Republic Economic NEWSLETTER

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# Flickers of Growth in an Otherwise Subdued Economy

**Overview**

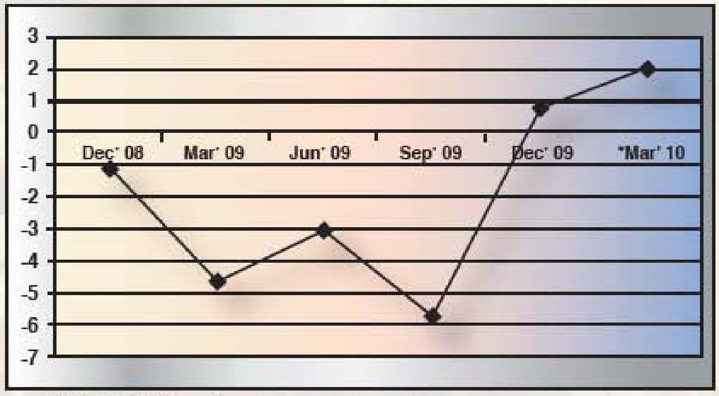
After registering weak growth in the final three months of 2009, the local economy is estimated by Republic Bank Ltd. to have maintained this trend in the first quarter of 2010 (figure1). Growth was largely propelled by the energy sector, as strong oil prices persisted throughout the period. The non-energy sector is expected to have experienced mixed fortunes, with construction providing some support. Election-related expenditures are anticipated to have provided a small spur to second quarter economic activity. The unemployment rate reached 5.1 percent in the fourth quarter of 2009 and likely remained around that figure for the first three months of 2010. Weak domestic demand continued to restrict the growth of credit, in spite of an accommodative stance adopted by the Central Bank. The re-emergence of the inflation menace is a major cause for concern and could soon lead the Central Bank to gradually increase the "Repo" rate again. Strong oil prices have provided an unexpected boost to government revenue and have also helped to shore up the country's foreign currency reserves.

## TRINIDAD AND TOBAGO KEY ECONOMIC INDICATORS

| Indicator | 2009 | 2009.1 | 20010.1 p/e |
|---|---|---|---|
| Real GDP (% Change) | -3.2 | -2.9 | 2 |
| Retail Prices (% Change) | 7.2 | -0.3 | 3.4 |
| Unemployment Rate (%) | 5.3 | 5 | 5 |
| Fiscal Surplus/ Deficit ($M) | -7,473.6 | -2320.3 | Surplus |
| Bank Deposits (% Change) | 29.87 | 4.8 | 3.7 |
| Private Sector Bank Credit (% Change) | -4.3 | 0.3 | -0.3 |
| Net Foreign Reserves (US$M) | 10800 | 10,332.5 | 10,500 |
| Exchange Rate (TT$/US$) | 6.27/6.33 | 6.23/6.29 | 6.32/6.37 |
| Stock Market Comp. Price Index | 756.28 | 821.82 | 817.72 |
| Oil Price (WTI) (US$ per barrel) | 61.66 | 42.90 | 78.64 |

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

**Figure 1: Real GDP Growth (%)**




*R.B.L Estimate

**Energy Sector**

The importance of the energy sector to the local economy was underscored as it provided the principal impetus for growth during the first quarter. Oil prices averaged US$78.64 per barrel, compared to $76.06 in the quarter ended December 2009. Oil production also increased slightly to 104,813 barrels per day from an average of 103,075 in the fourth quarter of 2009. Notwithstanding this increase, annual output is expected to continue its downward trend this year and as such, would stifle the impetus otherwise provided by rising prices. Gas production increased slightly from 4,353 million cubic feet (mmcf) to 4,383 mmcf, while its price rose from US$4.47 per mmcf to US$5.30. Downstream activity was enhanced by the coming on stream of a new Urea Ammonium Nitrate (UAN) plant in January and two Melamine plants in April. These plants form part of Methanol Holdings Trinidad Ltd's (MHTL) AUM Complex.

