

## **IMPACT OF THE FINANCIAL CRISIS IN THE CARIBBEAN – TOURISM AND BAUXITE**

### **BACKGROUND:**

1. The Caribbean economies' fastest growth period since the 1960s has been abruptly interrupted by the worldwide economic crisis that began with the meltdown in the US financial system. The impact on these countries is being felt through a slump in exports that started in late 2008, and falling tourist arrivals in the first nine months of 2009 that led to contracting GDP in nearly all countries, rising unemployment, and declining government revenues. Investment activity has also plummeted, and is reflected in sharp reductions in foreign direct investment flows and a downturn in the construction sector.
  
2. While there have been no financial panics as in earlier external shocks, some countries such as Antigua and Barbuda, Dominica, Guyana and Jamaica, are grappling with large current account and fiscal deficits, as well as difficulty in accessing private external financing. These countries have limited room to implement policies that could moderate the production and employment effects of the crisis. Hence, several of them have either settled or, as in the case of Jamaica, are negotiating borrowing arrangements with the IMF.
  
3. Some countries, including Barbados, Guyana, Suriname and Trinidad and Tobago, had, however, built up substantial international reserves over the past decade. The region's financial systems have also been less vulnerable to external conditions, and

so domestic credit has not been very sensitive to external pressures. Further, inflationary pressures, which had been elevated up to September 2008, have subsided with the drop in world food and fuel prices, allowing the easing of monetary policy in most countries.

#### **Trinidad and Tobago:**

4. Trinidad and Tobago (T&T), the largest economy in the English-speaking Caribbean, has been experiencing broad-based decline in GDP since the 4<sup>th</sup> quarter of 2008 that has led to rising unemployment. The T&T Central Bank has reported that GDP fell by 3.3 % in the 1<sup>st</sup> quarter of 2009, as output in the dominant energy sector dropped by 2.0 %, the manufacturing sector declined by a massive 11.7 %, and retail sales dropped sharply. Loans and advances to the private sector also fell.
  
5. There has been improvement in the trade balance as the contracting economy has compressed imports, but Government revenues have declined, pushing the fiscal accounts into a deficit. With energy prices recovering and increased public spending, the rate of decline in the T&T economy is expected to slow. But Central Bank Governor Ewart Williams anticipates slow recovery of private sector borrowing, due to weak consumer and business confidence. Analysts are forecasting that the T&T economy will decline in 2009 for the first time since 1993, and anticipating that weak demand activity will continue into 2010.

#### **Barbados:**

6. The Barbadian economy, the largest in the Eastern Caribbean, registered a 3.0 % decline in output in the 1<sup>st</sup> half of 2009. This is the first such contraction since 2002, and unemployment rose

sharply to 10.1% in the 1<sup>st</sup> quarter, from 7.9% in the corresponding period of 2008. Output was pulled down by an 8.2% fall in tourism, a drop of 7.6% in manufacturing output, and a downturn in other services and goods-producing sectors. Construction activity contracted by 4.4%, leading to an estimated fall of 18.4% in cement sales, as foreign financing inflows plunged.

7. The government has had to increase domestic borrowing to finance a widening deficit caused by public sector salary increases and subsidies. Imports have contracted sharply, but private capital inflows shrunk, and foreign reserves are projected to decline further by the end of 2009. The Central Bank of Barbados is projecting that GDP will contract by 3.0% for 2009, but is anticipating that the government will move to stimulate economic activity by stepping up capital spending later this year and in 2010.

**Jamaica:**

8. The Jamaican economy has also been undergoing a decline in output, exports, and remittances, while investment activity has slowed considerably. GDP is estimated to have declined by around 4 % in the 1<sup>st</sup> half of 2009, as output in all sectors except for agriculture fell. The Mining sector has been hardest hit, with output in the bauxite industry falling by 67 % in the first nine months of the year, while the Construction sector declined by over 7 %, pushing down cement sales by 15 %. The contraction of output has led to a decline in revenues and a widening of the fiscal deficit, and unemployment has increased.
9. Like the other Caribbean countries, imports have dropped sharply, going down by US\$2.38 billion, or by 49 % in the January-July

period, based on lower oil prices and reduced raw materials and consumer goods; but exports declined by 54.6 %. Bauxite exports declined by 67 % up to September, and are projected to fall further during the rest of the year.

10. Tourism, the leading sector, has, however, held up with stop-over visitor arrivals increasing by 4.1% in the January-September period, although earnings are down due to heavy discounting of hotel rates. According to John Issa, Chairman of Super Clubs and one of the pioneers of Caribbean tourism, *“People are prepared to travel, but are looking for a deal. While visitor arrivals to the Caribbean are down, operators offering attractive packages are able to maintain their market share. Jamaica is faring better than higher-cost destinations like the Bahamas and the Cayman Islands.”*
11. After a bout of instability in the foreign exchange that led to a hike in interest rates earlier, the foreign exchange market has stabilised, while inflation has trended down to 8.9% in June from nearly 17% in December 2008, facilitating significant cuts in interest rates in July and August. Jamaica’s heavy dependence on trade means that the slide in economic activity is likely to continue in 2010 as the major export sectors, foreign direct investment, and remittances are projected to remain soft in the immediate term.

**Dominican Republic:**

12. In the Dominican Republic, the region’s largest economy, GDP growth slipped to 1% in the 1<sup>st</sup> quarter of 2009 from an annual average of 8.5% over the past four years, as exports and tourism have slumped. With falling revenues from tourism, reduced remittance flows, and limited access to credit from the private capital market, the government has secured a standby

arrangement with the IMF and external financing from the World Bank and Inter-American Development Bank to cover the increased deficit in government revenues, which is projected to continue into 2010. The increase in the deficit was running at over US\$300 million in the first seven months of 2009.

