

DRAFT

Monitoring Private External Debt in the Caribbean

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Abstract

It is widely believed that private sector debt is supposed to be market determined and assumed to be allocated efficiently. However, recent evidence in advanced and emerging economies have demonstrated that increased private sector borrowing can have negative implications on economic growth and macro-financial stability. The undesirable effects of this were experienced in Europe, Japan, China and the USA (in the case of household debt). Meanwhile, in the Caribbean, large and entrenched conglomerates and financial groups dominate the landscape. These Systemically Important Institutions operate across many jurisdictions and at times within fragmented regulatory frameworks. These conditions can possibly lead to riskier borrowing practices and problems in the private sector's balance sheet which can have spillover effects on public debt service, growth and financial stability. In spite of this, data on the size, nature and composition of corporate liabilities remains scarce. This paper addresses this issue and makes the point that Private Sector External Debt data can be useful in assessing possible macro-financial risks associated with rising external liabilities. It recommends that there needs to be discussion about the policy and regulatory framework, institutional arrangements and data requirements for effectively monitoring Private External Debt in the Caribbean.

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1.0 Introduction

There is an emerging trend in developing countries that signals a shifting in the vulnerability of debt stocks. This trend involves a sharp increase in Private Sector External Debt (PSED) over the past two decades. In 2012, the private sector's non-publicly guaranteed debt liabilities accounted for 34 per cent of developing countries total external debt, up from a mere 5 per cent in 1990. Likewise, the private sector accounted for 65 per cent² of total external loans disbursed to developing countries in 2012, four (4) times more than the total external loans disbursed to developing countries in 1990.

The trend is the same for Latin America and the Caribbean (LAC), where the private non-guaranteed external debt stock rose sharply to 41.3 per cent of total external debt in 2013 from 30.2 per cent in 2000. In spite of this, there has been little emphasis on what are the causes and potential risks associated with this rise in debt. This may be partly because private sector external debt is viewed as relatively insignificant and given that it is supposed to be market determined, it is assumed to be allocated efficiently. Also, it should be acknowledged that the institutional arrangements for monitoring PSED can be complicated and outside of the immediate jurisdiction of the regulatory and fiscal authorities. However, increased external borrowing by the private sector can possibly have pass-through effects to sovereign liabilities and slow the development progress of countries. Of course, this relationship would be strongest in cases where private sector entities find themselves in financial difficulties, are systemically important and/or have increased their risk appetite.

In this regard, this paper aims to highlight the importance of improving the monitoring of PSED data and the possible macroeconomic implications of rising PSED. It analyzes the available data to give an indication of current trends in PSED and in particular that of corporate external liabilities. The paper makes the point that this is an area of data capture that needs significant improvement in the Caribbean. The paper is structured as follows: section II, which follows immediately, provides a review of the key definitions and explores the macroeconomic impact of Private Sector External Debt. Section III highlights the issues and challenges related to PSED monitoring in the Caribbean. Section IV reviews the trends and composition of corporate external liabilities. The paper then concludes in Chapter V.

2.0 Literature Review

2.1 Definitions

The private sector is defined simply in this paper as that part of a country's economic system that is controlled by individuals and companies, rather than the government. The private sector can be disaggregated into the following categories: the private financial sector (mainly banks) and the non-financial private sector (corporations and households). These sectors have claims on the liabilities to each other and to external (non-resident) entities. The Corporate External Debt (CED), at any given time, is the outstanding amount of those current, and not contingent, liabilities that require payment/s of interest and/or principal by the debtor at some point(s) in the

²World Bank Group, International Debt Statistics 2015.

future and that are owed to non-residents by private residents of an economy. (*International Monetary Fund, Balance of Payments, 5th Edition and the Guide*)

2.2 External Debt Data Sources

Baball (2002) indicated that comprehensive and consistent statistics on PSED are not presently available. The World Bank’s (WB) Global Development Finance (GDF) provides some data, however, this underestimates PSED, because only private non-guaranteed external debt is included. More so, many countries do not collect and report on this category of debt to the WB and the guaranteed component is aggregated into public and publicly-guaranteed external debt (PPGED). Alternatively, CED data can be sourced from national financial accounts including the Balance of Payments (BOP) and International Investment Position (IIP). The CED data in the BOP can be sourced from the Financial Account and Investment Income sub-account and are distributed as follows:

- (I) Foreign Direct Investment (FDI) refers to a lasting interest if an entity resident in one economy (the direct investor) in an entity resident in another country (the direct investment enterprise), defined as ownership of 10 per cent or more in the equity of a direct investment enterprise. Of the direct investment components, Other Capital, when owed to non-residents direct investors or affiliates, is included in the gross external debt position, but the other components are not. This includes, debt securities and suppliers credits (i.e. trade credits) between direct investors and subsidiaries, branches and associates. In the BOP/IIP tables, other capital is presented as Direct Investment: Other Capital- Liabilities to Affiliated Enterprises (Table 1).
- (II) Portfolio Investment (P.I.) covers financial instruments (other than those included in direct investment) that are usually traded or tradable) in organized and other financial markets, including over-the-counter markets. Of the portfolio investment components, when owed to non-residents, debt securities (bonds and notes) and money market instruments (e.g. treasury bills) are included. Equity securities are not included in external debt.
- (III) Other investment (O.I.) covers all financial instruments other than those classified as direct investment, portfolio investment, financial derivatives or reserve assets. When owed to non-residents, all the components of other investment- trade credits, loans, currency and deposits and other liabilities are included, and separately identified by the sector of debt, in the gross external debt position.

Table 1: Private External Debt Instruments and BOP Classification

Debt Instruments	BOP Classification
1. Inter-company loans	Foreign Direct Investment
2. Bonds and notes 3. Money Market Instruments	Portfolio Investment
4. Loans* 5. Trade credits*	Other Investment

Source: IMF, Balance of Payments Manual

*excludes inter-company loans

The Bank for International Settlements (BIS) has creditor-source data which can be used as an alternative source to cross check or supplement debtor-based national source data. The BIS external derivatives database and the BIS international securities database can also be used together with security-by-security information collected in national sources to significantly enhance the quality of national data on debt security liabilities.

2.3 Macroeconomic Impact of Private External Debt

In principle, the problems in the private sector's balance sheet can and should be resolved by restructuring the private sector's liabilities without any government intervention. However, reality has shown that depending on the systemic importance of the private sector entity (for example large conglomerates and major banks) the systemic risk of a possible default may be too great and may prompt government intervention. As seen in the recent economic and financial crisis, government can be forced to rescue the financial and parts of the non-financial corporate sector. These are the extreme manifestations of the interactions and spillovers between all sectors of the economy.

2.3.1 Impact on Public Debt and Debt Service

As a result, in the event of a shock or crisis in the private sector, the public sector may be forced to assume at least part of the private debt. Given that most Caribbean countries are already heavily indebted, this additional debt can lead to potential debt service difficulties for these countries. Cecchetti, Mohanty and Zampolli (2011) indicate that there is a clear interaction between private and public debt. This occurs when private borrowing has fiscal backing³, as such default on private debt, leads to a corresponding increase in public debt. The ability of the public sector to cope with the higher public debt and debt service will depend to a large extent on its ability to raise additional revenue. Thompson, Cassie and Cotton (2013) showed that Trinidad and Tobago's public sector debt to GDP ratio (excluding Open Market Operations) increased from 24.4 per cent in fiscal year (FY) 2007/2008 to 34.1 per cent in FY 2008/2009 and reached 44.5 per cent by FY 2011/2012. Unlike the experiences of most countries in the region, the main impetus for the rise was the Government's bailout to the failed Colonial Life Insurance Company (CLICO) rather than borrowing for deficit financing. Whilst Government intervention helped to prevent a systematic crisis, the fiscal costs of the bailout was significant. The government had initially envisaged a total cost of TT\$11.9 billion (8.6 per cent of GDP), but the costs incurred as at the end of FY 2011/2012 amounted to TT\$19.7 billion (13.5 per cent of the country's GDP⁴).

