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Recession or Slump: Recovery Delayed

Overview

The presumably weak performance of Trinidad and Tobago's economy in the first quarter of 2012 is consistent with the outlook outlined in our previous issue of The Republic Economic Newsletter (REN) *(March 2012)*. While the slowing US economy and deteriorating conditions in the eurozone undoubtedly had some impact, the expected contraction was largely due to domestic challenges, both old and new. Notwithstanding some optimism in the form of two promising oil discoveries, Republic Bank estimates that the economy contracted by about 2 percent in the first quarter. This, as problems of reduced hydrocarbon production and slow roll-out of government projects met new disruptions in the form of labour protests. Unemployment is forecasted to have risen to 6.2 percent in the quarter while credit demand remained flat. Inflation increased strongly during the period.

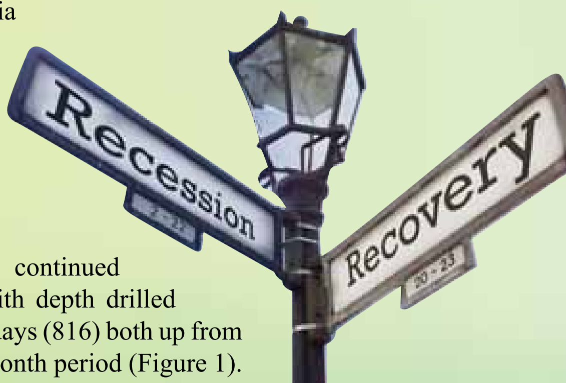
Trinidad and Tobago Key Economic Indicators

Indicator	2011	2011.1	2012.1 p/e
Real GDP (% change)	-1.4	-2.3	-2.0
Retail Prices (% change)	5.2	0.5	3.8
Unemployment Rate (%)	5.5	6.1 e	6.2
Fiscal Surplus/ Deficit ($M)	-1,039.3	-1,034.00	-207.00
Bank Deposits (% change)	14.1	3.6	1
Private Sector Bank Credit (% change)	6.5	2.9	-0.4
Net Foreign Reserves (US$M)	11,832.3	10,800.7	11,895.6
Exchange Rate (TT$/US$)	6.37 / 6.43	6.36 / 6.42	6.37/ 6.43
Stock Market Comp. Price Index	1,012.9	872.1	1,011.6
Oil Price (WTI) (US$ per barrel)	94.86	93.50	102.88
Gas Price (Henry Hub) (US$ per mmbtu)	4.00	4.18	2.25

Source: Central Bank of Trinidad and Tobago, TTSE, EIA
p - Provisional data
e - Republic Bank Limited estimate

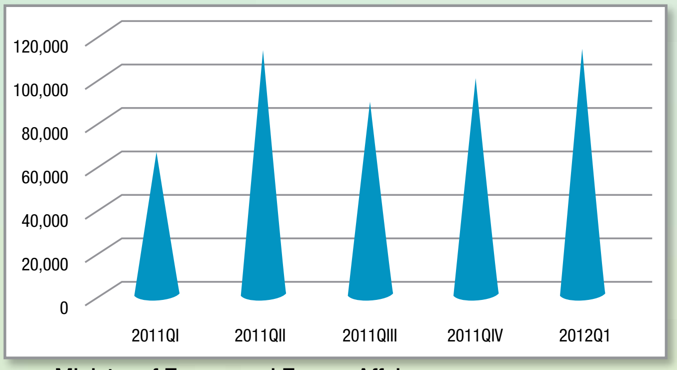
Energy sector

The performance of the hydrocarbon sector was mixed. While crude oil production and gas prices declined in the first quarter of 2012, the rest of the sector registered some improvement when compared to the previous quarter. Crude oil production fell by 4.8 percent to an average of 82,516 b/d (barrels per day) for the January – March period. Despite this, revenue from petroleum sales was bolstered with a 9.5 percent surge in the average oil price to US$102.88 per barrel. Gas prices, however, declined by almost US$1 as the average price fell to US$2.52 per thousand cubic feet (mcf) from US$3.42 per mcf in the previous quarter. It is worth mentioning that while this benchmark (Henry Hub spot price) has traditionally been a useful guide, with much of this country's gas now being sold outside of the US, prices in European and Asian markets are becoming increasingly relevant. Gas production improved to 4.23 billion cubic feet per day (Bcf/d) up from 3.92 Bcf/d in the last quarter of 2011. Ammonia and methanol production also increased at the start of 2012, compared to the previous quarter.



