MARCH 2010

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For the Alumni of the ECCB's Savings and Investments Course

YOUR FINANCES ……YOUR FUTURE

The ECCU Economy at the CROSSROADS. Where do we go from here?

"English is a funny language," sings a calypsonian. Well, finance is not a language, but there is nothing funny about failing to understand the subject matter.

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Your Money Meeting

Did you know?

Money Fixe$

Three Steps to a Secure Financial Future

1 TAKE ACTION. It is often said that good things come to those who wait, but the problem is that no one ever knows how long the waiting period is. It could be weeks, months or years…and you may not have the luxury of time to wait when you need funds urgently to pay for unexpected medical expenses, house repairs or to meet your living expenses during retirement.

Rather than waiting around for things to happen in your favor, get financially secure by making things happen. You can be financially secure and avoid going into financial ruin, by planning mindfully. Set aside funds each month for your retirement by starting a retirement fund. Also set aside funds to cover unexpected costs related to house repairs, health emergencies not covered by your insurance plan and other necessities you would have to pay out of pocket. If your fail to plan, plan to fail.

2 COMMIT TO A SECURE FINANCIAL FUTURE. Many of us start on the right path to financial security only to be waylaid by unhealthy spending habits that make us verve off course. Renew your commitment to what matters most to you financially. Remember, success is not made by how many financial goals you make but how many you achieve.

3 CREATE A NEW FINANCIAL VISION FOR YOURSELF. If you keep looking back at all of the things that went wrong financially, you will lose faith. Learn to let go of your past financial mistakes by looking for the lesson in those mistakes from which you can benefit and create a clear mental picture of where you are headed now financially.

THE ECCU ECONOMY AT THE CROSSROADS

by Sybil L. Welsh

- **What does the new global economy hold for the region's economy?**
- **What are the possibilities?**
- **What can we as individuals do?**

A crossroad is defined as a turning point. A time of decision regarding which direction to take. In the mid-seventies the Eastern Caribbean Currency Union (ECCU) faced such a crossroad as it grappled with a declining mono-economy based on agriculture largely dominated either by sugar or bananas. The response was a shift to a service-based economy mainly driven by tourism.

At the end of the last decade and continuing into this new decade, the region's tourism industry continues to feel the fallout from the global recession, and once again the region's economy finds itself at a crossroad... a turning point…a period of deep reflection regarding which direction to take. Should it change direction or stay the course?

If there was an issue of the decade it would be the economy. Everything revolves around it. But, what really is the economy?

A simple definition provided by a sixth grade scholar breaks down what is often explained using complex words, into three simple key elements.

"The ***resources*** *utilised by a country to* ***produce wealth****."*

These three key words—*resources, produce* and *wealth,* speak simply, yet clearly to the core definition of the word economy.

Economy— The resources utilised by a country to produce wealth.

Going back to basics one would recall that there are three types of economic resources - 1. natural resources 2. capital resources (*aka man-made resources)* and 3. human resources. Classical economic theorists would refer to these as *land, labour and capital.*

The ECCU is not endowed with mineral resources such as bauxite, diamonds and oil.

The land mass of the eight countries combined is approximately 1,092 square miles, compared to Brazil which has a land mass of 3.3 million square miles. The region's ability to rely on agriculture as a viable source of earnings is limited by the high cost of production which impedes the region's ability to be competitive in this sector within a global economy where trade protection is no longer available.

The same can be said in relation to capital resources *(resources used in the production process to produce a good or service).* The region has very limited scope to be competitive in the production of capital goods.

This same conclusion was conveyed in a World Bank Report in 2005 which stated, *"Given its relatively high wages, it is unlikely that the OECS can be competitive in labor-intensive manufacturing or in traditional agricultural production in a more open market trading regime."*

But what about human resources? There are over 600,000 persons living in the Eastern Caribbean Currency Union. Not to mention a similar number of persons living abroad. Can the region leverage these resources to produce wealth, to increase the level of economic activity in the region and raise the standard of living for all?

