



FINANCIAL STABILITY REPORT 2018

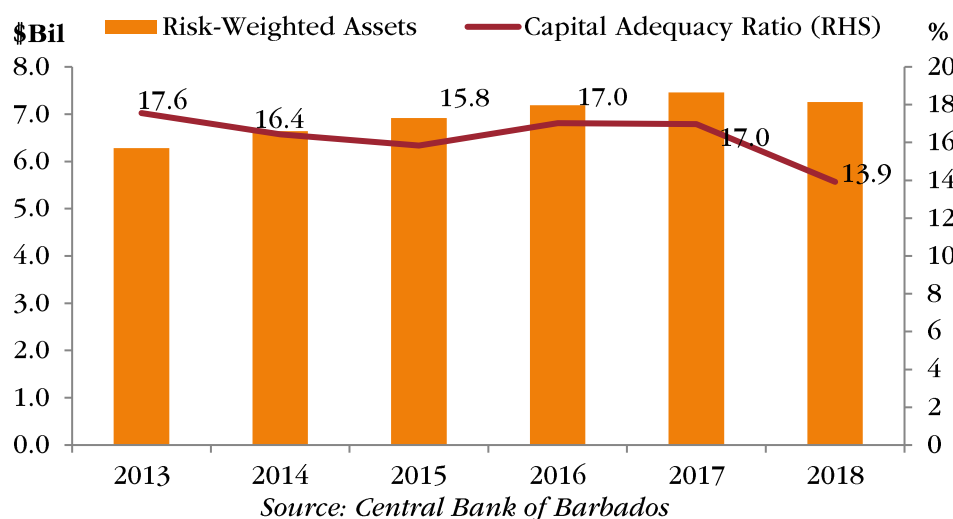


FINANCIAL SERVICES
COMMISSION

Commercial Banks

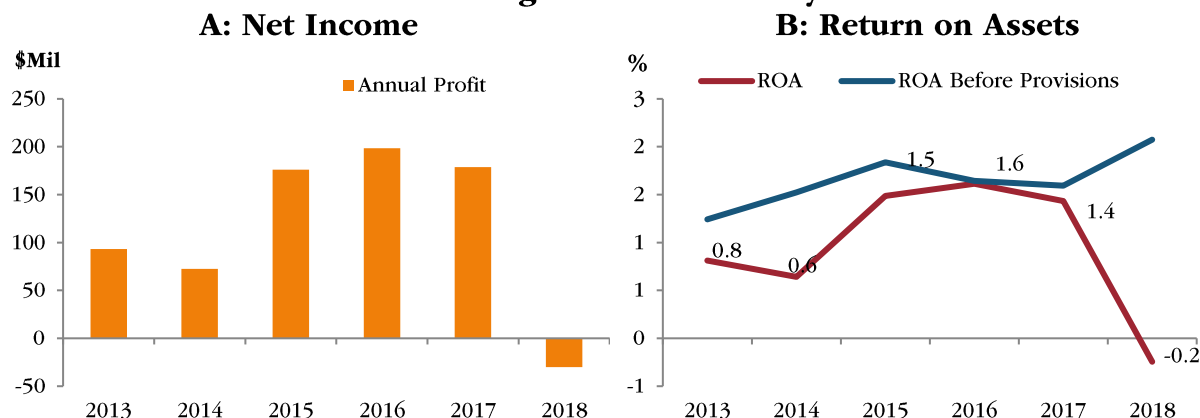
During 2018, the commercial banking sector remained solvent. Ordinary banking operations remained profitable, but the lengthening of the maturity on Government securities, the reduction in the coupon rates of the new instruments paid and the implementation of IFRS 9 resulted in a negative return on assets for the year and an overall reduction in regulatory capital. However, capital buffers remained in excess of the prescribed levels as the system's capital adequacy ratio declined to 13.9 percent by December 2018, from 17 percent at year-end 2017 (Figure 1). At March 2019, individual capital adequacy ratios ranged from 25.8 percent to just under the 8 percent benchmark, while the system capital ratio was 12.7 percent.