Exploration activity continued its positive trend with depth drilled (114,523 ft) and rig days (816) both up from the previous three-month period (Figure 1). The sector received a psychological boost in the first quarter with the announcement of two notable oil and gas finds. In mid-March, Bayfield Energy announced the discovery of hydrocarbon resources in its Galeota offshore block. The find was reported to have the potential for 32 million barrels of oil and 69 billion cubic feet of gas, with first production expected in 2015. Later that month, Petrotrin advised of its largest find in a decade, the discovery of an estimated 48 million barrels of oil in its Soldado fields. Ambitiously perhaps, production is set to begin in one year's time.

Figure 1: Depth drilled - feet

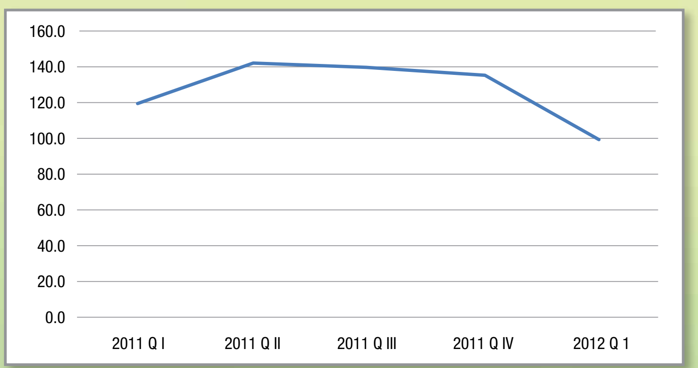


Source: Ministry of Energy and Energy Affairs

Non-energy sector

Following estimated fourth quarter growth of 1.2 percent (CBTT Monetary Policy Report – May 2012), the non-energy sector is likely to have remained flat at best in quarter one of 2012. Anecdotal evidence suggests the sector began the year well, with some recovery in retail and entertainment following the lifting of the State of Emergency, along with the introduction of government's Colour Me Orange programme. This boosted the distribution sector through increased purchases of clothing and food. The water and electricity sectors, following growth of 3.9 percent in the previous quarter, would have benefitted from a disconnection drive launched in February by the Water and Sewerage Authority (WASA) that saw a 53 percent increase in collections for that month to $75 million. It is believed, however, that much of the aforementioned gains were offset by a protracted 90-day strike at Trinidad Cement Limited from February 27th. The deadlocked wage dispute, which is now before the Industrial Court, effectively stalled a nascent recovery in the construction sector. Despite imports from regional factories, local cement sales plummeted and shortages were widespread, resulting in a 9.2 percent price increase to an average of $51.80 per bag for the quarter (Figure 2). Beyond construction, some aspects of the manufacturing sector were also affected as sales of related products like bricks also declined.

Figure 2 - Local Cement Sales (thousand tonnes)



Source: Central Bank of T&T

Fiscal Policy

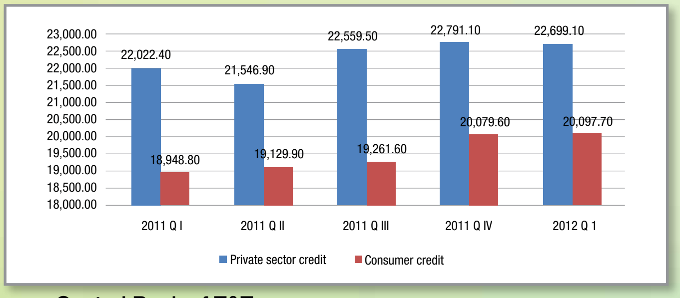
Government registered a surplus of $2.8 billion for the first half of the fiscal year, October 2011 to March 2012, due to a first quarter surplus of over $3 billion and a second quarter deficit of $207 million. The period under review, January to March 2012, saw a decline in current revenue to $11.4 billion from $12.7 billion in the October to December period, with a fall-off in energy revenue and an increase in non-energy revenue. While capital expenditure picked up in the second quarter of the fiscal year, it remained below government projections and has not been significant enough to provide the expected economic boost (see third article). The government's inability to execute many planned projects in fiscal 2011 continued into fiscal 2012. The situation was exacerbated in part, by increased public activism and a turbulent industrial relations climate. The start of the San Fernando to Point Fortin Highway project has been delayed by strident protests from some residents facing relocation, and the aforementioned TCL strike. Public sector as well as private projects have been affected.

