



Republic Economic newsletter

March 2007

ISSN 1027-5215

Vol. 15 No. 2

Falling Unemployment, Falling Prices: Is Sustainability in Question?

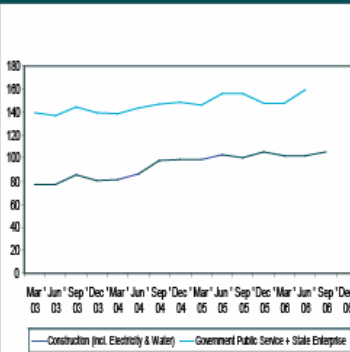
TRINIDAD AND TOBAGO KEY ECONOMIC INDICATORS			
INDICATOR	2006	2005.4	2006.4 ¹
Real GDP (% change)	12	2.00	1.60
Retail Prices (% change)	8.30	1.69	1.76
Unemployment Rate (%)	6.20	6.70	5.00
Fiscal Surplus/Deficit (\$M)	Surplus	2,413.80	Surplus
Bank Deposits (% change)	17.00	9.55	6.93
Private Sector Bank Credit (% change)	16.60	7.87	7.50
Net Official Reserves (US\$M)	6,762.30	4,765.20	6,762.30
Exchange Rate (TT\$/US\$) ¹	6.25/6.31	6.23/6.29	6.26/6.31
Stock Market Composite Price Index	969.19	1,067.38	969.19
Oil Price (WTI) (US\$ per barrel)	66.02	60.00	62.00

Source: Central Bank of Trinidad & Tobago, Weighted average buying and selling rates for the end of the period
1) Provisional Data
Republic Bank Limited estimates

Overview

Against the backdrop of strong government expenditure and a booming construction sector, Trinidad and Tobago's unemployment rate (provisional) fell to an all-time low of 5.0 percent in the last quarter of 2006. This achievement was primarily due to growth in government and construction sector employment (Figure 1) as employment in other sectors remained generally flat.

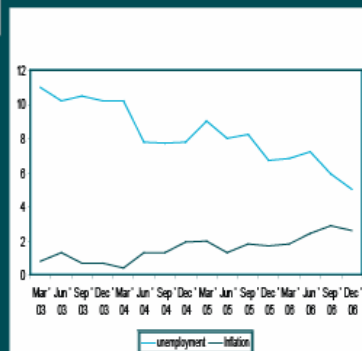
Figure 1: Employment by Sector ('000)



Consistent with a booming economy, real output for the entire year 2006 is estimated to have grown by a huge 12.6 percent following an estimated 1.6 percent growth in the fourth quarter. Strong energy prices were largely responsible for the expansion. In spite of some softening, oil prices remained strong throughout the quarter, averaging US\$60 per barrel (W.T.I.), while natural gas prices strengthened slightly, averaging US\$6.84 (Henry Hub). Buoyed by strong income growth, foreign

exchange sales by the Central Bank reached US\$1,393 million in December 2006, more than double that of 2005. Trinidad and Tobago has recently demonstrated the classic short term relationship of rising inflation coupled with falling unemployment (Figure 2). However, after a high of 10.0 percent in October 2006, headline inflation relented to 9.1 percent in December, falling further to 8.4 percent in February 2007. Intractable food price inflation fell marginally to 22 percent in December and further to 19.7 in February. The improvement in inflationary pressures seems to have come about as a result of the Central Bank's aggressive efforts to absorb excess liquidity through the use of open market operations, foreign exchange sales and a Government bond auction. However, the underlying forces remain strong, as initial data suggests that net fiscal injection for the first five months of this fiscal year was significantly above the previous year.

