

REVIEW OF MONETARY AND CREDIT POLICIES

IN BELIZE 1978 - 1983

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The views expressed in this paper are not necessarily those of the Central Bank of Belize.

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REVIEW OF MONETARY AND CREDIT POLICIES IN BELIZE

1976 - 1986

This paper traces the factors leading to the formulation and implementation of monetary policy in the Belizean economy during the years 1976 - 1986. An attempt is also made to analyse the degree of success achieved in reaching policy objectives. Section I provides a brief introduction to the Belizean economy and a description of the Currency Board system in operation prior to the establishment of the Monetary Authority of Belize in 1978. Section II assesses the impact of the Authority on the economy in its first three years of operations, while Section III discusses the degree of success of the Authority's attempt to influence the level and growth of monetary variables in 1979. Section IV provides a critical look at the series of monetary policies pursued as part of an IMF Standby Arrangement since late 1984. Finally, Section V appraises the capacity of the central monetary authorities to influence monetary variables in a manner that would ensure that the short-run objectives of monetary and exchange rate stability are consistent with long-run goal of balanced growth.

I: THE CURRENCY BOARD SYSTEM

Belize's economy is, and has always been, based on primary production for export. Timber, first logwood and later mahogany, constituted the mainstay of the economy until the 1950's when it was replaced by citrus. But since the 1960's sugar has been responsible for more than 50 percent of export earnings. Currently, agriculture and agriculture-based products account for close to 25 percent of GDP, while manufacturing contributes less than 10 percent. In addition to the skewed production base, the openness of the economy renders it extremely vulnerable to external influences. In 1985 exports and imports were 52.7 percent and 69.3 percent, respectively, of GDP.

The openness of the economy, and the dysjuncture between production and consumption were both exacerbated by the absence of a developed capital market and regulatory monetary authority. Until 1978, the four commercial banks in operation (three foreign and one local) functioned with virtually no public sector supervision. With the Belize Board of Commissioners of Currency as the central monetary authority serving only as a money-changer and in the face of unavailability of attractive short-term investments locally, the banks tended to look outside the economy more often than was desirable.

The Belize Board of Commissioners of currency operated from 1894 to 1976 and its primary function was to "provide, issue and re-issue currency notes and coins of the country." While theoretically the scope existed for the Currency Board to formulate and administer monetary policy in the country, there is little evidence of any attempt in this direction. The Board essentially functioned passively as a clearing house for

transactions involving exchange of foreign currency for Belize dollars or vice versa.

Up until 1937 the Board's primary obligation was to issue the Belize dollar in return for US 'current gold coin' and to redeem Belize dollars in return for silver or gold. As a precaution to ensure free convertibility at all times two-thirds of the face value of the note issue had to be kept as gold reserves to meet demands for redemption. The balance could be invested. This was amended in 1937, when the link with gold was severed, and the new regulations obliged the Board to issue and redeem the local dollar on demand in return for the US dollar. A new feature introduced at this juncture was the ability to maintain reserves in the form of interest-bearing investments. By 1940 amendments to the law allowed for convertibility of the Belize dollar into sterling also. However, in 1949, following the devaluation of the pound sterling and the massive reserve losses suffered by the local economy, the link with the US dollar was severed and the Belize dollar was linked to the pound sterling at BZ\$4.00 = 1.00. This rate of exchange prevailed until May 1976 when, because of the deterioration of the strength of the sterling on foreign exchange markets, the Belize dollar was once again pegged to the US dollar, this time at BZ\$2.00 = US\$1.00.

The requirement throughout this period that the Belize dollar be backed at all times by gold, US dollar or sterling served to circumscribe the Currency Board's function to that of money-changer. It also severely restricted its practical capacity to influence the money supply. Thus by default, the major determinants of the level and growth of the money supply became the balance of payments and the commercial banks. The former was a natural consequence of the openness of the economy and the high propensity to import, while the latter's power derived from their credit creation ability. The commercial banks' use of their power to determine economic growth in Belize proved to be inimical to the development of the country. The banks deepened the country's dependence on a mono-crop by channelling the bulk of their loans to the sugar industry. The other sector to receive large amounts of bank credit was the distributive sector, which is comprised primarily of importers. So the banks, operating with a virtual absence of controls helped to widen the dysjuncture between production, which was for export, and consumption which perforce had to be of imports. In November 1976 two ordinances were passed which sought to change, or at least modify, this situation.

II THE MONETARY AUTHORITY OF BELIZE ORDINANCE 1976 AND THE BANKING ORDINANCE, 1976

The Monetary Authority of Belize Ordinance 1976 (No. 9 of 1976) was passed into law on 1st November 1976, by Statutory Instrument No. 60 of 1976 with the following objectives:

- a) to manage the currency of Belize;

- b) to perform banking services for the Government for the banks, and other financial institutions operating in Belize, and for foreign central banks and international organisations and financial institutions;
- c) to assure monetary stability in Belize and to promote monetary conditions which are conducive to the balanced growth of the economy of Belize and which are compatible with the policy of the Government;
- d) to maximise and mobilise savings and to optimise the distribution of credit in Belize;
- e) to ensure that the foreign exchange reserves of Belize are administered in the interest of the economy and in accordance with the economic policy of the Government; and
- f) to ensure that the business of the banks and other financial institutions operating in Belize is conducted in the interest of their customers and of the general public and consistent with the economic policy of the Government.

Here we see that while the primary function of the central monetary authority remains the issue of currency, there is also scope for influencing monetary variables in the economy. The Authority was empowered to utilise the traditional tools of monetary control, namely, open-market operations, discount rate, reserve holdings, liquid asset holdings and selective controls. Seen as a prerequisite for the attainment of the above was some degree of supervision and control over the banking system. To this effect the Banking Ordinance, 1976 (No. 13 of 1976) was enacted.