After all, it would appear that if our analysis is correct one can deduce that of the three economic resources—natural, capital and human, it is the latter i.e. human resources which can be best leveraged to bring about sustainable economic growth in the region.

If only it was that simple, because we bump up against another challenging question.

Is the majority of the region's human resources equipped with the requisite skill sets and knowledge to produce at a low, medium or high level?

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Consider the following formula:

The level of skill sets of the region's human resources = The level of the region's productivity capacity = The level of the region's economic earning potential.

In answering the above question, therefore, one has to first get a clear sense as to what are the driving global forces that one has to consider when it comes to economic activity. These forces can be defined as follows:

1. A globally integrated economy.
2. Vast improvements in information and communication technologies.
3. Accelerating pace of scientific and technological change.
4. Constantly changing market demands.
5. Constant change.

Based on this one can clearly see that what is demanded from the region's human resources to drive the success of its economy are the following:

- A culture of innovation to revitalise current businesses and develop new ones.
- Expert thinking.
- Excellent customer service skills.
- Complex information technology and communication skills.
- The ability to produce internationally competitive products and services.
- Other cutting edge technical skills.
- Continuous learning at the individual and institutional level to keep pace with technological and other changes in order to remain competitive.

So are we there yet? I think we know the answer to the question. **No, far from it.**

According to a World Bank Report (May 16, 2007) Skill Challenges in The Caribbean: Phase I Report *"eight of every ten employers felt that productivity was low to moderate"*. The report went on to state that *"the numbers suggest that the OECS is one of the world's most affected regions in terms of the way firm competitiveness is severely constrained by the shortage of skilled workers… A paradoxical situation is emerging whereby large numbers of unskilled workers are looking for jobs, while companies are eager to hire but unable to find employees with the right skills."*

Given what has been discussed, how has the region's available resources, and its "limited" productive capacity shaped the region's economy? What are the defining characteristics?.

If one has to characterise the ECCU economy, words like small, import intensive, open, vulnerable, largely dependent on a mono-industry-tourism, would be appropriate descriptions. Statistics as at March 2010 obtained from the ECCB reveal the following:

- In 2009 estimates of Total Public Sector Debt as a percentage of GDP for the member countries of the ECCU ranged from 70.8% - 179.9% (*excluding the two ECCU British dependent territories*). Such fiscal imbalances mean that there is very little flexibility that governments have to stimulate economic activity. It would follow, therefore, that the private sector would need to take on a greater role in driving economic activity. But again one would come up against the many challenges faced by the private sector including the lack of the appropriate skill-sets to drive its competitive agenda.
- The region's merchandise trade statistics reveal an estimated trade deficit of $4,191.44 million in 2009, $5,293.34 million in 2008 and $4,895.87 million in 2007. This heavy reliance on imports means that the region needs to have an adequate amount of foreign currency inflows to finance imports. Most of these inflows are derived from exports of tourism services and foreign direct investments. Loans and grants denominated in foreign currency are also contributors.

The labor market is highly dependent on the tourism industry and the ancillary sectors that arise as a result of the tourism industry. According to the International Finance Corporation, World Bank, tourism represents 15% of GDP directly, 50% indirectly and employs about 40% of the OECS labour market. Tourism is the major export accounting for almost 70% of all the region's foreign exchange earnings. Hence, when this industry contracts, all sectors of the economy are adversely

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impacted. The concern with this heavy reliance on a single industry is linked to the issue of placing all one's eggs in a single basket. The result is the concentration of risk.

In finance one classifies industries according to how they move relative to economic cycles.

- **CYCLICAL** –These industries are sensitive to economic fluctuations and tend to exhibit more radical swings, correlated with the overall economic cycle. There is strong demand for these goods and services in an expanding economy and very weak demand in a weak economy **The hotels and restaurants, construction and manufacturing industries are all cyclical.** Consumption of the offerings of these industries usually gets postponed when money is tight.
- **DEFENSIVE**-These industries exhibit stable performance in economic downturns and upturns because their goods and services are based on human needs not wants. Examples include the production of utilities, medicines and basic consumer staples- *rice, flour, etc.*
- **AGGRESSIVE** -These industries usually grow at an above average rate relative to the market. Technology industries *e.g. software development* are included in this sector.

