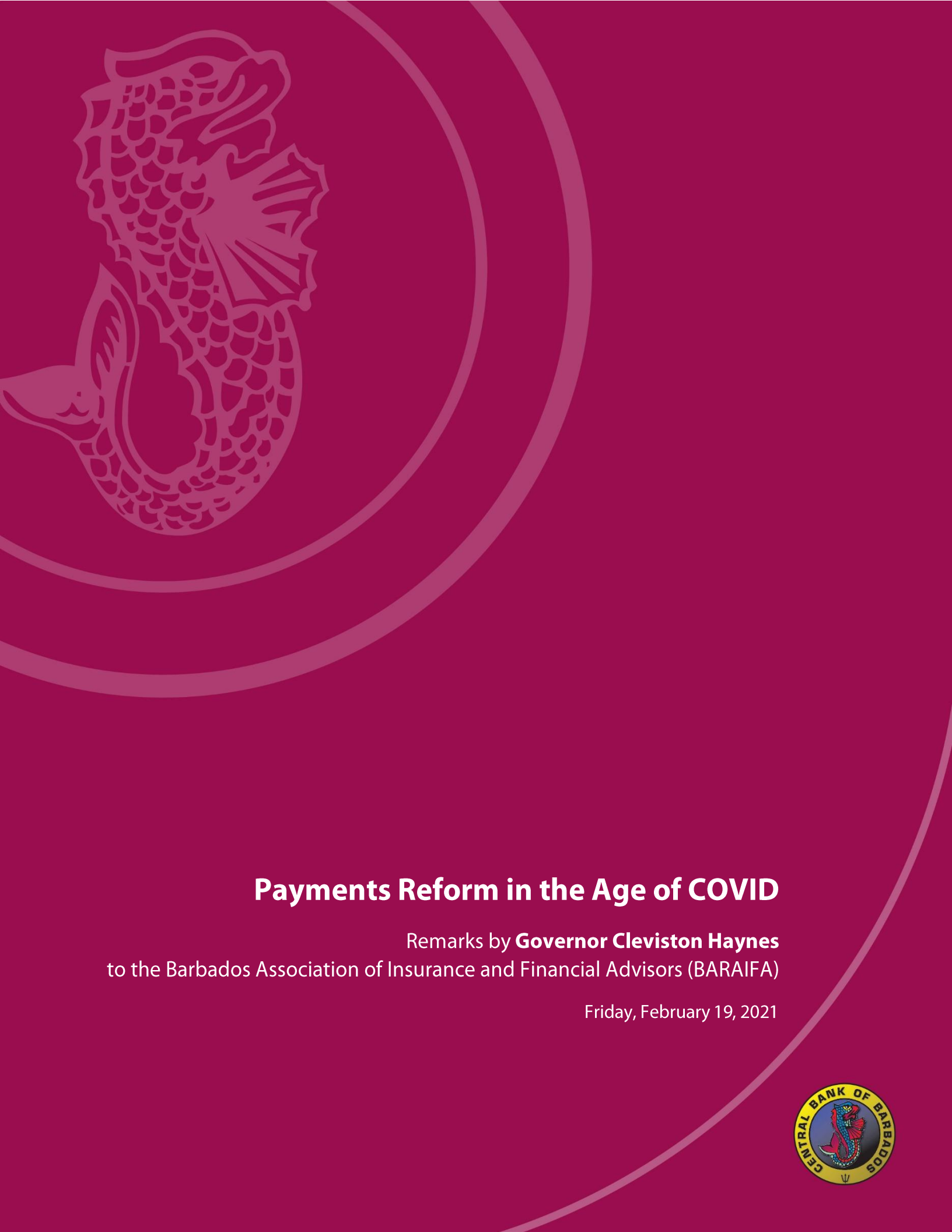




Payments Reform in the Age of COVID

Remarks by **Governor Cleviston Haynes**
to the Barbados Association of Insurance and Financial Advisors (BARAIFA)

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Payments Reforms in the Age of COVID

What a difference a year makes!

In my address to you at this time last year, I spoke of the progress that we had made in restoring economic stability, and of my optimism for a resumption of modest economic growth in 2020. In relation to growth, I stated then:

"External factors, principally related to the strength of the underlying demand for tourism services, the impact of ever-present global risk factors and the speed with which the myriad foreign-funded private sector investments in the pipeline start, will determine how strong the impetus for renewed growth in the current year will be."

