THE EASTERN CARIBBEAN
CENTRAL BANK

ANNUAL FINANCIAL STABILITY REPORT

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The ECCB welcomes your questions and comments on this publication.

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The Financial Stability Report is a publication of the Eastern Caribbean Central Bank. It aligns with the Eastern Caribbean Central Bank's financial stability objective by identifying, monitoring and communicating on systemic risks. The view is to enhance the resilience of the ECCU financial system by taking action to reduce or remove any threat to financial system stability. This is a key strategic priority of the Eastern Caribbean Central Bank and supports the Bank's objectives as it relates to growth, sustainability and employment.

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Abbreviations

AML/CFT	Anti-Money Laundering (AML) & Countering Financing of Terrorism
CAR	Capital Adequacy Ratio
ECAMC	Eastern Caribbean Asset Management Corporation
ECCU	Eastern Caribbean Currency Union
ECPGC	Eastern Caribbean Partial Credit Guarantee Corporation
FSU	Financial Stability Unit
GDP	Gross Domestic Product
IDA	International Development Association (IDA)
IFRS	International Financial Reporting Standards
LFI	Licensed Financial Institution
NBFI	Non-Bank Financial Institution
NPL	Nonperforming Loan
NSFR	Net Stable Funding Ratio
PARRT	Programme of Action for Recovery, Resilience and Transformation
RBC	Royal Bank of Canada
RBS	Risk-Based Supervisory Framework
SRU	Single Regulatory Units

The following symbols were used in this Report:

B	Billion
M	Million
L/A	Loans as a Proportion of Total Assets
L/L	Loans as a Proportion of Total Liabilities

Preface from the Governor

As the impact of the COVID-19 pandemic waned in 2021, the region experienced its first volcanic eruption in over two (2) decades. The eruption of the La Soufriere Volcano in St Vincent and the Grenadines is a reminder of the environmental risks facing the ECCU and its financial system. The ECCU is particularly exposed to environmental risks – particularly climate change risks – seen in the intense hurricanes experienced regularly. These increased environmental risks like others can have negative implications for the financial sector and the broader economy including households, businesses and member governments. These effects, are likely – by their nature to continue into the medium term especially as their impact increases in severity.

The ECCB remained committed during 2021 to serving the region well through enhanced partnerships and engagements to meet other challenges such as the negative spill-overs associated with the COVID-19 pandemic. The loan moratoria programme, which was endorsed by the ECCB and granted by the Licensed Financial Institutions and Credit Unions, was maintained throughout 2021 and brought much relief to households during the period. This initiative also contributed to the stability of the financial sector and whilst providing support to the real sector. Among other areas, we relentlessly pursued our strategic objective of developing a strong, diversified and resilient financial sector, and enhancing financial access and inclusion as the regulatory and monetary authority of the Eastern Caribbean Currency Union (ECCU).

This seventh edition of the Financial Stability Report seeks to highlight the key vulnerabilities and financial stability risks in the ECCU in 2021. It presents the implications of the ongoing pandemic on financial performance and soundness of ECCU commercial banks, credit unions, and insurers in 2021. The Report also shares key financial stability initiatives undertaken and planned. Based on in-house assessments of the resilience of the financial sector to future risks, a medium-term outlook for the region's financial system is given at the end of this Report.

We thank all contributors to this Publication, in particular, the Single Regulatory Units. May this Report update you on financial stability issues in our region, and ultimately inspire you to start or continue to be a part of the call for collective action towards further development of our region!

Photo Credit: Bing Image

SECTION ONE

Overview of Financial Stability in the ECCU

KEY INSIGHTS

1. Global economic activity recovered in 2021 following the unprecedented slowdown in 2020. This augured well for the ECCU, evident by the expansion in economic output relative to 2020.

2. However, the expansion in output was mitigated by several downside risks stemming from the war in Ukraine and the coronavirus pandemic.

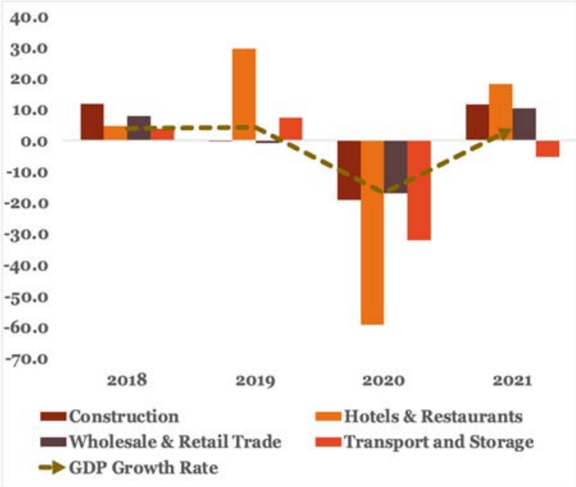
3. Despite the challenges, the ECCU financial system remained stable and resilient in 2021, backed by adequate capital and liquidity buffers.

4. Credit risk remained the most significant risk in the ECCU financial system in 2021. Asset quality improved marginally compared with 2020 however the ratio of non-performing loans remained above the prudential limit.

Global economic activity recovered in 2021 following the sharp downturn in 2020; a consequence of the coronavirus (COVID-19) pandemic. Global economic output grew by 6.1 per cent in 2021 from a 3.1 per cent contraction in 2020[1]. Despite divergences, the recovery was reflected in advanced economies and emerging markets and developing economies[1]. In advanced economies, GDP growth was 5.2 per cent, driven by activity in the United States of America (USA) – 5.7 per cent, the Euro Area (5.4 per cent) and a growth rate of 6.8 per cent in emerging markets and developing economies driven largely by China and India[1].

