



*THE DEVELOPMENT OF MONEY &
CAPITAL MARKETS IN THE
EASTERN CARIBBEAN
CURRENCY UNION*

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EASTERN CARIBBEAN CENTRAL BANK

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THE DEVELOPMENT OF MONEY & CAPITAL MARKETS IN THE EASTERN CARIBBEAN CURRENCY UNION

1.0 OVERVIEW

The Eastern Caribbean States of Anguilla, Antigua and Barbuda, Dominica, Grenada, Montserrat, St Kitts-Nevis, St Lucia, and St Vincent and the Grenadines constitute a monetary union, termed the Eastern Caribbean Currency Union (ECCU). These eight countries share a common central bank and a common currency.

The genesis of the capital market development programme in the currency union can be traced back to the early 1990's, when the Monetary Council of the Eastern Caribbean Central Bank (ECCB) mandated the Bank to proceed with the activation of Article 4(3) of the Agreement, which states that one of the purposes of the Bank is *“to promote credit and exchange conditions and a sound financial structure conducive to the balanced growth and development of the economies of the territories of the participating Governments”*. This was interpreted to mean, in practical terms, the development of money and capital markets. Accordingly, the latter part of the 1990's heralded the onset of a new era of financial sector development in the region.

Despite the existence of a currency union with a common currency and a common central bank, as well as the rudimentary issuance of shares by public firms and T-bills and bonds by ECCB Member Governments, the financial system was fragmented, with eight separate markets. This, along with a high degree of fractionalisation in these markets, was identified as a constraint to the development of the region.

The financial sector, comprising financial systems, markets and institutions, is an important element in economic development. The financial sector mobilises savings and allocates credit across space and time. It provides not only payment services, but also more importantly products that enable firms and households to cope with economic uncertainties by hedging, pooling, sharing and pricing risks. An efficient financial sector reduces the costs and risks of producing and trading goods and services, and thus makes an important contribution to raising standards of living, which has an indirect impact on economic development.

Money and capital markets form a significant part of the financial sector; their underdevelopment limits risk-pooling and risk sharing opportunities for households and firms. Within the ECCB region the underdevelopment of money and capital markets has made the economies more vulnerable to financial crises.

In an effort to address this, the ECCB has sought to develop and integrate the ECCU money and capital markets into a single financial space. The Bank began by the creation of both markets and institutions to achieve this goal. A special unit was established to

carry out this mandate, which after a number of changes has now become the Financial and Enterprise Development Department.

Arising out of a series of consultative meetings, held through the Currency Union, the ECCB identified five initiatives to be established at the regional level.

These are:

- (a) The Eastern Caribbean Home Mortgage Bank (ECHMB);
- (b) The Eastern Caribbean Securities Market (ECSM);
- (c) The Regional Government Securities Market (RGSM);
- (d) The Eastern Caribbean Unit Trust (ECUT); and
- (e) The Eastern Caribbean Enterprise Fund (ECEF).

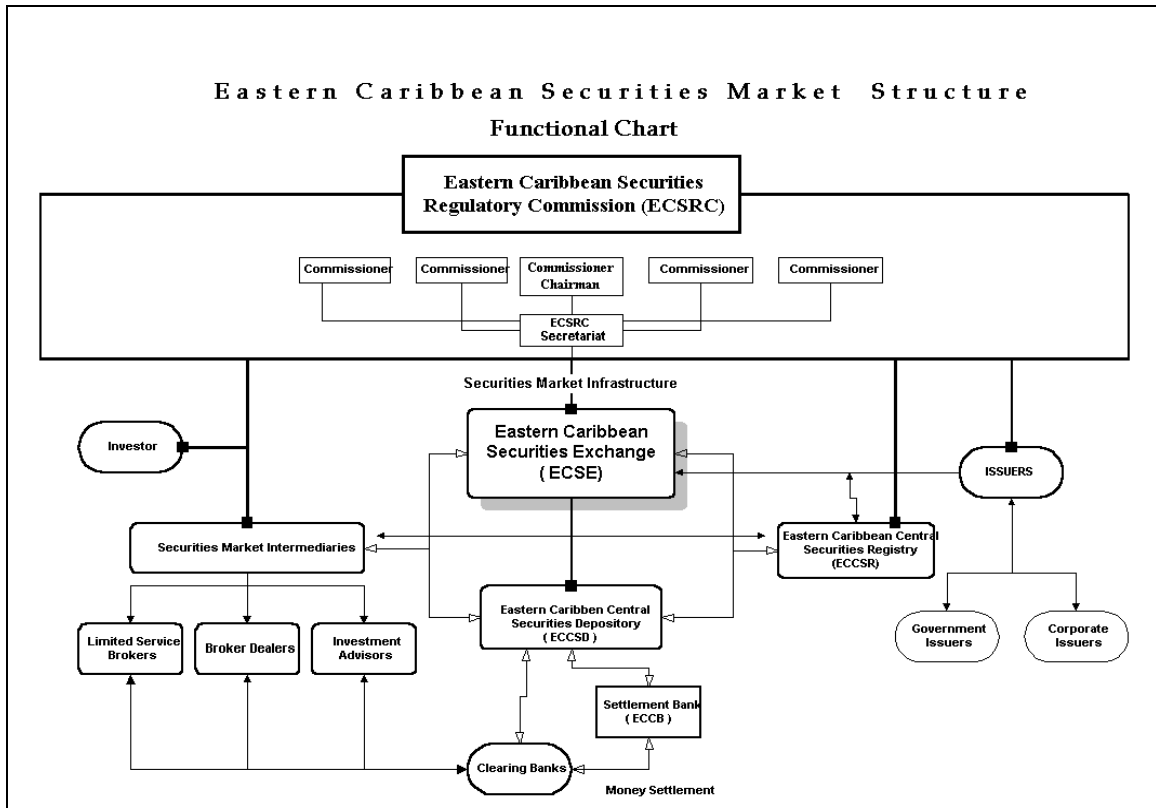
2.0 THE EASTERN CARIBBEAN HOME MORTGAGE BANK