Monetary Policy

With the domestic economy still sluggish and key international interest rates set to remain low, the Central Bank has continued to maintain a low-interest rate environment. The proverbial fly in the ointment has been the steady increase in the inflation rate, thus far in 2012. After recording a year-on-year increase of 6.8 percent in January, headline inflation rose to 9.1 percent in March and even higher to 11.8 percent in April. With core inflation still relatively subdued, impetus for the increases came primarily from food prices which jumped from 14 percent to 26.1 percent over the same period, reflective of adverse weather conditions. Not surprisingly, the Central Bank has raised its projection for average inflation this year from 5 percent to 7 percent.

Despite persistent low lending rates, credit demand effectively stalled during the first quarter, with commercial bank consumer loans outstanding as at March, just 0.1 percent higher than the December figure. Private sector credit contracted by 0.4 percent during the same period. On a year-on-year basis, however, stronger credit growth is evident (Figure 3). The Stock Market's Composite Index of 1,011.6, while 16 percent higher than 12 months ago was down 0.1 percent from the figure three months earlier. Net foreign reserves remained healthy at US$11,895.6 million at the end of March, half of a percent better than the December figure.

Figure 3: Credit Outstanding – TT$Mn



Source: Central Bank of T&T

Outlook

With anemic conditions in the first quarter extending well into the second, the outlook through June is likely to mirror the first three months of the year. Some obstacles to growth such as weak project implementation and crime may be addressed by the impending Cabinet reshuffle. There is a real possibility that the first six months may well have set the tone for the rest of the year. Nevertheless, if major hurdles are overcome and a more business-like environment is instituted, the economy can potentially perform better in coming months thereby posting positive growth. However, there remain major risks to this outlook.

Performance of Regional Economy Mirrors West Indian Cricket

Most of the West Indian cricketers, who took part in the recently concluded Indian Premier League, did so with distinction. However, it was the League's most valuable player, Sunil Narine and top run scorer, Chris Gayle that outperformed not just their Caribbean counterparts, but all other players in the tournament. This has generated some optimism for the West Indies team, which continues to struggle despite some signs of improvement and great individual performances by specific players. To a large extent, the performance of the regional economy during the first three months of 2012 mirrored that of the West Indies team. While a few economies such as Guyana and Suriname continue to record solid growth, economic activity in much of the region remains suppressed by global conditions.

Notwithstanding signs of improving tourist arrivals, low visitor spending continues to constrain revenue from the sector. The debt crisis in the European Union (EU) remains a significant deterrent to arrivals from that market. In the first quarter of 2012 domestic demand remained weak in most Caribbean economies, as high unemployment rates persisted. In these conditions, most of the region failed to record economic growth, while public debt and fiscal deficits remained uncomfortably high for several governments.

Barbados

According to the Central Bank of Barbados, economic activity increased by 1.5 percent in the first quarter of 2012, compared to a 1.4 percent contraction for the same period in 2011. Growth was recorded in both the tradable (2.1 percent) and non-tradable (1.3 percent) sectors and was largely driven by tourism and construction sector activity. The tourism sector experienced a 2.4 percent rise in arrivals, together with a slight increase in the length of stay to 5.2 days in the first quarter of 2012, from 4.7 days for the similar period in 2011. Nevertheless, the increased economic activity was not sufficient to significantly impact the unemployment rate, which reached 11.2 percent at end of 2011. High commodity prices pushed the rate of inflation to 9.7 percent, compared to 6.5 percent in first quarter 2011. By March 2012, credit to the non-financial private sector rose marginally by 0.3 percent above December 2011 levels and 0.9 percent above the figure recorded for the first three months of 2011. Public finance remains cramped by high debt and a sizeable, but improving fiscal deficit balance. With evidence pointing to a slowdown of the US economy and with no solution in sight for the EU debt crisis, it is our view that the Barbados economy may find it difficult to grow in the third quarter of 2012.