The Banking Ordinance, 1976 which became effective February 1, 1977), represented a new development in the system of currency management. For the first time the banks were required to maintain minimum cash reserves equal to 5 percent of their average deposit liabilities with a central monetary authority and liquid assets holdings equal, on average, to at least 20 percent of average deposit liabilities. In the initial stages it was clear that adherence to the law had to take place in a "spirit of understanding, cooperation and goodwill" between the banks and the Authority. The Authority, while requesting compliance with the law, facilitated its compliance. Up until August 1977 when the first quarterly Treasury bill issue of \$5.0 million was released the Authority paid the banks interest on any excess cash balances held with itself, mindful of the problems created by the absence of a local capital market where excess funds could be utilised to earn income. Loans of \$1.5 million were made to two banks who could not meet the minimum cash reserves in February 1977. (These loans were fully repaid by May 1977.) To enable the banks to meet the required liquidity ratios there was a special consideration whereby 80 percent of loans to Government and other public sector agencies and 10 percent of private sector loans and advances were classified as approved liquid assets.

1/ It is somewhat ironic that two loans not being properly serviced continued to receive special treatment as approved liquid assets. This really reflected the banks' unwillingness to comply with the rules and perhaps the Authority's flexibility in not strictly enforcing this stipulation. It may be noted also that presently these loan balances constitute 4.1 percent of total liquid assets holdings, compared with 22.2 percent in 1971.

In the first three years of its existence the Authority was essentially consolidating its position, but taking extreme care to ensure that there was minimal disruption to the financial system by its operations. Because of this "don't rock the boat" posture both the enforcing of the exchange control regulations and the general influencing of commercial banks' policy was minimal. Events in 1978 and 1979, however, broke the idyll.

The practice of earmarking special categories of liquid assets to facilitate the banks went through a series of changes. In November 1977 a new directive was issued to say that effective January 1, 1978, 100 percent of loans and advances to the public sector and 5 percent of private sector loans would constitute eligible liquid assets holdings. And by November 1979 only loans to Banana Control Board and the Reconstruction and Development Corporation were considered approved liquid assets. 1/ Control over the banks' operations took other forms as well. In January 1977 the Authority fixed the minimum buying and selling rates for banks' dealings in certain stipulated currencies. This action served to cover the banks against exchange rate risks. Also in October of the same year the Authority forbade the banks' from carrying out their usual practice of clearing local interbank balances with their Head Offices. A full year later a local clearing house agreement was formalised. Credit creation of the banks was circumscribed in two ways. First, quantitative restrictions existed which enabled the Authority to request that the banks reduce loans and advances by a maximum of 5 percent, either on an across-the-board basis or selectively. Secondly, the banks are prohibited from extending credit to any one customer in excess of 25 percent of its capital and reserves without the prior approval of the Authority. Regular meetings enabled the Authority to maintain free dialogue with the banks and to exercise a high degree of moral suasion over the banks' activities.

III: FIRST CREDIT DIRECTIVE ISSUED BY THE
MONETARY AUTHORITY

On September 18, 1978, Hurricane Greta struck Belize. Honored insurance claim funds received in the last quarter of 1978 and first quarter of 1979 were to have severe repercussions on the economy and create the conditions for the Authority's first exercise of its power to limit credit growth. Bank deposits, seasonally high in the latter part of the year because of sugar receipts were given a big boost with the inflows of insurance funds. Because of this and low private sector demand for credit at the time, reserves doubled in 1978 (Table 1).

Table 1
Credit Creation and the External Accounts
1977 - 1986 (Jun)

Year	Bank Advances	Change %	Money Supply (M2)	Change %	Trade Deficit	Change %	Net Foreign Reserves	Change %
1977	59,515		49,020		55,987		11,358	
1978	64,996	9.2	57,691	17.7	53,426	4.6	20,542	80.8
1979	86,550	33.2	60,138	4.2	90,213	68.8	9,106	-55.7
1980	91,892	6.2	68,335	13.6	78,214	-13.3	10,832	18.9
1981	108,909	18.5	82,327	20.5	85,920	9.8	2,366	-78.1
1982	132,344	21.5	93,577	13.7	73,972	-13.9	(11,339)	-579.2
1983	141,431	6.9	116,119	24.1	68,124	7.9	(17,137)	-51.1
1984	153,042	8.2	113,137	-2.7	79,772	17.1	(22,230)	-29.7
1985	141,478	-7.6	122,394	8.2	74,222	-6.9	(11,629)	47.7
1986	131,394	-7.1	134,185	9.6	10,853	-85.3	20,816	279.0

Source: Central Bank of Belize, Statistical Digest, June 1985
Central Statistical Office, Trade Report - 1977 - 1986

In the first half of 1979, however, these reserves were rapidly depleted to finance imports (up 40% on 1978 levels for the same period) needed to rehabilitate the economy. In the second half of 1979 bank liquidity had been reduced to the 1978 levels of \$24 million from a high of \$31.1 million in March, but banks continued to lend at such rates that credit expanded by 14 percent between August and November and by 33.2 percent over the year. Forty-percent of this credit expansion went to the distribution (or import) sector, so much so that reserves fell by 55.7 percent from \$20.5 million at the end of 1978 to \$9.1 million at the end of 1979. The banks were caught in a crunch; they had over-extended their loan portfolios in 1978 subsequent to the rapid growth in deposits seen in the early part of the year, not taking full cognisance of the extremely short-term nature of the insurance deposits. Some other factors fed this adverse situation of declining bank liquidity and contracting reserves. Increased petroleum costs and real and anticipated inflation precipitated greater demand for money along with rising interest rates abroad no doubt resulted in some degree of capital

outflows. 1/ In an effort to reverse the deteriorating conditions the Authority issued a directive on December 29, 1979 requesting the banks to reduce outstanding credit by 5 percent by March 1980. The banks were also allowed to raise their lending and deposit rates by 2 percentage points. The prime lending rate thus rose from 9.5 percent to 11.5 percent.

The banks complied with the directive and by the required date loans and advances at \$81.0 million reflected a reduction of 6.5 percent. The private sector bore three fourths of the decrease. Over the year 1980 loans were to be held to 6.2 percent growth compared with 33.2 percent in 1979. Two interesting points should be noted here. Initially the Authority helped the banks' credit expansion. The Authority's lending to the banks was negligible from January to September 1979, then rose from \$1.9 million in October to \$7.4 million in December 1979. And when the Monetary Authority did seek to restrict lending to the banks the banks borrowed from their Head Offices. As a result their balances due to their principals jumped from \$10.7 million in 1978 to \$26.5 million in 1979. But once the Authority's directive was issued, the banks complied with it. The Authority's directive, while requiring an across-the-board reduction, had minimal negative effects, since it came at that period when merchants are rebuilding inventories after the holiday depletion and credit demand from the sugar industry is low. Thus the distributive sector's credit was curtailed, while that for the major productive sector, sugar, went virtually unimpaired. However, even while the Authority was satisfied with the success of its credit regulation measures, it found itself powerless to stop the upward movement in interest rates both to protect the banks' income in the wake of the credit restrictions and, most importantly, in response to rising rates abroad.