Similarly, economic activity in the ECCU expanded in 2021 relative to 2020. The ECCU recorded a growth of 3.9 per cent in 2021 with evidence of recovery in economic sectors that were most impacted by the pandemic (**Figure 1**). This contrasts with the contraction of 17.0 per cent reported in 2020. The economic recovery was underpinned by the increased rates of vaccination, relaxation of travel restrictions and expansionary fiscal policy measures adopted by governments at the domestic and international levels.

Figure 1: ECCU Real GDP Growth by Selected Economic Sectors



Nevertheless, the extent of the recovery was subdued by several downside risks. The emergence of new variants of the SARSCov2 virus, increased geopolitical risks stemming from the prospects for Russia's invasion of Ukraine, continued supply chain disruptions and elevated commodity prices weighed on the recovery. Notably, the rising commodity prices and ongoing supply chain disruptions threaten persistent inflationary pressures which can further impede recovery in the domestic economies.

[1] International Monetary Fund World Economic Outlook, July 2022

The expansionary fiscal measures implemented in the wake of the COVID-19 pandemic has contributed to a build-up in the ECCU debt levels and reduced the fiscal space for responding to other potential shocks. Public sector debt to GDP increased significantly from 65.9 per cent in 2019 to 88.9 per cent in 2021. The ECCU governments continue to commit to reducing debt levels to 60.0 per cent of GDP by 2035.

Despite the challenges, the ECCB financial system remained resilient. The commercial banking sector, the dominant deposit takers in the ECCU maintained adequate capital and robust liquidity positions in 2021. The profitability of the banking sector in terms of return on assets (ROA) improved marginally in 2021. The annualized return on assets for the sector increased by 0.3 percentage point in contrast to a 0.1 percentage point decline in 2020. Likewise, the credit union sector, the second largest deposit takers after the commercial banking sector remained broadly stable with capital and liquidity levels above the regulatory minimum. However, credit risk remains significant in the risk profile of ECCU commercial banks and credit unions. Although the moratoriums on loan payments during the pandemic restrained the growth of non-performing loans (NPLs) and preserved the resilience of the financial system, the ratio of NPLs in the commercial banking and credit union sector remain above the prudential limits. Loans extended to the private sector by commercial banking and the credit union sector increased in 2021. The increase in credit along with expectations for most institutions to end the moratoriums in the short-term, may mean that capital buffers may need to increase to mitigate associated risks.

The payment system continued to function effectively and was assessed as safe. During 2021 all system participants in both the ECACH and RTGS systems facilitated the clearance and settlement of financial services in a timely manner. The operational capacity of the ECACH was judged as adequate relative to the regular transaction processing needs of the system participants.

The insurance sector a major subsector of the ECCU financial system remained broadly stable in 2021. Key performance indicators for the insurance sector reflected robust capital buffers in 2021 – although lower when compared with capital buffers in 2020. Profitability was also notably lower, driven primarily by higher claims in some member countries and higher levels of expenditure.

1.2 Key Vulnerabilities and Risks

Vulnerabilities

During 2020, the ECCU member countries faced several key risks and vulnerabilities. These were environmental risks, increased levels of borrowing and debt by firms and households, increased financial sector leverage and funding risks – which can contribute to liquidity risks.

Environmental Risks

Environmental risks were heightened during the 2021 period, mainly on account of the eruption of La Soufrière volcano in Saint Vincent and the Grenadines that erupted in December 2020 and ended in April 2021. This eruption would have affected the northern portion of the main island of Saint Vincent, and spread ash clouds to neighbouring islands such as Barbados (on account of wind conditions). The destruction to property and infrastructure as a result of mudflows, heavy ash fall and a combination of factors contributed to financial losses. The financial sector and in particular, the insurance industry, remained resilient during the period, meeting claim requests, while commercial banks and credit unions continued to provide access to credit and other financial services during the first half of 2022.

Credit Risks

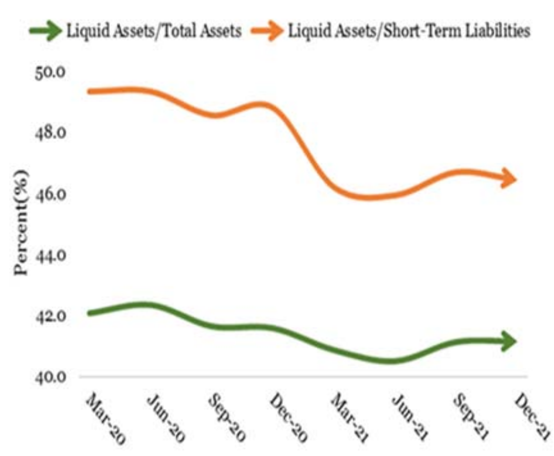
As 2021 closed, member countries experienced increased levels of inflation – primarily on account of global supply chain disruptions and increased debt levels due to unemployment in the tourism industry and tourism linked sectors in the ECCU. Increases in inflation can affect household incomes in the short to medium term and can lead to repayment challenges associated with loans and other forms of credit – contributing to increased credit risk. Compounding this issue, were the low levels of tourist arrivals recorded in 2021, which are likely to continue into early 2022. In a similar manner, a struggling tourism industry is likely to affect household incomes and contribute to increased credit risk. The non-performing loans ratio also rose to 11.7 per cent at the end of 2021, up from 11.4 per cent at the end of 2020, as the moratoria arrangements came to an end, and refinancing opportunities under those arrangements were limited (Figure *2*).

