Statement by Mr. Jennings, Executive Director,
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and Ms. Edwards, Advisor to the Executive Director,
on Eastern Caribbean Currency Union
July 27, 2022

Our Eastern Caribbean Currency Union (ECCU) authorities welcome the Staff Report and other related documents for the 2022 Common Policies Discussion. The report broadly reflects developments in the Currency Union within the context of the ongoing COVID-19 pandemic and the impact of Russia's invasion of Ukraine and acknowledges the efforts being pursued to address the current challenges. Our authorities appreciate their ongoing engagement with Fund staff and the open and frank dialogue and broadly concur with staff's analyses and recommendations.

Recent Economic Developments, Outlook, and Risks

ECCU economies continue to feel the effects of the lingering COVID-19 pandemic and the impacts of Russia's invasion of Ukraine. Gross Domestic Product (GDP) for the ECCU is estimated to have expanded by 5 percent in 2021, following a sharp contraction of 17½ percent in 2020. Economic activity has been largely uneven across the currency union with robust rebound in the tourism sector in some tourism-dependent countries, but activity remains low in others. Likewise, construction activity in some countries has led to economic growth but high prices supply chain and shipping issues are muting activities in the construction sector in some economies. Early indications are that the ECCU economies could grow by 7½ percent in 2022 and converging to around 2¼ percent over the medium term. Inflation is expected to peak in 2022 to above 5½ percent, reaching as high as 7 percent in some countries from 1½ percent in 2021. These price increases are driven by rising food, fuel, and transportation prices.

The current account deficit, estimated at 16¾ percent of GDP in 2021, remains high as stronger imports more than offset tourism receipts. International reserves remain stable and the currency backing ratio stood at 95.4 percent as at end-February 2022.

Inflation poses a major risk to the outlook. Our authorities are grappling with an inflationary shock whose duration is uncertain and which is posing a fiscal challenge and threatens to undermine growth prospects and social outcomes.

Fiscal Policy and Debt Management

The fiscal situation of ECCU member countries has deteriorated, and fiscal deficits remain high. Revenues declined with the implementation of measures to mitigate the impact of the pandemic while expenditure increased as authorities increased spending on health services and introduced measures to sustain employment, protect the vulnerable, and cushion the impact of rising food and fuel prices. Debt levels have increased as countries borrowed to meet the additional costs associated with the pandemic and to support the public investment program. Overall public debt in 2021 is estimated at around 85 percent of GDP.

Our authorities remain committed to achieving the 60 percent debt to GDP ratio by the target date of 2035. They recognize that stronger fiscal consolidation efforts are required and towards that end, countries have started the process of enhancing their fiscal framework including the establishment of fiscal rules. We take note of Annex VI on *"Lessons for the ECCU and Its Members from Countries' Experience with Fiscal Rules"* and the Selected Issues Paper section on *Fiscal Rules in Disaster-prone Countries: Implications for the ECCU"* and appreciate staff's guidance on how the work being done in the ECCU can be further improved.

Strengthening public financial management remains a vital activity. Our authorities see the measures adopted to address the pandemic and the impact of Russia's invasion of Ukraine as necessary at this time. It is not expected that measures will be unwound prematurely, but as the recovery takes hold, they acknowledge the necessity to gradually reset the parameters in pursuit of fiscal and debt sustainability. That said, they are also mindful of the several downside risks that could impact their ability to increase domestic revenues. Authorities are particularly concerned with the risks associated with the Citizenship by Investment (CBI) Programs. They have taken steps to strengthen the governance in the operation of these programs and are willing to collaborate with European and U.S. counterparts to settle any concerns that they may have about the integrity of their CBI programs. Steps are also being taken to improve the efficiency in the delivery of government services to reduce discretionary expenditure in order to have the fiscal space to provide support to the vulnerable, to continue to address the health concerns and to accelerate the implementation of the capital program.

Access to concessional financing for building resilience is key. A substantial part of the debt of the ECCU countries was contracted to respond to the impact of climatic events and our authorities know firsthand the imperative of building resilience. They welcome the establishment of the Resilience and Sustainability Trust (RST) which acknowledges the vulnerability of Small Developing States (SDSs) to external shocks but remain concerned that relatively high debt levels in ECCU countries may preclude them from gaining access to the RST. Our authorities also anticipate that the RST will serve as a catalyst to access other climate funds which have so far been left largely untapped because of the complexity of the application process. The assistance of the Fund is crucial on this matter.

Financial and Monetary Sector Developments

Financial sector conditions have remained broadly stable, but efforts will continue to ensure financial stability in both the bank and non-bank sectors. The level of non-performing loans remains high and requires special attention from the Eastern Caribbean Central Bank (ECCB) as the regulator and supervisor of the banking sector as well as from the regulators of the non-bank sector. As at end March 2022, moratoria on loans granted at the start of the pandemic have been unwound and we take note that this may have the effect of increasing NPLs in the near term. Therefore, asset quality and provisioning for bad assets will remain in the spotlight in keeping with the ECCB's new provisioning guidelines.

Our authorities accept that the financial sector can benefit from improved coordination on regulation and supervision. The proposed new Regional Standards Setting Body (RSSB) is intended to help the ECCU non-banks operate under a common regulatory rulebook and improve the quality of regulation and supervision.

