its customarily conservative investment strategy with the focus being more on preservation of capital rather than investment returns. Our external asset ratio, which measures the level foreign assets against domestic deposit liabilities including currency in circulation, has been above 60% since July 2008 and measured 67% at the end of May 2009, well above the legal threshold of 40%. Again, I can assure you that the Central Bank will continue to closely monitor external developments and take all necessary and reasonable actions to ensure the continued security of our foreign reserves.

So all this brings us to the question: What can we do?

First, let us start with the government as I understand some private and public sector businesses are already turning to Belmopan for help. The problem is that Belmopan has little fiscal headroom within which to wiggle. The large external debt, built up over the past ten years, hangs over our head like the Sword of Damocles, requiring the government to build up savings to meet its payback obligations that includes progressively higher interest rates as time goes by.

Unlike the US, Belize's economy is not driven by domestic demand therefore; any fiscal stimulus that stimulates domestic demand can be potentially harmful. For this reason, any measures aimed at stimulating the economy must be funded from external sources, lest we run the risk of widening the balance of payment deficit and depleting our foreign reserves given our high propensity to import (approximately 60 cents of every dollar). With Belize only recently forced to restructure its external commercial debt, foreign financial markets are essentially closed to us; and this is so even if the international credit crunch had not developed out of the sub-prime mortgage crisis.

Tax breaks to the private sector would lead to a reduction in government's revenue base and compromise its ability to provide essential investment, public services and goods as well as increase the difficulty of leveraging fiscal finances onto a more sustainable footing to support the higher external debt repayments down the road. Bear in mind that the first step-up in the Super Bond interest rate will kick in 2010.

Fiscal Incentives is not a panacea

So, with limited fiscal space and tightening public finances, one option is for the government to redirect its fiscal incentives packages to assist the more vulnerable sectors. The long standing practice of awarding and renewing fiscal incentives to mature and already profitable businesses should be reviewed. Not to be controversial, but some of these packages have long ossified into long-term subsidies for mature companies. In essence, we burden other taxpayers to incentivize inefficiency.

So with the government's limited capacity, what can the private sector do to mitigate the effects of this crisis and even stimulate the economy?

The economic survival and expansion opportunities are specific to each business but the overriding **emphasis should be the preservation of investment and jobs** both in the private and in the public sectors. Businesses must stay positive and recognize that **the recession is not permanent and that eventually the global economy will turn around.** The idea is to survive the recession and avoid the complete loss of your business or the cost of closing and restarting after the recession.

This may call for several things:

Rethink the Business Model

The approach described above calls for us to rethink our business models and **avoid unnecessary cutbacks in the interest of short-term profits.** For example, this may require **cutting back margins or even shifting to a breakeven costing model** just to stay afloat, maintain your clientele, service the debt and retain your valuable human capital investment. This may be less expensive than shutting down and then restarting after the recession is over.

Strategic Planning is a must

Strategic thinking is necessary if we are to make more informed and wiser business decisions. Today's challenges can be tomorrow's potential but we must recognize that the era of high mark-ups and high margins may very well be over. While, the swine flu pandemic is a strong disincentive to cross border shopping, retail merchants can further help themselves by cutting mark-ups to stimulate sales.

Contacts with a wide cross section of businesses have revealed that a variety of mitigating measures are already being employed. These include improved efficiency through cost controls on the input end and more focused marketing on the customer end. The former included conserving on utilities, ramping up of production to reduce unit costs, temporarily shifting to a least cost method of production, lowering inventories and procuring cheaper inputs or source of goods. One option is to source locally; the tourist sector seems to be more proactive in this area are to be commended for its swift action in that regard.

Cheaper financing is a must

With the build up of liquidity in the system, banks can play a critical role, as we know that the cost of capital is one of the biggest obstacles to Belize’s competitiveness. The build up offers a real opportunity for banks to realign their domestic rates to reflect the global situation. The Central Bank is working vigorously on a policy reform strategy to give more flexibility and precision to its monetary policy measures. We have engaged the banks in a discussion on interest rates liberalization. There is urgent need for collaborative action between the productive sector and the financial sector. Banks should sit down with businesses with high debt servicing to renegotiate loan terms even if only temporarily until the recession is over.

To businesses I say you can help yourselves in this regard by providing audited financial statements and being more transparent with your group accounting practices. This should help to lower your risk profile to creditors and make a better argument to reduce rates.

To the banks I say, shaving a few points off the lending rates will not cause any of our banks to fail but not doing so can be the difference between failure and survival for many of your customers.

Creative Marketing

On the marketing end, some businesses have shifted from a mass media outreach to personalized approaches to effectively sway target customers. Discounts and incentives have been employed as well as a focus on quality enhancements. We have seen a lot of this in the tourist resort sector. Getting Belize in the American Way magazine was quite an accomplishment and a much-needed shot in the arm. The BTB is to be congratulated for that feat.

To conclude:

I believe we still have a lot of work to do and to those skeptics I will close with a few thoughts to ponder:

- Prospective developments at the other end of this recession include the reintegration of Cuba. With the recent thaw in US/Cuba relations, we can anticipate a redirection of investment capital and tourist flow into that island.
- Other countries are doing the things we are only talking about today so they will likely emerge leaner and meaner than we are. Failure to act now will see us emerging from this crisis further behind our regional competitors than when we first started.
- Things will never return to the way they were.

If we do not act now to make Belize more competitive, we would have squandered an excellent opportunity because it is highly unlikely that we will ever contemplate these ideas in times that are more benign. This is one area where the Chamber can take the lead and organize such a push.

Our economy has proven to be very resilient in the past thanks largely in part to our productive sector. Now is the time to take it to the next level. Testimony to this resilience is our years of success in maintaining our fixed exchange rate peg for the past 32 years. Sometimes it seems we did so by mere social consensus even when faced with an almost empty treasury, evaporating foreign reserves and increased likelihood of international debt default. I attribute this feat to the indomitable spirit of the Belizean entrepreneur.

In closing, I would like to applaud and encourage the Belize Chamber of Commerce for initiating this discussion. I am honoured that you have invited the Central Bank to participate in this meeting, and once again reaffirm our commitment to this cause.