2.3.2 Impact on the Exchange Rate

Servicing external debt may involve demand for foreign currency which tends to affect the exchange rate of the country. As a result, in instances of countries with floating exchange rates such as Guyana and Jamaica, rising private debt denominated in foreign currency, while assets

³This fiscal backing can be either direct or indirect. *Excludes inter-company loans.

⁴As at March 2013 the cost had risen to TT\$24.4 billion on account of additional financing for the establishment of the CLICO Investment Fund. Further, is legal costs as well as assistance provided by the government of Trinidad and Tobago to other Caribbean countries are included the total cost incurred by the government for CLICO amounts to about TT\$26 billion.

and income are mostly in domestic currency can lead to pressures on the demand for foreign exchange and the exchange rate. If these pressures cause the exchange rate to depreciate further it means that private sector debt becomes more costly to service and becomes a challenge to the solvency of the private debtors.

2.3.3 Impact on Economic Growth

The accumulation of private debt can also play a role in lowering aggregate demand and as such cause a drag on growth. Izak (2014) suggests that when private sector debt levels rise above trend the likelihood of a strong economic downturn increases. This view is supported by Mian, Rao and Sufi (2011) that provided strong empirical evidence that household debt accumulation in the mid-2000s and subsequent busts contributed to the ensuing decline in consumption and economic crises. Likewise, Drehmann and Juselius (2012) proposed that when households and corporations are over indebted even small income shortfalls prevent them from smoothing consumptions and making new investment. Large shortfalls trigger a rise in default and bankruptcies. This in turn can contribute to output volatility and the likelihood of an economic downturn increases. However, the literature is less clear about the threshold debt level that are negatively associated with growth performance. Cecchetti, et. Al. (2011) indicate that for OECD countries the threshold for government debt is around 85 per cent of GDP, corporate debt 90 per cent of GDP and households 85 per cent of GDP. While, Reinhart and Rogoff (2010) suggest that the government debt threshold is slightly higher across a wider range of countries, at around 90 per cent.

2.3.4 Impact on Financial Stability

The relationship between private debt and financial stability can be explained through the Balance Sheet Approach (BSA). The BSA emerged as a useful framework in understanding financial crises after the earlier models proved unable to explain the crises of the 1990s. Theoretically, the BSA supports the view that financial crisis can originate in all of the three main sectors of the economy – the government, banks or corporations. It focuses on analyzing stock variables on a country's financial balance sheet and on the balance sheet of key sectors. The approach analyzes the size and composition of the assets and liabilities of a country's aggregate financial balance sheet as well as the balance sheets of its most important sectors.

Amo-Yartey (2012) indicated that in the BSA analysis, an economy is analyzed as a system of sectoral balance sheets, with a distinction being made between the public, financial, nonfinancial and external sectors. Assessing the mismatches in individual sector's balance sheets and the linkages among sectors helps understand how shocks can affect the liquidity or solvency of one sector and be transmitted to other sectors, possibly endangering the financial health of the whole economy. The BSA focuses on four (4) types of balance sheet mismatches⁵ including: (i) maturity mismatches; (ii) currency mismatches; (iii) capital structure problems

⁵ Maturity mismatches exist where there are gaps between liabilities due in the short term and liquid assets, such that a sector may be unable to meet its financial commitments if the market does not roll over debt or if interest rates rise. Currency mismatches relate to fluctuations in the exchange rate that can result in capital losses on the balance sheet. Capital structure problems exist where there is a reliance on debt rather than equity financing which may leave a firm or bank less able to weather revenue shocks. Solvency problems can occur when the present value of future revenue streams are insufficient to cover liabilities, including contingent liabilities.

and (iv) solvency problems, all of which affects a country's ability to service debt in the face of shocks.

The Balance Sheet Approach (BSA) explains the relationship between private debt and financial stability. According to this perspective, domestic firms are tempted to borrow abroad in order to reduce the cost of capital. However, excessive foreign borrowing without hedging for exchange risks can result in a liquidity crisis in the banking system. For example, high debt exposure and currency imbalances in the balance sheet of private entities can result in creditors losing confidence in the private entities ability to repay banks loans and other debt (Allen et. al (2002); Drehmann and Juselius (2012)). This would result in a plunge in demand for the private sectors assets and lead to a surge in demand for foreign assets and/or assets denominated in foreign currency. Ultimately, these factors will lead a sharp drop in the exchange rate and a hike in the interest rates which can produce a liquidity crisis in the banking system. The relationship between balance sheet mismatches and financial vulnerability were reinforced by Classens and Ayhan (2013) which indicated that financial crises have several common elements: (i) large scale balance sheet problems in both the financial and real sectors; (ii) severe disruptions in financial intermediation and the supply of external financing to the various sectors; (iii) substantial changes in credit volume and asset prices and; (iv) large scale government support in the form of liquidity support and recapitalization.

Among the historical evidence of the macro-financial risks associated with increased private sector borrowing include the South East Asian Crisis of the mid-1990s. It revealed, among other things that explicit and implicit government guarantees (such as the government absorbing the losses arising from bank failures so as to preserve the stability of the banking system) can lead institutions to engage in risky and speculative borrowing and lending (resulting in the banks receiving high profits if projects are successful and the government absorbing the losses if they fail) that can render the economy vulnerable. Amo-Yartey (2012) also indicated that the Asian financial crisis brought to the forefront the role of balance sheet weaknesses in the financial and corporate sectors in causing financial crisis and confirmed the view that the private sector, rather than the traditional fiscal generation fiscal imbalances⁶ could be the core of a crisis. In particular, debt exposure and currency imbalances in the balance sheets of private entities can adversely affect market confidence and heighten an economy's vulnerability to banking or a currency crisis. More recently, Lahnsteiner (2013) noted that the collapse of Lehman Brothers and the associated financial crisis was a stark reminder that private sector indebtedness, may constitute a core macro financial vulnerability.

Within the Caribbean, there have also been instances of private and public sector failures/challenges which constituted a major risk for macro-financial stability. Such instances include: the Jamaican financial sector crisis of 1995, the collapse of CL Financial in Trinidad and Tobago in 2009 and the banking sector challenges in the ECCU. Notably, these challenges are concentrated in large and entrenched conglomerates and financial groups which are a dominant feature in the Caribbean financial landscape. As a result, Caribbean researchers such as Layne (2010), Polius (2012), Seerattan (2013), have argued for greater emphasis on the

⁶First generation models explained a currency crisis in macroeconomic terms, usually as a result of monetized fiscal deficits leading to reserve losses and eventually the abandonment of an exchange rate peg (Krugman, (1979), Flood and Garber (1984).

supervision and regulation of these Systemically Important Institutions as their failure can threaten the smooth functioning of domestic financial markets and the economy and have socio-economic implications. In particular, (Stein, 1997) noted that the internal capital market, that is the way funds are transferred between different entities in these conglomerates needs regulations and standards so as to ensure that they function efficiently Without these controls the potential benefits of conglomerates may not be realized and abuse of the system can in fact generate instability and failure.