Figure 2: Non-performing Loans in the ECCU

Liquidity Risks

Liquidity risk remained low from 2020 into 2021. The high liquidity levels which were recorded prior to the pandemic provided adequate buffers for firms – including deposit-taking institutions (Figure *3*). However, liquidity levels are primarily high, on account of the limited opportunities for investment by deposit-taking institutions. Additionally, low liquidity risks were also maintained amongst insurance firms which although facing severe environmental risks in specific jurisdictions did not suffer from any major challenges.

Figure 3: Commercial Bank Liquidity in the ECCU



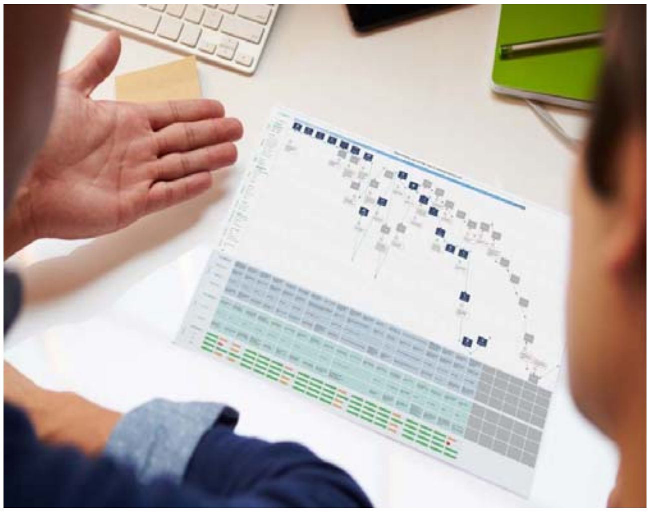
Market Risk

Market risks remained low during the 2021 period but varied across the financial system. This variation in risk can be attributed to specific factors in individual institutions, which can be traced to the asset mix of firms, duration of investments, the nature and currency profile of firm liabilities and overall risk appetite.

Concentration and Other Risks

The consolidation underway in the ECCU financial sector continued in 2021, as the sale of the assets of the Royal Bank of Canada to another consortium of local banks was finalised. The completion of this process points to a more concentrated commercial banking sector – which has one foreign branch bank in the jurisdiction. A more concentrated banking system can allow for greater scalability in services, and increased efficiency within the financial sector and likely amongst deposit-taking institutions. However, it also points to the likelihood of more systemically important licensed financial institutions which are larger in asset base. Additionally, with institutions which are too-big-to-fail limit the options for resolution within the financial system.

Other risks are also likely to appear as digital transformation of financial institutions is fast-tracked in response to the pandemic. Finally, both operational and sovereign risks are likely to remain unchanged from the 2020 period.



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SECTION TWO

Financial Performance and Soundness of Deposit-Taking Institutions: Banking and Credit Union Sectors

KEY INSIGHTS

1. The composition and size of the banking sector's balance sheet grew minimally compared with 2020.

2. The banking sector remained stable with adequate capital and robust liquidity levels. Profitability increased slightly and asset quality remained unchanged relative to 2020.

3. Balance sheet activity of the credit union sector expanded in 2021; driven largely by a growth in credit to the private sector.

4. The credit union sector maintained stability in 2021. Asset quality improved slightly and capital adequacy ratio remained above the prudential limit.

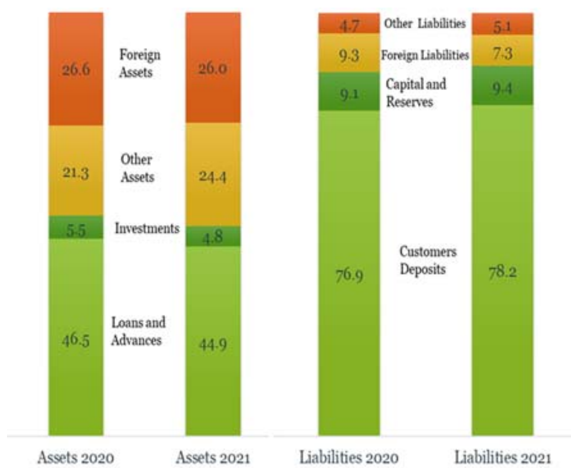
2.0 Financial Performance and Soundness of Deposit-Taking Institutions: Banking and Credit Union Sectors

2.1 Banking Sector

The commercial banking sector continues to maintain its position as the dominant deposit taker in the ECCU financial system. The asset base of the sector expanded by 6.8 per cent in 2021, which accounted for about 166.31 per cent of GDP. This compares with an asset to GDP ratio of 165.41 percent in 2020. The growth in assets was primarily due to an increase in accounts receivables, which grew by $0.85b or 212.7 per cent in 2021.

The composition of assets and liabilities changed minimally in 2021 (Figure 4). Total loans and advances increased by $0.4b in 2021; up from $13.2b in 2020. However, the increase in loans and advances was less than the increase in total assets, leading to a 1.8 percentage points decline in the share of loans and advances to total assets. Despite the slight drop in the per cent share, loans and advances remained the primary earning assets of the banking sector. Conversely, customer deposits continued to be the main source of funds for commercial banks. In 2021, consumer deposits rose to $23.7b; moving up from $21.8b in 2020. This accounted for 78.2 per cent of total liabilities; an increase of 1.3 percentage points relative to 2020 (Figure 4). The large holding of deposits in 2021 maintained the trend of previous years and signified that funding risk in the sector remained low.