Figure 1: Capital Adequacy

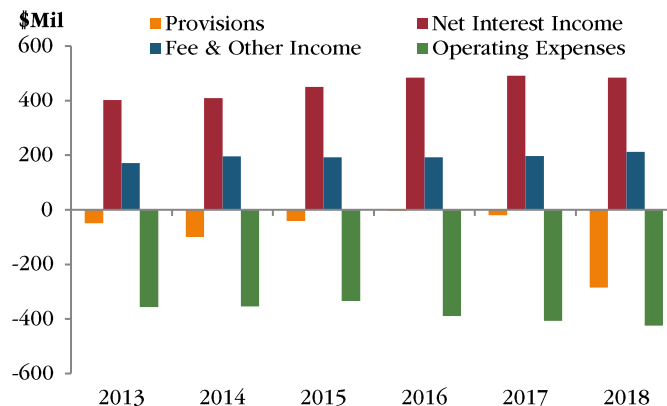


Pre-tax net income, before adjustment for provisions and net present value losses arising from the restructuring, declined by 5 percent. This largely reflected higher operational expenses and a contraction in net interest income of just over 1 percent, as falling interest expenses did not fully compensate for declines in interest income from loans and securities (Figure 2).

Figure 2: Profitability



C: Net Income by Category

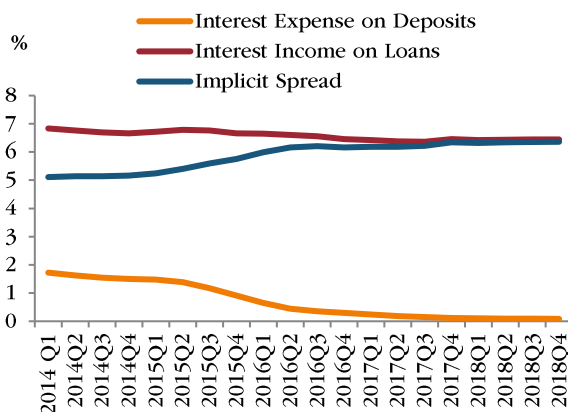


Source: Central Bank of Barbados

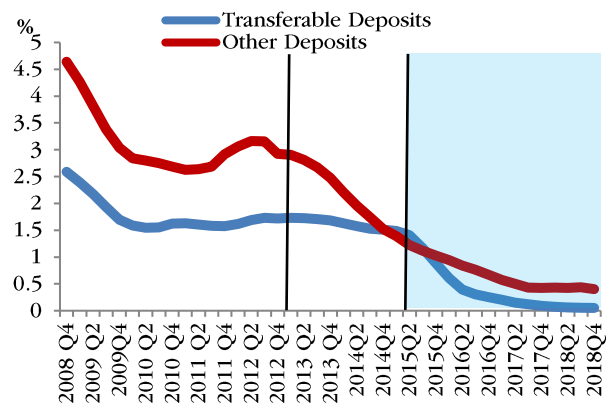
Interest rates on deposits remain at historical lows with the average deposit rate estimated at 0.1 percent in 2018. However, interest income on loans remained flat at 6.5 percent. With a marginal falloff in deposit rates, the implicit spread moved from 6.3 percent to 6.4 percent at year-end (**Figure 3**).