The ECHMB, which came into being in 1996, develops and maintains a secondary mortgage market in the ECCU thereby increasing the availability of mortgage credit and the liquidity and flexibility of institutions using its services. The ECHMB also seeks to harmonise a system of mortgage financing and allocation of long-term savings for housing investments. As at the end of the first half of 2003, the ECHMB had raised approximately \$92.0m in seven issues of tax-free bonds, providing an average yield of 6.75%, and had acquired \$66.7m in mortgages.

3.0 EASTERN CARIBBEAN SECURITIES MARKET

In October 2001, the ECSM was launched with the opening of the Eastern Caribbean Securities Exchange Ltd (ECSE) and its affiliated institutions along with the requisite laws and legal framework.

The ECSE is designed to provide an alternative mechanism for public institutions to raise capital within the regional financial system. It allows for the transfer of private sector savings to productive investments. This will essentially increase productive activity in the real sector, facilitate private sector development and create avenues for increased employment. Currently five corporate securities are listed on the ECSE with a total market capitalisation of \$322m as at 15 August 2003. After less than two years in existence, the ECSE has recorded in excess of \$6.0m in trading activities in relation to corporate securities. Market activity is expected to become more buoyant as additional companies are listed over the next few months.



4.0 THE REGIONAL GOVERNMENT SECURITIES MARKET

The RGSM, launched in November of 2002, provides primary and secondary market facilities for government securities from the ECCB member states. The initiative seeks to strengthen the existing primary market for treasury bills and bonds, and to promote the development of a secondary market for these securities. Currently three member countries; St Kitts-Nevis, St Vincent and the Grenadines and Grenada have issued securities on the RGSM. The total value of government securities listed on the secondary market, as at 15 August, is \$180.0m. The RGSM is expected to develop and expand significantly as more member countries issue their securities.

With the expansion of investment options beyond the individual countries, it is expected that the pricing of government securities will begin to reflect the concept of risk thus allowing for greater efficiencies in investment allocation and resource deployment and greater opportunities for wealth creation by households and firms alike.

The other two initiatives, the Eastern Caribbean Enterprise Fund, which is a venture capital fund, and the Eastern Caribbean Unit Trust, a collective investment vehicle, are still in the conceptualisation stage, and upon completion are expected to increase market activity.

5.0 THE EASTERN CARIBBEAN ENTERPRISE FUND

The ECEF is envisaged to provide another alternative to debt and equity financing, as well as export insurance coverage, business advisory and consulting services. It will be geared towards the development of the real/productive sector in the ECCU by assisting business creation and expansion. Location, taxes or boundaries will not affect regional businesses needing to access the services of the ECEF.

6.0 THE EASTERN CARIBBEAN UNIT TRUST

The ECUT will function as an investment company that pools shareholders' financial resources and invests them in a diversified portfolio of securities. By pooling investors' resources the ECUT will be able to ensure a broader spread of investments across a wider range of Money and Capital Market instruments. This Trust would be able to invest these funds in sound, stable and reliable securities in the ECCU.

7.0 THE EASTERN CARIBBEAN INSTITUTE OF BANKING AND FINANCIAL SERVICES

The Eastern Caribbean Institute of Banking and Financial Services (ECIB), an affiliated institution, was established by the ECCB with the support of the commercial banking community, in an effort to strengthen the human capital of the financial sector. The Institute provides professional development courses for staff of institutions across the financial services sector, and assists its members to develop and implement best practices to enhance their ability to compete in the changing global environment. It is envisaged that over time the ECIB will assist with training the professionals operating in the capital markets.

The Bank is also promoting the establishment of a regional institute of accountants to pursue the adherence to high uniform accounting standards across the currency union.

8.0 INTERBANK MARKET

In the Mid 1980s, the ECCB established an interbank market, in an effort to assist the commercial banks to manage their liquidity, and to facilitate the lending and borrowing of available reserve balances between commercial banks, in a timely and cost effective manner. The ECCB performed the role of broker and guaranteed the funds; interest rates were fixed.

In October 2001, the ECCB introduced changes to the arrangements governing the Interbank Market. Under the new arrangement, a Bulletin Board Service, facilitated by the Central Bank, replaces the ECCB's brokerage service. This service can be used by the commercial banks on a daily basis to advertise funds available for lending and to

source funds for borrowing. Commercial banks negotiate on a bilateral basis for the use of excess funds in the banking system and set the terms and conditions of each loan without the intervention of the ECCB. In the conduct of Interbank transactions, commercial banks can either enter into informal unsecured agreements, or can choose to enter into secured arrangements, whether by offering collateral or by repurchase agreements.

The changes to the Interbank Market arrangements are expected to result in market determination of the fund rates and contribute to the removal of the rigidity of interest rates in the Currency Union. This is in keeping with efforts by the Central Bank to develop and deepen the money and capital markets of the ECCU.

9.0 CONCLUSION

Collaboratively these institutions are expected to strengthen the ECCU's financial system, as the sub-region moves closer towards a single financial space. The ECCB's focus is to simultaneously integrate markets across national borders while further developing these markets internationally.