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Flat Quarter IV Growth Mirrors Weak Energy Performance

Overview

The domestic economy is estimated to have remained flat during the last three months of 2010. Economic activity declined marginally by 0.2 percent, following on anaemic growth of 0.7 percent in the quarter ended September 2010 (figure 1). Despite higher oil prices, the energy sector underperformed during the period, with reduced production for both oil and gas. Weak output from the non-energy sector, notwithstanding increased retail activity during the Christmas season, exacerbated the overall situation. Construction activity seemed to have been especially weak. Additionally, productivity would have been significantly undermined by industrial action instigated primarily by the Public Service Association (PSA). Unemployment is estimated to have risen to approximately 6 percent by December 2010 from 4.8 percent in the second quarter.

Rising by 30 percent in December, food prices remain the dominant component of domestic inflation, which peaked at 16.2 percent in August, but eased to 13.4 percent by the end of the year. Activity in the stock market improved moderately by 1.7 percent in the fourth quarter, compared to the previous three-month period.

TRINIDAD AND TOBAGO KEY ECONOMIC INDICATORS

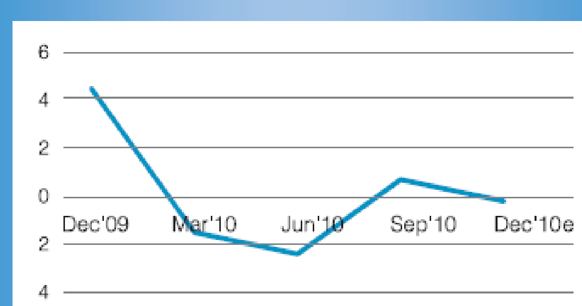
INDICATOR	2009	2009 .4	2010 .4 p/e
Real GDP (% Change)	-3.5	4.5	-0.2
Retail Prices (% Change)	7.2	-1.7	-1.5
Unemployment Rate (%)	5.3	5.1	6
Fiscal Surplus/ Deficit ($M)	-6,686.0	-442.9	-3500.0
Bank Deposits (% Change)	29.9	12.4	0.7
Private Sector Bank Credit (% Change)	-5.5	0	-1.8
Net Foreign Reserves (US$M)	10,783.9	10,783.9	10,456.1
Exchange Rate (TT$/US$)	6.27/6.33	6.32/6.36	6.33/6.38
Stock Market Comp. Price Index	756.3	765.3	835.6
Oil Price (WTI) (US$ per barrel)	66.66	76.06	85.10
Gas Price (Henry-Hub) (US$ per mmbtu)	4.00	4.34	3.80

Source: – Central Bank of Trinidad and Tobago, TTSE, EIA
p – Provisional Data
e –Republic Bank Limited Estimate

Energy Sector

Conditions in the energy sector were mixed, as oil prices rose to average US$85.10 per barrel from US$76.05 in the third quarter. Gas prices on the other hand, fell to an average of US$3.80 per mmbtu from US$4.41. Domestic oil production slid to an average of 86,610 barrels per day (figure 2), restrained by the temporary shut-down of BHP Billiton's operations at its Angostura field. The shut-down was to facilitate the installation of facilities for additional natural gas production. Gas production also slipped to 4,202 million cubic feet per day from the 4,371 in the third quarter. Along with declines in ammonia and methanol exports, the sector likely contracted during the fourth quarter. In order to boost

Figure 1 Real GDP Growth



E: estimate

oil production, the government has offered fiscal incentives to encourage oil companies to pay much greater attention to small and mature fields, starting in January 2011. The government's auction, in early 2011, of deep water acreage for oil and gas exploration attracted bids for only four of the eleven blocks offered. Associated exploration is likely to engender increased economic activity in the sector.

