Republic
Economic
NEWSLETTER

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Expected Growth In Abeyance

Overview

The economic expansion recorded in the first quarter of 2010 was not sustained, as the economy contracted in the second quarter (-0.9) and most likely the third quarter (-0.5) as well. Energy sector growth was offset by poor performances in the non-energy sector. The unemployment rate is estimated to have climbed to 7.5 percent in the third quarter from the 6.7 percent recorded for March. Strong price increases were recorded in the third quarter with the year-on-year inflation rate peaking at 16.2 percent in August and then coming down in subsequent months. Central Bank's attempts to stimulate economic activity through reduced interest rates, bore little fruit as both loan demand and investment activity remained depressed. On the external side of the economy, while the demand for imports has fallen there appears to be an increase in demand for outward investments.

TRINIDAD AND TOBAGO KEY ECONOMIC INDICATORS

Indicator	2009	2009.3	2010.3 p/e
Real GDP (% Change)	-3.5	-6.3	-0.5
Retail Prices (% Change)	7.2	0.8	4.8
Unemployment Rate (%)	5.3	5.8	7.5
Fiscal Surplus/ Deficit ($M)	-6,686.0	-5,871.0	Deficit
Bank Deposits (% Change)	29.9	6.5	-2.4
Private Sector Bank Credit (% Change)	-5.5	-5	-0.7
Net Foreign Reserves (US$M)	10,783.9	10,661.1	10,424.1
Exchange Rate (TT$/US$)	6.27/6.33	6.28/6.34	6.32/6.37
Stock Market Comp. Price Index	756.3	787.5	821.7
Oil Price (WTI) (US$ per barrel)	66.66	68.20	76.12
Gas Prices (Henry-Hub) (US$ per mmbtu)	4.00	3.17	4.28

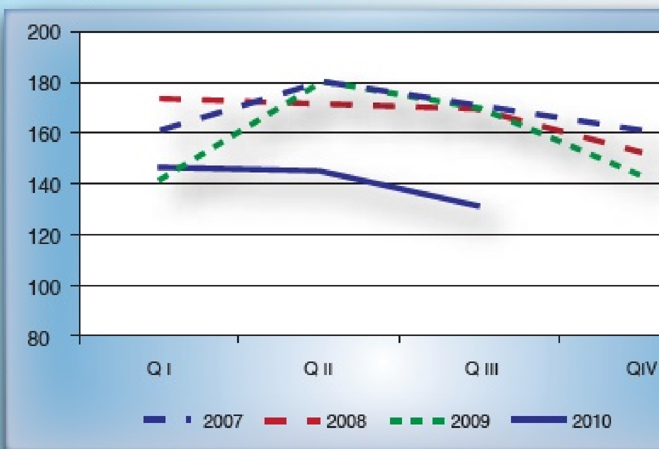
Source: - Central Bank of Trinidad and Tobago, Energy Information Administration
p - Provisional Data
e - Republic Bank Limited Estimate

Non-energy sector

Indications are that the malaise of the second quarter continued through the third, with energy sector expansion countered by weak performances in key non-energy sectors. The non-energy sector accounts for approximately 64 percent of GDP. According to the Central Bank's October Monetary Policy Report, construction, manufacturing and distribution declined by 8.9 percent, 0.6 percent and 5.1 percent respectively in the second quarter, and there was no indication of a trend reversal from July to September. Cement sales, always a good proxy of construction activity, were particularly depressed this year and declined even further in the third quarter (Fig.1). Interestingly, however, mortgage loans were up in the third quarter and 1,618 commercial bank loan approvals for residences were recorded for the first half of the year, a 44 percent increase over the 2009 period as individuals sought to take advantage of lower interest rates and material costs.

In one sub-group of the distribution sector, new car dealerships, September vehicle sales were 12 percent lower than a year ago.

Figure 1: Local Cement Sales ('000 tonnes)



Energy sector

Anecdotal evidence suggests the energy sector grew in the third quarter as prices and production remained buoyant. While the third quarter production of ammonia fell by 6 percent from the previous quarter, production of methanol and natural gas increased by 18 percent and 0.7 percent, respectively. Oil production remained above 100,000 barrels per day (bpd) registering 102,261 bpd in August. Production fell off in September and dropped to an average of 86,935 bpd in October due to the planned three-month shut-down of BHP Billiton's Angostura field. This is expected to impact GDP adversely in the fourth quarter. Energy prices dipped slightly in the third quarter, with average prices of US$76.12 per barrel of oil and US$4.28 per mmbtu of natural gas. Oil prices have since rebounded and are expected to average over US$80 for the rest of 2010. However, the production loss of around 13,000 bpd during this time will more than offset the gains from higher prices. The energy sector was no doubt boosted this year by the phased start-up of the various plants that comprise Methanol Holdings Trinidad Limited's Ammonia Urea Melamine (AUM) Complex which was officially commissioned in October.