Figure 3: Commercial Banks' Interest

A: Interest Earnings and Expense



B: Interest Expense by Type¹



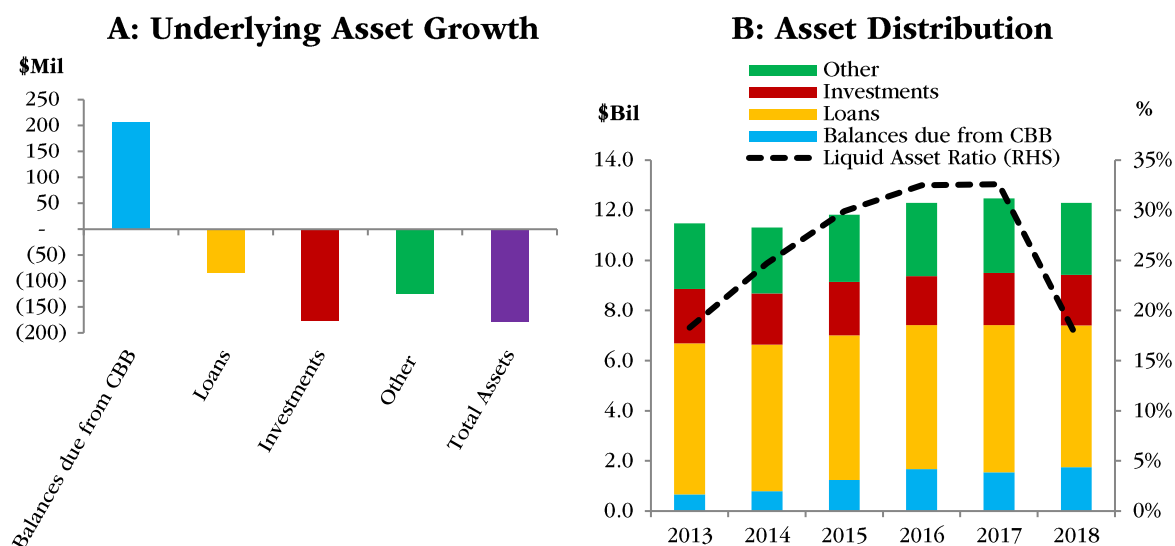
Source: Central Bank of Barbados

The consolidated balance sheet of banks contracted by 5 percent. The amalgamation of one of the larger banks with its subsidiary finance and trust company cushioned the impact of a one-off settlement of a foreign currency inter-company loan that reduced gross loans. Net of these transactions, total assets declined by 1.4 percent, principally the result of the accounting adjustment resulting from the debt restructuring.

¹ Transferable deposits comprise call deposits, demand deposits and savings deposits with unrestricted withdrawal privileges.

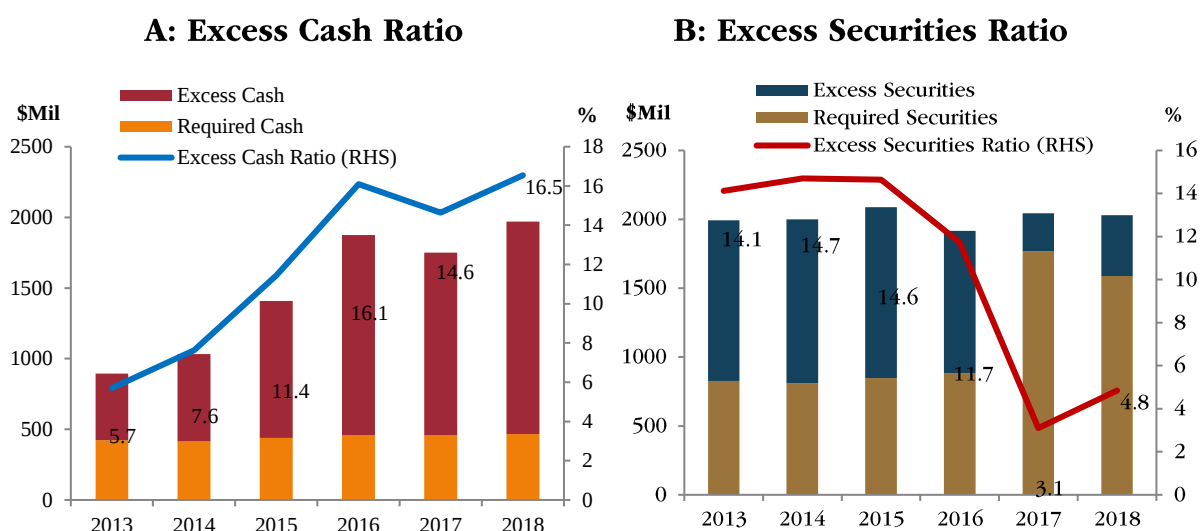
With banks indicating only modest lending opportunities, balances held on reserve at the Central Bank grew by 14 percent (**Figure 4**). Liquidity remained high with an excess cash ratio of 16.5 percent, up from 14.6 percent in 2017 (**Figure 5**). At the same time, the reduction in the securities requirement ratio from 20 percent to 17.5 percent helped to raise the excess security ratio which stood at 4.8 percent at the end of 2018. As a result of the debt restructuring, liquid assets as a percentage of total assets declined to 17 percent due to the maturity extension on treasury bills.

