



RESILIENCE AND STABILITY: THE CASE FOR ISLAMIC BANKING AND FINANCE	Pg 1
REGIONAL NEWS SUMMARY	Pg 2
SUMMARY OF CBB REVIEW SEMINAR 2011	Pg 3
ANNOUNCEMENTS	Pg 4

RESILIENCE AND STABILITY: THE CASE FOR ISLAMIC BANKING AND FINANCE

With many Western banks facing pressures from thin capital reserves and unstable sources of financing as a result of the global financial meltdown, Islamic banking has been touted as a banking model for sustainable growth and development that promotes the common good of both the financial sector and wider society. Islamic banking and finance have been now recognized as an ethical alternative to traditional Western financial service providers. They offer protection against excesses of leveraging while at the same time promoting the core ethical value of trust. Since their inception more than three decades ago, Islamic financial services have grown significantly with over 300 institutions operating in more than 75 countries. Islamic banking assets are currently approaching one trillion dollars. Islamic or Shari'ah-compliant banking provides financial services and products that conform to Islamic religious practices and laws. It is characterized by the prohibition against payment and receipt of interest at a fixed or predetermined rate, but instead, focuses on profit-and-loss (PLS) sharing arrangements, purchase and resale of goods and services, and the provision of services for fees. In purchase-resale transactions, a mark-up is based on a benchmark rate of return. For example, the rate of return on deposits is directly linked to the quality of the bank's investment decisions. In practice, when you place money in a bank, the bank guarantees to return the money to you. You are allowed to withdraw the money at anytime; the bank may charge you a fee (for looking after your money) and may pay hibah (gift) or other profit-sharing means, including dividends.

Islamic banking shares much in common with conventional banking but the former avoids activities such as riba' (the amount paid or received over and above the principal) or gharar (excessive uncertainty). Islamic banks give financing based on musyarakah (joint venture) and will contribute through mudharabah (profit sharing). The first Islamic bank was established in Malaysia in 1983. Shari'ah principles assure discipline and responsibility which are necessary for financial stability. At its very core, the Islamic financial system incorporates the inherent ability to deal with and preempt financial crises since it encourages business and trade activities that generate legitimate profits, and business transactions on a mutual fund risk-sharing basis.

The basic principles of Islamic finance include (Islamic Finance and Global Financial Stability, April 2010): prohibition of interest or riba' (interpreted as any unjustifiable increase of capital), money as potential capital (money ought not to be

utilized to increase the purchasing power without productive activity; the creation of wealth through trade and commerce is advocated), risk sharing (suppliers of funds become investors rather than creditors), prohibition of speculative behaviour (discourages hoarding and prohibits transactions featuring gharar (extreme uncertainty) and maysir (gambling)), sanctity of contracts (contractual obligations and disclosure of information is a sacred duty which reduces the risk of asymmetric information and moral hazard), Shari'ah approved activities (for example, business dealing with alcohol or gambling is prohibited), and social justice (transactions leading to injustice and exploitation is prohibited).

The model has proved resilient, especially in light of the recent global financial meltdown: debts cannot be securitized, instruments that carry debt-based credit risks cannot be purchased, selling or leasing assets that one does not own is prohibited (speculative short selling is not allowed). In particular, safeguards of the Islamic financial business model include: (1) the universal banking model that integrates commercial banking, investment banking and asset management activities that are carried out without clear and established legal, financial or administrative separation, (2) the transformation of risks in Islamic financial instruments, (3) direct investment in real estate activities with the objective of financing real economic activities, rather than speculative trading, and (4) the management of investment accounts which contractually share in the overall risks of assets funded by these accounts and managed by the bank (<http://www.worldscibooks.com>).

The recent global financial meltdown has questioned the stability and soundness of financial systems. It is an opportune time to examine alternate models that are based on some ethical principles. Islamic finance and banking promote financial transactions which support real economic activity, as well as profit and risk sharing opportunities. Today, it has become one of the fastest growing financial models in the international financial community, in both Muslim and non-Muslim countries. It offers the possibility and the capacity to address the challenges as the global financial system continues to face increased risks and vulnerabilities, and it can promote resilience and stability in a world that is swimming in an ocean of systemic risks and uncertainties.