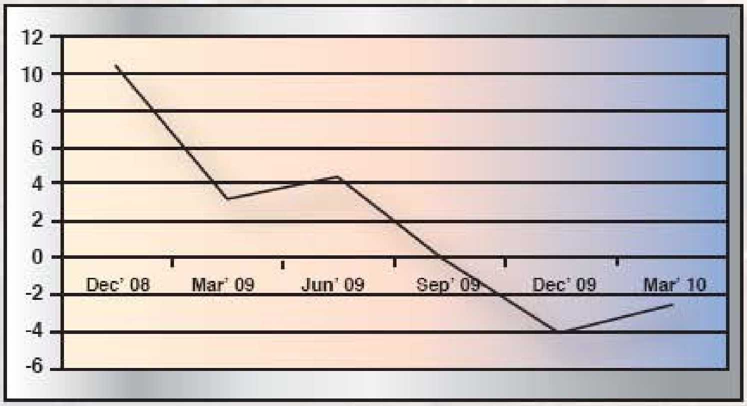
In the 2010 Competitive Bid Round, seven offshore blocks have been offered with fiscal incentives intended to attract investors and boost government revenue. As a result of this, exploratory activity may pick up towards year-end.

**Monetary Conditions**

After a short interval in which inflation relented significantly, prices are once again increasing at a worrying rate. The year-on-year inflation rate rose to 5.1 percent in March from 1.3 percent in December 2009 and rose further to 7.3 percent in April, with food prices leading the way. In response to the weak domestic economy, the Central Bank reduced the "Repo" rate by 25 basis points to 5 percent in January 2010. Despite this, economic activity remained relatively weak, with private sector credit contracting by 2.6 percent, year-on-year to March, following a contraction of 4.1 percent in December 2009 (figure 2). The slide of credit, together with high fiscal injections, continues to bolster high system liquidity and in so doing, suppress interest rates. The three-month Treasury bill rate fell to 1.11 percent in May 2010 from 1.36 percent in January and 5 percent in early 2009. The basic prime lending rate was reduced to 9.5 percent from 10.25 percent in fourth quarter 2009, while commercial banks' mortgage rates fell to 9.5 percent from 9.9 percent.

The decline in the country's external account underlied a small depreciation in the exchange rate, from $6.29 per US dollar in the first quarter of 2009 to $6.37 in the first quarter 2010. Notwithstanding, energy revenues were strong enough to protect the country's reserves of foreign currency, estimated at US$10,500 or roughly 12 months of import cover. The Heritage and Stablisation Fund also rose by US$103.8 million to US$3.2 billion in April 2010 as actual energy prices surpassed the budget prices.

**Figure 2: Private Sector Credit (% Change)**



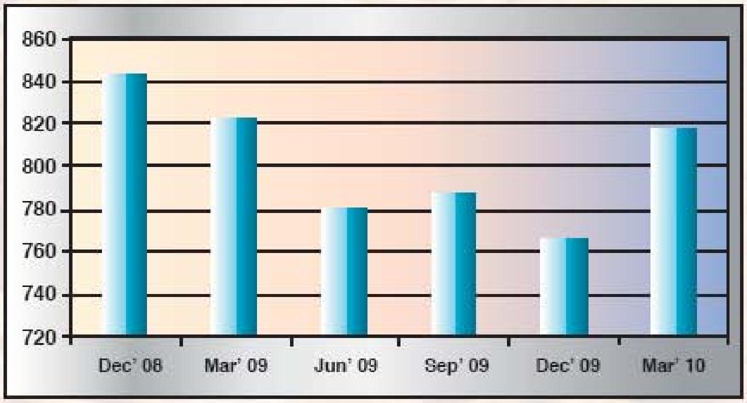

**Fiscal Conditions**

The slight increase in oil and gas production, together with higher prices, is estimated to have provided a fillip to government revenues during the first quarter. After a fiscal deficit of $442.9 million in the three months to December, the government likely recorded a surplus of several million dollars in the first three months of 2010. While energy prices have been consistently above the budgeted price, it will be a surprise if a surplus is registered for the year as a whole, especially when elections-related spending is considered.