In keeping with the efforts to build resilience, our authorities support initiatives for strengthening supervision, reporting and regulatory frameworks against climate change risks. The ECCB is fully committed to undertake these initiatives and has launched an ambitious program to integrate climate risks in supervisory and regulatory frameworks including the implementation of a technical assistance project to build capacity in ECCU regulators and financial institutions. We also take note of the results of the assessment in Annex VIII on *"Natural Disaster Impact on the ECCU Banking System Asset Quality"* as it gives further guidance on addressing climate risks in the banking sector.

Maintaining a strong currency continues to be a major policy objective. Despite the economic challenges and the uncertainties in the external sector, the exchange rate parity with the US dollar has remained fixed. The fixed exchange rate policy has served the region well and given confidence to potential investors. Foreign reserves remain high and no change in the exchange rate is anticipated.

In support of strengthening governance in the financial sector, our authorities will continue implementing reforms targeted at improving the AML/CFT framework and to pursue initiatives to prevent further loss of correspondent banking relationships (CBRs) by adopting global regulatory standards. **The loss of CBRs remains a concern for the region as it poses a risk to financial stability and every effort is being made to minimize the materialization of these risks**.

Looking ahead, the implementation of measures to increase credit will be pursued. Under the guidance of the ECCB and the approval of the Monetary Council, country authorities are committed to passing the necessary legislation including those related to the establishment of the credit bureau, foreclosure, and solvency. In addition, they have participated in the Eastern Caribbean Partial Credit Guarantee Corporation that aims to address collateral constraints to access credit by micro, small and medium-sized enterprises (MSME) and to provide capacity development. The introduction of D-Cash (central bank digital currency) with the appropriate safeguards offers a new opportunity to increase economic efficiency and foster financial inclusion. The ECCB will intensify its public education on this payment instrument to increase participation by ECCU citizens. The formalization of crisis management plans remains work in progress and on completion will provide a framework for financial institutions to respond to unanticipated events.

Achieving Sustained and Inclusive Growth

Economic recovery post pandemic and within the context of Russia's invasion in Ukraine will be challenging for the ECCU. To boost tourism arrivals, and within the context of an improving health environment, our authorities have removed several of the COVID-19 mandates. To date, arrivals have increased but are still well below the pre-pandemic period and with an uneven distribution among various ECCU member countries. Inter-regional travel is important to boosting tourist arrivals in the ECCU, but the gap created by the diminished service offered by the regional airline LIAT has not been fully addressed and poses a major challenge that requires concerted and urgent action to improve regional transportation. Additionally, our authorities continue to make investments in other sectors such as agriculture, physical infrastructure, renewable energy, and digitalization. However, supply chain and transportation constraints could thwart the timeliness and success of these interventions.

Addressing climate change remains a priority for the region. Our authorities have adopted comprehensive adaptation programs which are being implemented through the public sector investment program with a focus on building resilient housing and climate proofing public infrastructure such as schools, health facilities and roads. At the same time, they expect to accomplish the commitments given on the nationally determined contributions. Our authorities continue to advocate for concessional financing and grants to finance resilience building and for debt accumulated to address response to climatic events to be treated differently.

Regaining losses of human capital is vital. The ECCU Region will require a good quality labor force to support the recovery process. Investments in education will be needed to address the fallout from extensive school closures during the height of the pandemic and to provide remedial opportunities to those that may have been left behind due to constraints related to online learning. Retooling of displaced workers and investment in skills development and broadband technology is also part of the strategy being adopted. Support to the health sector will also continue, to minimize future impacts of COVID-19 including the emergence of new variants and to increase vaccination coverage. In pursuing these reforms, our authorities will ensure gender equity and that there are benefits for the youth.

Advancing structural reforms to enhance competitiveness and resilience is essential. To address the increasing cost of food and fuel, greater investments will be undertaken. In regard to food, the ECCU member states are part of an initiative to increase food production in the wider Caribbean and to reduce imports from outside of the Region. Regarding fuel, our authorities are seeking to accelerate their plans to transition to greater use of renewable energy and are focused on increasing investments in wind, solar and geothermal energy systems. These actions will not only address the current inflationary concerns but will take the ECCU closer to the goals they have set themselves with respect to addressing climate change.

Capacity Development

Capacity development is required to support the implementation of the ECCU recovery plans. Technical support is required at both the country and institutional level and our authorities are open to varying modalities for delivery of technical assistance. Our authorities are grateful to the Fund's area and functional departments as well as the Caribbean Regional Technical Assistance Centre (CARTAC) for their tremendous efforts in facilitating capacity building in the ECCU. Considering the critical expanding policy agenda, such as climate change, digitalization and data analytics, the replenishment of CARTAC is important for supporting the member countries with their policy reforms. We look forward to the continued strong support of CARTAC's work in the Region.

Conclusion

Our authorities express appreciation to the Fund and in particular the staff of the Western Hemisphere Department for their tireless support and advice.

Significant challenges and downside risks threaten the success of the development plans for the ECCU region, but our authorities are not daunted by the tasks that lie ahead. They will continue to address the immediate imperative of high food and fuel prices and to protect the vulnerable from these impacts but will not lose sight of the long-term goals of addressing climate change, pursuing fiscal and debt sustainability, and the attainment of inclusive and sustainable growth. The pursuit of a development agenda under the umbrella of regional integration will no doubt be more effective and the ECCU member countries have demonstrated their ability to work together.

Our authorities also remain committed to enhancing the quality of National Statistics to ensure accurate reporting that will form the basis for quality advice.

Our authorities anticipate the continued support of the international community, including the Fund, in the pursuit of their development goals.