3.0 Monitoring Private External Debt

3.1 Shortcomings of Private External Debt Data

In the Caribbean, there are significant gaps in the frequency and detail of reporting on External Sector Statistics. This represents a challenge in assessing the size and composition of external corporate liabilities, and the risk associated with private borrowing. These gaps are particularly noticeable in the IIP statistics which is the main source of stock information for the PSED statistics. Currently, only five (5) Caribbean countries produce an IIP statement (Barbados, Haiti, Jamaica, Suriname and Trinidad and Tobago). The most comprehensive reporting in frequency and coverage can be obtained from the Balance of Payments accounts (See Table 2). However, the BOP accounts can only provide an indication of the flows of private sector debt and to a lesser extent the direction of increase/decrease in the PSED stock in Caribbean islands.

Table 2: Reporting of External Sector Statistics by Caribbean countries

	BOP		IIP		BPM6	CPIS	CDIS	QEDS
	A	Q	A	Q				
Anguilla	X							
Antigua & Barbuda	X							X (GDDS)
Bahamas, The		X				X		X (GDDS)
Barbados	X		X		in progress	X	X	
Belize		X			X			X (GDDS)
Bermuda	X				X	X		
British Virgin Islands								
Cayman Islands						X		
Dominica	X							X (GDDS)
Grenada	X							
Guyana	X							
Haiti		X	X					
Jamaica		X		X	X			X (GDDS)
Montserrat	X							
St. Kitts & Nevis	X							
St. Lucia	X							
St. Vincent & the Grenadines	X							in progress
Suriname		X		X				
Trinidad & Tobago	X		X					
Turks & Caicos Islands								

Source: IFS January 2014, BOPSY 2013, and QEDS database.

3.2 Issues and Challenges

There are several factors ⁷ that contribute to the shortcomings of PSED data within Caribbean countries. These factors include: (i) inadequate survey response rates; (ii) weak legislation and enforcement; (iii) the need to develop adequate institutional frameworks; (iv) limited human and technical capacity; (v) the loss of administrative records and (vi) identifying the existence of transactions that pass outside the domestic banking system. The aforementioned issues and challenges are discussed further in the paragraphs below.

3.2.1 Inadequate Survey Response Rates

Survey data is used to compile information on PSED in the Caribbean. While in most instances the participation in these surveys are mandatory and under the Parliamentary authority of a Statistics Act, which guarantees the confidentiality of data about individual businesses. However, Statistical agencies rarely enforce the mandatory provisions of the Act through the courts, preferring to rely on gentle albeit persistent persuasion and the good corporate citizenship of enterprises. This has resulted in low to moderate response rates to these surveys, although they are improving in some cases. Amongst other reasons, the modest response rate from firms to the survey may also be partly attributed to challenges in completing the survey and understanding its usefulness to the economy and to the private sector.

3.2.2 Weak Legislation and Enforcement

As mentioned previously, the surveys are supported by legislature and have associated penalties for non-compliance. However, in some cases, these penalties are not onerous enough to be a major deterrent for noncompliance, or are not enforced rigidly. Although punitive actions are deemed a less desirable strategy to boost compliance rates to surveys, they should be meaningful enough to be a deterrent, even if used as a strategy of last resort.

3.2.3 Weak Institutional Frameworks

The institutional frameworks for monitoring PSED are notably more complex than public debt. For instance, public sector debt information is usually readily available in a few departments within the ministry of finance, ministry of planning and/or central bank, while sector ministries will have information on public enterprises and guaranteed debt. However with PSED, the institutional arrangements can vary from simple to complex depending on the exchange rate regime prevalent in the country. As a result, there is need to develop adequate institutional frameworks, including appropriate legislation, communication between agencies and resourcing to better facilitate the monitoring of PSED.

3.2.4 Limited Human and Technical capacity

Given the relatively small population of several Caribbean economies, human resource constraints are a common challenge. In particular, the compilation of the External Sector Statistics including the IIP and BOP requires specialist training for compilers and analysts. While staff members in government statistical agencies are routinely exposed to training to assist in compilation, these efforts are thwarted by other circumstances such as small departments with heavy workloads, staff turnover, and priorities on other pressing areas. This

⁷In addition, Baball (2002) highlighted some broad issues related to PSED data collection that makes it more problematic than public debt data. Among these he noted: the Ownership/Mandate to Collect Data; Methods of Collection; and Types of Debt.

results in some countries not reporting all of the External Sector Statistics, delays in compilation and large errors and omissions.

3.2.5 Loss of Administrative Records

As countries move towards liberalized financial markets this limits the potential sources of available data on private external transactions. For instance, capital controls are usually connected with administrative sources of data, when these controls are relaxed capturing PSED transactions and positions becomes more complex.

3.2.6 Identifying transactions outside of the banking system

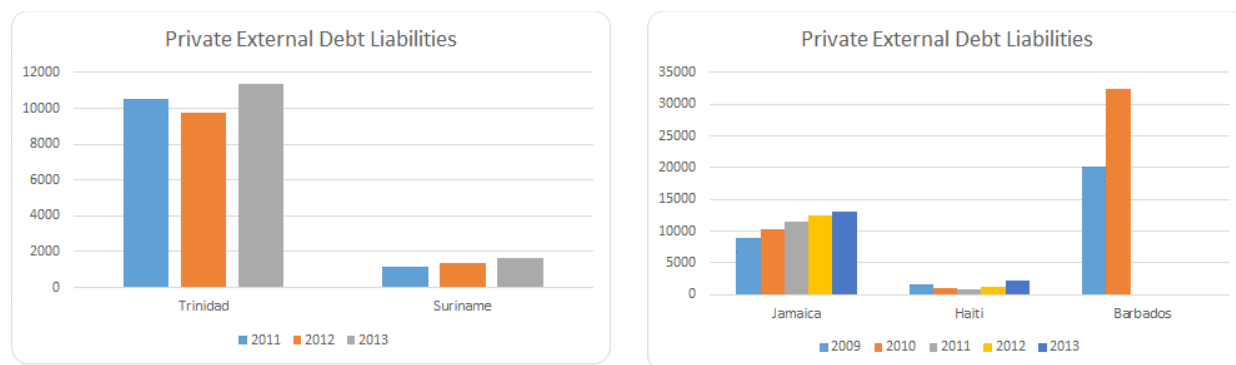
Identifying the existence of transactions that pass outside the domestic banking system can be very challenging to capture and in particular inter-company lending⁸. This however, has become a major area of concern and particularly for Caribbean economies where high related party exposure could adversely impact all of the other members of the group of companies.

4.0 Trends in Private Sector External Debt

4.1 IIP Data

This paper utilizes balance sheet data to analyze recent trends and the composition of PSED liabilities. The available IIP data shows that PSED liabilities are increasing, this upward trend was easily discernable for Jamaica, Suriname and Barbados, but there was some variability in the data for Trinidad and Tobago and Haiti (See Chart 1).

Chart 1: Private Sector External Debt Liabilities /US\$Mn/



Source: author's computations.

