

Republic Economic NEWSLETTER

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Fiscal Expenditures Underlie Strong Growth

TRINIDAD AND TOBAGO KEY ECONOMIC INDICATORS

INDICATORS	2006	2006Q3	2007Q3 ^{P/E}
Real GDP (% Change)	12.0	1.2	2.75
Retail Prices (% Change)	8.3	2.96	2.68
Unemployment (%)	6.2	5.9	6.6
Fiscal Surplus/Deficit (\$M)	7426.7	-294.6	Surplus
Bank Deposits (% Change)	18	4.93	4.07
Private Sector Credit (% Change)	16.6	5.2	2.82
Net Foreign Reserves (US\$Mn)	6760.6	6469.3	6236.1
Exchange Rate (TT\$/US\$)	6.25/6.31	6.23/6.29	6.28/6.33
Stock Market Composite Index	969.19	868.77	936.57
Oil Price (US\$)	66.02	70.41	75.46

Source: - Central Bank of Trinidad and Tobago
P - Provisional Data
E - Republic Bank Limited Estimates

Overview

In the context of a November general election, preliminary indications are that growth in the non-energy economy remained strong towards the second half of 2007, spurred on by strong fiscal injections and strong credit growth. Republic Bank estimates show growth for the quarter ending September 2007 at 2.7 percent compared to 1.8 in the previous quarter. The robust economy continues to support high employment as just around 6.0 percent of the labour force was estimated to be without work in the third quarter. Interest rates were generally stable and the stock market experienced a marginal lift. Unfortunately, a high level of crime continued to plague the nation, with murders threatening to eclipse the 2006 number of 371. There was some ease in inflation as the year-on-year rate fell to 7.3 percent in October from 10.0 percent over the corresponding period last year.

Energy Sector

Output of crude oil fell for the third consecutive quarter reaching 118 thousand barrels per day (Figure 1). However, this decline was counterbalanced by rising prices, which averaged US\$75.46 in the third quarter from US\$65.03 in the second. Fourth quarter prices are likely to be even higher at an average US\$82.15 per barrel (WTI). Unlike oil, gas production rose marginally although the price softened during the third quarter to US\$6.35 per thousand cubic feet (Henry Hub) from US\$7.76 in the second. Nevertheless, the gas price is expected to average US\$7.72 in the fourth quarter partly due to seasonally strong demand. Layoffs by key multinationals including BPTT, which caused some unease in the domestic industry, seem to be part of a global restructuring strategy by companies to deal with rising costs of operations.

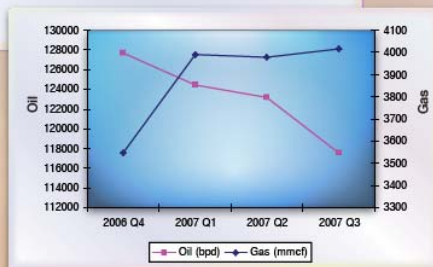


Figure 1:
Oil and
Gas
Production

Fiscal Conditions

According to the Central Bank “net fiscal injections rose sharply in October and November” and was likely spurred on by the government’s drive to complete several of its projects including the Highway Interchange and Waterfront projects. Fortunately, this increase was largely negated by open market operations of the Central Bank and by the sale of foreign currency in November. Though there is evidence of some shrinkage in the fiscal surplus, caused largely by heightened government expenditure, a surplus is still projected for the first quarter of the new fiscal year.

Monetary Conditions

Notwithstanding some concern with the rate of credit expansion, in its November media release the Central Bank announced that the Repo rate would remain unchanged at 8 percent. Overall, interest rates remained steady during the quarter under review although there is some evidence of tightness in the deposit market. Central Bank policy remains focussed on restraining inflation with open market operations, the maintenance of a secondary reserve requirement and indirectly, through the sale of foreign currency. However, the Bank is unlikely to win its fight to achieve a year-end inflation target of 7.0 percent, given high government expenditure, the rise of global food prices and the fall in the US dollar against major currencies (figure 2). The sale of foreign currency to the domestic market amounted to US\$668 million during the first nine months of 2007 and may have accounted for a marginal decline in net official reserves to US\$6,236.1 million, representing roughly 9 months of import cover.