Figure 2: Unemployment & Inflation (%)



Energy Sector

Oil production rose in 2006 to 148,000 bpd. Production is however projected to fall below 142,000 bpd this year. Estimates from the last audit of the country's oil and gas reserves suggest that they are on the decline (Figures 3 & 4). At current production levels the country's proven oil reserves can last another 12 years. Gas production is however projected to rise in 2007 to just over 4000 mmcf from 3900 mmcf in 2006. At current production levels proven natural gas reserves can last another 16 years. All stakeholders are no doubt keenly awaiting the results of the next Ryder Scott oil and gas survey which is expected in second quarter 2007. Significant discovery of new reserves would no doubt improve the outlook for the sector. So too would our ability to source supplies from Venezuela or Africa. In February, Energy Minister Dr. Lenny Saith announced plans for the drilling of eleven exploratory wells in 2007 at a cost of US\$234 million. Another six wells are scheduled to be drilled in 2008 at a cost of US\$164 million.

Figure 3: Proven Oil Reserves (MMBLS)

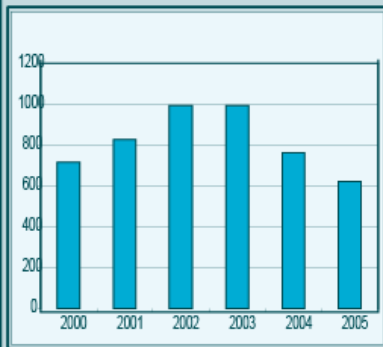


Figure 4: Proven Gas Reserves (TCF)



Monetary Conditions

The March meeting of the Central Bank's Monetary Policy Committee marked the sixth consecutive meeting that the Central Bank has opted to maintain the Repo rate at 8 percent. The Bank has instead increased its focus on liquidity absorption, which if successful will result in greater efficacy of the Repo rate. The success of the Bank's "mop up" strategy is embodied in the fall of system liquidity and the resultant easing of inflation pressures in January 2007. In February the Bank completed a bond auction totaling TT\$674 million. Notwithstanding some tightening of liquidity, the growth in private sector credit remained strong.

Stock Market

The market rallied late in the fourth quarter to register positive growth for the first time since May. The Composite index ended the quarter at 969, while the All T&T index was 1205. This late climb would have elevated investor hope for more positive conditions going into 2007 after mostly bear market conditions in 2006. Despite the late pick up, the market exhibited a general decline for the year, with the Composite index experiencing a year-on-year plunge of 9.2 percent and the All T&T index falling 8.86 percent for the same period.

Consumer Confidence

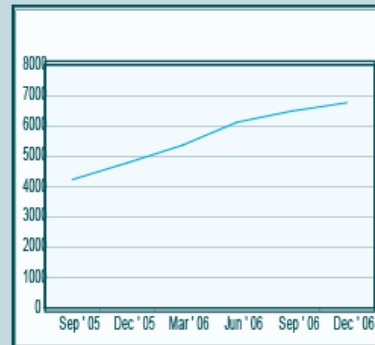
According to the MFO Republic Bank Consumer Confidence Index, local consumer sentiment declined consistently throughout 2006. The index fell to 67 in the fourth quarter from 69 in the previous period. Consumers believe themselves to be worse off than they were a year ago, principally because of rising inflation levels. However, the Corporate Confidence Index of the Arthur Lok Jack Graduate School of Business displayed a marginal improvement in the fourth quarter. Executives' view of their organizations' current financial performance improved over the period, while they also expressed optimism about their firms' financial outlook. Concerns about government spending and inflation however, continue to test their confidence in the local economy.

Fiscal Position

Preliminary estimates suggest that the government started its fiscal year with an overall fiscal surplus, which was due primarily to the continued strong performance of the energy sector. The

softening of energy prices in the fourth quarter of 2006, however, is likely to have restricted the size of the surplus and helped underscore the need for more diversified revenue sources. With the non-oil sector trailing the oil sector, government's revenue is largely dependent on the performance of the energy sector. The country's favourable reserve position persists, with net official reserves climbing to over US\$6 billion at the end of 2006 (Figure 5).