Fiscal Policy

Government revenue fell during the fourth quarter of 2010, constrained by reduced production of both oil and gas, resulting in a fiscal deficit (figure 3). Preliminary data suggests the shortfall measured an estimated $2,500 million for October and November cumulatively. The deficit may have grown further during the last month of the quarter. The resumption of operations at BHP Billiton's Angostura field in early 2011 brought local production levels to around 100,000 barrels per day, thus allowing the country to better take advantage of currently higher oil prices. Nevertheless, with government plans to start paying CLICO policy holders early in 2011 and agreements yet to be reached with regard to wage negotiations with the PSA and police officers, the potential for sharp increases in expenditure remains strong.

Monetary Policy

Despite persistently high inflation rates during the fourth quarter of 2010, the Central Bank opted to maintain its accommodating stance in an effort to stimulate the sluggish domestic economy. Inflation reached 13.4 percent, year-on-year in December, up slightly from 13.2 percent in September, while core inflation (inflation without the influence of food prices) remained relatively subdued, rising marginally to 4.7 percent from 4.1 percent. Based on the relative stability of core inflation, the Central Bank decided to reduce the "Repo" rate from 4.25 percent to 3.75 percent over the period. The "Repo" was further reduced to 3.25 percent in February 2011, following a fall of inflation to 12.5 percent in January. As a result, the average prime lending rate of commercial banks eased from 9 percent in September to 8.38 percent in December. However, the fall of interest rates did little to spur economic activity during the last three months of 2010, as private sector credit contracted by 1.8 percent. On a positive note, consumer credit rose 5.4 percent, up from 1.9 percent in final three months of 2009.

Foreign Reserves

With energy prices consistently above budgeted figures during the period, the country's reserves increased slightly from US$10,424 million in September, ending the year at US$10,456 million and representing approximately 13 months import cover. Net sale of foreign currency totaled US$501 million from October to December 2010, up from the US$403 million recorded in the similar period in 2009. Strong demand for foreign currency exerted significant pressure on the TT dollar, causing it to depreciate against the US and Canadian currencies during the period by 0.5 percent and 3.3 percent, respectively.

Figure 2 Oil Production & Prices

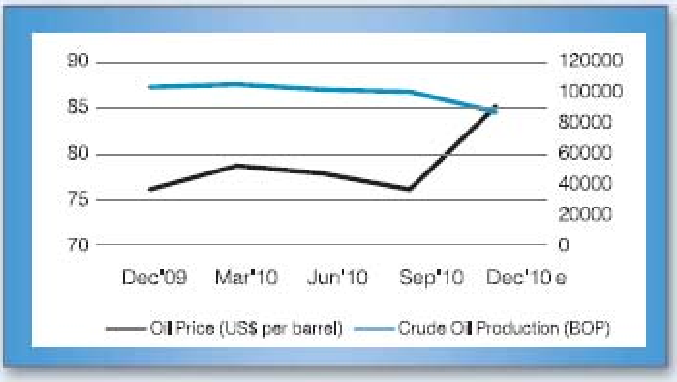
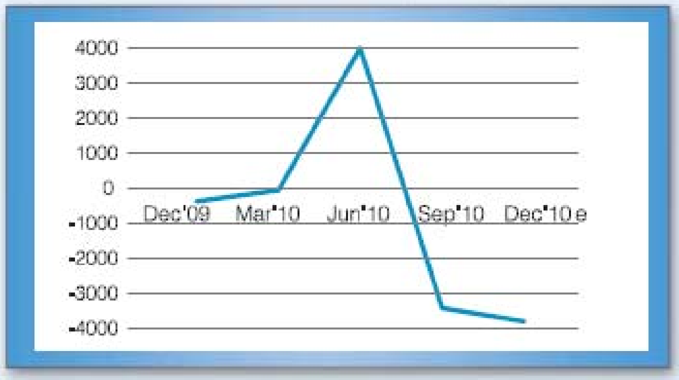


Figure 3 Overall Fiscal Balance (TT$mn)