13. Economic analysts expect the deficit to rise to over 2.0% of GDP, even with spending cuts. In an effort to boost construction and to stimulate investment, the government is increasing spending on housing and other infrastructure works.

#### **TOURISM:**

14. Globally, the tourism sector has been hard hit by the fall-out in the economy, particularly in North America and Europe, with a decline of more than 9% in the first five months of the year. In the Caribbean, all destinations except for Cuba, Jamaica and, initially, Cancun, experienced steep decreases in visitor arrivals during that period. In fact, several destinations, including Antigua, the Bahamas, Cayman Islands, Martinique, St. Maarten, and U.S. Virgin Islands suffered double-digit rates of decline in the winter season. Barbados, Belize, and St. Lucia experienced high single-digit declines.
15. Combined with the heavy discounting of rates, the falling arrivals led to significant drop in earnings, job losses and a downturn in overall economic activity in tourism-dependent economies of the region. According to UNWTO, receipts from international tourism contracted by over 10% in the first six months of the year, or 1 – 2 percentage points more than the rate

of decline in arrivals. This means that for Caribbean destinations the loss in earnings in most cases would have been up to 15% or more.

16. The most recent UNWTO World Tourism Barometer issued in October indicates that by August, the rate of decline of international tourism demand had come down to 7%, and that it expects that arrivals could witness a moderate recovery of 1% – 3% in 2010. In the meantime, data from the Caribbean Tourism Organisation [CTO] show that while Martinique and U.S. Virgin Islands are no longer experiencing double-digit declines, Barbados has now joined that group. Cuba and Jamaica have, on the other hand, been making steady progress, and Cancun is recovering gradually from the swine ‘flu fall-out.

17. With the region’s heavy dependence on the US as a source market for visitors, particularly the Bahamas, Belize, Cancun, Cayman Islands, Jamaica, Puerto Rico and US Virgin Islands, we can expect continued pressure, given what appears to be a wobbly US economic recovery. US consumer spending continues to be dampened by the rising unemployment rate and the severe loss of wealth arising from the financial crisis. Europe, the region’s other major tourism source market, is also recovering slowly, though most economies in that region have begun to climb out of recession. This market is therefore not likely to provide strong momentum in 2010. The bright spot is Canada, which has generated robust growth in visitors to several Caribbean destinations, including Barbados, Cuba, Jamaica, and St. Lucia. In the case of Jamaica, arrivals from Canada increased by over 28% in the January-September period.

18. Prior to the recession, the tourism sector had been the main source of investment, and especially foreign direct investment in most regional economies. The downturn in the global economy has brought this to a virtual halt. The sharp decline in the construction sectors of the Bahamas, Barbados, and Jamaica, among others, is reflective of this downturn. In Jamaica, where tourism investments have accounted for over 50% of total foreign direct investment in the past decade, the two remaining major investment projects will be completed by the first quarter of 2010. To date, only the Falmouth Cruise Pier is confirmed for implementation next year.

**BAUXITE:**

19. The bauxite sector in Guyana, Jamaica and Suriname is an enclave which is wholly subject to the vagaries of the international economy, and the international aluminium industry itself is directly hinged to global economic performance, to a greater extent, than for many other products and commodities. Growth in aluminium consumption tends to exceed that of GDP by a respectable margin in times of economic expansion, but falls far in excess of GDP in times of economic downturn. Thus, global demand for aluminium is expected to fall at least 7% in 2009, more than twice the rate of decline of world GDP. But the rate of decline in North America and Europe, the Caribbean's major markets for bauxite and alumina exports, is likely to be in double digits of about 15%, after falling 12% and 9% respectively in 2008.

20. The steep decline in demand for aluminium in these markets has been driven by the collapse in the housing and transport

sectors, which account for nearly 50% of total aluminium consumption. Aluminium prices and those for bauxite and alumina that are linked to them fell drastically as the recession took hold, and went as low as US\$1,279 per tonne in February 2009, and are now hovering in the US\$2,000 per tonne range. Prices were dragged down by rapidly falling demand in a situation of rising capacity which resulted in an enormous overhang of metal stocks. Producers were therefore forced to institute severe production cuts in aluminium and alumina capacity to the tune of 1.6 million and 18 million tonnes respectively at the end of the first quarter of 2009. Almost half of the alumina cutbacks took place in China, which also closed 27% of its aluminium capacity.

21. U C Rusal, the major operator in Jamaica that was affected by a severe financial crunch and an oversupply of aluminium in its system, closed its Jamaican refineries, Alpart and Windalco, as a result. But Alcoa maintained full production at its Jamalco plant in Jamaica, while Noranda cut bauxite production by nearly 30% at its St. Ann Bauxite mines. In Suriname, Alcoa curtailed alumina output by over 600,000 tonnes, or one-third, while Bauxite output in Guyana is projected to decline by 61% from 2.2 million tonnes to 0.86 million tonnes.

22. At the current rate of aluminium consumption and the projected incremental increases through 2012, it is anticipated that the 2008 level of aluminium consumption will not be regained until about the middle of 2011. Recovery of the Jamaican bauxite industry will depend on external conditions in terms of metal demand, the financial state of U C Rusal in particular, but also on the success of initiatives to diversify the energy source of the local alumina refineries. Major investment in modernisation and

expansion of these refineries is also essential to raising their cost competitiveness.

4<sup>th</sup> December, 2009.

19<sup>th</sup> Annual Conference of the Caribbean Actuarial Association