Figure 5: Net Official Reserves USD\$ Mn



Outlook

The prospects for the next few months of this year are good as external demand for energy commodities is expected to remain strong. The economy is projected to record robust growth for the year though not of the magnitude of last year. The fact that the Central Bank was able, at least for the time being, to rein in overall inflation to single digits may have eased some of the anxiety of the general public. However, inflation still remains a significant threat and in this regard the authorities cannot afford to be taken up with small victories. The goal of under 5.0 percent must be at the forefront. Amid high government expenditure and employment rates, repeated calls for expenditure restraint remain valid. Should these calls go unheeded, the absorption strategies of the Central Bank may not be up to the task at hand. The uncertainty that normally pervades the economy in the lead-up to national elections, combined with clear institutional weaknesses in high places should serve to caution the country's leaders to be far more judicious in the performance of critical responsibilities.

Caribbean Update..... Riding the CWC wave

Overview

Increased investment by both government and the private sector spurred solid GDP growth across the region as the Caribbean prepared to host the Cricket World Cup (CWC) 2007. Many states following similar paths, are seeking to enhance their tourism product to propel their respective economies. Several countries too, are planning to introduce value added tax (VAT) regimes. With sugar production no longer economically feasible in some states, the notion of producing ethanol for fuel is gaining currency across the region.

Barbados

According to the Central Bank of Barbados, the economy grew by 3.5 percent in 2006, driven largely by non-traded sectors such as tourism (2.5 percent) and construction (7 percent). Estimates put the average inflation rate at over 7 percent with significant increases in housing, fuel, transportation and food. The unemployment rate remained steady at 9.1 percent as increases in tourism, construction and utilities offset losses in manufacturing, government services and financial services.

Liquidity tightened last year and debt indicators are showing improvement. Barbados received 2.3 million Euros from the European Commission (EC) to assist in its efforts to restructure its sugar industry and make it more viable. Several prospects are being explored including the production of specialty sugar and ethanol. The island recently received kudos as a tourist destination and for its economic freedom. With an estimated US\$100-150 million having been spent on preparations for the CWC now in progress the authorities are banking on this event to generate tangible returns in the future, and add further lustre to 'Brand Barbados'.

Guyana

Guyana's economy grew by an estimated 4.5

percent last year following the contraction in 2005 as reported by the Economist Intelligence Unit (EIU), London. Inflation averaged 7.2 percent while sugar production grew by 5 percent last year, with continued growth expected in 2007. Bucking the regional trend, Guyana is maintaining its sugar industry and is presently investing to improve its competitiveness. It was recently assisted in this regard by a 5.6 million Euro grant from the EC. Infrastructure work on drainage and irrigation is also being undertaken to provide relief to rice farmers. Other reconstruction, combined with the expansion in hotel accommodation spurred a 12 percent growth in construction.

Guyana is expected to get some relief from high oil prices this year, as it is scheduled to get half of its petroleum needs (5,200 bpd) from Venezuela at a concessionary rate under the Petro Caribe agreement from May 1st. Notwithstanding this, there is strong interest in domestic oil exploration. The Guyana Geology and Mines Commission is projecting a significant increase in petroleum prospecting and drilling activities following the imminent resolution of the Guyana-Suriname border dispute. In November last year Guyana was granted 100 percent debt relief from the Inter-American Development Bank for US\$400m in funds borrowed before the end of 2004.

Like several of its Caribbean neighbours, the DR is exploring ethanol production and is aspiring to become a regional leader in this area.

Dominican Republic

Led by construction, communication and agriculture, the economy of the Dominican

Republic (DR) grew by an estimated 10 percent in 2006 (EIU, London). The inflation rate declined in the fourth quarter to average 7 percent for the year. Tourism continued its steady growth with air arrivals growing by 8.2 percent to cross 3.3 million visitors in 2006. Foreign exchange receipts were also boosted by remittances, which crossed US\$2.5b (8 percent of GDP) last year. Like several of its Caribbean neighbours, the DR is exploring ethanol production and is aspiring to become a regional leader in this area.

