Republic
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Ease in Inflation as Interest Rates Rise

Overview

Internationally, the US economy is still slowing in spite of some positive signs. Growth in the first quarter was 0.9 percent compared to 0.6 percent in the previous quarter. In the midst of this, the Trinidad and Tobago economy is estimated to have grown by 2.9 percent during the first quarter of 2008 compared to 2.8 percent in the previous quarter. This growth was largely linked to the robust energy and construction sectors. Stock prices advanced marginally during the beginning of the year as bank interest rates also rose. The unemployment rate remained at 5 percent. The inflation menace seemed to have responded to rising rates as the year on year rate declined further in April, 2008 to 9.3 percent. The unrelenting scourge of crime remains a vexing issue, with in excess of 200 murders committed already for the year compared to 123 at this time last year. On the political front, and following the firing of the Minister of Trade and Industry, the government acquiesced to the establishment of a Commission of Enquiry into the Urban Development Company of Trinidad and Tobago (UDECOTT) in the face of mounting criticism. The main issues in contention centre on regulatory oversight of government construction projects in the context of rising government expenditure and the use of special purpose state enterprises to execute these projects.

TRINIDAD AND TOBAGO KEY ECONOMIC INDICATORS

INDICATORS	2007	2007.1	2008.1 p/e
Real GDP (% Change)	5.5	2.4	2.9
Retail Prices (% Change)	7.9	0.6	0.43
Unemployment Rate (%)	5.6	6.5	5
Fiscal Surplus/ Deficit ($M)	5100	90.9	Surplus
Bank Deposits (% Change)	13	-4.8	1.98
Private Sector Bank Credit (% Change)	20.3	3	5.85
Net Foreign Reserves (US$M)	8143	7290.1	8453.4
Exchange Rate (TT$/US$)	6.27/6.3	6.27/6.31	6.27/6.32
Stock Market Comp. Price Index	982.03	929.11	992.85
Oil Price (WTI) (US$ per barrel)	73.32	58.08	97.94

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

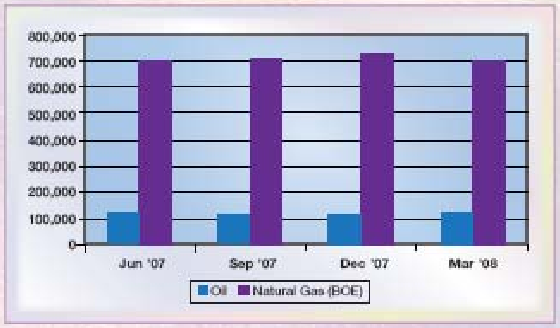
Energy Sector

During the first quarter of 2008 energy prices strengthened further, with crude oil in particular experiencing significant upswings and establishing new records. The crude oil price averaged US$97.94 (WTI) during the period, up from US$90.75 the previous quarter, while the more steady gas price rose to US$8.93 per thousand cubit feet (Henry Hub) from US$7.19. The buoyancy of prices in the sector is attributed to strong global demand, the weak US dollar and speculation by global traders. Future prices have increased further such that in June, oil and gas for delivery in July 2008 have soared to US$140 and US$13 respectively. The rise in the price of crude oil does not mean as much as it might, partly because this country now produces about six times more gas than oil, measured in barrels of oil equivalent (figure 1). However, as crude oil prices continue to rise, so too does the financial burden on government, amplified by the gas subsidy to consumers, which has risen to about $6 billion. The rising subsidy now places the government in a difficult situation, as a reduction in the subsidy will propel the inflation rate even higher. Some unease has attended the layoff by BPTT of 103 of its local employees, after a similar activity in the second half of 2007. The multinational has attributed this restructuring to the Company's global efforts at streamlining activities, a position faced by other energy multinationals.

Fiscal Conditions

Strong energy receipts continue to boost government revenues as crude oil prices remain consistently above the budgeted US$50 mark. Soaring energy prices have gifted the government $6 billion more in revenue than was estimated in its budget. However, the significant growth in government expenditure continues to restrict the size of the budget surplus. Government revenues through March 2008 were estimated at $22 billion, while expenditure reached $18 billion, resulting in a surplus of $4 billion. The recent request to Parliament for a Supplementary Allocation of some $3.5 billion raises total planned expenditure to $46 billion for the fiscal year, a 16.5 percent increase from the last fiscal year. This injection will test the Central Bank's ability to fight inflation even further and flies in the face of repeated appeals by the Governor of the Central Bank, Ewart Williams, for fiscal restraint.