**Stock Market**

Some life has returned to the local stock market during the first quarter, with the composite price index increasing by 52.44 points or 6.9 percent to 817.72 (figure 3). This compares favourably with the 2.83 percent decline that occurred in the previous quarter. In early June, the index increased further to 835.89. The marginal improvement in the stock market is largely related to the temporary impetus provided by one-time events such as the trade in RBTT Bank shares and in the purchase of cross-listed shares principally on the Jamaican market.

**Figure 3: Composite Stock Index**




**Outlook**

The last few months have witnessed a sluggish economic performance against a backdrop of still reasonable, macroeconomic fundamentals. On May 24th, a new Government (Peoples Partnership Party) came into office headed by Mrs Kamla Persad-Bissessar, who is now the country's Prime Minister. Over the next few months, many challenges abound not the least of which is the necessity of addressing expenditure-related, election promises in the context of an expected domestic budget deficit and a hostile external environment. Coming months will demand fiscal prudence from the government and understanding from the governed.

# Caribbean States: Victims of the Vagaries

Vagaries: erratic, unpredictable or extravagant manifestations or actions. This seems to characterize the reality of Caribbean existence in today's world. From the global financial crisis, volatile commodity prices, removal of preferential prices and economies of scale, to drought, earthquakes and hurricanes, regional states are constantly battling with circumstances often not of their making and ultimately beyond their control. This quarter's installment sees economic hardship becoming more entrenched throughout the Caribbean despite early signs of growth in many of the world's leading economies.

**Table 1: Growth in tourist arrivals - 2010**

| Country | 2010 period | % change from 2009 period |
|---|---|---|
| Aruba | Jan only | 3.1 |
| Barbados | Jan - Feb | 1.7 |
| Bermuda | Jan only | -17.9 |
| Cayman Islands | Jan - Mar | 8.3 |
| Cuba * | Jan - Apr | 0.6 |
| Dominican Republic | Jan - Mar | 3.9 |
| Grenada | Jan - Mar | -1.3 |
| Guyana | Jan - Mar | 7.3 |
| Jamaica | Jan - Feb | 6.3 |
| St. Lucia | Jan - Mar | 12.5 |

**Sources: Caribbean Tourism Organisation (CTO), * EIU (UK), Grenada Board of Tourism**

***Barbados***

Following a 4.8 percent (revised) economic contraction in 2009, the first quarter of 2010 has continued in the same vein. Tourist arrivals for January and February grew by just 1.7 percent over the same 2009 period, as increased visitors from the USA and Canada just managed to eclipse the decline in visitors from the UK, Barbados' largest source market. Receipts from the sector are likely to be even less impressive due to discounting by hotels and reduced tourist spending. Sugar production was affected by the island's worst drought since 2002 and receipts from the sector fell by almost 28 percent in the first quarter of 2010 compared to 2009. Nevertheless, foreign reserves remained largely unchanged after the first quarter and, at US$750 million, can cover 20 weeks of imports. Unemployment fell marginally to 9.8 percent, while inflation came in at 3 percent. Government's efforts to shore up economic activity, in a scenario where its revenue fell by 23 percent in the first quarter, ultimately led to increased borrowing, which took the gross debt-to-GDP ratio to 93.6 percent. A near-term recovery for Barbados is unlikely, as the UK is experiencing only fledgling growth at this time, with a robust recovery still someway off.

***Grenada***

Declines in tourist arrivals and construction activity spurred the 7.7 percent contraction in Grenada's economy in 2009 and the increase in the year-end unemployment rate to 30 percent. With remittances, foreign direct investment (FDI) and government tax revenue from imports all down, the island's debt-to-GDP ratio climbed to 122 percent by the end of 2009 from 100 percent a year earlier. This year has not brought any respite, with the positive effects of improving economic conditions in the US yet to be felt. Tourist arrivals and construction activity remain depressed and the island's slowly recovering agriculture sector would have been significantly stressed by an estimated 40 percent drop in rainfall in the first quarter. On a positive note, Grenada secured a new three-year IMF loan for US$13m. The funds are expected to improve the island's financial outlook and help cushion the effects of the global financial crisis.