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REGIONAL NEWS SUMMARY

CL FINANCIAL

- Former CL Financial chairman, Lawrence Duprey, is arguing that being a witness in the Commission of Enquiry into the collapse of his empire could be prejudicial to him (TG 28 Jun) but the chairman Sir Anthony Colman ruled that he must (TE 30 Jun)
- Commissioner Sir Anthony Colman made a call for all Clico policyholders to come to the Commission of Enquiry and tell their tale. He observed that only one witness had so far come forward (TG 7 Jul)
- CL Financial Limited instructed Jamaican creditors that it would devise a payment plan by month-end for its US\$240 million of notes in "default". The payment options could include cash or selling shares in CL Financial assets – including its local subsidiary, Lascelles de Mercado and Company (Newsday 11 Jul)
- CL Financial managing director Marlon Holder signed the definitive share purchase agreement concerning the sale of 100 % of the shares of the energy company, the Primera group, to Canadian oil company Touchstone Exploration Inc. The money from the sale of Primera would be used to settle noteholders of Lascelles de Mercado, the publicly listed Jamaican spirits company that is a CL Financial subsidiary (TG 12 Jul)
- The Clico Policyholders Group is claiming victory, following the ruling by Justice Maureen Rajnauth-Lee in favour of six CLICO Executive Flexible Premium Annuity policyholders (TE 25 Jul) but Finance Minister Winston Dookeran says Clico will appeal that decision (TG 25 Jul)

THE STANFORD GROUP

- A motion filed on behalf of the investors who lost money in Allen Stanford's alleged Ponzi scheme two years ago claims the man overseeing the recovery of assets is using up the money instead of helping the victims.
- They say that since the US Securities and Exchange Commission shut down Stanford's investing and banking operations in 2009 the moneys collected, which were intended to help them recover their losses, has mostly been used to pay expenses (Carib360 8 Jul)

CARIBBEAN

- Guyana's finance Minister Dr. Ashni Singh said the Government, recognising the need to maintain a strong financial system has, over the years, implemented the necessary policies and legislative framework to ensure that the system remains strong (GCO 28 Jun)
- Just over six in every 10 Jamaicans experienced a slide in their economic situation last year, with most persons having to budget more or cut down on their spending (JG 29 Jun)
- National Commercial Bank Jamaica's board has chosen to list on the New York Stock Exchange (JO 29 Jun)
- The Paris Club has advised international private sector institutions that Antigua and Barbuda has turned a corner and begun to service its debt obligations (Carib360 30 Jun)
- THE Guyanese economy was hailed in an IMF country report for demonstrating resilience and recording a fifth consecutive year of robust growth for 2010, in the face of external and domestic shocks (GCO 1 Jul)
- Stakeholders in the tourism sector need to change their way of doing business to suit their customers, even if this means opening later and longer, according to David Rice, CEO of the Barbados Tourism Authority (BAdv 1 Jul)
- Jamaican financial institution Capital & Credit Merchant Bank Ltd has been delisted from the Trinidad and Tobago Stock Exchange. The company decided to redeem shares and began paying shareholders in May (TE 4 Jul)
- Haiti will give "utmost importance" to full integration in the CARICOM Single Market, Michel Martelly, president of Haiti, has indicated) (CNnow 5 Jul)
- The Branson Centre of Entrepreneurship Caribbean, a collaboration between Virgin Unite and Virgin Holidays, opens in September, and will support local entrepreneurs to create and grow small businesses, ultimately generating jobs for the region (CNnow 6 Jul)
- President Michel Martelly has issued an urgent call to businessmen in CARICOM to invest in Haiti to help create wealth for that country's development and reconstruction (Carib360 7 Jul)
- The Jamaica Stock Exchange expects its new US dollar platform to attract local and foreign listing and consequently reduce flight of foreign capital (JG 7 Jul)
- The International Monetary Fund has grudgingly accepted Jamaica's decision to start paying public-sector workers their outstanding 7% increase this fiscal year (JG 8 Jul)
- The Barbados Workers' Union has negotiated wage increases for workers at several companies despite the crippling slowdown in the economy (BN 8 Jul)
- St. Maarten has expressed interest in becoming an Associate Member of the Caribbean Community (Caribseek 8 Jul)