Grenada

With GDP expanding in 2011 by 1.1 percent for the first time since 2008, some momentum likely carried over into the first three months of 2012. The continued recovery of the agriculture sector and greater tourist arrivals provided some impetus for the domestic economy during the first three months of 2012. The recently presented 2012/2013 national budget entails a considerable increase in capital expenditure, which is expected to impart some economic impetus. The rate of unemployment, which is suspected to be above 20 percent, may decline modestly in response to the higher level of government expenditure. However, Grenada's policy makers' commitment to prudent management of the country's massive debt burden is likely to limit the stimulus provided by government expenditure. Modest growth is expected in the third quarter of 2012. The dismissal of the Minister of the Environment in January 2012 suggests that there may be some division within the ruling National Democratic Congress (NDC). The NDC is expected to face keen competition from the main opposition party, the New National Party (NNP) in the next general election due by July 2013.

Guyana

Guyana's economy continues to perform creditably, propelled by growth in the agriculture and mining sectors. Rice production continues to improve because of expanded acreage and improved drainage and irrigation, among other initiatives. Although sugar output has been rising in recent times, the industry continues to be blighted by a host of labour and managerial problems and output consistently falls short of production targets. Consequently, the government has had to repeatedly fund financing gaps of the state-owned sugar company, Guysuco. The expansion in mining sector activity during the first three months of 2012 has been paced largely by increased gold production. Government is expected to increase expenditure significantly in 2012, as it seeks to, among other things, complete several infrastructural projects and transfer G$4bn to the loss-making Guysuco. Accordingly, both the fiscal deficit and public debt are expected to expand. Nonetheless, strong government expenditure is anticipated to bolster economic activity during the July to September 2012 period.

Cuba

Based on a 5.3 percent increase in tourist arrivals, economic activity in Cuba is estimated to have expanded moderately during the period January to March 2012. However, given the 25 percent drop in the price of nickel that occurred during the period, growth estimates may yet prove to be optimistic. Work on economic reforms aimed at enlarging the role of the private sector, is proceeding, albeit at a slow pace. Nevertheless, the challenges of the transformation remain evident, with regressive tax rates, credit and supply shortages curtailing private sector activity. Additionally, weak competition in the private sector means that customers are being asked to pay high prices. Cuba's efforts to become energy self-sufficient could be significantly delayed as Spanish oil giant Repsol announced in May 2012 its plans to cease exploration activity on the island. The decision comes after the 12-year search by the company for offshore oil produced two dry holes. This news could cause other international energy firms to develop a dim view of the country's energy prospects and ultimately stifle new investment in the sector. Economic growth could slow in the second half of 2012, given threats to tourism presented by the global economy and the current trend in nickel prices.

The Region

Jamaica's GDP is estimated to have expanded marginally by less than 1 percent in the first quarter of 2012. The sectors in which growth was recorded include wholesale and retail and agriculture. In spite of this, preliminary data suggest that the rate of unemployment may have risen during the period, with some sectors experiencing growth with rising unemployment. The country is confronted by a significant current account deficit, based on a large trade deficit and high oil prices. Inflation rose to 7.3 percent in March 2012, from 6 percent in December 2011.

Most states of the Organization of Eastern Caribbean States (OECS) have seen increased tourist arrivals during the first quarter of 2012. Yet, the level of optimism this brings could be outweighed by uncertainty surrounding the weak growth of the US economy and the debt crisis which threatens the very survival of the EU. Further, the general high level of public debt among OECS members continues to undermine growth prospects. With the Antigua Overseas Bank Ltd placed under receivership by the Financial Services Regulatory Commission (FSRC) in April 2012, the financial sector appears not to have fully settled following the Allan Stanford debacle. This follows the bailout of the Antigua and Barbuda Investment Bank (ABIB) in July 2011.

Outlook

Given the challenging global economic climate, regional growth is anticipated to be tepid at best in the third quarter of 2012. Downside risks include the slowing growth in Asia and the US, the EU debt crises and the resultant squeeze expected to be applied to tourist arrivals and international finance to the region. With fiscal policy in the region largely hamstrung by large deficits and high debt, little stimulus is expected from government spending. As global commodity prices are expected to remain high in the short-term, inflation pressures may elevate during the remainder of 2012. Although some jurisdictions reported some ease in the level of serious crime, suppressing the level of criminal activity remains a critical part of restoring confidence in the regional economy. The political climate is expected to remain fairly stable through to September 2012, even as the 2013 election dates for Barbados and Grenada loom.