⁸In external debt statistics, “intercompany lending” is identified separately as part of gross external debt. Intercompany lending has three components: debt liabilities of parents to their affiliates, debt liabilities of affiliates to their parents, and debt liabilities between related affiliates. Intercompany lending is also recorded in BOP and international investment position (IIP) statistics, as a “debt instrument” under foreign direct investment (IMF (2009)).

Relatedly, the data also shows that PSED net liabilities are increasing ⁹ (see Appendix chart 1) and implies that the private sector in Jamaica ¹⁰, Suriname, Haiti and Trinidad and Tobago ¹¹ are net external debtors to the rest of the world. This suggests that the private sector in these countries are contributing to upward pressures on the external debt stock and debt service payments. Also, in the case of Jamaica which has a floating exchange rate regime, the additional private sector demand for foreign exchange could have a negative impact on the exchange rate and on the solvency of private debtors.

In terms of the composition of liabilities, most of the external liabilities were classified as other investments (see Table 3). These other investments or other debt instruments can include: increasing external loans, trade credits or other liabilities owed by residents to non-residents. Much of the details of these transactions such as the purpose of the loans, terms and conditions, nature of the trade credit and particulars about the other liabilities are largely unknown. As a result, it is difficult to properly assess the factors driving these increases and the associated risks of the transactions.

Table 3: Private External Debt (by instrument)

	Jamaica	Trinidad and Tobago	Haiti	Suriname
	as % of Total Private External Liabilities			
Inter-company lending ¹	-	22.3	-	30.0
Debt securities ²	22.3	22.9	-	-
Other Debt Instruments ³	77.7	54.8	100	70.0
Memorandum items:				
Private External Liabilities (US\$ Mn)	13,102.7	13,656.9	2,211.6	1,654.5
Private External Liabilities as % GDP	91.2	55.9	26.2	31.2
GDP(current market prices) US\$ Mn	14,362.2	24,433.8	8,452.7	5,298.8

Notes:

1. Comprises increasing liabilities to Direct Investors.
2. Non-residents holding Portfolio Investments (debt securities) in the resident financial & other sectors.
3. Other debt instruments owed to non-residents.

However, we know that part of the explanation for the rising PSED liabilities relates to higher related-party exposure (increasing liabilities to Direct Investors) as reflected in table 3. In the Caribbean, high related party exposure (inter-company borrowing) has resulted in significant inter-company exposure, where issues in one institution (an inherent contagion risk) could severely impact all of the other members of the group. Kirkpatrick and Tennant (2002) cited contagion risk as being one of the major contributors to the Jamaican financial crisis in 1995. Research related to the causes and consequences of failures or near failures of financial institutions in the Caribbean indicates that high related party exposure was one of the factors

⁹Net liabilities increase when the increase in liabilities more than offsets the change in assets.

¹⁰The net increase in PSED foreign liabilities appears to be most persistent in Jamaica, having recorded net liabilities since 2009.

¹¹Trinidad and Tobago data as at September 2013.

contributing to these crises or near crises. Da Costa, Polius and Grenade (2012) purports that a review of the financial statements for BAICO, an affiliate of the CL Financial group with significant intergroup exposure averaging 53.2 per cent 2004 and 2007 and growing to 81.4 per cent in 2009, showed that issues in one institutions (an inherent contagion risk) could severely impact all members of the group. Also, William (2012) noted that in Jamaica in the 1990s and in the case of CL Financial, there were numerous related party transactions and the shifting of assets from regulated to unregulated entities to get around restrictions on the investment of funds. Conglomerates which own regulated entities should be made to submit consolidated accounts to the regulator and where there are private companies publish consolidated statements in the press.

A notable exception to the aforementioned was the case of Barbados, where the private sector is a net creditor to the rest of the world; that is its external assets exceeded its liabilities. In 2010, the net external debt assets of Barbados amounted to US\$10.5 billion which was more than 3 times the amount in the previous year (US\$3.2 billion). The sharp improvement was mainly due to rising other investment debt assets which includes: trade credits, currency and deposits and loans.

4.2. BOP data

The IIP¹² data was not sufficient to provide regional insights into the state of PSED liabilities. As a result, BOP data was utilized to determine whether the increase in corporate liabilities evident in Jamaica, Suriname, Haiti and Trinidad and Tobago may also be occurring in the wider Caribbean and particularly in the Eastern Caribbean Currency Union (ECCU).

The relationship between the BOP and IIP can be understood in the context of the integrated IIP statement. While the IIP relates to a point in time. The integrated IIP statement relates to different points in time, and has an opening value (as at the beginning of the period) and a closing value (as at the end of the period). The integrated IIP statement reconciles: opening and closing values of the IIP through the financial account (flows arising from transactions), and the other changes in financial assets and liabilities account (other volume changes and revaluation) (Chart 1).

The PSED flows (BOP) data and the stock (IIP) were compared for Caribbean islands in instances where they were both available¹³ to assess whether they appeared consistent in terms of direction. Broadly, the data seems consistent, that is in instances when the Net PSED (flows) are positive (net assets), either the stock of PSED assets increases or the stock of PSED liabilities decreases. Conversely, when the PSED (flows) are negative (net liabilities), either the stock of PSED assets decreases or the stock of PSED liabilities increase. It should be noted however, that in some instances there can be discrepancies between the flow and stock data, for instance: if the BOP and IIP statements are not integrated, also the aforementioned analysis did not take into consideration other changes in financial assets and liabilities.

¹²One way to think about the IIP (or net foreign assets) is the cumulative sum of the current account.

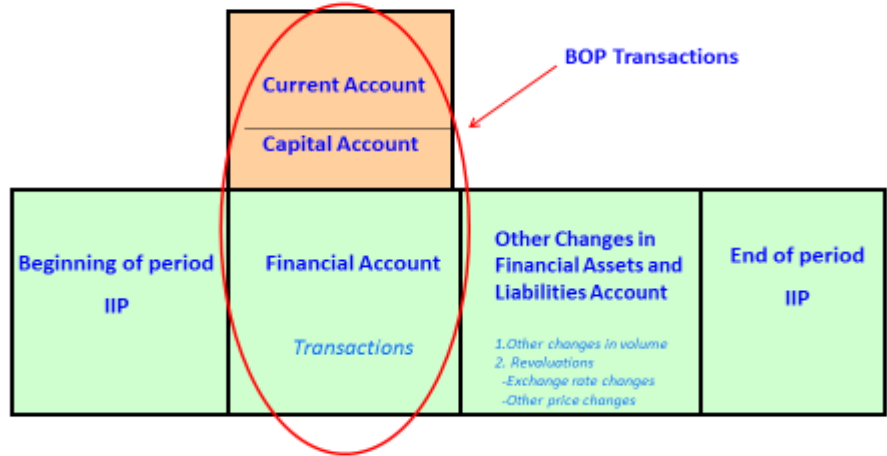
¹³Stocks and flows data were available for: Trinidad and Tobago, Barbados, Haiti, Suriname and Jamaica.