The pressure of rising international rates forced domestic rates up so that by December 1980 the prime lending rate was 17 percent, the three-month time deposit rate 15 percent, and the discount rate 14 percent compared with 11.5 percent, 6 percent and 10.75 percent, respectively, at the beginning of the year.

The year 1982 heralded the upgrading of the Monetary Authority to Central Bank status. The Central Bank Act was passed into law in November but made retroactive to January. For the Central Bank of Belize, making interest rate adjustments to keep pace with developments abroad and protecting the economy's reserves constituted the brunt of monetary policy between 1981 and 1984. The Central Bank was legally and explicitly empowered to

1/ It might also be noted that 1979 was an election year with the incumbent Government seeking a mandate to lead the country into independence. Given the Guatemalan claim to Belize territory and uncertainty about its actions in the event of Belizean independence, there were some uneasiness in financial circles.

determine limits on domestic rates of interest. This and two other features distinguished it from its predecessor. The Central Bank was authorized to maintain an external assets ratio (ratio of approved external assets to demand liabilities) of 40.0 percent compared with 50 percent for the Monetary Authority. In January of 1982 the Authority had been forced to suspend its own trading in Treasury bills as the reserves were being rapidly depleted. It was also hoped at the time that inter-bank trading would have been stimulated. The latter objective was not achieved, but there was some improvement in the reserves position by March as reflected in the external assets ratio, which dipped to 47.7 percent in February but by end March had returned to the January level of 51.1 percent.

Also the Central Bank was allowed to hold up to five times its paid-up capital and reserves in Government securities, whereas the relevant figure for the Monetary Authority had been seven. Given that interest rates abroad were falling the Central Bank requested the banks to reduce the prime lending rate from 18 percent to 16 percent, effective January 1, 1983. Deposit rates also fell by 2 - 3 percentage points.

IV DEVELOPMENTS LEADING TO AND RESULTING FROM THE IMPLEMENTATION OF AN IMF STAND-BY ARRANGEMENT

While active monetary policy was minimal in 1981 - 1984, certain developments created the need for restrictive monetary policies in the latter half of 1984. Since 1981 the Government had found itself in difficulties balancing its budget (Table 2) as a result

Table 2
Operations of Central Government
1980/81 - 1986/87
\$M

	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87*
Current Revenue and Grants	77.8	82.5	91.4	90.6	90.9	98.4	107.3
Recurrent Expenditure	62.8	74.7	87.3	90.5	93.2	103.7	116.0
Capital Revenue	7.8	10.4	0.3	0.3	7.1	1.8	73.0
Capital Expenditure and Net Lending	26.4	24.4	36.7	27.7	28.2	42.3	98.0
Recurrent Surplus/deficit (-)	15.0	7.8	4.1	0.1	-2.3	-5.3	-8.7
Overall Surplus/deficit (-)	-3.6	-6.2	-32.3	-27.3	-23.4	-45.8	-33.7

* Estimates approved by Parliament.

of reduced international aid flows. This trend compounded by international aid flows. This trend compounded by contracting economic activity forced the Government to resort increasingly to the domestic banking system for financing its budget. In 1982

the banks were the Government's major source of finance with their credit rising by 67.8 percent in 1982. (Table 3) Central Bank's credit to Government fell by 30.8 percent in the same

Table 3
Domestic Credit to Central Government by Source
1977 - 1986 (Jun)

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986 (Jun)
Central Bank	5.0	6.8	11.4	12.5	28.1	29.8	36.7	50.5	53.9	46.1
of which										
Treasury bills	0.9	6.2	7.2	7.4	14.4	17.1	16.2	35.0	29.5	11.8
Other	4.1	0.6	4.2	5.1	13.7	12.7	20.5	25.5	34.4	36.3
Commercial banks	3.5	7.0	2.5	9.8	6.7	16.2	32.0	19.6	31.2	51.0
of which										
Treasury bills	2.7	5.9	0.3	7.3	2.3	1.8	16.6	5.3	14.6	36.7
Loans and Advances	0.3	-	1.9	2.2	4.2	14.2	15.3	14.2	16.4	14.1
Other	0.5	1.1	0.4	0.3	0.2	0.2	0.2	0.1	0.2	0.2
TOTAL	8.5	13.8	14.0	22.3	34.8	46.0	68.7	50.1	95.1	98.9

Central Bank of Belize Statistical Digest, June 1986

period. During this period the fiscal deficit widened from \$6.2 million in FY1981/82 to \$32.3 million in FY1982/83. The credit extended by the banks to the Government during this period was oftentimes very expensive, as the banks had taken to lending in foreign currency at rates of interest linked to LIBOR to protect themselves against interest rate and exchange rate fluctuations. The rising cost of credit did not act as a deterrent to Government spending in the short-run, as attempts were made to maintain spending patterns in the face of general economic contraction, made particularly acute by:

- a) the Mexican peso devaluations which had a negative impact on a thriving re-export trade with that country;
- b) falling world market sugar prices and reductions in Belize's sugar quota with the USA and the UK by 22 percent and 16 percent, respectively; and
- c) the depreciation of the pound sterling which meant significant losses on sugar and banana exports denominated in sterling.

Given this scenario of depressed economic activity and falling reserves-net international reserves fell from \$2.4 million in 1981 to negative \$11.3 million in 1982. In May 1983 the authorities requested and received SDR 3.6 million from the IMF under the Compensatory Financing Facility as a first measure in efforts to adjust to the new financial and balance of payments situation. This stop-gap measure proved inadequate to deal with

the problem, and by mid-1984 the Central Bank's foreign assets had fallen to \$0.7 million (less than two weeks' imports). At this juncture financial programming as part of efforts to secure a Standby Arrangement with the International Monetary Fund ensued.