If we consider these three classifications, it is clear that the engines of growth of our economy are concentrated in one industry sector, *i.e. the cyclical sector.*

I came across this quote on the Web that seems to articulate in a very graphic manner a viewpoint that may be instructive for the region. "*In a struggling recessional economy, being concentrated in the cyclical industry is like sunbathing on an anthill and using jam instead of sun block. Not a pretty picture.*"

Over the decades the region has moved from one mono-industry called agriculture to another mono-industry called tourism. However, the vulnerabilities that arise as a result of concentration remain. So once again we find ourselves at a crossroad...**Where does the region's economy go from here?**

While I do not have the answer to this question I have concluded the following:

1. We cannot predict economic cycles but we must realise that different industries respond differently to economic fluctuations and therefore we must be strategic as to how we divide the region's economic pie. In short, we must diversify our economy across various types of industries in which we can achieve both a competitive and comparative advantage.
2. The region's future economic success **has to be linked** to its ability to be significant in the global market economy. G*one are the power days when sugar, cotton and bananas were necessary for the wealth creation of the industrialised world and therefore the region was important on the world's economic stage.* Today the region has little influence on the world's economic stage having lost its **old power base** and has not yet been successful at crafting a replacement. Finding a replacement is an economic imperative if the region is to achieve sustained economic success.
3. The region on a general level can still be said to be at a very basic level of production of goods and services. The main industry, tourism, continues to be hampered by structural inefficiencies and a rudimentary approach to its development devoid of the wide spread application of modernised logistics and systems as well as high technology to enhance efficiency and productivity. (*The author acknowledges that there are exceptions)* The same can be said in relation to the other economic sectors.

What is required therefore are the following:

- **Addressing the Structure of the Economy.** Industry targeting to include a focus on non-cyclical industries in which a competitive and comparative advantage can be achieved.
- **Human Capital Development** Moving beyond primary and secondary education with a focus on higher technical, ITC and academic skills. The region needs highly skilled human resources to carry out its growth agenda.
- **Strong public/private sector partnerships** to formulate and drive the growth agenda.
- A strong focus on being **globally competitive**. **SLW**

There is nothing funny about failing to understand financial issues

Bring up the word finance and many people start to stare at you as if you were speaking a foreign language - "*Félicitations, vous avez gagné … »* Then they put up mental blocks while mumbling "*that financial stuff sounds like mumble jumble to me. I just can't deal with those issues. They are too difficult to understand."*

The problem with this attitude is that failing to make it a priority to understand financial issues is to erect stumbling blocks to one's financial security and success.

It may surprise many of us to know that finance is not a language and furthermore it is not complex. Every financial subject can be simplified to everyday phrases, events and happenings. In fact how we live and everyday sayings provide a framework for breaking down seemingly complex financial concepts to their simple core elements.

Consider for example that it is not unusual for us to go to a clearance sale of a furniture and appliance store and ask the sales clerk "*Excuse me. What price are you asking for that refrigerator"* or go to an auction and indicate in a loud voice *"I am bidding on that 36' television"*. So how can we claim utter bewilderment when confronted with discussions about the bid (buy) and ask (sell) prices of financial products.

Don't we use the word "bid" to signify our buying intentions of a particular item and the word "ask" to find out the selling price of an item. There is certainly nothing complex in words like "bid" and "ask". They are part of our everyday language. The only problem is that as long as we have those mental blocks we will not see the parallels between words used in our daily conversations and those used in reference to financial issues.

But even more serious is that if we fail to understand these words as they apply to financial issues we most likely would not explore the possibility of buying and selling financial instruments as a route to wealth creation.

The other day somebody said to me *"I don't understand what is a Treasury bill."* I responded by asking the question *"Do you understand your telephone bill?"* to which she responded in the affirmative. I questioned further. "*Whose name is on the bill?"*

"Mine's of course.". She responded.

I continued. *"And when you get that bill what are you obligated to do?"*. She responded without pausing "*Pay the amount to the company on or before the due date"*.