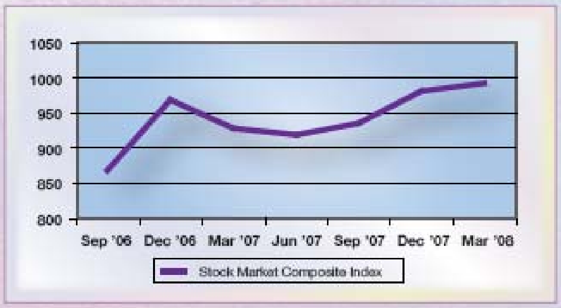
Figure 1: Oil & Gas (BOE) Production



Monetary Conditions

The Central Bank remains locked in a battle to restrain galloping of inflation. It has been severely tested by the high level of liquidity in the system, which, to a large extent, is the result of government's fiscal injections. The high liquidity is reflected in the strong growth of commercial bank credit, which, according to the Central Bank expanded 23 percent year on year in February. Led by a 19.7 percent rise in food prices, inflation increased to 9.8 percent year on year in March from 7.6 percent in December 2007. The rate declined to 9.3 percent in April 2008. It would appear that the February 2008 increase of the Repo rate to 8.25 percent led to an increase in most interest rates and apparently to some ease in the inflation rate as well, if only temporarily. The nominal exchange rate adjusted for inflation (the real rate) has been appreciating for sometime now but even the nominal rate appreciated in May to TT$6.27 to US$1.00. This reflects strong foreign exchange inflows coupled with rising domestic prices.

Figure 2: Stock Market Composite Index



The Stock Market

The market received a much-needed fillip in the first quarter of 2008 with an upswing in investor confidence. The Composite Index rose 1.10 percent from the previous quarter to 992.85, while the All Trinidad and Tobago Index rose 4.66 percent to 1,256.61 (figure 2). This advance was welcomed as the increase in the value of several stocks re-energized the market. The increased activity carried forward to April as the Composite Index advanced 7.32 percent and the All T&T Index advanced 8.91 percent. The improvement, which has continued into the second quarter of the calendar year, is due to increased demand as investors seek to rebalance their portfolios in the wake of the acquisitions of RBTT Financial Holdings by Royal Bank Canada and Barbados Shipping and Transport by Neal and Massy. The return of some confidence to the market might suggest continuing improvement over the next few months.

Outlook

Given the vigor of energy prices, the country is still expected to withstand the slowdown of the global economy. Positive growth is expected over the next few months as high prices compensate to some extent for lower output of crude oil. While Central Bank action at the beginning of the year has brought some success as far as inflation is concerned, this is unlikely to be the case in ensuing months as government spending is likely to rise towards the close of the financial year.

Global Challenges Give New Leaders Food (and Fuel) for Thought

With the very first tropical storm (Arthur), on the very first day of the hurricane season causing loss of life as well as serious flooding in Belize, the 2008 season has gained the early attention of regional states that are perennially at risk of natural disasters of this kind.

Following a year in which Caribbean economies performed reasonably well with average GDP growth of 4.7 percent, growth was expected to be lower this year due, in part, to the US economic slowdown and high commodity prices. The sharp increase in food prices, combined with the accelerated rise in oil prices over the last six months, however, has been beyond most expectations. In a region that spends over US$3 billion annually on food imports, the increases have left already beleaguered regional states desperate for solutions to mitigate the economic and social fallout. The experience has been a baptism of fire for regional leaders, many of whom by some quirk of coincidence have only been in office for a few months following recent elections. Many states have suspended import duties on a number of staples and put some measures in place to protect their most vulnerable. At the regional level, an emergency meeting held this month in Guyana sought to fast-track regional food production by exposing investors to large-scale farming projects.

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BARBADOS

Barbados' economy grew by 4 percent in the first 3 months of 2008 spurred by a pickup in tourism activity and some increase in manufacturing. While liquidity remained high as deposits grew faster than credit, government's fiscal deficit for the 1st quarter nearly quadrupled as expenditure outpaced revenue. While the increase in the inflation rate for the quarter is expected to be modest, the new Democratic Labour Party administration will be challenged to keep it in check following the strong increases in global prices.