Figure 4: Balance Sheet Composition of the Domestic Banking Sector



Moreover, in 2021, 65.0 per cent of banking sector deposits were held by households and business, most of which were savings deposits (Figure 5). These forms of deposits earn interest and can be withdrawn at any time.

Figure 5: Composition of Private Sector Deposits

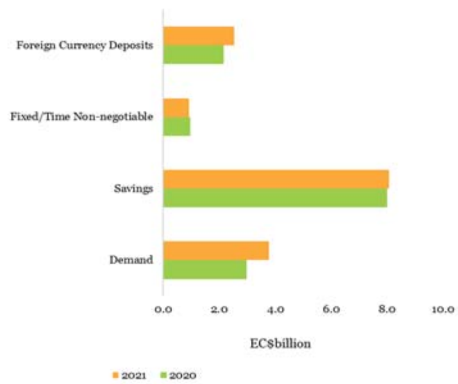
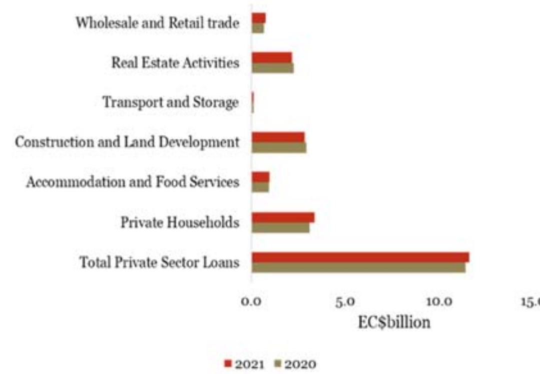


Figure 6: Distribution of Private sector Credit by Economic sector



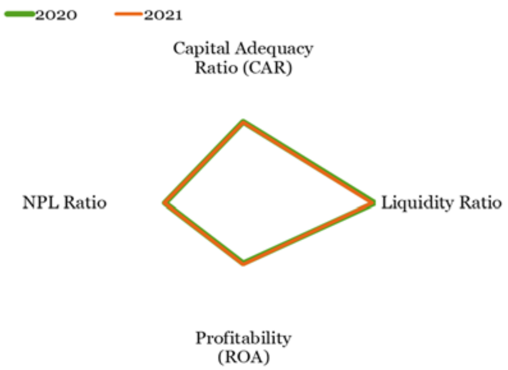
Commercial bank exposure to the private sector increased slightly in 2021. Private sector credit rose from $11.4b in 2020 to $11.6b in 2021. The increase was mainly driven by credit to households for purposes other than real estate activities, which rose by 0.3 per cent relative to 2020. However, marginal decreases in credit were recorded for real estate activities, and construction and land development (Figure 6). The growth in personal loans underscored the reliance of households on the banking sector and the increased risk to asset quality particularly during unfavourable economic conditions.

The contribution of private sector credit to GDP fell by 2.8 per cent in 2021 from 66.4 per cent in 2020.

Key performance indicators point to a stable commercial banking sector. The sector remained well capitalized with sufficient liquidity in 2021. Capital and liquidity levels changed minimally in 2021 relative to 2020 (Figure 7). The Capital adequacy ratio (20.0 per cent) and liquidity levels (56.8 per cent) remained well above the prudential benchmark of 8.0 per cent and 20.0 per cent respectively.

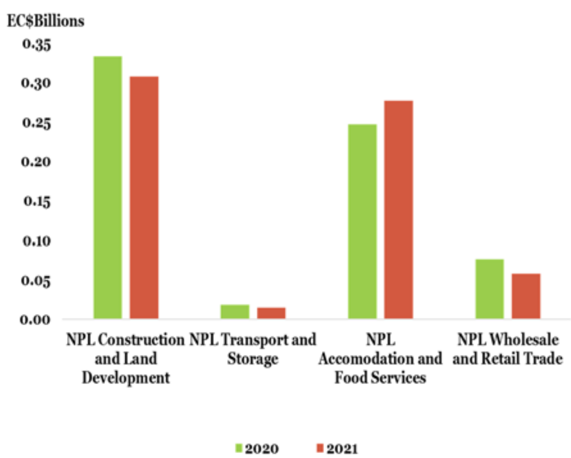
The profitability of the banking sector, measured by return on assets (ROA) increased marginally in 2021 (Figure 7), even as the earning capacity of the banking sector, measured by the credit-deposit ratio, fell slightly from 60.5 per cent to 57.4 per cent. Additionally, the NPL ratio was relatively unchanged in 2021 (Figure 7).

Figure 7: Key Performance Indicators (2020 and 2021)



With the exception of Accommodation and Food Services, the NPL ratio of loans in sectors hardest hit by the pandemic declined slightly relative to 2020 (Figure 8).