"Well" I said "*You have just explained a big part of what a Treasury bill is. The bill is in the name of the Government Treasury, so it follows that the Government Treasury is obligated to pay the specified amount of money on the stated date."*

I then went on to explain why the Government Treasury has to pay the specified amount of money. At some time prior the individual or institution to whom the Treasury was obligated, had loaned the government money with the understanding that it would be repaid with interest at a given date.

This is similar to lending one's family member, friend or neighbour a sum of money. The major differences are as follows;

1. In the case of lending to the Government Treasury one has a formal contract governing the loan unlike in most cases regarding loans to one's family member, friend or neighbour. The loan to the Treasury therefore is more secure.
2. Additionally, the Treasury pays the lender an agreed interest which is the price for the use of the loaned funds. More often than not one lends funds to a family member or friend and receives no interest to compensate for the period of time one did not have access to his/her funds.

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There is nothing funny about failing to understand financial issues …Cont'd

So, having understood the basics about a Treasury bill, the question is - Would you prefer to lend to your family member or the Government Treasury? Only you can decide what is in your best financial interest.

Take another example. The word "prime". This word is no stranger to our everyday vocabulary. We talk about programmes airing during prime time. *i.e. the best time slot.* And, any butcher, cook or chef worth his or her salt knows very well the expression "prime beef". It speaks to the highest quality of beef. So how come when we are engaged in negotiations with our loan officer and the officer indicates that the loan in question would be calculated based on the bank's prime rate plus 2% we get all confused?

If we are to use the beef or broadcast analogy one would quickly conclude that the word "prime" in relation to the bank's loan interest rate refers to the best interest rate offered by the bank. If the loan in question is calculated based on the bank's prime rate plus 2% it must follow that if the bank's best loan rate (i.e. prime rate) is 7.5% and the loan in question is based on this rate plus 2% then the loan, as long as the prime rate stays at 7.5%, is a 9.5% loan.

If we put up a mental stumbling block to this, we would be unable to compare and contrast loan rates among different banks to determine which one is potentially offering the best interest rate.

While we are on the topic of loans, there is the issue of making sure we compare oranges to oranges and apples to apples. Not all loans are calculated the same. A $100,000 8% loan depending on how it is calculated may be more expensive than $100,000 10% interest bearing loan. Now, don't you dare put up a mental block to this financial concept. This is too important for you not to grasp.

Interest rates on credit transactions can be broadly classified as either a flat interest rate or a reducing balance interest rate.

In a **flat interest rate,** also referred to as the add-on interest rate method, the interest is calculated on the entire loan throughout the period of the loan. This means that even though you repay part of the principal with each instalment, the interest you continue to pay monthly will be on the full amount of the original principal.

To illustrate, let us say for example that you take a loan for EC$100,000 at a flat interest rate of 8% per annum for 3 years. The estimated total interest that you will pay over the life of the loan, assuming that this rate does not included any consideration of compounding, will be calculated as follows:

$100,000 X (8 x 3) /100 = EC$24,000

Your estimated monthly loan payment towards the principal and interest will be calculated as follows:

($100,000 + $24,000)/(3 x 12) = $ 3,444.00

The **reducing balance interest rate** can be computed on a daily, monthly or annual basis. In a reducing balance interest rate the principal amount keeps reducing as you repay the loan. This means that you pay interest every month on that part of the original sum that remains unpaid up to that period.

To illustrate, let us use the same example of a loan for EC$100,000 at an interest rate of 10% per annum for 3 years. Applying the daily reducing balance interest rate method, the total interest that you will pay over the life of the loan will be approximately EC$16,162 and the monthly loan payments towards the principal and accrued interest will be approximately **EC$3,226.72.**

From the two illustrations it is obvious that you can end up paying much more in the case of an 8% loan calculated using the flat rate interest method rather than the 10% loan calculated using the reducing balance method. If a penny saved is a penny earned then understanding interest rates is your first step to saving and building wealth.

Proverbs 4:7 states:

"*Wisdom is the principal thing; therefore get wisdom: and with all thy getting get understanding.*"

We should all embrace this teaching in all aspects of our lives including our financial lives. Get Understanding.