GRENADA

The Grenada tourism industry is recovering well with an estimated 9 percent increase in stopover tourists in 2007. Future prospects also appear encouraging with the island being identified as one of 10 prime locations in the world, set to experience long-term growth in residential tourism. The authorities are amending current finance laws as Grenada plans to re-launch its offshore banking sector after a 6-year hiatus. National elections announced for July 8th this year are expected to be keenly fought with the incumbent New National Party holding only a 1-seat majority over its main challenger, the National Democratic Congress in the 15-seat parliament.

GUYANA

While GDP growth for this year is not expected to be as high as 2007's 5.3 percent, a solid 4.8 percent is expected. The nation's fiscal deficit declined to US$84.4m (9.5 percent of GDP) due to higher than anticipated returns from the 16 percent value added tax (VAT) regime introduced in January 2007. Despite financing the deficit by external borrowing, external public debt fell to US$718m, its lowest level in decades. In February, the government delivered its 2008 budget of US$585.7m, the largest in the country's history. Despite being one of the few Caribbean states that is a net exporter of food, Guyana has also been affected by current high commodity prices and has implemented support measures for farmers and distributed seeds and fertilizer to citizens to increase food production. The authorities have also reduced the excise tax on gasoline from 17 percent to 7 percent in order to keep its cost below US$4.94 (G$1000) a gallon.

CUBA

Following relatively moderate GDP growth of 6.5 percent in 2007, Cuba's economy is expected to maintain a growth rate above 5 percent this year. Key revenue earners, tourism and nickel exports will remain relatively flat this year. Rising food imports will only be partly offset by higher sugar exports, and Cuba's arrangement with Venezuela will only partly cushion the impact of rising oil prices. Raul Castro, the recently confirmed leader of the socialist state, has avoided any fundamental economic shifts up to this point, but has signaled his intentions by relaxing restrictions on mobile phones and Internet access.

DOMINICAN REPUBLIC

GDP growth in the Dominican Republic was 6.1 percent in the first quarter this year, down from 9.1 percent a year earlier. Growth is expected to slow to just under 5 percent this year as consumer demand is curbed by high oil and food prices. Remittances, which account for almost 8 percent of GDP, were flat in 2007 and are likely to be constrained this year as well by the US economic slowdown. Increases in commodities over the past year have erased gains made in curbing inflation, pushing the rate to 9.7 percent in March this year. Newly re-elected President Leonel Fernandez has announced that his country intends to forge ahead with bio-fuel production in the form of ethanol produced from sugar cane, in order to reduce its dependency on oil.

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REGION

In Belize, newly elected Prime Minister, Dean Barrow is facing a challenging time in office as a result of high commodity prices. Far from his election promise to lower food and electricity costs, the people of Belize are faced with rising food prices and the prospect of blackouts if local electricity provider Belize Electricity Ltd. doesn't increase rates by 25 percent. In Jamaica, the Bruce Golding-led administration is also battling high food and energy costs. The government has secured an accommodation from Guyana for its rice imports and is seeking assistance from Brazil in sugar and fruit crop production and Venezuela for lower cost fertilizer and natural gas supplies.

OUTLOOK

Across the region Caribbean states are struggling to come to terms with the challenges presented by high international prices. While it does not help that many of the region's governments are fairly inexperienced, this global phenomenon is confounding new and veteran leaders alike. Already one the most highly indebted regions in the world, the Caribbean can ill afford the onslaught on fiscal balances that high commodity prices represent. Inflation rates and debt positions will face upward pressures over the short term until remedial measures begin to have some impact.

Getting Prices "Right":

The Cases of Food and Fuel

In market economies such as Trinidad and Tobago, the prices paid for goods and services play an important role in determining what and how much is produced, consumed and saved. Put another way, prices help to determine the behaviour of consumers towards the usage of fuel, food and much more. This article argues that appropriate prices or getting prices right is a very important economic issue, as much as it is a social and political one. Getting prices right, therefore, warrants close attention by policy makers as they are primarily responsible for setting the framework. Nevertheless, the necessity for getting pries right ought to be appreciated by all sections of the national community as well.

It seems that everywhere one turns these days– nationally or internationally– there are heated debates about continually rising prices. While food and energy prices stand out the world seems to be engulfed in a wave of rising commodity and other prices. In this environment, it is almost inconceivable to think that this has not always been so. There were times in the past when prices were indeed, low.

In the short-run, some sections of the population may benefit from price increases while others lose. In the end however, all are likely to endure some amount of pain as no section benefits permanently from unjustified, unnecessary or uncompetitive price increases or declines. Ultimately, all are adversely affected by a misallocation of resources, which is the outcome of any unjustified change in prices.