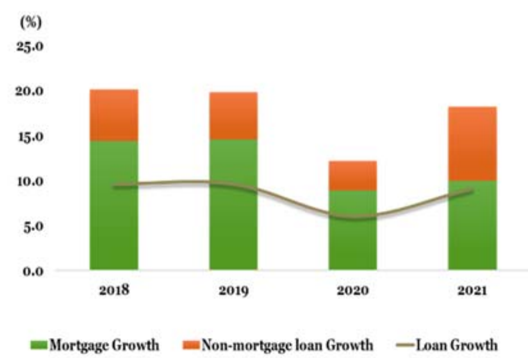
Figure 8: Non-Performing loans (NPL) by Selected Economic Sectors



2.2 Credit Union Sector

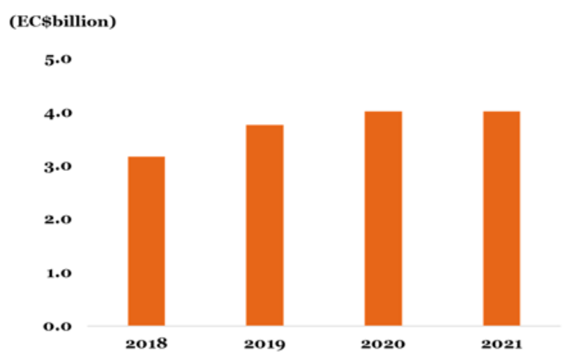
The credit union sector expanded in 2021, after reporting a decline in balance sheet activity in 2020. Total assets of the sector grew marginally by 0.4 percentage points to 8.4 per cent in 2021. This follows a 2.3 percentage points decline in 2020. Loans to the private sector which accounted for 68.0 per cent of total assets in 2021, increased to 9.1 per cent after recording a 3.6 percentage point decline in 2020 (Figure 9).

Figure 9: Loans in the Credit Union Sector



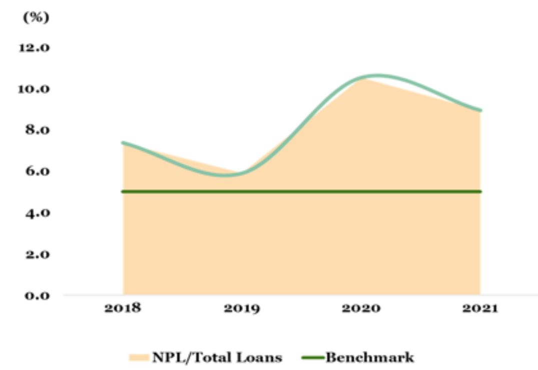
The growth in credit was largely driven by mortgage loans, which rose by 1.1 percentage points to 10.0 per cent in 2021. This contrasts with a 5.7 percentage points decline in 2020 and underscores the increased exposure to the real estate sector. Total non-mortgage loans grew by 4.9 percentage points to 8.1 per cent in 2021; marking a larger increase than total mortgage loans. Total deposits for the sector in 2021 remained relatively unchanged at $4.0b (Figure 10).

Figure 10: Deposits in the Credit Union Sector



Credit risk remained the greatest risk for the sector. The ratio of non-performing loans to total loans (NPL ratio) fell slightly, moving from 10.4 per cent in 2020 to 9.0 per cent in 2021 (Figure 11). This contrasts with an increase of 4.5 percentage points to 10.4 per cent in 2020 during the coronavirus pandemic. Despite the decrease in 2021, the ratio remains above the 5.0 per cent prudential benchmark.

Figure 11: Non performing loan ratio in the Credit Union Sector



The capital position of the credit union sector was adequate in 2021. Capital adequacy, namely institutional capital to total assets, was above the prudential limit. The ratio stood at 11.6 per cent in 2021; representing a 1.6 percentage points above the 10.0 per cent benchmark and slightly less than the 11.9 per cent recorded in 2020 (Figure 12).

Figure 12: Capital Adequacy in the Credit Union Sector

Photo Credit: Bing Image

SECTION THREE

Financial Performance and Soundness of Non-Deposit-Taking Institutions: Insurance Companies

KEY INSIGHTS

1. In the insurance sector, gross premiums in the ECCU rose, and total claim payments also increased in 2021.

2. Insurers maintained strong capital buffers in 2021 despite lower levels of profitability in several member countries.

3. Profitability across the insurance sector was mixed – as evidence by the combined ratios.

3.0 Financial Performance and Soundness of Non-Deposit-Taking Institutions: Insurance Companies

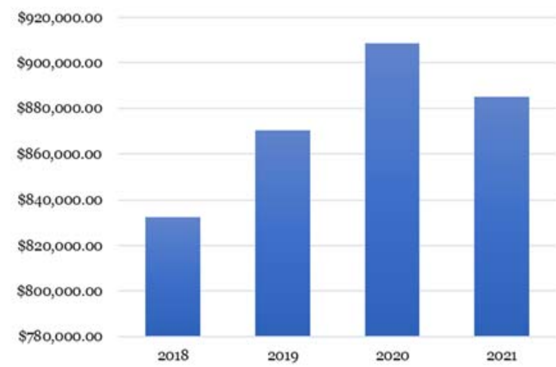
During 2021, the insurance sector was challenged with COVID-19 related exposures and the environmental risks associated with the volcanic eruption in Saint Vincent and the Grenadines. Although COVID-19 was of global proportions, the environmental risk associated with the volcano was significantly more localised with reverberating effects on countries located close to the eruption. Nevertheless, the sector remained stable and negative spill-overs of these macro-financial risks were mitigated.

Aggregate Premiums

Aggregate premiums collected by the industry during 2021, rose to EC$885.1m, a smaller increase than that of EC$908.4m (revised) in 2020. Premium activity continues to be driven by activity in the non-life insurance industry – which represents approximately 55.8 per cent of all premiums collected. This higher level of non-life insurance is mainly attributed to its requirement for motor vehicles and as property insurance for mortgages. Demand for life insurance is – on the other hand – less elastic and as such is likely to draw lower levels of revenue.