COVID-19 had already started to spread its international tentacles but it had not yet reached our shores. How far it would spread was unknown. Its virulence and longevity could not be predicted with certainty. Surely there had been other viruses that were quickly brought under control. Unfortunately, COVID-19 escalated and, in less than three weeks after my remarks to you, it was defined as a pandemic by the World Health Organisation.

COVID's Economic Impact

What started as a health-related issue has transitioned into a major global economic problem, adversely affecting large and small economies alike. The International Monetary Fund (IMF) now estimates that in 2020 the global economy contracted by 3.5 percent, with Barbados' major source markets for tourism, the United States and the United Kingdom, falling by 3.4 percent and 10 percent, respectively. Global tourism, the industry that drives the Barbados economy, is estimated to have fallen by over 70 percent.

The impact of these developments on the Barbados economy is well-known, as the external risks to which I alluded last year were realised and combined to depress economic activity. The tourism sector, which was expected to be the engine of growth, was brought to a virtual standstill during the last three quarters of the year and, as a result, economic activity registered a double digit decline for the year. Lockdowns, curfews and physical distancing, while necessary to contain the spread of the virus, together with the attendant reduced incomes, helped to dampen private spending. In addition, given the uncertain environment, several of the envisaged private sector investment projects did not materialise during the year.

At the peak of the shutdowns, unemployment rose to historic levels. Even as some jobs returned during the second half of the year, the labour market remained soft with an increased number of persons engaged in part time work. However, payments on unemployment insurance claims cushioned the impact of reduced household incomes. Government raised its spending in order to strengthen the social safety net for the disadvantaged, while allocating increased resources to healthcare and infrastructure development. Government's revenues contracted in light of reduced spending, and the fiscal stance shifted dramatically as the targeted primary balance was reduced from a surplus of 6 percent of GDP for FY (fiscal year) 2020/21 to a deficit of 1 percent.

One major consequence of this policy shift is that government borrowed substantially from international financial institutions, including the IDB (Inter-American Development Bank), the IMF and CAF (the Development Bank of Latin America), to ensure that financing was available to support the anticipated weaker fiscal outcome. The debt to GDP ratio started to rise again, reaching 144 percent by year-end, but this increase was primarily due to the contraction in the size of economic activity, as much of the new external borrowing was offset by the repayment of existing debt.

Of equal note is that the increased borrowing also had a favourable impact on the international reserves, which rose to the equivalent of 40 weeks of import cover. The strengthening of reserves also reflects the favourable impact of reduced demand for foreign exchange and lower oil prices.

The challenges presented by the pandemic extended to the financial sector. In view of the expected deterioration in credit quality and the related concerns regarding the ability of businesses and households to service their debt obligations, lending institutions pre-emptively offered cash-flow relief to their customers, by providing moratoria on loan payments. These moratoria generally lasted six months but as they came to an end, some loans were restructured to better enable borrowers to adapt to the altered circumstances in which they operate. At the aggregate level, household indebtedness declined, particularly for credit card debt.

The Central Bank supported the initiatives by lending institutions to assist their clients, by adjusting monetary policy to enable its licensees to access additional liquidity, if needed, and relaxing regulatory policy to provide increased flexibility to financial institutions in the management of their loan portfolios. At year-end, no institutions had availed themselves of Central Bank liquidity.

Prospects for Recovery

We were optimistic that we would realise a strong, though partial, recovery in 2021. But prospects for a sharp recovery this year have waned in the face of the uncertainty created by rising COVID infections at home and in our major tourism source markets. The introduction of vaccination programmes globally offers hope that demand for tourism will enable some revival

in the latter half of the year, but to fully take advantage of any *“green shoots”*, it is equally important that we are able to control the spread of the virus at home. The short-term costs of the current shutdown therefore represent a significant investment in promoting economic recovery and sustainable job creation over the near-term.

The buffers, particularly in international reserves, that we have built over the past 27 months will be crucial in helping us to navigate the volatility and the uncertainty that confront us. The marked change in our economic fortunes illustrates both our need and our ability to adapt. Our policy responses so far, whether through loosening short-term fiscal targets or in providing relief to those disadvantaged by this crisis, demonstrate our willingness to pivot. Further adjustments will be required, as we seek to mitigate the impact on households and businesses while preserving jobs. Execution of government’s capital works programme will be pivotal in addressing the reduced private sector spending.