Figure 4 : Total Assets



Source: Central Bank of Barbados

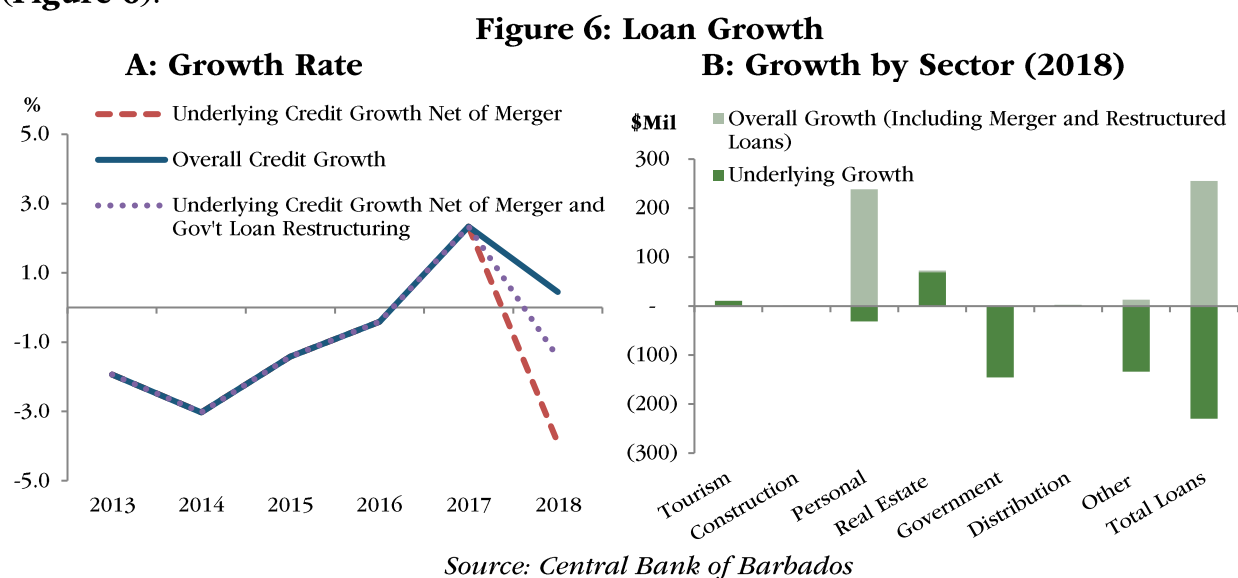
Figure 5: Excess Liquidity



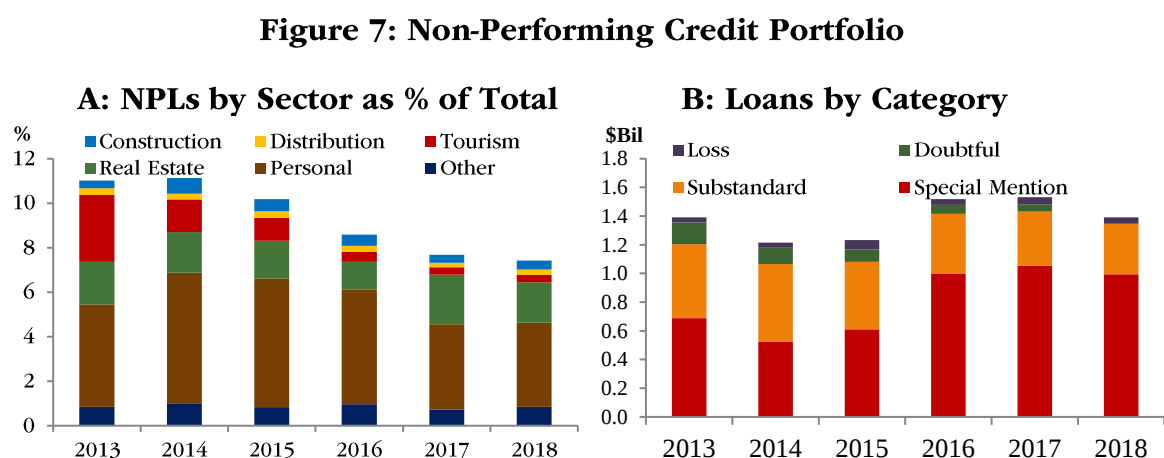
Source: Central Bank of Barbados

During 2018, the amalgamation of the parent bank with its mortgage lending affiliate enabled domestic-currency credit to expand by 0.4 percent but there was an underlying

contraction of 3.9 percent. The decline was largely attributed to the reclassification of loans to Government into securities and a shrinkage in the consumer credit portfolio. After adjusting for both the reclassification of Government loans and the amalgamation, domestic currency credit contracted by approximately 2 percent. However, there was modest growth in real estate and tourism loans by 5 percent and 10 percent, respectively (Figure 6).