***Guyana***

Guyana's economy contracted through the first three quarters of 2009 and key crops, rice and sugar faced challenging growing conditions in the fourth quarter. Despite reports of strong growth, 2009's economic performance was more likely to have been flat or negative. Because of the importance of agriculture to the economy, Guyana would have been more affected by the recent drought than other Caribbean countries. Rainfall across the sugar industry from November 2009 to February 2010 was only 27 percent of the average for that period from 1997 to 2008, negatively affecting the rice, sugar and mining sectors. Paradoxically, Guyana's tourism sector outperformed most of its regional counterparts with 7.3 percent growth in first quarter arrivals. Although Guyana's economy is influenced more by commodity prices than economic growth in the metropoles, it will not be smooth sailing for the country. Weather extremes threaten agriculture production levels, which would negate the benefit of current high prices. In this context, the government's forecast of 4.4 percent GDP growth in 2010, announced in the US$694m National Budget, presented in February, seems optimistic.

***Cuba***

Following relatively weak economic growth of 1.4 percent in 2009, a strong recovery in 2010 is unlikely, with the outlook for tourism inflows, nickel exports, remittances and agriculture over the coming quarters, all weak. While tourist arrivals for the January-April period this year were marginally better (0.6 percent) than in 2009, price discounting could see revenue fall to levels similar to last year. Due to a lack of rainfall and significant under investment in the sector, Cuba registered its worst sugar harvest in over a century. Besides leaving hundreds of thousands of people without piped water, the impact of the drought on other sectors is unclear but likely to be negative. While agriculture's contribution to GDP - at less than 5 percent - is small, it helps to reduce the island's food import bill. Cuba's trade balance improved significantly in 2009 as the reduction in imports significantly outpaced that of exports. While the continuing oil spill in the Gulf of Mexico could possibly reach Cuba's North Coast beaches, at this time the risk to major resorts is considered to be slight.

***The Region***

The situation in OECS states seems even more acute than that of the larger Caribbean countries. Weak tourism performances that led to economic contractions in 2009 have improved only slightly thus far. Access to finance remains costly and restrictive, even more so for states whose debt-to-GDP ratio approaches or even exceeds 100 percent. FDI remains weak and remittances are down from previous levels. Far from providing stimuli to boost economic activity, most governments have been forced to cut expenditure. With struggling tourism and construction sectors and domestic agricultural production undoubtedly affected by limited rainfall, increased unemployment and government indebtedness across the OECS is inevitable.

The positive start to Jamaica's 2010 tourist season was a welcome sign. Growth prospects for the rest of the year, however, have been seriously jeopardized by the Tivoli Gardens stand-off that left 3 law enforcement officers and 73 civilians dead. The 'internal warfare' and subsequent limited state of emergency in May, made international headlines, and there are concerns that Jamaica's image and ultimately its tourist arrivals may be affected.

***Outlook***

The Caribbean outlook is not encouraging in the near term. Economic indicators will remain challenged over the next two quarters despite signs of growth in source markets. Financing will remain difficult and high commodity prices will stretch the resources of hapless consumer nations. Tourism growth will be spotty and is likely to have suffered even more this year with the FIFA World Cup currently underway in South Africa, no doubt luring some potential visitors away from the Caribbean. Further, when growth picks up, many states will be hamstrung by higher debt levels and poor economic fundamentals for years to come. In short, it will be some time before Caribbean states return to normal. But should that even be the objective now? Leaders may need to consider new and varied economic pathways to reduce their nations' vulnerability to external shocks.

As we digest our present circumstances, and ponder on the issues going forward, we are encouraged to spare a thought for Haiti, which heads into the second half of this year critically exposed to the vagaries of the Atlantic hurricane season.