Figure 13: Aggregate Gross Premiums written in the ECCU

Gross premiums written fell across all sectors and countries...

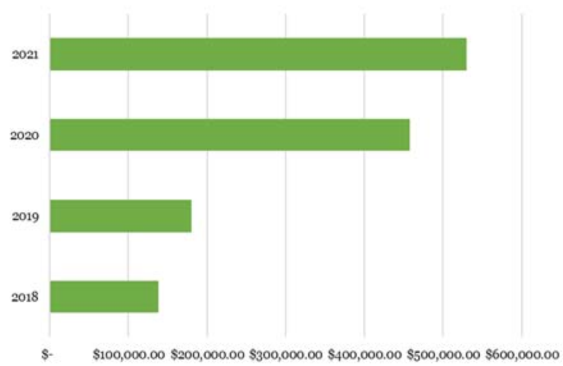


Claim payments

Net claims increased in 2021 driven primarily by the increased environmental risks. Net claims incurred rose to EC$245.5m in 2021, mainly driven by increased claims in Saint Vincent and the Grenadines and Saint Lucia. Claim increases in Saint Vincent and the Grenadines were attributable to higher non-life insurance claims, whilst life insurance claims would have driven claims expense in

Saint Lucia. Although, claims increased in both of these countries, the stability of reinsurance arrangements ensured that payments were met in 2021.

Figure 14: Net Claims Incurred in the ECCU – 2021
Maintaining claim payments are a combination of the insurance firm's stability and the stability of reinsurance firms...



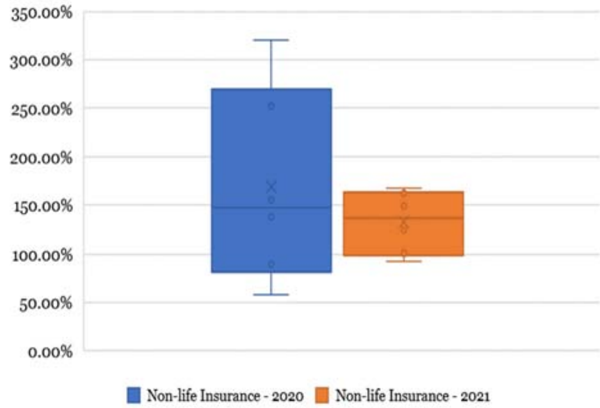
Life insurers continued to maintain strong capital buffers during 2021. In contrast to 2019, where capital buffers ranged between 30.0 per cent and 40.0 per cent, the capital to total assets ratio ranges from 19.1 per cent to 86.7 per cent in 2021. The median value for the capital to assets ratio rose to 55.6 per cent, an improvement over 2020's ratio of 43.0 per cent and 2019. Similarly, a wide dispersion amongst capital positions remained in 2021, suggesting losses in capital positions during the period relative to 2020. The higher ratios are therefore attributed to increased total assets.

General insurers also maintained robust capital buffers into 2021. Similar to life insurers, the dispersion of capital ratios amongst general insurers was also wide. The net premiums to capital ratio ranged from 10.3 per cent to 81.3 per cent. This range in ratios can be linked to the lower levels of premiums collected in some member countries – while total asset levels remained stable. However, despite some ratios on the lower end, of the range, technical reserves remained adequate to support the sector during the 2021 period.

Profitability in the insurance sector was notably lower in 2021, when compared with 2020. Combined ratios for both the life and non-life segments of the business were also notably lower and reflective of the low interest rates, high expenditure and increased claim environment faced by the sector.

Figure 15: Profitability in the Life and Non-life Insurance Segments

Non-life insurance profitability remained robust although having declined on aggregate to 115.3 per cent in 2021 when compared with 128.4 per cent in 2020…



Life insurance profitably was also strong declined on aggregate to 120.0 per cent in 2021 when compared with 219.4 per cent in 2020…

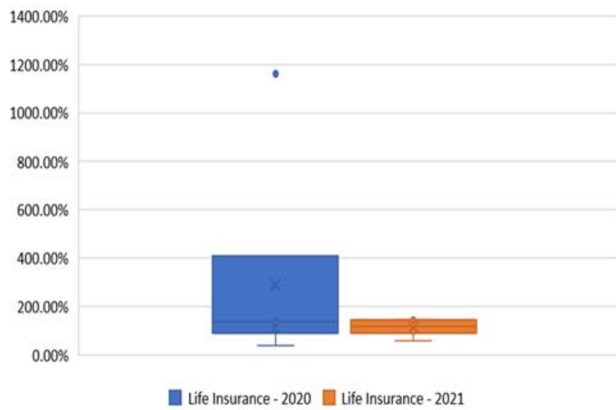


Photo Credit: Bing Image

SECTION FOUR

Policy Initiatives for Enhancing Financial Stability in the ECCU

KEY INSIGHTS

1. Unprecedented policies and responses including the loan moratoria helped to contain the impact of the COVID-19 pandemic and other environmental risks on the ECCU's financial system.