REGIONAL NEWS SUMMARY cont'd

- The Barbados Government is having a hard time meeting its fiscal targets despite an increased VAT rate and restraint in discretionary spending. The Central Bank, in its six-month economic review, said that business profitability had not yet recovered and corporate tax receipts had fallen short of expectations (BN 13 Jul)
- Trinidad and Tobago economy is expected to grow by no more than 2% this year and this is dependent upon new construction projects by the Government, said ECLAC (Newsday 14 Jul)
- The Caribbean Development Bank's US\$200 million floating-rate senior unsecured note issue, which matures in July 2016, has been assigned "AAA" rating by Standard and Poor's (Caribseek 14 Jul)
- Guyana's GDP is projected to grow 4% in 2011 and 5% in 2012, UNECLAC said in its 2011 Economic Survey (GuyTimes 14 Jul)
- The Caribbean Association of Indigenous Bankers is calling for the implementation of a centralised Caribbean credit bureau that will be the main credit-assessing and reporting agency in the region (JO 15 Jul)
- Cuba is welcoming any company willing to assist with the country's oil and gas industry (TE 15 Jul)
- Trinidad and Tobago needs to invest millions of dollars on research and development so the country can gain more when it exports its products (TE 16 Jul)
- The Antiguan Government has announced a stimulus package for local manufacturers, the construction sector, tourism, and other businesses in an attempt to turnaround the flagging economy (JO 22 Jul)
- Intra-regional tourism, which was a strong driver of tourist arrivals, has been consistently declining, and it is hoped that the arrival of REDjet on the scene will cause a turn around (BAd 25 Jul)
- T&T's Heritage and Stabilisation Fund now stands at \$23.7 billion (Newsday 25 Jul)
- The Eastern Caribbean Central Bank has taken control of the Antigua & Barbuda Investment Bank to save it from collapse in a move that officials say will not affect deposits (TG 25 Jul)
- Executives Without Borders, a non-profit organization, has launched Ramase Lajan, a "cash for recyclables" programme aimed at spurring sustainable jobs by removing the plastic from Haiti's landscape and beaches (Carib360 26 Jul)
- Jamaica's sovereign bond rating will remain stable at 'B3', or three grades from default, provided there are no external shocks, says Moody's (JG 27 Jul)
- FDI into Jamaica declined by 62% in one year to US\$201 million in 2010 (JG 27 Jul)

SUMMARY OF THE CENTRAL BANK OF BARBADOS ANNUAL RESEARCH REVIEW SEMINAR

The Central Bank of Barbados recently held its 31st Annual Research Review Seminar on the theme *Macroeconomic Policy and the Way Forward: Redesigning Economic Policy in the Context of Global Challenges*. Over the four-day period, Monday 25th - Thursday 28th July 2011, ideas and current work of researchers and practitioners were aired and discussed. Participants made valuable contributions on topics that ranged from Tourism and Climate Change to Financial Markets and Economic Development. Other themes were Government Operations, Employment and Business and Trade and International Markets.

A Panel Discussion on the second day of the Seminar on the general theme *Macroeconomic Policy and the Way Forward: Redesigning Economic Policy in the Context of Global Challenges* was very well attended by a broad range of participants from business, government, international and regional organizations and academia. This panel discussion was streamed live to all the employees of the Central Bank of Barbados. Panelists included Dr. Wayne Robinson, Chief

Economist at the Bank of Jamaica, Dr. Gobind Ganga, Deputy Governor at the Bank of Guyana, Mr. Rohan Stowe, Deputy Director Research Department at The Eastern Caribbean Central Bank and Mr. Dave Seerattan, Research Fellow and Officer in Charge at the Caribbean Centre for Money and Finance. Another important event during the Seminar was a workshop on *Economic Stability Policy Targeting a Market-Determined Exchange Rate Peg* that was facilitated by the Governor of the Central Bank of Barbados, Dr. DeLisle Worrell.

Participants also attended a cocktail reception in celebration of the sterling contribution Dr. Kevin Greenidge, Director of Research has made to the Central Bank and to wish him well in his new posting at the IMF. Additionally, participants were treated to a guided tour of the popular Harrison's Cave, which was followed by a tour of the Island that culminated at the popular tourist liming spot, Oistins.

ANNOUNCEMENTS

JBFE—JUNE 2011

The June 2011 Issue of the Journal of Business, Finance and Economics in Emerging Economies is now out. This issue contains the following papers: *Dynamic Interaction of Bank Assets in two Foreign Currency Constrained Economies* by **Tarron Khemraj, R. Brian Langrin**; *Exchange Rate Determination in Jamaica: A Market Microstructures and Macroeconomic Fundamentals Approach* by **Roland Craigwell, Allan S Wright, Diaram Ramjeesingh**; *The Impact of Credit Constraints on Private Aggregate Consumption* by **Chanit'A Holmes**; *The Macroeconomic Impact of IMF Supported Programmes in Small Open Economies: The Case of Barbados* by **Kevin Greenidge**;

An Empirical Analysis of the Inflation Targeting Framework in a Time of Financial and Economic Crisis by **Keyra Primus, Reshma Mahabir** and *Are Caribbean Countries Diverging or Converging? Evidence from Spatial Econometrics* by **Roland Craigwell, Alain Maurin**.

The Journal publishes papers over a range of topics and welcomes submissions in general areas of Finance and Economics. Papers are available free online at <http://www.ccmfuwi.org/?q=journal/papers/2011>

43RD ANNUAL MONETARY STUDIES CONFERENCE

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- Economic Growth Strategies
- Fiscal Policy and Debt Sustainability
- Trade and Regional Developments
- Exchange Rate and Inflation Dynamics
- Tourism, Culture and the Environment
- Education, Health, Welfare and the Political Economy
- Labour Market Dynamics

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