Very often, rising prices pit consumers against producers or so-called middlemen against consumers. The government often finds itself somewhere in the middle, though most times, on what it considers the side of consumers. Ultimately, however, government must ensure that prices continue to encourage production and/or import on the one hand and that consumers obtain goods and services at competitive prices on the other. A major way to achieve this is to remove bottlenecks in the economy so that there are few, unnecessary cost add-ons. Most important as well, government has to ensure that liquidity does not so overwhelm the economy, fuelling price increases through too rapid increases in expenditures.

Since getting prices wrong can be very costly, for consumers, producers and politicians. What then are "right" prices?

For most goods and services, prices that are too low increase consumer demand beyond sustainable levels. Let us take the case of gasoline. Low prices encourage drivers to make more unnecessary trips, purchase less fuel-efficient vehicles and may even encourage some to purchase a vehicle thereby contributing to road congestion. Too cheap fossil fuels may also have contributed to the dangerous level of stress on the environment. In the case of food, too low prices encourage wastage and may even help in promoting bad eating habits leading to health problems such as obesity. In general, the same principle applies to electricity, water or telecommunications.

Subsidies, as a part of support to society can be helpful, especially for the less fortunate. However, because they hide the true price they often encourage consumers to behave in ways that demonstrate little appreciation for the true value of the good or service.

If the selling price is so low that farmers, say, cannot recover their costs, which include normal profits, at some point, they will not be inclined to produce more and may very well switch to some other business thereby creating a shortage and causing a jump in prices by the remaining producers. Desperate efforts to increase output now, may well result in a drastic fall of some food prices over the next year or so. This will be welcome news to consumers but farmers may very well be driven out of production.

Unjustifiable, high prices on the other hand, hurt the consumer. Such prices cannot be sustained for a long time. They have negative consequences for the poor, if applied to basic foods for example. They may also encourage overproduction, leading to low prices in the next round, which would benefit consumers but could also result in the failure of some businesses. In the next round, higher prices are likely to prevail because of insufficient production and the cycle would continue.

A contentious issue in food pricing has to do with the difference in the price at the farm or at the port compared to the final price paid by the consumer. This final price can be several times that of the farm gate price or the price at the port. The retailer is often chastised for price "gouging". This charge is often, though not always, unfair. Among reasons for the divergence in prices are the added costs of transport, labour, traffic jams and cold storage, which would be reflected in the final price to the consumer. If farmers can get, say, ten times the price in the retail market as they get from the wholesaler at the farm gate then what prevents them from taking their goods to the market themselves to obtain the far higher retail price? The reality is that in most cases, the higher retail price is not reflective of profits but of the higher costs in bringing the product to the retail market.

Ultimately, prices are signals that businesses must heed in making decisions. For example, rising food prices indicate that there are problems in production, consumption or distribution. There may be need for more competition, consumer education or information dissemination, or for bottlenecks to be removed; liquidity may be too high; the transport network may be poor; or some combination of some or all of the above. A recent example of competition bringing prices down is the lowering of telephone rates, as a result of a new provider in the telecommunications market.

In market economies so-called market failures may occur, where for several reasons the market might be inefficient or even if efficient, does not give rise to the most desirable result from a social standpoint. A case in point is the availability of food to the very poor. In such cases, state or state-assisted intervention can be helpful. In cases where the market does not give the most desirable outcome, the response may necessitate temporary and targeted support to those who are most adversely impacted.

Another important pricing issue from a policy standpoint is that of domestic products vis-à-vis imports. This is especially relevant to the poultry sector in the Caribbean. As far as the typical consumer is concerned, what matters is that he or she pays the cheapest price. That cannot be the whole story however. The development of entrepreneurship, maintenance of production capacity, employment and exports are also important economic activities and is promoted by all countries. From the angle of national development, reliability of supply is important too. Today, some countries are discouraging exports of food in the interest of food security for their domestic population. In this special case then, importing countries may have to produce selected food commodities notwithstanding that they might be higher cost producers. This action however must not be generalized.

Getting prices right then is important from several vantage points including that of the consumer, producer, importer and policy maker. Policy makers have the responsibility to ensure that an appropriate and balanced framework exists for meeting the varied needs of the market place. Getting prices wrong has adverse consequences for all, regrettably, a point that is poorly appreciated.