2. Enhanced monitoring, supervision and collaboration all supported the stable financial environment.

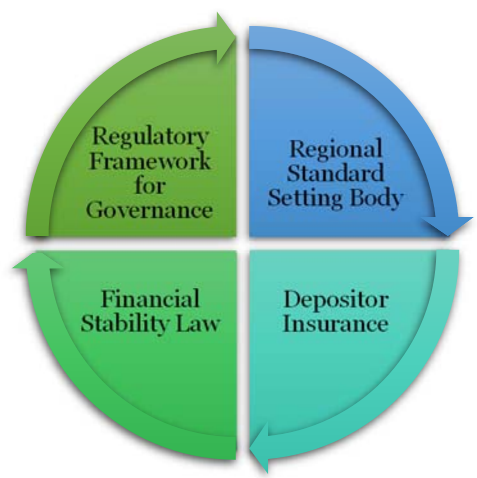
3. The ECCB has also initiated efforts at designing a taxonomy to support developments in greening the financial sector.

4.0 Policy Initiatives for Enhancing Financial Stability in the ECCU

The ECCB continues to strengthen its policy-making framework to support and enhance financial sector resilience in the ECCU. Enhancing financial sector resilience through effective policies also contributes to the maintenance of a stable currency and can redound to the reduction of financial sector risks. Reducing these risks can contribute to safety for depositors, enhance consumer protection, increasing access to credit and lead to positive developments in domestic financial markets. These initiatives are important given the multiple macro-financial risks faced in 2021, including COVID-19 and environmental risks such as the volcanic eruption in Saint Vincent and the Grenadines.

Efforts continue at implementation of the Programme of Action for Recovery, Resilience and Transformation (PARRT) for the ECCU. This framework was approved by the Monetary Council of the ECCB in October 2020 and focuses on medium-term actions at both the national and regional levels. Included within the PARRT is the Development and implementation of an Optimal Regulatory Framework – which has started. An initial policy framework has been developed and approved by the Monetary Council in July 2021 and provides guidance on several areas and proposes actions for financial stability.

Figure 16: Key Financial Stability Actions Proposed in the PARRT for 2020-2021



Access to credit also remains a pressing concern for the ECCB and by extension the people of the ECCU. The implementation of the

Credit Bureau will aid in enhancing this objective.

Regionally and locally, work continues apace on the enhancement of supervision for licensed financial institutions and institutions regulated by the Single Regulatory Units. To this end, the ECCB continues to design and enhance standards according to the Basel Accords whilst insurance firms within the ECCU are expected to incorporate IFRS17 into their reporting framework in 2023. This accounting standard and its application, which were initially scheduled for 2021, were delayed. Additionally, Saint Christopher (St Kitts) and Nevis passed the Virtual Assets (Amendment) Bill 2021 – strengthening regulation of those asset types.

In addition to the enactment of legislation, the ECCB and the SRUs worked with institutions to extend the loan moratoria to support households affected by COVID-19 and the volcanic eruption in Saint Vincent and the Grenadines, the latter of which would have displaced more than 15,000 persons from affected zones on the main island of St Vincent.

The ECCB has begun efforts at designing the necessary taxonomies to facilitate the incorporation of environmental risks into LFI portfolios. Environmental risks pose a significant threat to the ECCU and may occur in the form of hurricanes, earthquakes and volcanic eruptions. More on environmental risks, especially climate change, can be found in the box below.

Box 1: Environmental and Climate- related Risks and Macroprudential Analysis

What are environmental and climate-related risks?

According to the Network for Greening the Financial System (NGFS) Comprehensive Report, environmental risks, "relate to risks (credit, market, etc.) posed by the exposure of financial sector firms and activities that may cause or be affected by environmental degradation. Climate related risks focus on the exposure of financial firms and the financial sector to physical and transition risks caused by or related to climate change."

In November 2021, COP26 concluded with the adoption of the Glasgow Climate Pact and the recommitment to reach global net zero emissions by 2050. In addition to this agreement, countries also agreed through collective action to maintain the target of 1.5-degree global warming target. This target and discussions at COP26 have revealed that urgent and immediate action is required to combat the challenge of climate change.

Small open and vulnerable economies such as the member countries of the ECCU have and will continue to be buffeted by the effects of climate change such as increasing temperatures and rising sea levels. More intense and potentially frequent storms and other severe weather conditions such as droughts are some of the effects of climate change already being felt by ECCU member countries. These effects, although causing real physical damage can have feedback effects to real economic activity which are likely to be transmitted to the financial sector through insurance firms, pension funds and licensed financial institutions.

Climate Change Risks and Financial Stability

Of the environmental risks considered, perhaps the most urgent of these are risks for the ECCU are associated with changes to the climate.

Physical Risks
These risks are associated with events linked to climate change such as hurricanes, floods and heat waves. Longer-term negative shifts in temperature are likely to cause more intense events.