The Standby Arrangement became effective on December 6, 1986, and a programme was implemented, the primary objectives of which were:

- a) to strengthen the finances of the public sector;
- b) to restore the balance of payments to a sustainable position; and
- c) to increase the country's reserves.

It was especially envisaged that the loss in the foreign exchange reserves of the Central Bank be contained to US\$6.5 million in 1984 and reserves be increased by US\$5.0 million in 1985. Initially it was felt that fiscal restraint should be the primary target for achieving these results. Later on, however, there was increasing recognition that monetary measures would work faster to reduce aggregate demand and reverse the deteriorating foreign position.

In November 1984 the banks' cash reserve ratio was raised from 5 percent to 7 percent of average deposit liabilities. This was a precursor to a concerted package of measures introduced in January 1985, following upon the continued deterioration of the economy to the end of 1984. At December 1984 net reserves of the Central Bank were negative at \$5.0 million compared with a positive figure of \$10.1 million at the close of 1983 (Table 4).

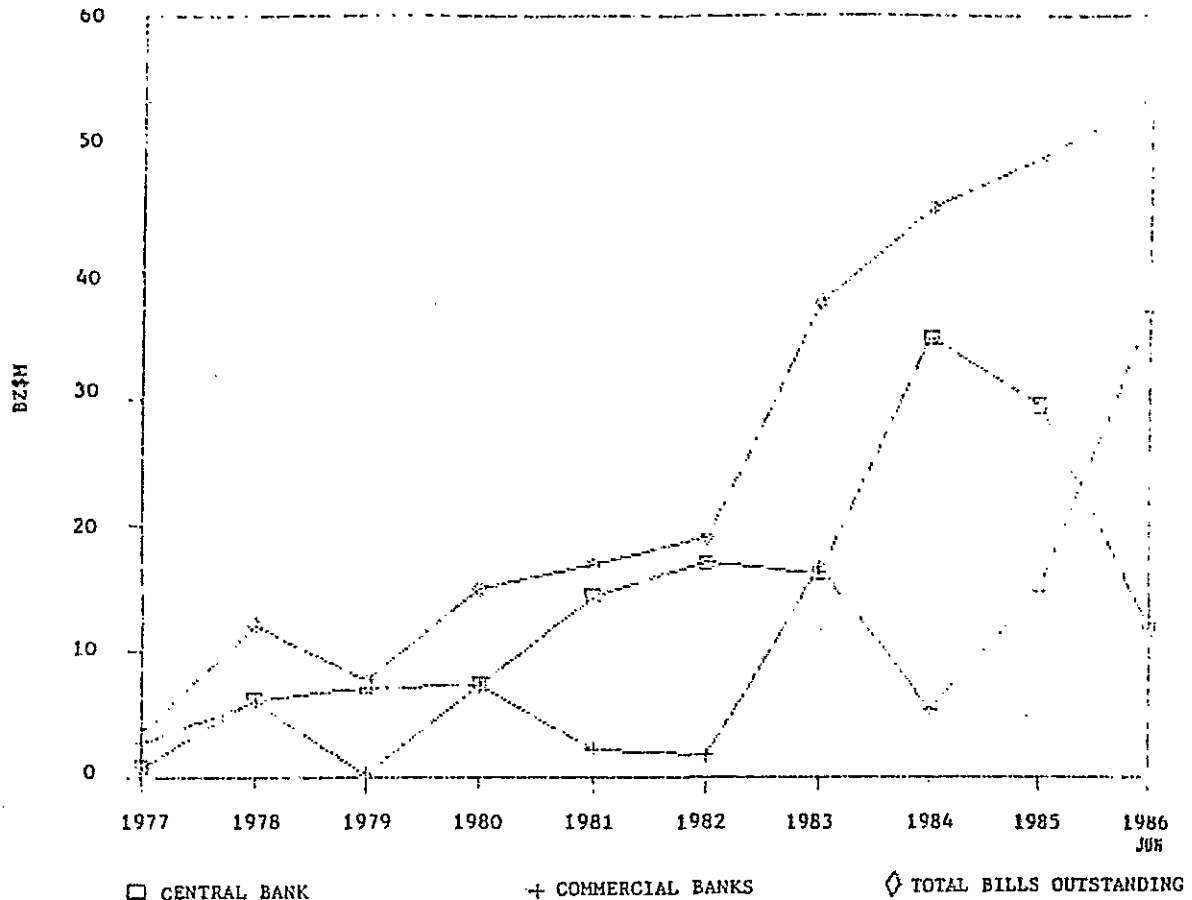
Table 4
Central Bank's Net Foreign Assets
1977 - 1986 (Jun)

1977	1978	1979	1980	1981	1982	1983	1984	1985	1986 (Jun)
15,622	23,566	19,344	23,871	20,267	19,326	10,060	(5,008)	7,561	34,408

Source: Central Bank of Belize Statistical Digest, June 1986.

Domestic credit meanwhile had expanded from \$124.5 million to \$221.4 million. This increase of \$26.9 million (13.8 percent) was mostly received by the non-financial public sector whose credit grew by \$15.3 million to \$130.5 million. The growth in credit to the Government emanated from the Central Bank who financed the entire fiscal deficit in 1984. During this period the banks reduced credit to Government by \$11.5 million. At the same time the banks were reducing their Treasury bill holdings drastically (Chart A), forcing the Central Bank to increase its levels of financing to the Government and depleting its reserves. The banks had excess liquidity averaging \$14.0 million monthly

TREASURY BILL HOLDINGS
1977 - JUN 1986



compared with average monthly requirements of \$23.0 million so could afford to divest themselves of bills. New monetary measures were, therefore, considered necessary to reverse this trend, and these were implemented in January 1985.