Inflation

Average prices increased by 4.8 percent in the July-September period over the second quarter. While food remains the usual villain, core inflation (without food prices) has remained fairly sticky and has not declined from its 4 percent level, despite the drop in economic activity. The year-on-year inflation rate for October was 12.5 percent, coming down from the year's high of 16.2 percent recorded for August. Notably, the core inflation rate for October jumped to 4.7 percent, from 4.1 percent in September, due largely to higher prices for packaged holidays and new vehicles.

Monetary policy

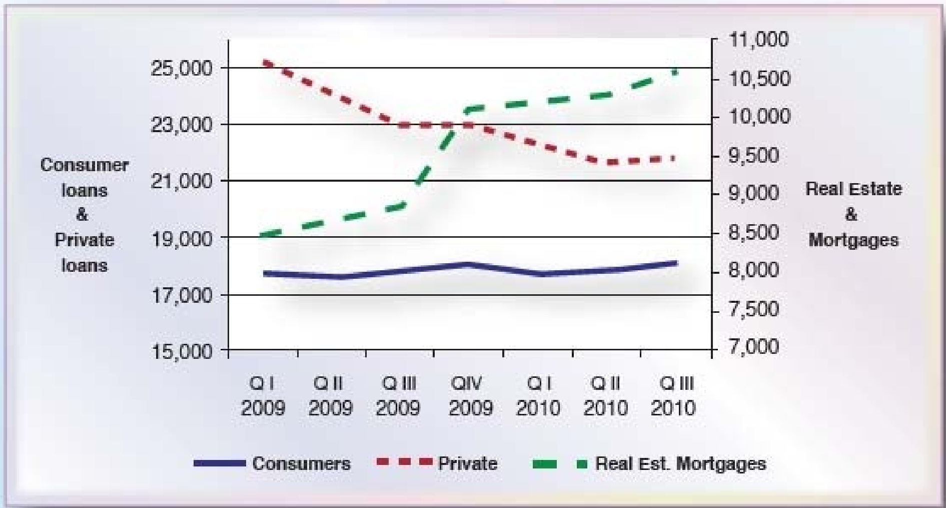
Despite the persistently high inflation rate, the Central Bank was resolute in its goal to spur economic activity by reducing interest rates. Its benchmark 'Repo' rate was lowered on 3 occasions since our last issue, taking it from 4.50 percent in September to 3.75 percent in late November. The commercial banks have followed the Central Bank's lead, reducing their prime lending rate to between 8.25 and 8.75 percent over the same period.

Loan demand

Despite the lower interest rates, loan demand continued to falter. The value of private sector loans outstanding continued to decline steadily, while that of consumer loans showed modest growth, accentuated by the traditional increase in the third and fourth quarters. Taken by itself, the real estate and mortgages sub-group showed steady growth (Fig. 2).

While the public remained wary of taking on new debt, government had no such qualms and in November negotiated a US$1.3 billion loan from the Inter-American Development Bank (IDB), to be disbursed over a 5-year period. With much of the loan package earmarked to fund infrastructure and development projects, US$140 million was disbursed this December, with US$430 million to be released in 2011.

Figure 2: Commercial Bank Loan Balances - TT$ Mn



Fiscal

Data to August 2010 put the fiscal deficit at $3,807 million. One month shy of the end of the 2010 fiscal year, this represented a significant reduction on the expected deficit of $7,702.6 million. Recent reports, however, indicated some significant payments outstanding that could increase the final figure of the deficit.

Foreign Reserves

While total foreign exchange inflows were greater in 2010 due to higher oil prices, net foreign reserves fell from US$11,065.1 million in January to US$10,424.1 million in September. This decline was largely due to net investment outflows. Net foreign reserves represented 13 months of import cover compared to 13.5 months at the corresponding point last year.

Outlook

The start of the new year should see increased construction activity as government seeks to begin its public sector investment programme in earnest. This should stimulate increased activity in complementary private sector investment. Output should also be boosted by the energy sector, as buoyant energy and petrochemical prices are expected to continue and domestic oil production is likely to be back up over the 100,000 bpd threshold. Further, the recent award of contracts for shallow water exploration, along with the planned construction of the Carisal chemical plant, signal increased investment, employment and dynamism in the energy sector and, by extension, in the overall economy.