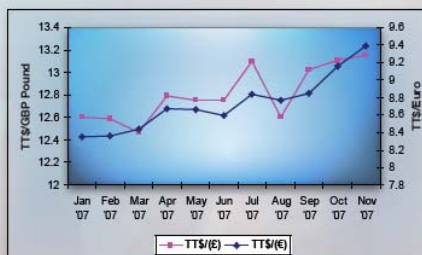


Figure 2: Exchange Rates

Stock Market

In the context of steady interest rates, the still anemic stock market recovered slightly during the third quarter with the Composite Index advancing 1.94 percent and the All T&T Index advancing 2.36 percent over the previous quarter. However, notwithstanding good year-end financial results of some companies, investors are still cautious about the prospects for the market and no significant changes are expected in activity in the fourth quarter.

Outlook

The third quarter of 2007, highlighted by the annual Budget and the run-up to general elections witnessed buoyant economic conditions. These conditions continued towards the end of the year. As the Christmas festivities give way to Carnival in early 2008, all eyes are expected to be on the performance of the new Ministers of Government. Challenges abound however and the new administration would have to move with urgency on several fronts. Government expenditure is expected to remain strong, grounded in projected high energy prices. Accordingly, inflation (especially food price inflation) would continue to be a major concern in the New Year.



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CARIBBEAN UPDATE

BANKING ON BUSY SKIES AND BOUNTIFUL SEAS

Growth in output was generally solid across the region for the nine months through to September, despite high energy prices and lacklustre tourism performances in some quarters. From October 1, 2007 the Western Hemisphere Travel Initiative (WHTI) went into full effect for the Caribbean. This policy requires all citizens of the United States, Canada, Mexico and Bermuda to have a passport or other accepted document that establishes the bearer's identity and nationality to enter or depart the United States from within the Western Hemisphere. With only 20 percent of US citizens in possession of this document, the WHTI represents a serious challenge to the region's all-important tourism sector because of the relative importance of the US market. Americans comprise the largest visitor segment for most states, averaging 38 percent of all visitors for the countries presented in Table 1. While plans have been put in place to mitigate any negative fallout, only time will tell how successful they will be.



Table1: Tourist Arrivals by Main Market - 2005 (%)

	US	Canada	Europe	Other
Anguilla	67.2	2.9	13.1	16.8
Antigua Barbuda	27.9	4.2	44.1	23.7
Barbados	23.9	8.7	41.9	25.4
Belize	61.7	5.7	14.1	18.4
Cuba	0.0	26.0	40.6	33.5
Dominican Republic	27.4	11.6	37.8	23.3
Grenada	25.6	4.4	22.6	47.4
Guyana	51.5	13.6	7.5	27.4
Jamaica	71.6	7.9	15.8	4.7
St. Lucia	35.4	5.2	31.5	27.9
St. Vincent & Grenadines	28.4	6.5	20.9	44.2
Trinidad & Tobago	36.3	10.3	19.8	33.6
Average percentage	38.1	8.9	25.8	27.2

Source: Caribbean Tourism Organisation (CTO)

Barbados

Economic activity is estimated to have grown by 4.4 percent for the first nine months of 2007, spurred by solid performances in tourism, construction as well as the wholesale and retail sectors. The increased activity in these sectors saw the average unemployment rate decline to 8 percent in mid 2007. A moderation in credit growth along with an increase in domestic deposits saw an increase in excess liquidity, which allowed the government to obtain financing locally. The island is pressing ahead with its oil exploration agenda, with its bid round launched and contracts with successful bidders expected to be signed by January 2008.

Grenada

While this country's agriculture sector is still floundering, its other key sector, tourism, seems to be on a path of resurgence. Grenada bucked the OECS trend, recording strong growth in arrivals of 10 percent for the first half of this year compared to 2006. Importantly, growth was driven by UK visitors whose numbers grew by 34 percent while all other markets declined. The urgent appeal for a regional summit on food prices issued by Grenada's Prime Minister Dr. Keith Mitchell suggests that, like its sister states, the island continues to grapple with the effects of high commodity prices. In his G\$752m Budget presentation last month Dr. Mitchell announced some domestic initiatives aimed at bringing relief to the most vulnerable.