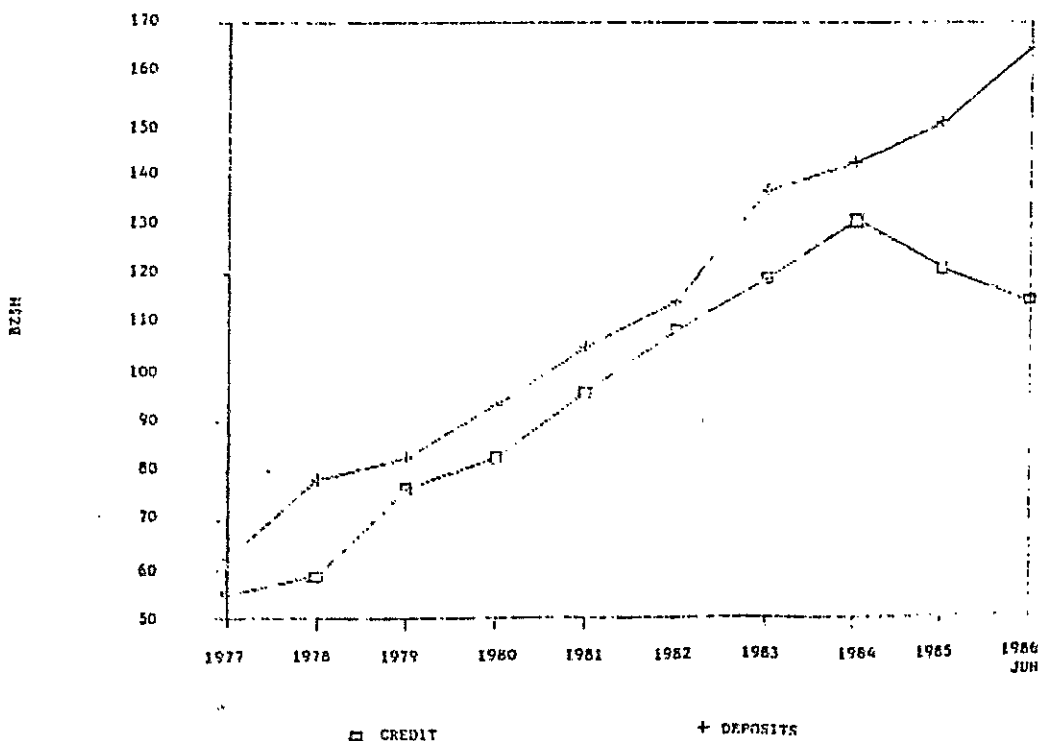
Monetary measures introduced early in 1985 included a two percent rise in the prime lending rate from 12 percent to 14 percent (reversing a similar move in the opposite direction witnessed in January 1984), a three percent increase in all deposit rates taking the minimum three-month time deposit rates to 12 percent and raising the Treasury bill rate from 9.75 to 13 percent, subject to banks' bids. Liquid assets and cash reserve ratios were raised from 20 percent to 25 percent in March and by a further 5 percentage points to 30 percent in April. The banks were also discouraged from borrowing from the Central Bank, except in cases of emergency. The Central Bank's lending rate was raised from 12 percent to 20 percent. This measure reflected abandonment of the previous practice, whereby the rate was automatically calculated at 2.0 percentage points above the Treasury bill rate rounded to the nearest 0.5 percent, for the arbitrary selection of a rate thought to be sufficiently high to discourage excessive credit creation. Besides the high discount rate banks' borrowing from the Central Bank was discouraged by an announcement that banks' requests would be entertained only in cases of emergency. Other measures designed to induce fiscal

restraint and enhanced revenues were expected to complement these measures in reducing the demand for credit, arresting the fall in the banks' holdings of Treasury bills, and improving the foreign exchange reserves.

Quarterly inflows under the SDR7.125 million Standby Facility and an economic stabilisation programme agreed with USAID (intended to provide \$13 million in loans at concessionary terms and \$1.0 million in grants) assisted in improving the external position. An added boost to the balance of payments came from movie-filming activity carried out during November 1985 to May 1986, involving an expenditure of US\$5 million.

The improvement in the external accounts was achieved in 1985, and so far for 1986 the level of reserves has surpassed all previous levels. The Central Bank's net foreign assets increased by \$12.6 million to \$7.6 million during 1985. They have increased even further by \$29.8 million in the first half of 1986. During the eighteen-month period to June 1986 loans and advances to the private sector contracted by 12.6 percent or \$18.4 million (Chart E). Concurrently deposit liabilities of the banks expanded by 16.4 percent or \$23.3 million. The sharpest growth in deposits occurred in the first three months of 1986 (6.4 percent) while the contraction in credit was most evident in the first three months of 1985 (4.9 percent). Strong growth of 10.2 percent or \$15.2 million deposit liabilities witnessed in the first half of 1986 is largely explained by high foreign exchange inflows during this period. Lastly, use of Central Bank credit by the banks had dropped from \$7.8 million in December 1984 to zero by March 1985.