Chart 1: Integrated International Investment Position



Balance of Payments Division
IMF Statistics Department

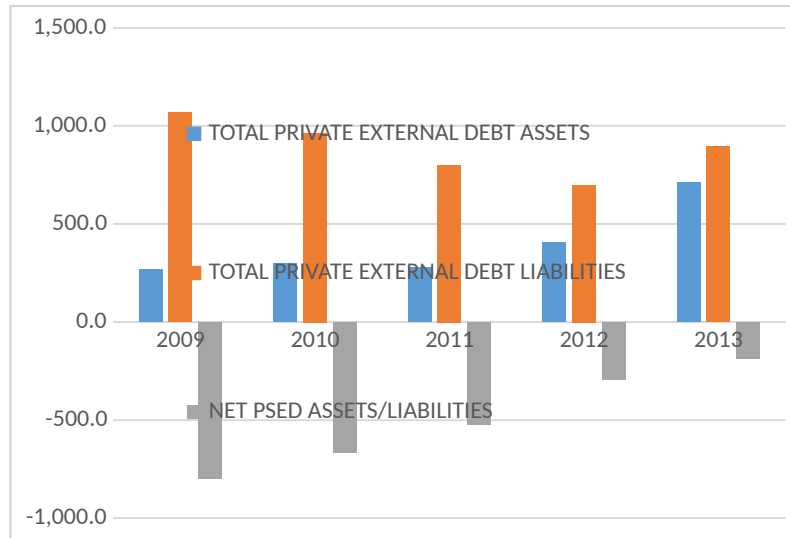
Integrated IIP Statement



Source: International Monetary Fund.

The BOP flows data revealed that Guyana, Suriname and Haiti recorded sharp increases in PSED liabilities, as well as negative net PSED flows which corroborates with the earlier IIP data. Furthermore, the BOP flows data suggests that the rising corporate external debt liabilities may be a challenge affecting the ECCU. For example, the net PSED (flows) in the ECCU were persistently negative during the period 2009-2013 (Chart 2). Which could mean either the stock of PSED assets has been decreasing or the stock of PSED liabilities is increasing. Within the ECCU the following islands recorded persistently negative Net PSED flows: Anguilla, Antigua and Barbuda, Dominica and Grenada. It should be noted however, that the Net PSED liabilities flows in the ECCU has been decreasing since 2009.

Chart 2: Eastern Caribbean Currency Union PSED Flows /US\$Mn/



Source: International Monetary Fund.

4.3 Creditor Source Data

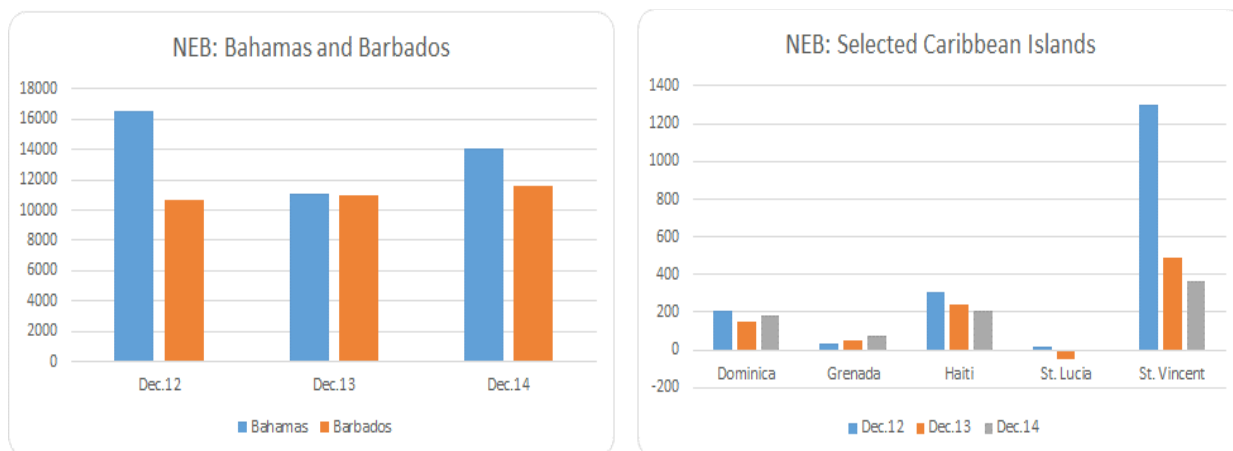
The BIS Creditor source data was used to supplement the previous information and also as a verification check for the previous findings of the paper. It should be noted however, that the Creditor source data was much narrower in focus than the assets/liabilities data as it focused mainly on the non-bank private sectors (NBPS) external loans and deposits.

The Creditor source data validated some of the earlier observations regarding the potential exposure of the private sector to external debt vulnerabilities and particularly for Jamaica, Guyana and to a lesser extent Suriname. In the case of Jamaica the NBPS net-external balance has been negative since 2010 and has averaged US\$383 million during the years 2010-2014. Meanwhile, the NBPS net loans amounted to US\$701 million and US\$202 million in Guyana and Suriname respectively in the year 2014.

Beyond these countries, the evidence may also be pointing to a more widespread challenge in the Caribbean as the net external balance was either negative or declining in 6 out of the 11 countries for which data was available (Appendix Charts 5). These include Eastern Caribbean countries such as St. Vincent and the Grenadines and St. Lucia. In St. Vincent, there has been a sharp decline in the non-bank private sector NEB, falling to US\$369 million in 2014 from US\$3,289 in 2006. In St. Lucia there was some variability in the trend in the NBPS net-external balance, particularly after 2009 with the economy recording net loans in 2013 and 2014 of US\$94 and US\$7 million respectively.

The NBPS net-external balance has also been on the decline in Haiti and to a lesser extent in the Bahamas. Conversely, the non-bank private sectors NEB has shown some improvement in Trinidad and Tobago, Barbados and Grenada within recent years.

Chart 3: Non- Bank Private Sector Net External Balance /US\$Mn/



Source: Bank for International Settlements.

5.0 Conclusions and Recommendations

The paper examines the topic of PSED in the Caribbean, with an emphasis on corporate external liabilities. It highlights the potential impacts of rising corporate external liabilities on macro-financial stability and argues that the existing data gaps in PSED represents a major challenge to assessing the extent of the risk faced by Caribbean economies. Using the available IIP, BOP and Creditor source data the paper makes the following observations which were consistent in all of the data sources.

Firstly, PSED net liabilities are increasing and this upward trend is easily discernable for Jamaica, Suriname, Barbados and Trinidad and Tobago. This suggests that the private sector may be contributing to upward pressures on the external debt stock and debt service payments in these countries. Also, in the case of Jamaica which has a floating exchange rate regime, the additional private sector demand for foreign exchange could have a negative impact on the exchange rate and on the solvency of private debtors.

Secondly, the paper highlights that not much is known about the composition of these corporate liabilities and as such it is difficult to properly assess the factors driving these increases and the associated risks of the transactions. This notwithstanding, we are aware that part of the explanation for the rising PSED liabilities relates to higher related-party exposure (increasing liabilities to Direct Investors).

Thirdly, the paper proposes that the challenges with rising corporate liabilities may be a concern for the wider Caribbean region. The BOP flows data and Creditor source data seem to suggest that the rising corporate external debt liabilities may be a challenge also affecting the ECCU. Within the ECCU the following islands recorded persistently negative Net PSED flows: Anguilla, Antigua and Barbuda, Dominica and Grenada.

As a result of the previous observations this paper makes the following recommendation. There needs to be significant improvement in the monitoring and reporting on PSED in the Caribbean. There needs to be a better understanding of who are these private sector borrowers? (are they conglomerates, insurance companies, individuals); what types of instruments are they holding?;

what is the purpose for borrowing? This data needs to be sourced by sector and by company if possible. This position was also supported by Ellmers and Hulova (2013) who indicated that the private lending and borrowing boom is taking place in a largely unregulated environment and is essentially uncontrolled.