Dominican Republic

Preliminary Central Bank data indicate that GDP grew by an estimated 8.2 percent in the first nine months of this year driven by private consumption and investment. Annual inflation was recorded at 6.8 percent in

September, above the target range of 4-6 percent. Despite the relatively creditable performance, available data for 2007 suggests a decline in competitiveness. The Dominican Republic's heavy dependence on the US economy for export sales, tourists and as a source of foreign direct investment makes its foreign exchange earning capacity in the short-term tenuous due to the ongoing problems facing the US economy at this time.

Guyana

Strong performances in agriculture, mining, construction and services drove economic growth of 4.9 percent for the first half of the year. Inflation increased from 4.2 percent at the end of 2006 to 13.1 percent in June 2007 due to strong increases in imported food prices, rising demand fuelled by private-sector credit growth and a one-off spike in prices caused by the introduction of value added tax (VAT) in January. The Bank of Guyana has indicated that it plans to intensify open-market operations in an attempt to hold inflation to 8 percent by the end of 2007. With its maritime border dispute with Suriname settled largely in its favour, Guyana has won sovereignty over an area with significant prospects for oil discovery. The South American state will no doubt be hoping for exploration success over the short to medium term.

Cuba

In the absence of published data for 2007 thus far, indications are that both the tourism and construction sectors have not performed as well as expected. On a more positive note, oil and gas extraction are progressing smoothly and the refinery upgrade is reportedly on track. Unlike its regional neighbours, because US nationals account for such a miniscule part of Cuba's visitor arrivals, its revenue from the sector is insulated from the effects of the falling US dollar and its arrival numbers won't be affected by the WHTI or a possible US economic slowdown.

Rest of the Region

In Jamaica, a weak performance in tourism led to a disappointing first half GDP growth of 1.5 percent in 2007. Inflation is expected to pick up towards the end of 2007 following the damage inflicted by Hurricane Dean in August. On the energy front, Jamaica continues to solicit exploration offers from oil companies for its offshore blocks. However, international interest has been hard to generate because of the paucity of available survey data. Further west, Belize's average oil production increased to 2,722 bpd for the first half of this year from its 2006 value of 1,929 bpd. Its current exploration efforts however are proceeding slowly.

The position of the Organisation of Eastern Caribbean States (OECS) is similar to that of Grenada, although the Spice Isle's tourism sector appeared to have fared better in 2007. Beyond grappling with high energy and commodity prices, the key challenge for these islands going forward will be to retain their US tourism market in the face of mounting challenges, while also seeking to attract greater numbers of visitors from Europe and Canada. For the first time, several of Trinidad & Tobago's neighbours are either actively involved in energy production or have prospects of so doing. The authorities in these states will all be hoping their various patches of Caribbean Sea yield significant energy resources, so that the seemingly intractable high energy prices will be a source of gain rather than pain.

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New Year CHALLENGES

As a New Year dawns it is helpful not only to be reminded of the achievements of the past year but perhaps more importantly to ponder on the challenges, which undoubtedly lie ahead. This applies no less to businesspersons and policy makers as it does to people in general. The importance of pondering the challenges ahead as far as the economy is concerned, is in order to implement appropriate action. Such action must (i) benefit from lessons learned from the previous year and (ii) help mitigate the worst effects of adverse shocks to the economy and society in the coming year.

Few will argue with the view that based on well-established criteria the Trinidad and Tobago economy performed well during the last twelve months. In 2007, output grew at an estimated 5.5 percent and the unemployment rate fell to approximately 6.0 percent. Net international reserves, excluding the Heritage and Stabilisation Fund, rose to US\$6.2 billion at the end of September 2007 or over nine (9) months of import cover. The country's external debt ratio fell further to approximately 5.6 percent and even the inflation rate was lower. In short, during the course of the year energy prices rose and so did government revenues and expenditures, employment, wages and salaries and in most cases profits as well. Even the international agencies, including the International Monetary Fund (IMF), were high in praise of this country's achievements.

This buoyancy was partly sustained on account of a 24 percent rise in fiscal injections in 2007, which translated, into a higher non-oil deficit of some 15.5 percent, according to the Central Bank. This means an even greater dependence on energy revenues. The reality is that there are penalties of an overheating economy, which can sometimes be severe. The size of the fiscal injection meant bottlenecks of various kinds including high consumer prices and traffic jams.