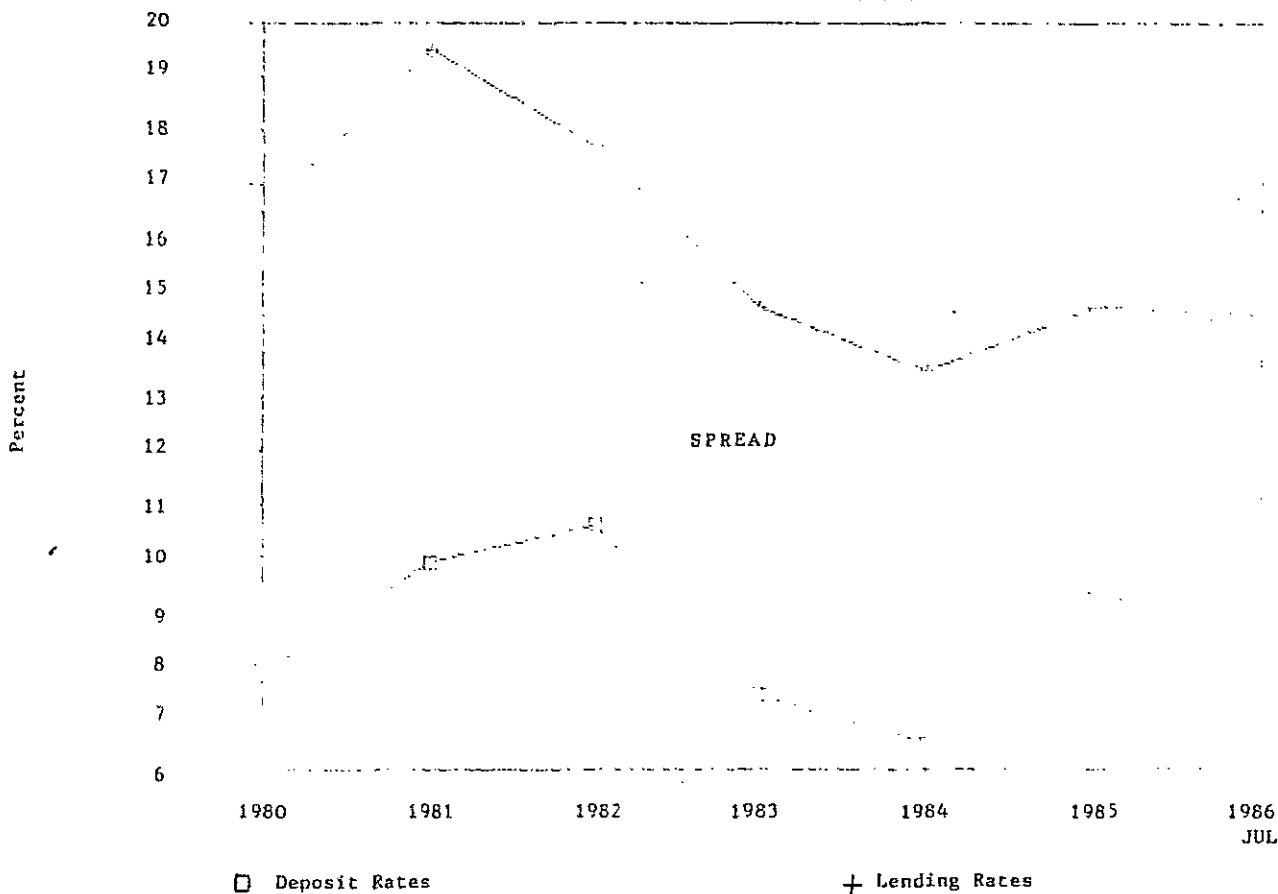
Chart E
COMMERCIAL BANKS' DEPOSIT LIABILITIES
AND CREDIT TO THE PRIVATE SECTOR
1977 - JUN 1986



Besides reducing excess demand for credit the monetary measures sought to narrow the interest rate spread earned by banks which averaged 7.9 percentage points from 1980 - 1984 and to adjust domestic rates to rising international rates. The banks' spread did narrow to 5.5 percentage points by December 1985 although it was up to 5.8 percentage points by June 1986 (Chart C). In addition to these objectives the measures succeeded in raising the real rate of interest on savings from 2.6 percent December 1984 to 6.0 percent December 1985 and 8.8 percent as of June 1986 and in restoring growth in real financial savings to 1983 levels (Chart D). The real rate of borrowing was also raised

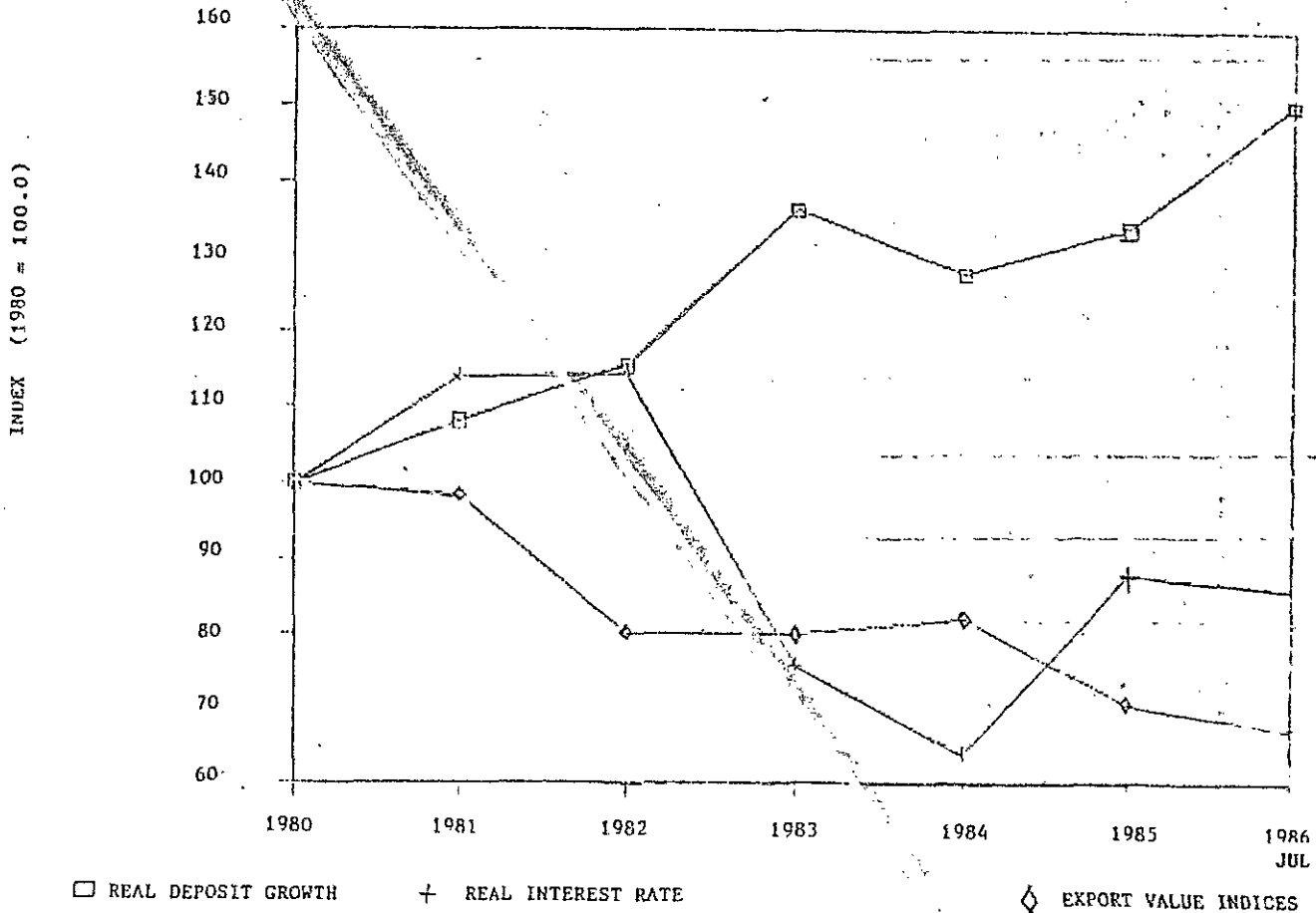
Chart C

COMMERCIAL BANKS WEIGHTED AVERAGE LENDING
AND DEPOSITS RATES 1980 - JUL 1986



from 9.6 percent in 1984 to 11.5 percent in 1985. Thus the main objective of the monetary measures which was to bring demand for credit in line with supply of savings and capital inflows from abroad to reduce the drain on the balance of payments was largely achieved by May 31, 1986, and the IMF Staff Report has subsequently stated that Belize successfully implemented its adjustment programme.