The free-zone sector continues to struggle, and activity declined by an estimated 5 percent last year. The long delayed implementation of the DR-Central American Free Trade Agreement (CAFTA), could take place within weeks. While this agreement will improve free zone exports to the US, it is no panacea. The DR will continue to struggle against Chinese exports to the US.

Cuba

Cuban authorities have indicated that the economy grew by 12.5 percent in 2006, however, more conventional estimates have put the figure closer to 9 percent. Increases in services, construction, oil production and some industrial production along with high nickel prices were enough to offset declines in agriculture production, manufacturing and tourism. While Cuba actively promotes a healthy relationship with key countries, there has been a decline in joint ventures between the state and private investors. The overall prospects for 2007 appear positive, with improvement expected in most of the sectors although the growth expected in tourism, nickel and oil is likely to be relatively small.

Grenada and the OECS

The EIU London, reported that Grenada registered GDP growth of 1.3 percent in 2006. Recoveries in agriculture and tourism were large enough to offset a 20 percent contraction in construction from the extraordinary levels of 2005. VAT is to be re-introduced as a revenue-neutral tax, replacing 3

existing indirect taxes. The Grenada National Stadium, which was rebuilt with funding assistance from China, was recently opened, signaling the Spice Isle's readiness to host matches for the current Cricket World Cup. Grenada is looking to this event to provide a fillip to its tourism aspirations as the island seeks to become a premier destination.

Collectively the OECS economies performed creditably in 2006 with the Eastern Caribbean Central Bank (ECCB) estimating GDP growth at 7 percent.

Other countries in the OECS are also placing greater emphasis on tourism as the driving force of their economies. Generally, 2006 was a good year for these islands as most enjoyed increases in both cruise and stopover tourism. Construction related to CWC 2007, also provided a boost, with infrastructure work, hotel expansions and stadium construction taking place across the sub-region (see Table 1). Notwithstanding the assistance from benefactor countries for some of these projects, these preparations would have done no favours to the OECS's chronically high debt levels.

On the other side of the spectrum, VAT is being introduced in most of the islands no doubt as a means of rationalizing their tax regimes, widening the tax net and increasing government revenue. Collectively the OECS economies performed creditably in 2006 with the Eastern Caribbean Central Bank (ECCB) estimating GDP growth at 7 percent.

**Table 1 :
Stadia Constructed or Renovated for CWC 2007**

Country	Stadium	Cost (US\$)	Status
Antigua & Barbuda	Sir Vivian Richards Stadium	55 m	New stadium
Barbados	Kensington Oval	69.1 m	Renovated
Barbados	3 Wis Oval	5 m	Renovated
Grenada	Queen's Park	40 m	Renovated
Guyana	Providence Stadium	26 m	New stadium
Jamaica	Sabina Park	26 m	Renovated
Jamaica	Greenfield Stadium	35 m	New stadium
St. Kitts Nevis	Warner Park Stadium	12 m	Renovated
St. Lucia	Beauséjour Stadium	23 m	Renovated
St. Vincent, Grenadines	Amos Vale Stadium	12 m	Renovated
Trinidad & Tobago	Queen's Park Oval	20 m	Renovated
Trinidad & Tobago	Sir Frank Worrell Ground	1.5 m	Renovated

Source CWC 2007 website and on-line news reports.

Note: The cost of the above projects totals US\$325 million. The author cautions however, that some of the data are preliminary estimates.

Jamaica

Significant investment inflows in tourism and mining provided impetus for the estimated 2.7 percent growth registered by the Jamaican economy in 2006. The Jamaican Minister of Tourism reported that stay-over visitors increased by 15.3 percent to cross the 3 million mark, translating to almost US\$2 billion in receipts. In the mining sector, a record 15 million tonnes of bauxite were extracted last year. The inflation rate fell by almost half to 8.0 percent and the total debt-to-GDP ratio while still high, has been trending down. Remittances, at 19 percent of GDP, continue to be a valuable source of foreign exchange.