In the course of the year as well, the country witnessed a number of fatal road accidents, which now stands at 195 or just below the total of 210 recorded in 2006. The number of homicides remains high. According to one newspaper, the total at the time of writing is 353 and threatens to surpass the 2006 total of 371.

The international economy presented its own challenges with the global drive for bio-fuels, increasing food consumption in rapidly developing countries such as China and India and adverse weather conditions colluding to put strong upward pressure on global food prices.

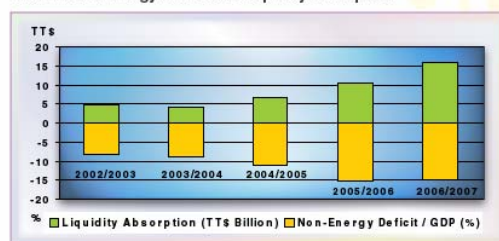
The ruling PNM Government was returned to power in general elections under the first-past-the-post system of parliamentary democracy. Elections were held on November 5th, following the presentation of the national budget less than three months earlier on August 20th, 2007.

Let us now consider what might be some of the main challenges, which face this country in the year ahead. To begin with, rising price levels will continue to be a cause for concern. While the average inflation rate for 2007 of just about 8.0 percent may still be lower than the 8.3 percent of 2006 it is far above the rate of 2.0 percent for the USA, this country's major trading partner. The challenge is to recognise the infrastructural and other constraints (human and physical) of a small developing economy and to ensure that while the supply constraints are being addressed high expenditures do not overwhelm capacity as is happening at present. Doing otherwise results in wastage, which is manifested in significant expenditures without the requisite returns. We concur fully with the statement of the Central Bank in its October, 2007 Monetary Policy Report that "...this may be an appropriate time to review and re-phase spending commitments in order to reduce the public sector's contribution to demand pressures and inflation."

Food prices are of particular concern to lower income groups and those on fixed incomes. However, there is little to indicate that there will be any fall in prices of imported food in the short or medium run. Indeed, the days of “cheap food” may very well be over. In this context, the challenge is to remove domestic and regional constraints to increased supply as soon as possible while at the same time giving targeted support to the most vulnerable in the society. Additionally, promotion of healthy eating habits can also address prices from the demand side. Put another way, it may well be possible to eat healthier or differently for less. The fact that this country has one of the highest obesity rates in the Caribbean is a clear sign of both the problem and its solution.

Any measure to reduce the price of food however, should not be seen as a substitute for prudent fiscal policy and greater savings generation in the context of huge oil windfalls. As is evident in Chart 1, the Central Bank seems to have borne the brunt of the burden of price reduction, through various forms of liquidity absorption including through increasing sales of foreign exchange. This cannot continue without some adverse consequences. Fiscal policy must play its part in keeping prices under control in the coming year.

Chart 1: Non-Energy Deficit and Liquidity Absorption



During 2007, the US dollar, to which the TT dollar is effectively pegged, has dropped to record lows against the major international currencies. As the US dollar continues to weaken, imported inflation is projected to increase. Thus, imports from Europe, England and Canada are all likely to become more expensive and Government's target inflation rate of 5 percent in 2008 will be difficult to achieve.

The falling value of the US dollar makes this country's exports more competitive on the international market, as this country's goods and services become cheaper. This change in relative prices should help to spur expansion in (i) domestic production for export and (ii) the production of domestic substitutes for higher cost imports. This is the challenge for the private sector as well as for the Government.

The recent Ryder Scott Audit of Trinidad and Tobago's natural gas reserves indicated that the country's reserves are dwindling and that an appropriate tax regime can be helpful in discovering new sources of supply. One of the challenges for the new administration in this area is to negotiate an incentives regime, which will encourage companies to explore for gas and oil especially in deeper water, while at the same time ensuring that the country gets its fair share of any new find. Clearly, the country's energy contract negotiators must be up to first world standards. Another challenge stemming from the Audit is the establishment of a platform for aggressive business expansion in selected clusters.

The truth is that the success of governmental initiatives largely depends on a truly professional public sector, which in turn demands decisive action in public sector reform. A fresh start should be made. There is no doubt that the economy will continue to do well in 2008 but major challenges loom. In the context of a New Year and a new administration, this is a good time to rethink priorities, strategies and opportunities.

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