As I indicated in my recent economic report for 2020, COVID has amplified our economic vulnerabilities, emphasising the need to promote greater diversification of economic activity and thus dampen the impact of a shock to a single sector. COVID has also demonstrated our capacity to adapt and innovate, and we now need to build on these gains as we seek to create a sustainable framework over the medium term. This requires the input of all stakeholders. The structural reforms that we have undertaken in our economic reform remain central, as they will help to improve efficiency, strengthen institutions and, in some cases, better mobilise resources. Our financial institutions continue to have a crucial role to play, working with their clients to ensure that they come through this difficult period and are able to innovate, grow, create jobs and earn or save foreign exchange. This is an important dialogue that we will have in the coming weeks.

Payments Reform

Developments in digital technology and computer networks, internet-based businesses, e-commerce platforms, including peer-to-peer transactions, are influencing the nature and scope of financial intermediation and the payments and settlement ecosystem. Financial service firms are adopting technological innovations which have the potential to encourage financial inclusion, effectively increasing the number of locations at which your savings can be conveniently accessed and often without the need for an in-person presence.

Indeed, the increased use of digital payment methods, represents the trend of the future financial architecture evolving in the Caribbean and across the globe. There is now a greater demand for and use of alternative forms of payment. In recent times, both the Government and the Bank have recommended the reduced use of cash and a movement toward digital payments.

The pandemic conditions brought into sharp focus the convenience of reduced reliance on paper-based transactions and accelerated the adoption of electronic payments. For example, more businesses transitioned their payroll systems on-line, enabling their employees to receive

their salaries without the need to encash cheques. The need for many businesses to move their services online during the ongoing pandemic – and I know several in the insurance sector were among the first to make the transition – has almost certainly accelerated the adoption of e-commerce and e-banking, even among those that were previously hesitant to embrace it. Increasingly, bills and taxes are being settled via on-line transactions, and the emerging on-line delivery services are reliant on card-based transactions.

Government itself is now making an increasing share of its transactions through direct payments via the ACH. The National Insurance Scheme has also reduced its use of cheques through direct transfers. It occurs to me that the recent delay in the availability of cheques for NIS pensioners, suggests that greater use of direct transfers could be one potential solution to this problem.

What is clear is that e-commerce is not a temporary measure, a stopgap until things return to “normal”. This is the path for doing business in the future.

It is therefore necessary for us to ensure that there is a robust framework for the effective and secure operation of the national payments system capable of the smooth execution of both domestic and cross-border transactions. This is critical because if the payments and settlement system is impaired, economic activity may grind to a halt, with individuals and businesses experiencing difficulties, including the payment of salaries, pension payments and other transfers, which they need to pay their bills, loan payments, insurance premiums and purchase food and medicine, needed to sustain their lives.

In the current environment, care has to be taken that operational disruptions do not materialise which can cause the unavailability or limited availability of critical payment systems, which can further disrupt financial stability. One can think of scenarios involving market participants not being able to settle transactions or that liquidity needs cannot be met or redistributed across the financial system. This must be avoided at all costs given the significant economic and social hardships that could ensue.

As we embrace these trends, it is also critical therefore that adequate safeguards are adopted to protect all stakeholders in the payments systems. Government will therefore bring before Parliament shortly a National Payments Systems Bill, the objective of which is to promote a safe, efficient, resilient and competitive payments system that manages risk, promotes financial stability and safeguards the interest of consumers. The Central Bank will be responsible for supervising the system, but unresolved consumer complaints will be adjudicated by the planned Financial Services Tribunal.

The new legislation creates a framework for licensing payments services providers by the Central Bank. In addition, it establishes a Payments Council to advise the Bank on matters pertaining to payments. The Bank will over time issue guidance and regulations to give force to the new legislation and will be prepared to take action against licensees which breach the law.

Apart from the new legislation, the payments system is undergoing change. Enhancements to the ACH will allow for real time settlement of direct transfers. Access is being made for non-traditional participants, emphasising the need for interoperability so that payments instruments can be used seamlessly. It is critical that customers have choice in the payments instruments and providers, so as to ensure that transaction costs are contained. The Bank firmly believes that pricing must not act as a disincentive to the use of new modalities for the execution of financial services and that consumers must have choice of alternative products to ensure that the economy remains competitive.

As we enact new legislation, we will work to educate consumers and financial institutions on their rights and obligations. We believe that this will be crucial to gaining buy-in from all stakeholders as we promote increased competition in the payments system. I trust that you as financial advisers, will work with us to achieve this objective.

Stay safe and follow the protocols.

I thank you.