Mexico and Thailand have made some progress in terms of improving data collection and compilation on PSED and as such the strategies of these countries can be reviewed as a basis for improving monitoring and reporting in the Caribbean. Another useful source of information may be the Bank of Indonesia which has developed a survey to examine risk behavior of the corporate sector external debt. Based on this survey the Central Bank can take anticipatory measures through appropriate controls and policies.

In charting the way forward, special attention has to be paid to the regulation of Conglomerates which may be involved in cross-border lending given the history of the potential threats associated with this in the past. As well as there needs to be some discussion about the policy and regulatory framework for managing corporate external debt; the institutional arrangements for effective monitoring and analysis of private capital flows and short-term debt; data requirements; communication between agencies and resourcing to better facilitate the monitoring of PSED.

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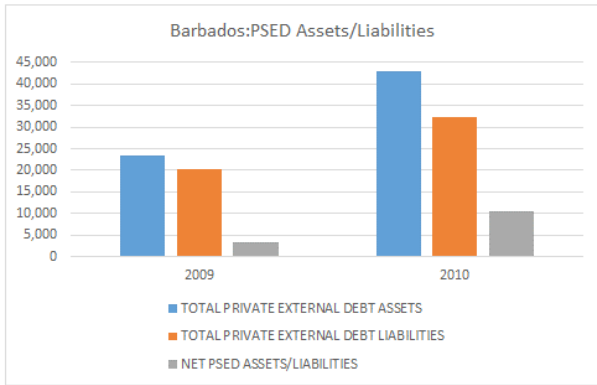
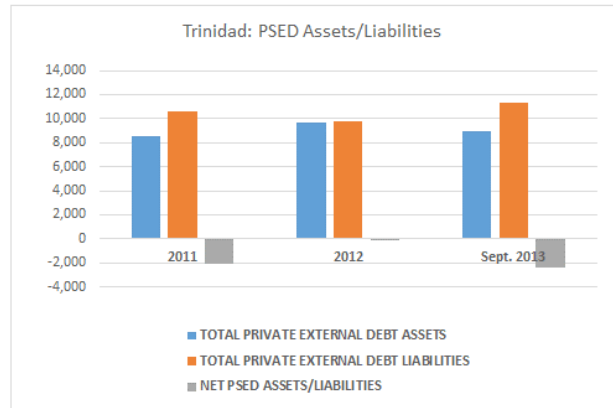
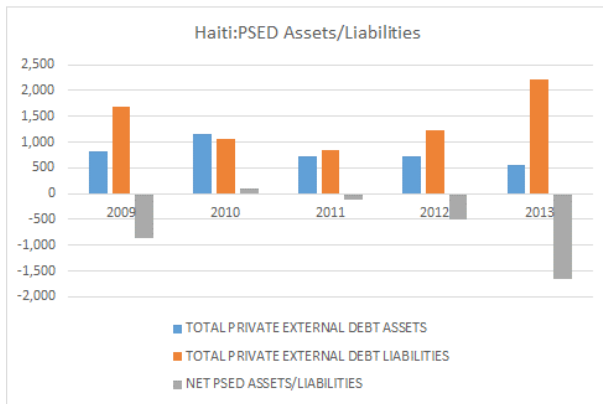
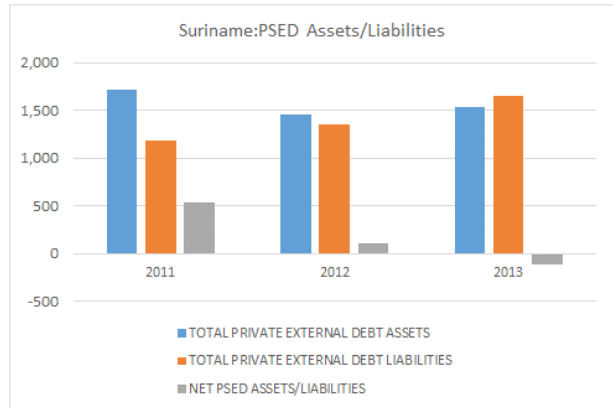
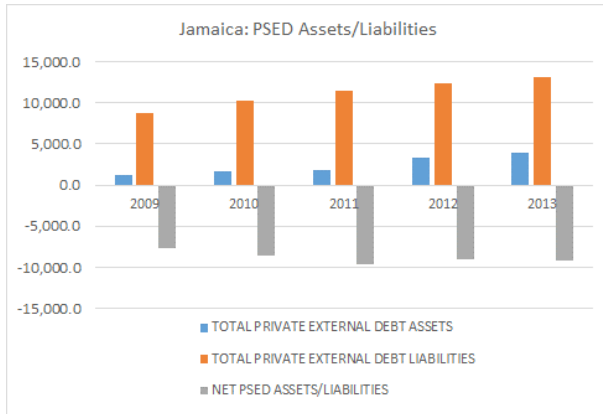