Jamaica has also received assistance from the EC in the form of 5.2 million Euros, towards the transformation of its sugar industry and there is interest in ethanol production. Having hosted a successful opening ceremony for the

Cricket World Cup, the Jamaican authorities will no doubt be looking to translate this into tangible returns both now and well into the future.

Outlook

Whatever the eventual outcome of CWC 2007, regional states have set their hopes on tourism and leisure services. In light of this, the US\$47 million Caribbean Catastrophe Risk Insurance Facility, piloted by the World Bank is especially timely, as it would allow regional states to access funds quickly in the event of a natural disaster, thus shortening the recovery time. The anticipated slowdown in the US economy is not likely to be as severe as initially expected, and its effects on the region may not be felt until the 2008 tourist season. Of greater immediate concern is the unavoidable falloff in investment and economic activity that follows mega events. Regional planners and their respective workforces will need to be nimble to adapt to new opportunities and mitigate losses. However, with so many eggs in the tourism basket, one wonders how easy this will be. Nonetheless the regional economies should maintain their positive growth trends from 2006 with GDP growth projected to average 4-5 percent in 2007. With respect to the impact of CWC 2007 over the medium term.... only time will tell.

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To Industrialise or Not to Industrialise: That is Not the Question

In the midst of heady growth in energy-based incomes and expenditures and in the context of ongoing arguments as to the merits and demerits of establishing smelter plants, industrialisation is one of several vexing issues confronting the island state of Trinidad and Tobago. The fact is that this country has been industrialising for many decades now. In more recent times, attempts to industrialise can be traced to three broad phases viz. (i) industrialisation by invitation of the fifties, à la Sir Arthur Lewis (ii) import substitution industrialisation of the sixties and (iii) resource-based industrialisation of the seventies, which with minor modifications continues up to today. Understandably, there is some overlap among these phases. Industrialisation has always been accompanied by some degree of discomfort, as it has brought with it both benefits and adversities. This will continue to be the case.

...what is the ultimate objective of industrialisation?

This article seeks to identify fundamental issues that should be addressed in deciding on a path of further industrialisation. Among issues to be considered are, what does industrialisation mean? Since it involves both costs and benefits, is the likely outcome a net cost or a net benefit? How should costs be measured? Specifically, how much weight should be placed on any damage to the environment when the overall cost is being considered? What are the net benefits of a particular path to industrialisation in relation to

alternative ones? What are the proximate costs and benefits of those paths? Who should determine the particular path to industrialisation? Should the “people” have a say at all or is it sufficient to allow any elected government to decide? Why? Indeed, perhaps the most fundamental question is: what is the ultimate objective of industrialisation?

Traditionally, industrialisation has meant the design and construction of factories, installation of machinery, processing of some input to produce a final output, either as final consumption or for input into another process. This manufacturing process usually produced some sort of waste that was re-used in another production process or dumped. In all of this jobs were created, people employed, foreign exchange used and earned through exports and taxes were paid to government. While this is a simplified explanation it should suffice for the purpose at hand. Understandably, a country with mineral resources, such as Trinidad and Tobago will tend to industrialise along a path such as described above.

A country without such resources may import the raw material to process or choose some other path such as fish or agro-processing. While the above seems straightforward one might ask, is tourism a form of industrialisation? What if an economy is largely based on eco-tourism say, can it be described as industrialised? Is that desirable or not? Arguably, in the latter case the country might not be described as industrialised but indeed that may well be a desirable state for that country.

As stated earlier industrialisation involves both costs

and benefits. Costs of industrialisation include not only the direct costs of inputs but also indirect costs as well or what economists call “externalities”, such as damage to the environment. Industrialisation undoubtedly has brought benefits to this country and will continue to do so. Some of these benefits have included well-paid jobs, hard currency, substantial tax payments, trained professionals in engineering and other disciplines and linkages to other support businesses and industries.