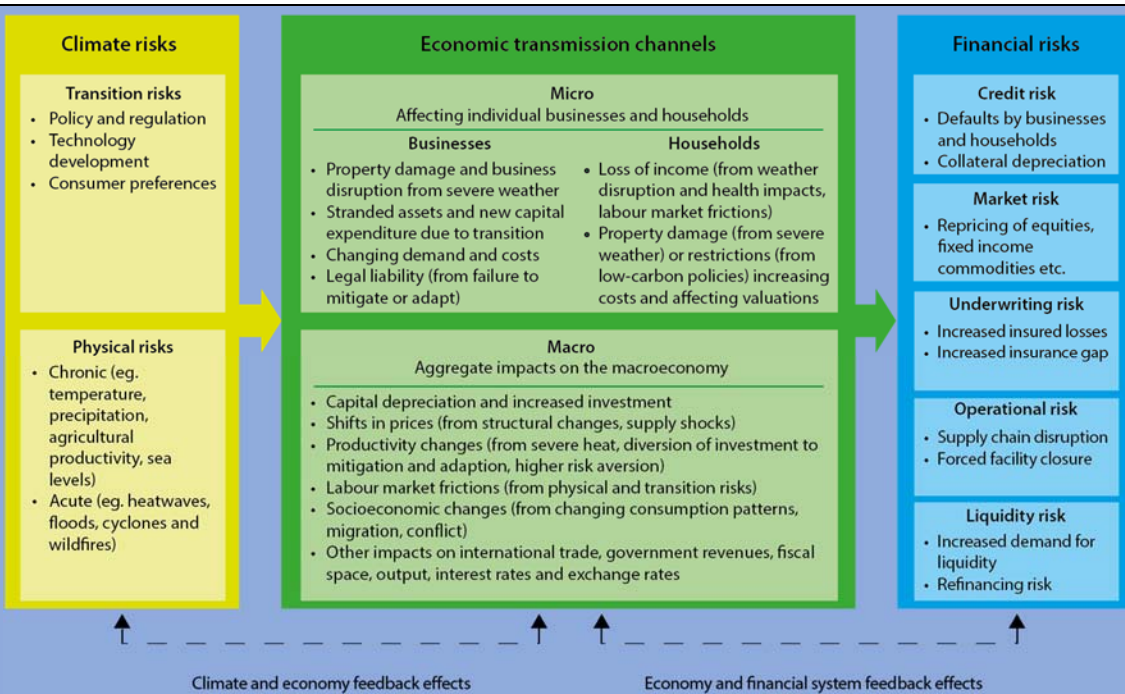
Transition Risks
These risks are related to policy changes, regulatory impacts and policy changes as countries transition towards a low carbon economy. This transition includes but is not limited to transitions in energy markets, transportation, supply chains (natural resource) and financial services. Transition and physical risks are likely to have negative impacts on asset values and can even affect cash flows.

Transmission Channels

The physical and transition risks outlined above are likely to affect the economy through microeconomic and macroeconomic channels. These may range from a reduction in revenue and profits in firms and other businesses, especially small businesses along with loss of income to households due to damage to property and other negative externalities associated with the climatic event. At the macro level, intense climatic events can lead to losses in productivity and labour market disruptions. Additionally, there may be socioeconomic changes and other disruptions such as reduced trade and even lower travel to the affected destination. These channels then generate increased risks to the financial system which may materialise in the form of, (1) Credit Risk, (2) Market Risk, (3) Underwriting Risks, (4) Operational Risks and (5) Liquidity Risks. These risks can then feed back into the economy at both the micro and macro levels.

ECCB Policy

The Eastern Caribbean Central Bank in recognising the importance of climate change has begun consultations on the development of a taxonomy to guide the incorporation of environmental risks into microprudential supervision. These efforts are expected to contribute both to increased financial stability – especially in the face of environmental risks but also contribute to achieving the climate change targets as established in Paris and Glasgow.



Source: Transmission Channels, Network for Greening the Financial System

Photo Credit: Bing Image

SECTION FIVE

Outlook

KEY INSIGHTS

1. The economic recovery which began in 2022 has been significantly tempered by the War in Ukraine and higher levels of inflation.

2. The anticipated positive performance of deposit-taking institutions will be supported by robust capital buffers and high levels of liquidity.

3. The insurance sector although facing some weakness in 2021 is likely to remain stable in 2022 given robust capital and more than adequate levels of liquidity.

5.0 Outlook

The general economic recovery, which began in 2021, has now been tempered significantly on account of the War in Ukraine, higher levels of inflation and an economic slow-down in China. With increased levels of inflation, it is anticipated that advanced economies will increase and continue increasing interests to align inflation with monetary policy objectives.

Within the ECCU, the region which continues to grapple with the effects of high inflation and the gaps in air and sea transportation – especially as price takers within the global economy. The effect of inflation will dampen real household income and thereby influence debt repayment and consumption in the near term. Consequently, macroeconomic output will likely be lower with negative impact on longer-term credit dynamics.

Environmental risks remain major concerns but are likely to be mitigated to a large extent by robust capital buffers and high levels of liquidity.

Despite these downside risks, financial stability is expected to be maintained, consistent with economic activity in 2022.

Outlook for Deposit-Taking Institutions

Deposit-taking institutions are expected to remain stable during 2022, despite increased levels of credit risk, attributed to lower real wages – which can affect repayment. Additionally, institutions remained concentrated on the household sector which can have feedback effects should unemployment rates increase and persist over the medium term. Environmental risks are also a cause for concern in light of the prevalence of hurricanes and the geological make-up of most member countries – being volcanic.

Outlook for Non-Deposit Taking Institutions

The insurance sector, despite several mixed indicators, performed well; and is expected to continue to improve. Risks to this outturn include major environmental and health risks associated with the hurricane season, the lingering COVID-19 pandemic and the presence of any new public health challenges. Capital buffers are expected to remain stable and robust, whilst exposure to investments such as fixed income instruments will likely be maintained.

Continuous monitoring of insurance sector liquidity and reinsurers will contribute to the stability of the domestic insurance sector in the ECCU. Although stable reinsurers suffered substantial losses from catastrophes in the past few years. A continuation of this trend, can therefore have negative implications for domestic insurers.

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