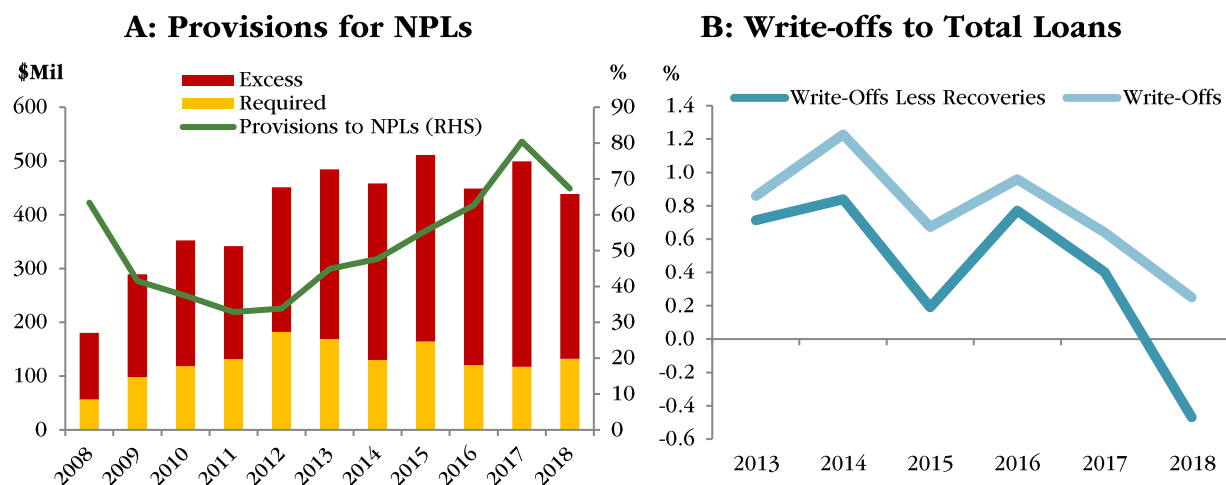


The non-performing loans to total loans ratio fluctuated during 2018. NPLs increased by 20 basis points to 7.9 percent in the first quarter before rising 11.2 percent by the end of the third quarter. This temporary surge in non-performing loans occurred due to the classification of loans to Government and its entities as “substandard”, following the debt restructuring announcement. At the end of the fourth quarter, NPLs reverted to 7.4 percent as loans to government were restructured and converted to debt securities (Figure 7). Total classified loans declined by 5 percent and this was reflected in loans classified as “substandard” and “loss”. The substandard category continued to account for the largest share of gross classified debt, accounting for 78 percent while the doubtful and loss categories represented 12 percent and 10 percent, respectively.



Provisions-to-NPLs contracted to 67 percent, from 80 percent in the previous year (**Figure 8**). However, the fall in provisions to NPLs largely reflects adjustments made by institutions that had significantly over-provisioned prior to the debt restructuring. Banks are also making considerable strides towards recovering bad debt, indicative of recoveries outstripping write-offs for the year. Furthermore, write-offs continue to represent a modest percentage of total loans outstanding.