Outlook

The local economy is expected to grow in the first six months of 2011, propelled by the energy sector but also by the $100 million stimulus provided through government expenditure on Carnival. Additionally, government's plans to start several projects in early 2011, such as the extension of the Solomon Hochoy Highway and house and road construction, would provide a much needed fillip for the construction sector. Further, government revenues can be expected to improve on account of the civil unrest currently plaguing the Middle East and North Africa, which has driven spot oil prices beyond US$100. However, major challenges would continue to plague the Trinidad and Tobago economy. For example, a higher oil price can be compared to the proverbial two-edged sword, as it increases transportation and other costs and raises the cost of goods and services. In this regard, the UN's Food and Agriculture Organization has already warned of an impending food crisis, with global food prices reaching record highs in January 2011. Overall, although prospects for the economy in early 2011 seem brighter, these would certainly be accompanied by major challenges.

Caribbean Update

A Longer Road to Recovery

As the Caribbean continues to grapple with difficult economic conditions, the road to recovery is turning out to be longer than anticipated. Home to some of the most highly indebted countries in the world, many of the region's small states do not have the leeway to boost key sectors or make up for the shortfall in revenue and foreign investment. Mild improvements in tourism have been spotted but growth continues to be inconsistent due to high rates of unemployment and weak consumption in the major source markets of the USA, UK and Europe. Rising commodity prices, particularly of food and crude oil, despite boosting the revenues of Caribbean commodity exporters, will spur additional challenges for all Caribbean countries. Already experiencing persistent upward pressures due to growing demand from developing countries, global food prices escalated as extreme weather conditions in major producing countries such as Russia and Australia, affected supplies. Meanwhile, growing political unrest in key oil-producing regions has seen spot crude oil prices cross the US$100 mark. As a result, significant inflationary pressures for regional states will be reminiscent of those experienced in 2008.

Table 1: Average annual inflation rates (% change)

	2008	2009	2010 p
Barbados	8.1	3.7	5.0
Grenada	8.0	-0.3	3.6
Guyana	8.1	3.0	3.7
Jamaica	20.2	9.0	11.2
St. Kitts-Nevis	5.4	1.9	2.5
St. Lucia	7.2	0.6	1.7
St. Vincent & the Grenadines	10.1	0.4	1.2
Trinidad & Tobago	12.0	7.2	10.5

p - provisional
Source: International Monetary Fund (IMF), Central Bank of Trinidad & Tobago (CBTT)

Cuba

Cuba's GDP growth is estimated at 2.1 percent for 2010. The island ended that year on a positive note with a trade surplus of US$3.9 billion due to increased prices of some of its main exports such as nickel, petroleum derivatives and medical services. However, while the value of Cuba's exports rose by an impressive 28.8 percent in 2010, in volume terms exports actually fell by 14.8 percent. The tourism industry is showing some early positive signs, as Cuba registered record international tourist arrivals of 222,296 for January 2011, a year-on-year increase of 15.9 percent. Nonetheless, the government, facing protracted revenue shortfalls, sought to introduce a series of austerity measures to alleviate its fiscal burden. President Raul Castro's decision to delay job cuts in the public sector and the removal of subsidies, was seen by many as an attempt to avoid the widespread social unrest that triggered political upheavals in parts of the Middle East and North Africa. Cuba's fiscal challenges remain and with few other options available, it remains to be seen how long the authorities will be able to put off these adjustments, despite the significant increases in unemployment and inflation that will inevitably result.

Barbados

Real output contracted further in 2010 by 0.5 percent. A slow recovery in the tourism sector was not enough to prevent Barbados from experiencing its third consecutive year of recession. Although total visitor arrivals rose by 4.1 percent over the first nine months of 2010, the number of UK tourists (traditionally the higher spenders) dropped by 8.1 percent, with the increase in arrivals due to higher numbers of American and Canadian visitors. The weak tourism recovery, along with almost non-existent investment financing, resulted in a decline in construction sector activity. As an important employer, this sector's decline contributed to the rising unemployment rate which stood at around 11 percent at the end of 2010. Despite a reduction in its fiscal deficit to 8.8 percent of GDP in 2010, from 9.4 percent one year earlier, Barbados continues to be burdened by high debt levels. Food imports grew 8 percent in 2010 when compared to the previous year and with food prices on the rise, inflation will definitely be a cause for concern in the near future. In light of this, the Minister of Agriculture is proposing that the local agricultural sector find ways to boost production to reduce the country's high food import bill.