Struggling for Growth: *What Do We Do Now?*

Now that the Central Bank has warned that the projected 1.7 percent growth in real output might not be realised this year, it is timely to examine the "growth issue" once again. The importance of growth for this economy was emphasized in this space in March and June 2011, as well as other preceding issues. We wish to raise this concern again, drawing on some common and successful growth factors identified across thirteen countries. Particular attention is paid to the role of government expenditure on infrastructure.

Trinidad and Tobago's economy experienced the first year of decline in 2009, after 15 consecutive years of growth. Arguably, this decline was understandable given that the Great Recession in the United States began in December 2007, negatively impacting foreign direct investment. It is noteworthy however, that most major mineral producers either did not go into decline or recovered in one year (Table 1).

Table 1 – GDP Growth of Major Oil Producing States (%)

Country	2008	2009	2010	2011
Ecuador	7.2	0.4	3.6	7.8
Oman	12.9	1.1	4	5.5
Qatar	17.7	12	16.6	18.8
Saudi Arabia	4.2	0.1	4.6	6.8
UAE	5.3	-3.3	0.9	4.9
Venezuela	5.3	-3.2	-1.5	4.2
Trinidad and Tobago	2.7	-3.3	0.0	-1.4

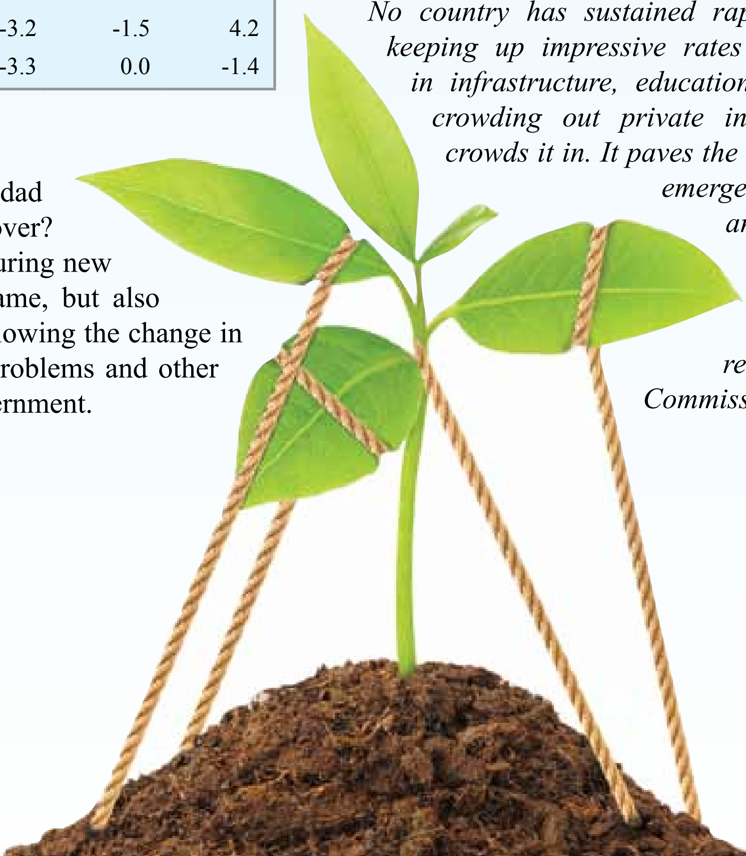
Source: IMF, World Economic Outlook

The obvious question is why has Trinidad and Tobago taken so long to recover? Our view is that the long lag in securing new energy investments is partly to blame, but also attributable are the uncertainties following the change in government in 2010, the teething problems and other challenges of the new coalition government.