Chart D
 REAL DEPOSIT RATES, REAL DEPOSIT GROWTH,
 AND EXPORT VALUE INDICES 1980 - JUL 1986



LIMITS TO EFFECTIVE EXECUTION OF MONETARY POLICY

Excess liquidity of the banks at June 1986 was \$27.8 million against required holdings of \$48.7 million (Table 5). Net

Table 5

LIQUIDITY POSITION OF COMMERCIAL BANKS

OUTSTANDING POSITION

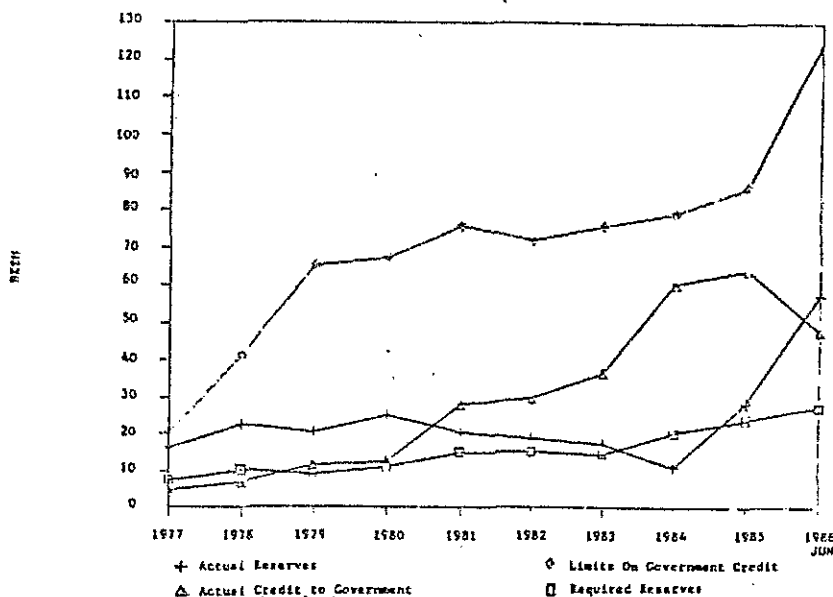
	June 1984 - June 1986					BZ\$M	
	1984	1984	1985	1985	1986	Change Dec 84-Dec 85	Change Dec 85-Jun 86
	Jun	Dec	Jun	Dec	Jun		
Approved Liquid Assets	42.2	41.9	46.6	52.5	76.5	10.6	24.0
Vault Cash	3.6	3.7	3.8	4.1	4.0	+0.4	-0.1
Balances with Central Bank	7.5	10.5	12.8	14.9	17.4	+4.4	+2.5
Money at call and Foreign Balances (due within 90 days)	11.2	11.5	15.4	13.0	13.2	+1.5	+0.2
Treasury Bills maturing in not more than 90 days	14.3	5.5	9.4	14.4	36.4	+8.9	+22.0
Other Approved Assets	5.6	10.7	7.2	6.1	5.5	-4.6	-0.6
Required Liquid Assets	28.4	28.2	43.8	44.2	48.7	+16.0	+4.5
Daily Average Cash Reserves	7.5	10.5	12.8	14.9	17.4	+4.4	+2.5
Required Cash Reserves	7.1	9.9	13.2	13.3	14.6	+3.4	+1.3
Excess/Deficiency Liquid Assets	13.8	13.7	4.8	8.3	27.8	-5.4	+19.5
Excess/Deficiency Cash Reserves	0.4	0.6	-0.4	1.6	2.8	+1.0	+1.2

foreign reserves of the banking system are at an all-time high of \$28.8 million. Real financial savings have been restored to 1983 levels, and the spread between the banks' weighted average borrowing and lending rates have narrowed from 7.0 percentage points December 1984 to 5.8 percentage points in June 1986. At the same time, however, the level of economic activity is very low.

The question arises as to whether promoting credit expansion will assist in reflation of the economy in the face of existing unfavorable demand conditions in our primary export markets as a result of falling commodity prices and rising protectionism. One cannot ignore the supply constraints resulting from poor infrastructural development, low levels of domestic savings, and lower than desired levels of foreign investment. The general impediments to development are thus also effective constraints to the success of monetary policy as tools to facilitate the attainment of balanced growth. It would appear, therefore, that until the supply constraints are removed, monetary policy will most often prove to be reacting to external developments in order to moderate their influence on the domestic economy, rather than leading the way to the attainment of minimal inflation, strong balance of payments position, high employment and sustainable rising levels of economic activity.

In addition to the problems in the real sectors - high levels of unskilled and low levels of skilled labor, low infrastructural development, highly skewed productive sector - there are obstacles in the financial sector which have to be overcome. In the first instance, the Central Bank as chief agent for formulating and implementing monetary policy has to operate within an inconsistent legal framework. Chart E depicts the limitations inherent in the ability of the Central Bank to

Chart E
CENTRAL BANK OF BELIZE
RESERVES AND CREDIT TO GOVERNMENT - 1977 - JUN 1986



maintain levels of required foreign assets holdings which should at all times be equal to or greater than 40.0 percent of demand liabilities - given limits on credit to the Central Government. Legal limits on credit to the Central Government - direct advances not to exceed 15 percent of estimated current revenue and holdings of Government securities not to exceed five times

its capital and reserves - ensure that the Bank's credit to the Government would lead to deterioration of the reserve position.