Guyana

Guyana's economy grew by an estimated 3 percent in 2010, on the back of strong performances in some commodities over the first 9 months of the year. Rice production increased by 29 percent over 2009. Gold production at 231,035 oz. was similar to that of the 2009 (Jan–Sept) period but revenues were boosted by higher prices. The construction sector also played a part, with a 9.5 percent increase in activity in the first half of 2010, which was likely to have continued through the year. Sugar production was disappointing, with the combination of unfavourable weather conditions and industrial unrest resulting in significantly reduced output. Government's revenue position was ably supported by increased collections of corporate taxes and VAT. A worrying sign is a recent trend of increases in Guyana's debt stock, both local and foreign. Led by gold, rice and bauxite, revenue from goods exports increased by 19 percent in the first three quarters of 2010. However, this was offset by a 25 percent increase in import costs due largely to fuel and consumer goods, resulting in the widening of the trade deficit. According to the Bank of Guyana, the country posted a balance of payments surplus of US$90.1 million in 2010, boosting foreign exchange reserves to a high of US$675.1 million in November 2010.

Grenada

Grenada's economy contracted by 1.4 percent in 2010, which was an improvement from the previous year, which saw a contraction of 7.7 percent. While tourism and construction continued to struggle, strong performances were recorded in the agriculture and manufacturing sectors which expanded by 8.5 percent and 25 percent, respectively. The hotels and restaurant sector, a good proxy for tourism activity, shrank by 9 percent in 2010 compared to 19 percent in 2009. Average inflation was estimated at 3.5 percent last year, and the unemployment rate was put at 29 percent, despite government's efforts at job creation. Grenada's economy was found to be larger than previously estimated, with a new methodology giving an estimated size of EC$2.1 billion, a 28.8 percent increase. The central government debt, at EC$1.88 billion, resulted in a lower debt-to-GDP ratio of 91.5 percent based on the revised GDP estimate. In the EC$783.4 million, 2011 National Budget presented in January, it was disclosed that 24 cents of every dollar spent by the authorities, went towards debt repayment. On a positive note, Grenada was ranked among the top ten countries with the most improved business environment in the International Finance Corporation's (IFC) 2011 Doing Business survey.

The Region

The Jamaican economy shrank by 0.8 percent in 2010. Inflation and unemployment averaged 12.6 percent and 12.9 percent respectively, for this period. The island's trade deficit widened in the first eight months of last year, due to a lower level of exports and higher spending on fuel. An improved performance in tourism and a gradual resurgence in alumina production should see an improved revenue position in the coming months. Despite rising inflationary pressures, the Bank of Jamaica has been reducing interest rates due to weak domestic demand. In addition to spurring economic activity, lower rates reduce the interest payments on government debt, 55 percent of which is in local currency. A grim economic scenario is playing out across virtually all of the OECS states. From St. Vincent and the Grenadines to Antigua and Barbuda to St. Lucia, the story is the same. Revenue inflows continue to be weak as the key tourism sector struggles in the face of difficult economic conditions in key source markets. Foreign Direct Investment (FDI) inflows have been reduced to a trickle. Fiscal deficits have increased, as governments have sought to support their economies and stave off increased job losses with stimulus spending. This, combined with higher food and fuel costs has exacerbated the already difficult debt position facing these countries. While the tourism sectors in these islands have been slowly recovering, this will not be enough to counter the growing challenges in the short term.