Some more developed countries are placing greater emphasis on what is called “knowledge-based industrialisation”.

For various reasons, some countries may not choose the traditional path outlined above or depending on the stage of economic development may, over time, shift the form that industrialisation takes. In this context, the February 3rd–9th 2007 issue of the Economist magazine notes that some more-developed countries are placing greater emphasis on what is called “knowledge-based industrialisation”. In choosing this path a process of “de-industrialisation” is said to be occurring, where countries such as Britain, are moving “industrial” activities offshore. The emergence of India and China in the world has made it not only economically advantageous to some developed countries to outsource traditional manufacturing activities to these

countries but environmentally friendly as well. By retaining the more 'high-tech' industries or 'research-based fields', developed countries are more likely to introduce new higher-value goods and services to the market place and thus reap greater rewards than if they were to concentrate on manufacturing standardised products.

A comparison between five developed countries and three Caribbean countries (Table 1) indicates that the developed countries are more service-based. High-tech exports in Singapore and the UK account for 59 percent and 24 percent, respectively, of merchandise exports. To be fair, it may be argued that Trinidad and Tobago is still developing and is on its way to becoming developed. The Wallerfield Business Park may be viewed as part of that new vision which will emphasise knowledge-based industries.

Table 1: International Trends

	GDP per Capita US\$	HDI Rank	High-Tech Export % of Merchandise Exports	Education Exp. % of GDP
Norway	38,454	1	18	7.7
USA	39,676	8	32	5.5
UK	30,821	18	24	5.5
Hong Kong	30,822	22	32	4.7
Singapore	28,077	25	59	N.A.
Barbados	15,720	31	15	4.3
T&T	12,182	57	1	4.3
Jamaica	4,163	104	N.A.	4.9

Source: United Nations Human Development Report 2006.

N.A. Not Available

Whatever the form of industrialisation a country chooses, it is fundamental to ask, what is the purpose of industrialisation? While the intermediate purpose will be to provide jobs, earn foreign exchange and in so doing assist in

the development of the economy the ultimate purpose must be to promote growth and development. The purpose surely cannot be to acquire a multitude of tall buildings and large plants and busy people working shifts or consuming huge amounts of electricity. Rather, the ultimate purpose must be to provide a high standard of living for as many people as possible. This will likely involve some expansion in physical infrastructure but it is important to distinguish here between the ends and the means. Industrialisation is viewed as one of the means through which improvements in human development can be brought about; it cannot be interpreted as "development" per se. It is expected to contribute to higher standards of living without unduly threatening environmental sustainability. Indeed, in the extreme, a country can become very industrialised as is the case in many countries in the world but the quality of life of its citizens can lag very far behind. This cannot be desirable.

Given available choices is there an optimum way to industrialise?

If the ultimate purpose of industrialisation then, is the creation of a higher and sustainable standard of living, as it should be, then the question must be asked, what is the "best" way to achieve this? Put another way, given available choices is there an optimum way to industrialise? The answer will depend on such factors as (a) whether or not a country has natural resources (b) the rate of depletion/accumulation of those resources (c) the trade-offs that the population is willing to make and (d) other options or combinations of options.

For a mineral-based economy like Trinidad and Tobago, industrialisation-related issues such as those raised above are likely to be around for quite a while. The issues are fundamental, have far-reaching consequences and are contentious. On the one hand there are issues such as the optimum number of mega plants, availability and best use of mineral resources and environmental safety and sustainability. On the other hand are issues such as the imperative of economic growth, demand for jobs and expectations of almost instantaneous improvement in the standard of living. This is not an envious mix for any government in a democratic setting characterised by contesting parties. However, no government that embarks on a path to industrialisation can fail to observe the highest standards of debate and democratic practice. The alternative can be far more time consuming and costly!

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