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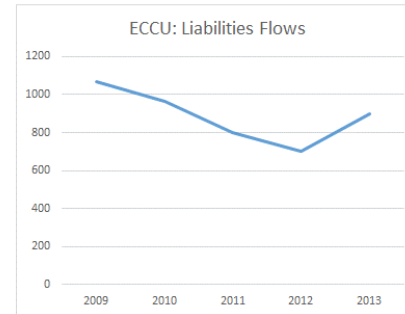
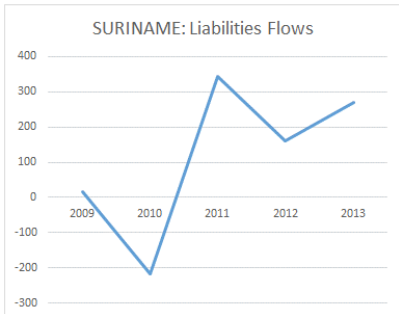
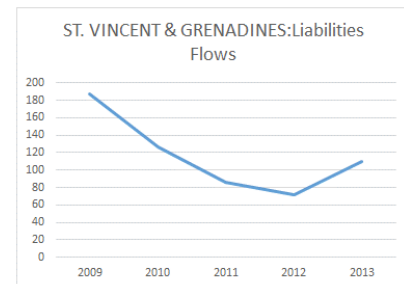
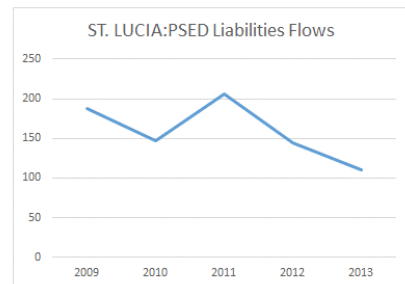
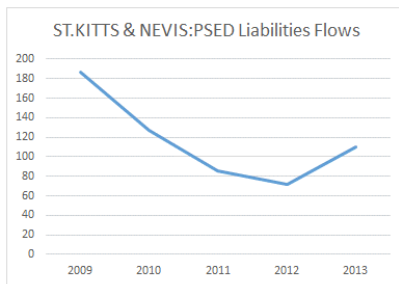
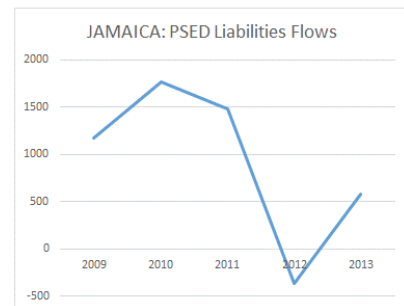
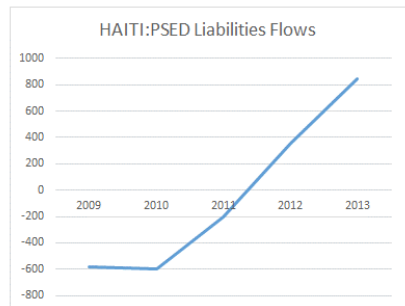
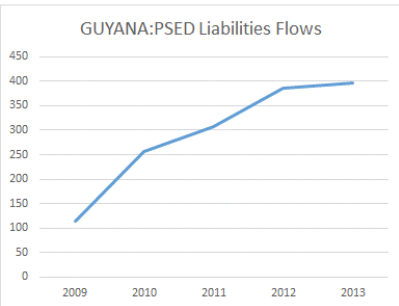
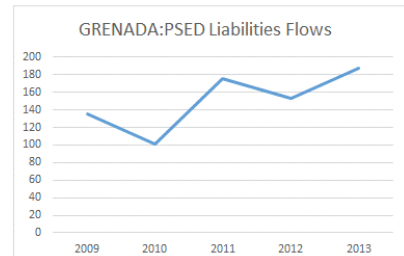
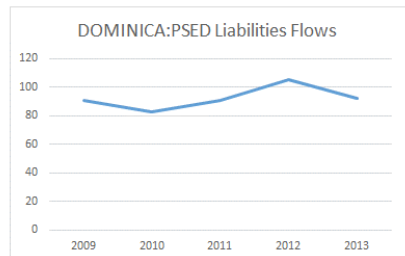
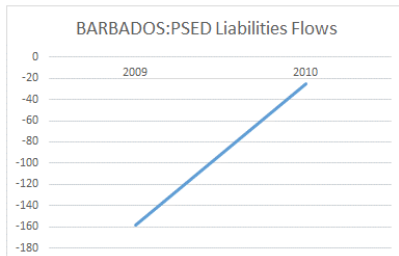
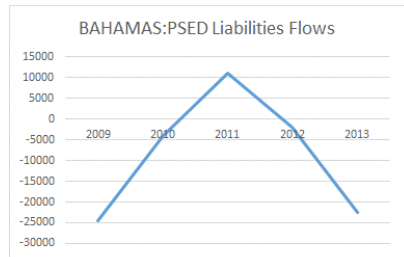
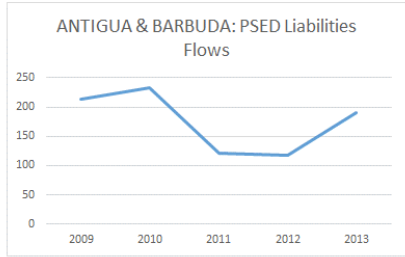
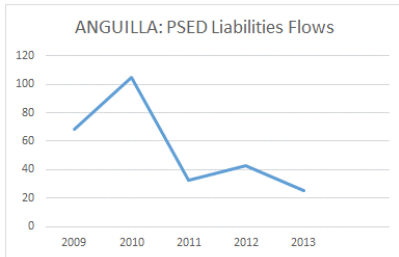
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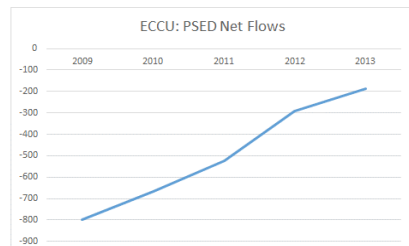
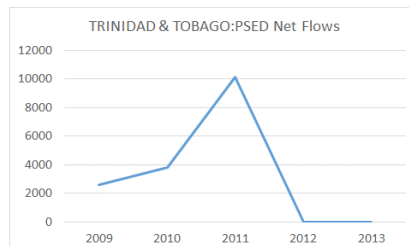
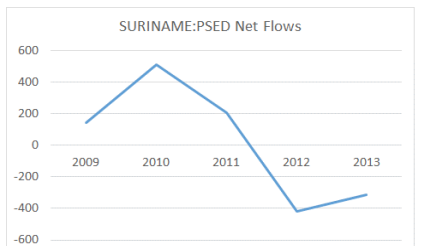
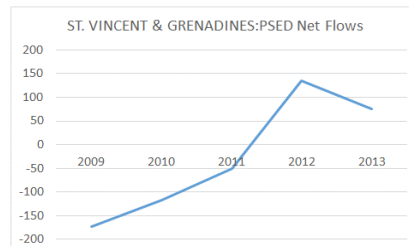
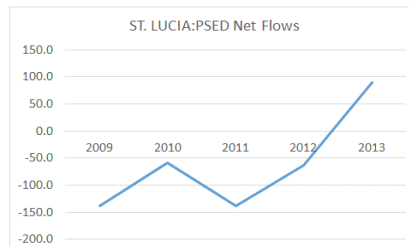
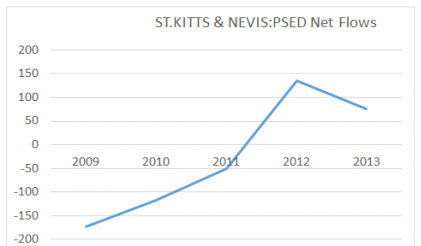
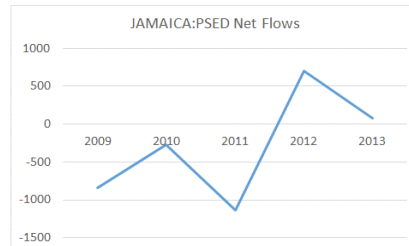
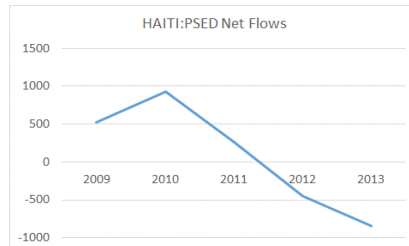
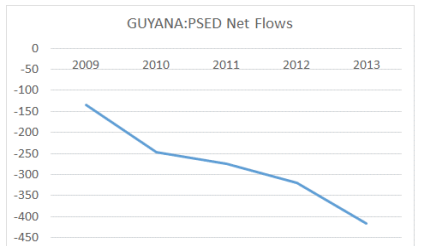
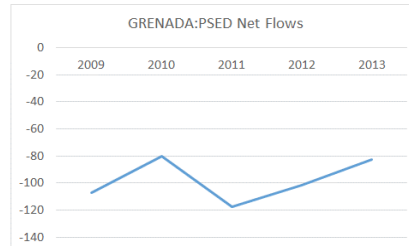
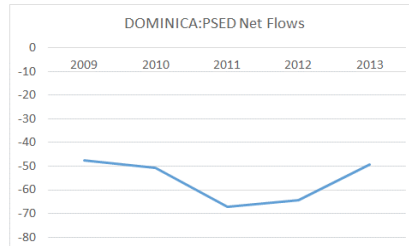
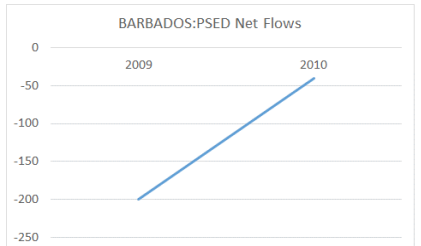
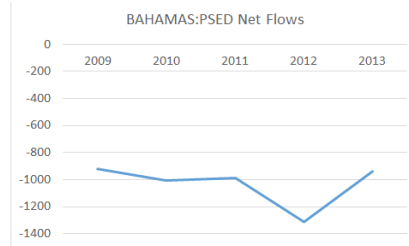
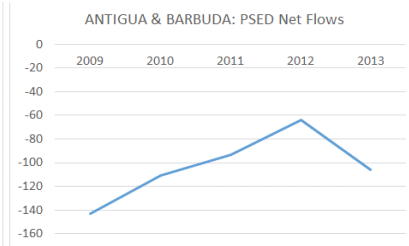
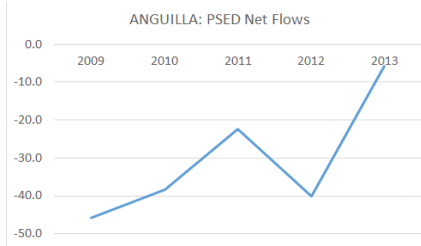
Appendix Charts 1: IIP Data /US\$Mn/