Regardless of the cause, the consequences can be dire, if as a country we do not get this economy growing again. If growth is to be re-established, are there common lessons that were pursued among rapidly growing economies that this country might wish to at least consider? Of note, in this regard, are the recommendations of the so-called Growth Commission established in 2008, comprising noted policy makers, government and business leaders and two Nobel prize-winning economists, which produced the "Growth Report". While acknowledging that their findings were not generic and that countries would still need to focus on their individual constraints, the Report noted five factors that were common to the success of all 13 economies that were studied. These factors were (i) openness to the global economy (ii) macroeconomic stability (iii) high saving and investment rates (iv) market allocation and (v) leadership and governance. The Report also identified some "bad ideas" which hamper growth. Among these were subsidizing energy; relying on the civil service to provide jobs and reducing fiscal deficits by cutting expenditures on infrastructure. These "bad ideas" are especially pertinent to Trinidad and Tobago at this time.

The Overview to the Report pays special attention to one particular ingredient among the set of policy interventions proposed, namely public or government investment. According to the Report:

> *No country has sustained rapid growth without also keeping up impressive rates of public investment – in infrastructure, education, and health. Far from crowding out private investment, this spending crowds it in. It paves the way for new industries to emerge and raises the return to any private venture that benefits from healthy, educated workers, passable roads, and reliable electricity (Growth Commission, 2008, p. 5).*

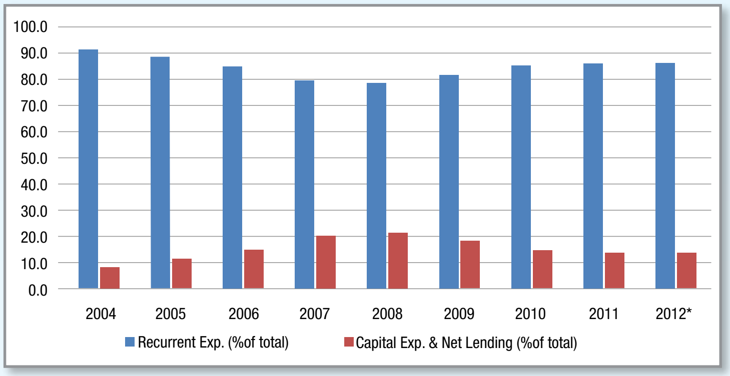


As if to mirror that Report, the Caribbean Development Bank, Inter-American Development Bank and the World Bank signed a Memorandum of Understanding in May 2012 to jointly support the work of the Caribbean Growth Forum (CGF). We eagerly await the findings and recommendations of the one-year Forum, which seeks to “identify policies and initiatives aimed at inducing growth and creating jobs in the Caribbean region through analytical work, knowledge exchange and inclusive dialogue.” Hopefully, Trinidad and Tobago is taking part in the deliberations, but the country cannot wait until then. While the energy sector is once more showing signs of life, increased output will be several years hence. Shorter term initiatives are therefore critical.

Foreign direct investment (FDI) was especially instrumental in the long period of growth that was experienced by this country. This changed over the years of decline. FDI averaged US$675 million over the period 2009 – 2011 compared to US$1148 million over the previous three-year period 2006 – 2008. If investment is crucial to growth, as we believe it is; if foreign direct investment (FDI) is weak; and if public sector expenditure can “crowd in” or stimulate domestic private investment, then the imperative for the government at this time is clear; the government must get its public sector investments going.

If we look at this country’s public sector investment in recent years we can discern a shift in the emphasis on capital expenditure. The share of capital expenditure in total expenditure rose steadily from fiscal year 2004 to 2008, but has been declining since then, with a corresponding increase in recurrent expenditure. Recurrent expenditure averaged almost $41 billion over the four-year fiscal period 2008/9 to 2011/12 or 84.8 percent of total expenditure. Capital expenditure averaged $7.2 billion or 15.2 percent (Figure 1).

Figure 1 – Central Government Expenditure



Source: Annual Economic Survey – Central Bank

Not only does recurrent expenditure represent the larger component by far, which is not unusual, such expenditure rose while investment expenditure declined. Not only does recurrent expenditure mainly stimulate consumption expenditure, which is limited in its impact, but most importantly it does not lead to a “crowding in” of private capital expenditure or investment as government’s capital expenditure tends to do.

Capital expenditure is the key to growth in the short term, which this country’s current national Budget seems to recognize. However, the government has not been successful so far in implementing major projects identified in the 2011/2012 Public Sector Investment Programme (PSIP).

If investments are much longer in coming, it stands to reason that the still comfortable macroeconomic indicators might begin to move in an adverse and undesirable direction.