**Sources: Barbados Central Bank, Guyana Central Bank, Economist Intelligence Unit (EIU) UK, Latin America Monitor (LAM) , Caribbean Tourism Organisation (CTO)**

# *Challenges for the New Administration*

A world economy in crisis; falling domestic output; fiscal expenditures exceeding revenues; promises made in the heat of a political campaign; high prices and high expectations: enter a new government. The preceding helps, if only partially, to identify some of the major challenges facing the new Peoples Partnership Government of Mrs. Kamla Persad-Bissessar, which won the Trinidad and Tobago general elections of May 24, 2010.

*So the question must be: How do we get the economy growing again on a sustainable basis?*

It is only if the economy begins to grow again that the new Government will be able to provide the range of social services it has promised. So the question must be: How do we get the economy growing again on a sustainable basis? "Sustainable" means, inter-alia, that growth is broad-based and not solely government-driven for any length of time. In other words, the government of Trinidad and Tobago, like governments in other parts of the world can only provide stimulus measures for a very limited period of a few years, and at great cost, through increased expenditure usually derived from shrinking tax revenues or from borrowing. This kind of growth is not sustainable. Therefore, the private sector must again begin to invest, make profits, pay taxes, employ people and spend and together with government, work towards sustainable economic growth.

Unfortunately, the governments of some countries try to spend their way out of a recession – but seem unable to get out. This path usually culminates in a crash of one sort or the other. The result is economic contraction and adverse social conditions such as high unemployment and poverty – conditions they might have been trying to avoid in the first place. Greece is a case in point. That country ran deficits for at least ten years, part of which went into hosting the 2004 Summer Olympics and saw its debt (reported) almost double over the same period. Its debt-to-gross-domestic-product (GDP)-ratio reached over 100 percent in 2009. Unfortunately, recent protests by themselves are unlikely to make the situation any better.

What is to be done in the case of Trinidad and Tobago? Trinidad and Tobago's situation is not like that of Greece. The country still has a good international credit rating and a cushion of on-going activity which can give it some breathing space. When one considers the available statistics and the recent announcements of the Minister of Finance, certain action seems necessary:

1. Policy makers and citizens alike must act wisely;
2. The relevant Ministries must cost the various election promises against the available revenues and contending uses in order to determine what are the precise boundaries of expenditure;
3. Promotion of private sector growth must be a priority with clear focus on the removal of the constraints to growth, in the first instance;
4. Plans and programmes must drive efficiency and productivity across the public sector, first in areas which attract little or no additional costs;
5. The government must identify and fast-track investments that are revenue-generating;
6. The relevant Ministries must evaluate all economic sectors including those flagged by the previous administration for their growth potential;
7. The Ministry of Energy must review energy investment policy and fast-track action on the fiscal incentive regime.

This list is not exhaustive. Some of these actions must be taken in the short term and others in the medium to longer term. Prioritization is absolutely necessary as everything cannot be done at the same time, even if that is the expectation.

The pre-election period was characterized by a host of quarrelsome issues which were compounded by the global economic crisis. The end result of this might have served to cause some delay – and even postponement – of investment. Post-election periods tend to find investors more willing to take firm investment decisions. This might now be exploited in the quest for growth, especially where there is some indication that global growth is likely to resume once more.

A major pre-election issue was that of crime. Addressing crime must not be viewed only as a social imperative, as important as that is. A joint study by the United Nations Office on Drugs and Crime and the Latin America and the Caribbean Region of the World Bank in March 2007 showed that Caribbean countries could boost economic growth by reducing crime and violence. (Crime, Violence and Development: Trends, Costs and Policy Options in the Caribbean. New York: UNODC, 2007). In other words there is a potential increase in this country's GDP which is "locked up" in the high crime statistics. If the high cost of crime can be addressed then not only would there be an increase in the welfare of the population but an increase in GDP as well.

Trinidad and Tobago faces major challenges on most fronts. Fortunately there is a confluence of events that if appreciated can make a big difference to the development of this country. Among these events are a new administration, which will hopefully bring new ideas and action to the many challenges, and a gradually improving world economy. These, in the context of a still strong domestic economy, are useful ingredients in putting this country on a sustainable growth path.

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