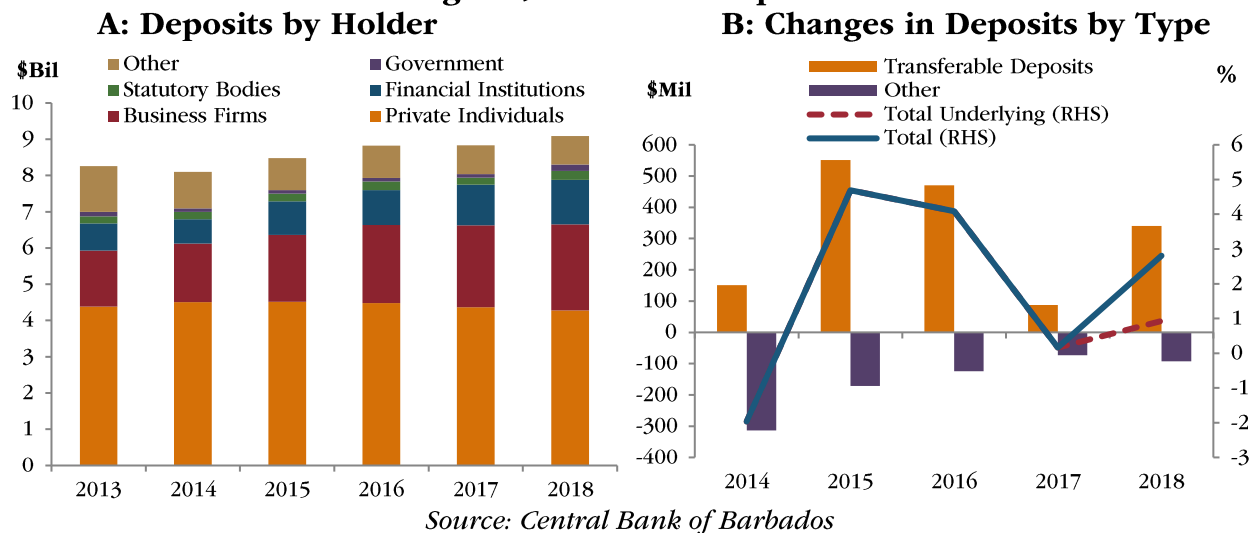
Figure 8: NPLs Provisions and Write-offs



Source: Central Bank of Barbados

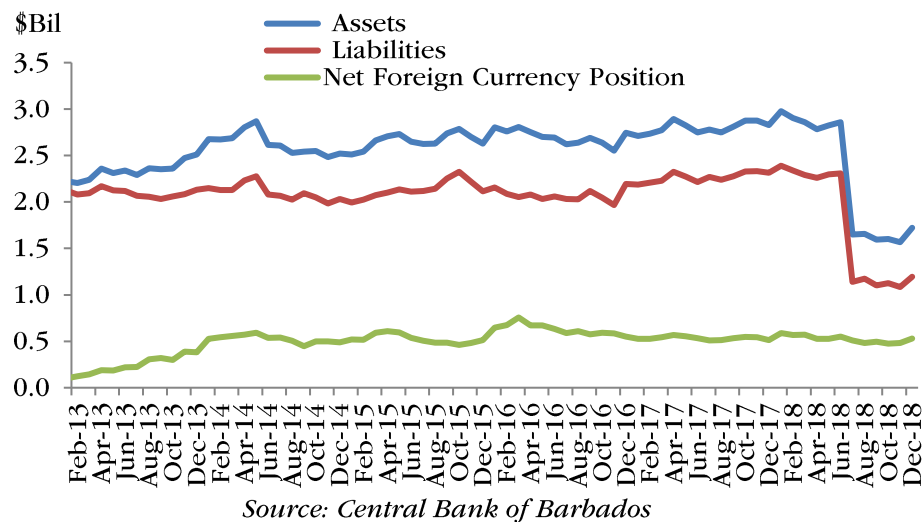
Deposits grew by 2.8 percent, but net of the amalgamation deposits growth was only 1 percent. These gains were fuelled by increases in deposits held by all major categories except private individuals. In the prevailing low deposit rate environment, deposits by private individuals have been falling since 2015, with some individual deposits migrating to the credit union sector in search of higher yields. Consequently, deposits held by private individuals declined by 2.0 percent (**Figure 9**). In contrast, deposits held by businesses and financial institutions grew by 5.1 percent and 9 percent, respectively. The decline in deposit rates has also spurred an increasing proportion of deposits held in immediately accessible or “transferable” accounts versus deposits which are largely on fixed term contracts.

Figure 9: Domestic Deposits



There was a moderate improvement in the net foreign currency position of banks. The settlement of the large foreign currency group transaction reduced both assets and liabilities denominated in foreign currency, but there were declines in other foreign assets and liabilities (**Figure 10**). Foreign currency deposits which accounted for 6.8 percent of total deposits at year end and foreign currency loans which represent 4 percent of the overall loan portfolio declined.

Figure 10: Net Foreign Currency Position





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