The Caribbean: Worrying Trends Overshadow Marginal Improvements

The Caribbean region continues to be affected by the global economic slowdown, despite some improvement in economic activity. Economic indicators are showing cautious signs of improvement, with fiscal deficits easing and inflationary pressures moderating. However, weak economic activity in the region's major source markets continues to impede the rate of recovery in most of the islands. Along with sluggish tourist arrivals, rising debt (Table 1) and the slower rate of recovery in remittances have left many of the islands facing severe financing constraints. Added to this, a recent increase in air passenger duty by United Kingdom has seen UK arrivals drop by 12.2 percent for the region (according to the Caribbean Tourism Organisation). The 2010 hurricane season, has not helped matters either, with hurricane Tomas causing significant damage to Saint Lucia, Barbados, Haiti and St Vincent & the Grenadines.

Barbados

The Barbadian economy has seen some improvement but continues to be affected by the global slowdown. The economy contracted by 0.9 percent for the first 9 months of the year, much better than the 4.7 percent decline recorded for the same period in 2009. Inflationary pressures also moderated, averaging 5 percent for the first nine months of the year, as opposed to 6.4 percent in 2009. Ongoing fiscal consolidation resulted in an easing of the fiscal deficit to 9.3 percent of GDP compared to 10.4 percent for the similar period of 2009. Nevertheless, debt levels continued to rise, marginally crossing the 100 percent of GDP threshold in September 2010, standing at 100.2 percent of GDP. This resulted in Standard and Poor's lowering the country's credit rating from BBB to BBB- in October, citing the worsening debt situation over the next two years. Added to these woes, the island suffered the loss of its Prime Minister, David Thompson, who succumbed to pancreatic cancer, on September 23rd. In the midst of these developments, the new Prime Minister, Freundel Stuart presented the 2011 Budget, seeking to enhance government's fiscal position. Value Added Tax (VAT) was increased from 15 percent to 17.5 percent, while the excise duty on gasoline was increased by 50 percent. On the other hand, a number of measures were adopted to help boost the tourism and manufacturing sectors. While some of these fiscal measures are indeed severe, they should strengthen government's finances and help return the economy to a path of growth. The planned US$400 million five-star facility by Harlequin Hotel and Resorts, should aid government's recovery drive by stimulating the construction sector and generating employment.

Guyana

Unlike other Caribbean countries, Guyana continues to do well, with the economy growing by 2.8 percent in the first half of the year. Overall positive economic activity was reflected in the country's balance of payments, which recorded a surplus of US$34.6 million for the first half of the year. Debt levels also fell, from 56.8 percent in 2009 to an estimated 55.2 percent for 2010 (Table 1), while inflationary pressures were contained at 2 percent when compared to the first half of 2009. Construction, gold, and forestry contributed to the growth in the economy, with the sectors growing by 9.5 percent, 8.1 percent and 11.8 percent, respectively in the first half of the year. However, the agricultural sector was negatively affected by a prolonged drought in the early half of the year. Sugar production fell by 1.8 percent for the period January to June and given current trends, output is projected at 260,000 tonnes, as opposed to a projected 280,000 tonnes for the entire year. Contrary to earlier forecasts, output from the bauxite industry also declined, falling by 19.6 percent for the first half of 2010. Weak demand on the global market continues to affect the industry but with global demand for alumina and aluminum products expected to rebound in the second half of 2010, an improved performance is anticipated.

Table 1: Debt-to-GDP Ratio (%) (2010e)

Trinidad and Tobago	38.5
Barbados	100.2
Jamaica	140.0
Grenada	119.0
Guyana	55.2
St. Lucia	79.1
St Kitts Nevis	192.1
St. Vincent & Grenadines	91.7

Source: International Monetary Fund

Grenada

Grenada's economy is projected to grow by 0.8 percent in 2010 after contracting by 7.7 percent in 2009. Government announced a number of steps to help reinvigorate the economy. Following discussions with the Grenada Hotel and Tourism Association, Prime Minister Tillman Thomas announced the removal of VAT (15 percent) on service charges for hotels, as well as a 50 percent rebate on the VAT charged on hotel rooms for the months of September to November. Additionally, to further bolster the tourism sector, government will continue to expand airlift capacity, with US$2.9 million already spent in 2010 on direct airlift to Grenada from North America and Europe. VAT is also being reduced by half on building materials, such as steel, cement, roofing sheets, and lumber, while duties on the import of sand aggregate have also been reduced by half. These measures should contribute to some level of activity in the private construction sector. GDP is projected to expand by 2 percent in 2011 and debt levels should also improve marginally from 119 percent in 2010 to 116 percent of GDP in 2011, according to the IMF.