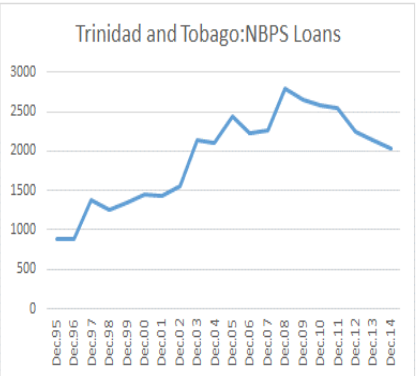
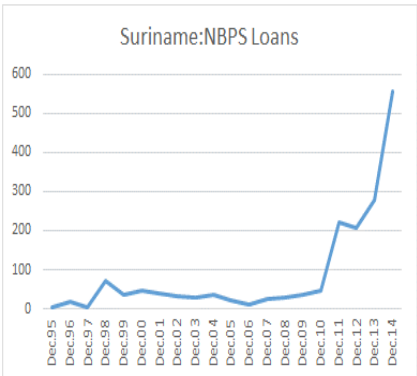
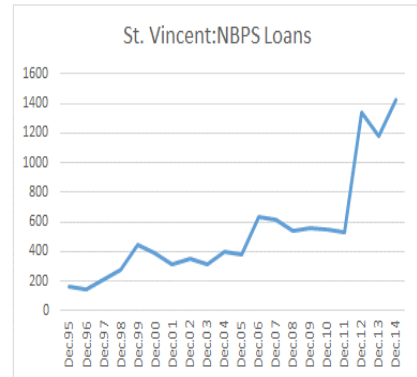
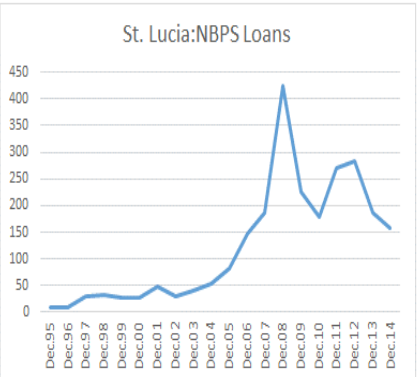
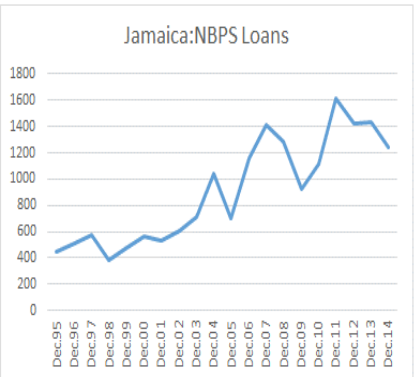
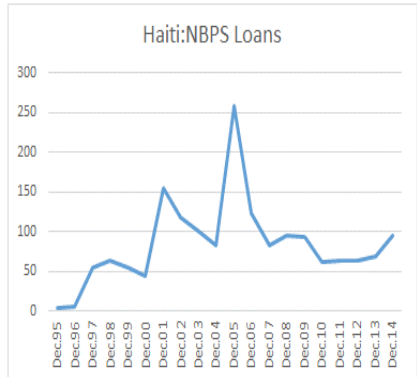
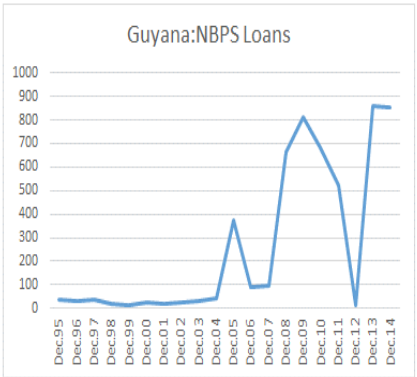
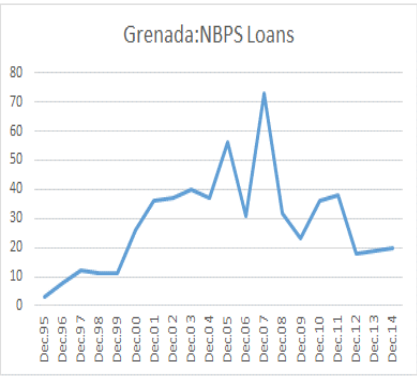
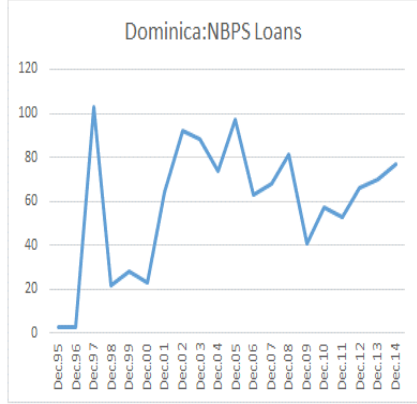
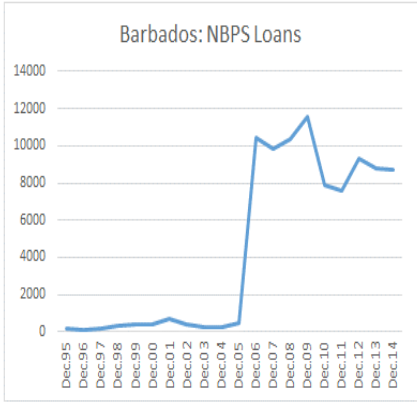
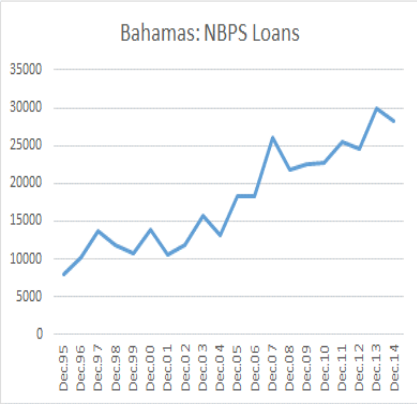
Appendix Charts 2: BOP Data – Liabilities /US\$Mn/



Appendix Charts 3: BOP Data - Net Flows /US\$m/



Appendix Charts 4: Creditor Source Data - Loans /US\$Mn/



Appendix Charts 5: Creditor Source Data - NEB /US\$Mn/