Secondly, between 1977 and 1985 commercial banks' liabilities to their Head Offices averaged \$30.5 million or 18.2 percent of average total assets of \$167.3 million for the same period. These liabilities to Head Offices have great implications for the creation of domestic credit. Recognising this, the Central Bank has had to include the banks' long-term foreign liabilities with deposits when calculating their advances to deposits ratio to avoid having the ratio exceed 100. Another negative feature for the domestic financial system of the banks' relations with their Head Offices has been their ability to include net foreign balances due within ninety days as part of their liquid assets holdings. This obliges the central monetary authorities to ensure that domestic interest rates remain higher than rates abroad to prevent outflows of funds. It also leads to undesired situations whereby the banks, while not bringing their capital into Belize, attempt to force an artificial improvement in their liquid assets holdings by simultaneously increasing assigned capital and balances due Head Offices on the liabilities and assets sides of their balance sheets, respectively. Thirdly, the banks in Belize finance primarily trade of consumer imports and channel insufficient resources to the productive sectors.

Monetary policy cannot operate in a vacuum, and indeed its success usually hinges on its joint implementation with complementary fiscal policy. However, formulation and execution of fiscal policy are themselves circumscribed by a number of factors. There is the problem of the Government's weak revenue base and its apparent inability to generate sufficiently high savings to build the infrastructure and productive capacity of the country. There is also the attendant problem of dependence on overseas aid, which may not be adequate in magnitudes.

In short monetary policy, and its effectiveness, can only be judged in terms of its interaction with other policies and other factors - both economic and non-economic which together will determine both the pace and type of economic development Belize would enjoy.

APPENDIX

CHRONOLOGICAL DEVELOPMENTS IN MONETARY AND CREDIT POLICIES 1976 - 1988

Chronological Events

- MAY 1976 - Severing of Belize dollar link with pound sterling at 1.00 = EZ\$4.00 and pegging to US dollar at BZ\$1.00 = US\$0.50.
- NOV 1976 - Establishment of Monetary Authority of Belize to replace Belize Board of Commissioners of Currency and Banking Ordinance Exchange Control regulations in force.
- JAN 1977 - Monetary Authority fixed minimum buying and selling rates for banks' dealings in foreign currency in US\$, CN\$, & sterling and Caricom currencies.
- FEB 1977 - Banking Ordinance 1976 (No. 13 of 1976), became effective
- 80 percent of loans to Central Government and other public sector bodies plus 10 percent of private sector loans and advances considered approved liquid assets.
- AUG 1977 - First quarterly Treasury bill issue of \$5 million; end of practice where banks paid interest on excess cash balances with Monetary Authority of Belize.
- OCT 1, 1977 - Banks restricted from clearing local interbank balances with Head Offices abroad.
- NOV 1977 - 100 percent of loans and advances to Government and five percent to private sector considered approved liquid assets.
- JAN 1, 1978 - Specially designated approved liquid assets changed to above, became effective.
- MAY 1978 - Commencement of monthly Treasury bill issues.
- JUL 1978 - Private sector loans and advances no longer considered other approved liquid assets.
- SEP 1978 - Hurricane Greta - subsequent insurance claim receipts would be added to record sugar earnings to facilitate in the banks' overextension of credit.
- OCT 1978 - Clearing house agreement signed by Monetary

and commercial banks..

- 1979 - Over-extension of credit by commercial banks.
- NOV 1979 - Only loans to Banana Control Board and Reconstruction and Development Corporation considered approved liquid assets. (Down from 22.2 percent of banks' total liquid assets in 1981 to 4.1 percent in October 1986).
- DEC 1979 - Monetary Authority of Belize directive for banks to reduce outstanding credit by five percent by March 1980 - first move by MAB to actively influence growth of monetary aggregates.
- JAN 1980 - Discount rate raised from 10 percent to 10.75 percent.
- MAR 1980 - Prime lending rates up by two percentage points from 9.5 percent to 11.5 percent.
- Discount rate up again - to 12.5 percent.
- DEC 1980 - Prime lending rate raised to 17 percent and three month time deposit rate to 15 percent, discount rate raised from 13.5 percent to 14 percent.
- 1981 - Establishment of Central Bank of Belize with:
1) power to set limits on interest rates;
2) external assets ratio of 50 percent (compared with 40 percent for MAB); and
3) ability to hold up to five times capital and reserves in Government paper (compared with seven for MAB).
- Banks commence lending in foreign currency with rate of interest linked to Libor to protect themselves against interest rate and exchange rate fluctuations in face of instability in international interest rates and foreign exchange markets.
- JAN 1982 - Central Bank suspended its trading in Treasury bills for first time to stem reserve losses and with hope of stimulating inter-bank trading.
- JAN 1983 - Prime lending rate reduced from 16 percent to 14 percent.
- JAN 1984 - Prime lending rate reduced from 14 to 12 percent.
- JUN 1984 - Financial programming carried out for the first time as part of effort to secure IMF Standby

Arrangement and improve knowledge of operations of financial system.

- JUL 1984 - Banks allowed to include US\$3.0 million balance of payments support loan to Central Bank in other approved liquid assets.
- NOV 1984 - Commercial banks' average cash reserves ratio raised from 5.0 percent to 7.0 percent - banks fall short by \$0.3 million.
- DEC 6, 1984 - IMF Standby Arrangement for SDR 7.125 million (75 percent of quota) signed, included series of monetary measures designed to counter deteriorating balance of payments position.
- JAN 28, 1985 - Commercial banks' prime lending rate raised to 14 percent.
- Savings and time deposit rates up three percentage points with minimum rate of 12 percent for three-month term deposits.
- Treasury bill rate raised from 9.77 percent to 13 percent, based on banks' bids.
- MAR 1, 1985 - Banks' cash reserves ratio raised to 9 percent from 7 percent (against legal maximum of 10 percent)
- Interest rate on CEB loans to banks raised from 12 to 20 percent (this signified abandonment of previous practice whereby Central Bank's lending rate to Government and commercial banks calculated automatically at 2.0 percentage points above Treasury bill rate, rounded to nearest 0.5 percent).
- Banks' liquid assets ratio raised from 20 percent to 25 percent.
- Banks discouraged from utilising Central Bank credit except in cases of emergency.
- APR 1, 1985 - Liquid asset ratios raised from 25 to 30 percent (five percentage points below present legal maximum of 35 percent).
- MAY 31, 1985 - Successful completion of IMF Stand-by Programme.

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