SLW

ECSE
EASTERN CARIBBEAN SECURITIES EXCHANGE

A GLIMPSE INTO THE ECSE

Market Capitalisation—Equity Securities as at 25 March 2010

Name	Trading Symbol	Date Listed	Last Closing Price	Shares Outstanding	Market Capitalisation	Sector/ Industry
Bank of Nevis	BON	1-Oct-01	$6.00	7,478,150	$44,868,900.00	Financial Services - Banking
East Caribbean Financial Holding Company	ECFH	1-Oct-01	$14.50	24,215,589	$351,126,040.50	Financial Services
St Lucia Electricity Services	SLES	1-May-03	$25.00	11,200,000	$280,000,000.00	Utilities - Energy
TDC	TDC	3-Jun-03	$2.05	52,000,000	$106,600,000.00	Conglomerate
St Kitts Nevis and Anguilla National Bank Ltd	SKNB	3-Nov-03	$2.49	135,000,000	$336,150,000.00	Financial Services - Banking
Dominica Electricity Services	DES	3-Jun-03	$2.90	10,417,328	$30,210,251.20	Utilities - Energy
S L Horsford & Co. Ltd	SLH	4-Jul-04	$1.95	30,148,430	$58,789,438.50	Conglomerate
GraceKennedy Ltd*	GKC	5-Mar-05	$3.75	331,705,747	$1,243,896,551.25	Conglomerate
FirstCaribbean Int'l Bank*	FCI	20-Jul-05	$5.50	1,525,176,762	$8,388,472,191.00	Financial Services - Banking
Trinidad Cement Limited*	TCL	6-Dec-06	$3.55	249,765,136	$886,666,232.80	Manufacturing
Cable & Wireless St Kitts & Nevis Limited	CWKN	30-Jan-08	$6.00	33,130,418	$198,782,508.00	Telecommunication
Republic Bank (Grenada) Limited	RBGL	8-Jun-08	$55.00	1,500,000	$82,500,000.00	Financial Services - Banking
Grenada Electricity Services Limited	GESL	8-Jul-08	$10.99	19,000,000	$208,810,000.00	Utilities - Energy
Grenreal Property Corporation Limited	GPCL	8-Jul-08	$5.40	7,662,598	$41,378,029.20	Real Estate
Total Market Capitalisation					**$12,258,250,142.45**	

*** Cross listed securities**

DEFINITIONS

Market Capitalisation = No of shares outstanding x closing price of the shares

Shares Outstanding = Number of shares issued by a company

YOUR MONEY MEETING

Did You Know?

Rule of 72

The rule of 72 helps to determine approximately how many years it will take to double your money:

72 divided by the interest rate on your investment = No. of years to double your initial investment.

Based on the rule of 72, a $1,000 savings account earning 3% interest annually would take 24 years to double.

$$\frac{72}{3} = 24$$

A $50,000 fixed deposit earning 6% interest annually would take 12 years to double.

$$\frac{72}{6} = 12$$

360 vs 365-day loan year

Loans calculated on a 360-day basis can be more expensive than loans calculated on a 365-day basis.

e.g. -In the first month, a $100,000 loan at 10% interest calculated on a daily basis using a 365 day will incur $849.32 in interest compared to the same loan calculated on a 360 day basis which would incur $861.11 in interest.

*[(10 % x 100,000)/360] x 31 days =**861.11***

*[(10 % x 100,000)/365] x 31 days =**849.32***

Applying a 360-day year to calculate the daily rate extracts more interest from the borrower.

Asset Allocation Rule of Thumb

The rule of thumb for asset allocation advocates that an investor's fixed income allocation should be equal to his/her age.

That is, if he/she is 30 years old, he/she should be 70% invested in stocks, and 30% in fixed income instruments *(e.g. fixed deposits, Treasury bills, bonds.)* As the investor gets older the portfolio should be more heavily weighted to fixed income instruments.

The objective is to ensure that as one gets closer to retirement age one selects more conservative investments.