Cuba

Tourist arrivals continue to do well, with the Cuban Ministry of Tourism announcing in October the arrival of another two million tourists for the seventh consecutive year. Nevertheless, continued USA sanctions and a severely weakened agricultural sector have resulted in government taking steps to shed 500,000 workers from its workforce. Given these impediments, growth in the first half of 2010, is estimated to have reached 1.5 percent. The prospect of protracted, difficult, economic conditions appears to have intensified the winds of change. Under the direction of Raul Castro, longstanding restrictions on private enterprise were removed in an effort to help laid-off workers find jobs. Cubans will now be able to open small private businesses in 138 different areas, inclusive of: restaurants, taxi driving, button-making, hairdressing and catering, to name a few. To aid this drive, government announced the issuing of 250,000 business licenses. However, these measures seem primarily geared towards sole proprietorship, as they are subject to a simpler and less onerous tax system than businesses that hire employees. Businesses that employ labour face a tax rate of nearly 75 percent on their incomes. Some of these taxes include: a payroll tax of 25 percent, a 10-percent tax on revenues and a payment of 25 percent employee social security contributions, while profits will be taxed separately.

The Region

Jamaica's debt problem has eased since the beginning of the year, according to the World Bank, as Jamaica's Debt Exchange offer (JDX) has almost halved the interest rate government was paying. Nevertheless, the country's huge debt burden of 140 percent of GDP has proven to be a major impediment to growth, with the economy projected to contract by 0.5 percent in 2011 on the back of lower growth rates for the island's major trading partners. The challenges presented by high debt levels in the OECS countries have been compounded by the damages inflicted by hurricane Tomas. St Lucia was devastated, with parts of the island being cut off, a reported 14 deaths and damages amounting to an estimated US$500 million. In St. Vincent and the Grenadines, the hurricane caused extensive damage to the banana industry, with the entire crop being wiped out in the northern part of St Vincent. Banana production contributes significantly to the economy, accounting for over 50 percent of the country's merchandise exports and employing more than 60 per cent of the labour force. Despite these events, Dr Ralph Gonsalves the Prime Minister of St. Vincent and the Grenadines announced national elections on December 13th, seeking a third consecutive term in office.

Outlook

Growth continues to be sluggish in most of the region's major source markets and while the USA and the UK have reported growth, this has not translated into increased tourist arrivals. The Caribbean Tourism Organisation projects tourist arrival growth at 2 and 3 percent in 2010. Going into 2011, tourist arrivals will continue to be lethargic, further constricting the region's finances. Given the already high level of debt in most CARICOM countries, ongoing fiscal deficits are beginning to pose a serious threat to fiscal stability. While many of the islands are on standby agreements with the International Monetary Fund (IMF) more needs to be done to increase revenue inflows. Accordingly, the IMF expects CARICOM countries to take a longer time to recover, with flat growth in 2010, rising tentatively to 2 percent in 2011.

The T&T Economy: Review and Prospects

The year 2010 has been typified by anaemic domestic economic activity, in the context of high expectations and sweeping changes in the local political landscape. The domestic economy is projected to record a less than stellar performance in 2010, following a decline of 3.5 percent in 2009. The poor performance is linked to flagging output in the energy and non-energy sectors, with construction, manufacturing and distribution performing well below potential. In this environment, the rate of unemployment rose appreciably to 6.7 percent early in the year, from 5 percent at the end of 2009. The experience of most developed economies was no less daunting.

As is usually the case, the energy sector has been the main driver of what little growth there was during the year. According to the Central Bank's latest Monetary Policy Report, the domestic economy is expected to remain flat, or at best, expand by 1 percent in 2010. In spite of the consistent lowering of the repo rate by the Central Bank (to 3.75 percent as of November 2010) and the accompanying reduction of commercial banks' prime lending rate to 8.9 percent in October, credit demand remains weak. In the twelve months to September, total private sector credit extended by the financial system decreased by 2.7 percent and could decline by an overall 4 percent in the twelve months to December, even as the prime rate is expected to fall further to 8.5 percent by year's end.

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Notwithstanding sluggish economic activity, the country faced rising consumer prices for most of the year, as weather conditions (drought followed by heavy rains) undermined domestic food production. The latest available data placed inflation at 12.5 percent year-on-year to October. Despite high inflationary pressures—largely emanating from rising food prices—the Central Bank has chosen to lower its benchmark rate over the past quarter, with the Repo Rate standing at 3.75 percent in early December.

Public sector debt, which was well within international norms, averaged 38.5 percent of GDP for the 2009/2010 fiscal year, up from 37.5 percent. As government seeks to fight off recessionary conditions, this figure is likely to climb to around 50.0 percent by the end of the 2010/11 fiscal year.

Despite the considerable slowing of imports, along with the country's still healthy reserve position (approximately US$9 billion), the business community voiced its concern during the year, about difficulties accessing adequate amounts of foreign exchange. Net sale of foreign currency by commercial banks for the first 11 months of 2010 fell to US$1.5 billion from US$1.7 billion for the similar period in 2009, still strong by most standards.

On the political front, historical firsts and periods of significant disquiet characterized the year under review. On January 24th, Mrs. Kamla Persad-Bissessar became the first female to lead a major political party in this country. Under pressure of various corruption allegations and considerable public outcry with regard to the operations of the state's special purpose institution, the Urban Development Corporation of Trinidad and Tobago (UDECOTT), then Prime Minister Patrick Manning called early general elections in May. The amalgam of opposing political parties under the umbrella of the People's Partnership, won the elections, elevating its leader, Mrs. Persad-Bissessar, to the office of Prime Minister, the first female to hold the title. As part of the fallout of the elections, Mr. Manning stepped down as political leader of the People's National Movement and was replaced by Member of Parliament Dr. Keith Rowley.

On assuming office in May, the People's Partnership hit the ground running, having to deal immediately with severe flooding. Other challenges abound, however. The government is still to reach an agreement with the Public Services Association (PSA) over wages for public officers. The Union's membership has threatened to take protest action to another level and has refused the usual early salary payments for December, in response to its leader's call to "boycott Christmas". Additionally, the government's proposal to pay CLICO depositors (in particular, its offer to pay balances in excess of $75,000, over a 20-year period, at zero percent interest) has met with great resistance by the affected investors. Unhappy with the government's response to their demand for an improved offer, the depositors have threatened legal action.

On the external front, growth of the US and EU economies is falling short of earlier projections. The IMF revised US growth rates downwards in 2010, from an estimated 3.3 percent to 2.6 percent. Lethargic demand, as well as high rates of unemployment in major source markets means that Caribbean tourism—and thus GDP—is expected to recover, but slowly. This has implications for Trinidad and Tobago's exports, since CARICOM is the largest importer of this country's manufactured goods. Although the price of oil remains fairly strong—averaging over US$70 per barrel during the year—declining production continues to limit the contribution of the sector. A virtual glut on the global gas market continues to keep prices below historically high levels.

Domestically, uncertainty and rising unemployment seem to be holding back private expenditures and the demand for consumer and business credit. Preliminary evidence suggests that total investment is well below pre-recession levels and this shrinkage has proven to be a further drag on the domestic economy. The 2011 budget sought to boost investment activity, with a long list of incentives and tax concessions. Among these are, a $10 million innovation financing facility for businesses with avant-garde ideas; removal of customs duties on equipment and parts imported for use in approved manufacturing industries; and removal of customs duty for goods on consignment valued above $1,000 but below $20,000. While these measures are indeed positive, the business community remains cautious about the current economic environment. In an uncertain world, strategic marketing might be required if potential investors are to be encouraged to take advantage of fiscal incentives.

With many claims upon its limited financial resources, controlling the fiscal deficit and the country's debt would be major challenges for the government in 2011. Indeed, 2011 promises to be a testing year for Trinidad and Tobago. The economy is expected to grow marginally between 1 and 2 percent. Growth is likely to be driven by strong energy prices and public sector spending.

Major construction projects include the extension of the Solomon Hochoy Highway and building of the Mamoral Dam. The government has requested a US$1.3 billion loan from the Inter-American Development Bank (IDB) to be used to help stimulate the economy. In the case of the energy sector, the award of contracts following the shallow/average water depth bid round is positive for the New Year. So too are the anticipated awards for the deep water in early 2011. Unfortunately, with world food prices on the uptick since the middle of 2010, domestic inflation could remain robust, averaging 8 to 9 percent for the year. Nevertheless, increased agricultural output arising from state-funded, large farms could control the rise of food prices (the major component of local inflation).

All in all, the economy should be able to avoid slipping into stagflation, defined as the existence of high prices alongside a stagnant economy. All together, a combination of lower interest rates, wide-ranging fiscal incentives and less uncertainty should see some improvement in the economy, as the New Year progresses.

Season's Greetings

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 Subscriptions, enquiries and other correspondence should be addressed to:
The Senior Economist, Republic Bank Limited, P.O. Box 1153, Head Office, 9-17 Park Street, Port of Spain, Trinidad and Tobago.
Tel: 868 623 1056, Fax: 868 624 1323, E-mail: email@republictt.com