Outlook

Political unrest in the Middle East coupled with the tsunami devastation in Japan will create serious challenges for the US economy and consequently, the Caribbean. Historically, turmoil in the Middle East has led to high oil prices, global inflation and stock market uncertainty, which negatively impacted the US economy. Caribbean countries are highly dependent on the US for tourism, FDI inflows and remittances. As a result, the Caribbean will have to monitor recent global trends, as there is the possibility that the US economy could slip back into a recession for the next two quarters. Inflationary pressures are likely to be widespread, and far from the relatively optimistic 2011 inflation forecasts put forward by some governments, as the average price increases this year are more likely to mirror those of 2008. With many Caribbean countries carrying high debt levels, significant expenditure contraction combined with external funding assistance seem unavoidable.

Igniting Growth in Trinidad and Tobago: Can a Social Compact be Useful?

(By Ronald Ramkissoon Ph.D., Senior Economist, Republic Bank. Based on a presentation to the American Chamber of Industry and Commerce (AMCHAM), Port of Spain, February 8, 2011)

Everyone, regardless of affiliation or status, should accept that most economic indicators for Trinidad and Tobago have been moving in the wrong direction for the last two years or so. In this scenario, igniting growth must be the first order of priority, if this country is not to repeat some of the errors of the eighties that saw a period of some eleven years of negative growth. I respectfully suggest that while several initiatives are necessary to get the economy growing again, a social compact can be a useful lever in this process.

Kick-starting growth is important for several reasons. For one thing, only a growing economy can ultimately, if not immediately, provide jobs. A growing economy is likely to be one producing exportable goods and services, earning foreign exchange and paying taxes to the government. Very importantly, only a growing economy is capable of addressing poverty and other social ills. Mind you, a country's economy can be growing with its social needs still left unaddressed, but social improvement cannot be sustained in an environment of pervasive negative or stagnant economic growth.

> ***For any investment however, whether from local or foreign sources, a stable industrial environment is an important consideration.***

A review of the experience of this country in the eighties can be useful to all interests. A falling crude oil price led to a reduction in government revenues and a jump in domestic and external debt in order to maintain high recurrent expenditures. Unemployment rose to perhaps its highest level and social conditions deteriorated. The average crude oil price was cut in half by 1988, reaching just about US$16 per barrel from approximately US$33 in 1982, the last year of economic growth. Government revenues fell by 28 percent between 1982 and 1988. The unemployment rate reached 22 percent in 1988 and public sector wages were cut. Total debt to GDP reached almost 56 percent, a fivefold increase from 1982. As is to be expected, the private sector experienced business failures and workers were retrenched. With foreign reserves depleted and unable to meet external debt commitments, the country entered into an International Monetary Fund (IMF) structural adjustment programme in 1989. If due care is taken this time around, this situation need not be repeated.

In order to stimulate economic activity, however, several levers of growth must be acted upon. Perhaps, the most important is investment. Investment possesses both a global and domestic dimension. In the case of foreign direct investment (FDI), inflows are currently restricted by weak conditions in the global economy, following the financial crisis which first struck the USA in 2008. Many companies were hurt and are still in recovery stage. Competing destinations also make the attraction of FDI a major challenge. Domestic investment by government and the local private sector are also important drivers of growth. For any investment however, whether from local or foreign sources, a stable industrial environment is an important consideration.

One way of ensuring such an environment is through conditions of relative industrial peace. The current environment sees marches, sickouts and rancorous exchanges between public sector unions and the government. While these things are considered par for the course in the collective bargaining process, the ongoing consequences are production losses, distractions and wasted energy, which are especially harmful in the context of the currently weak domestic and external economy. It is in this context that I suggest that a social compact involving labour, business and government, can be useful. Adapting from the World English Dictionary, a social compact might be defined as "a voluntary agreement among institutions or individuals to regulate the relations among members". This compact should include inter alia, discussions and action on working conditions, productivity, competitiveness, merit-based remuneration, education and training. One Caribbean country which has been successful in instituting a social compact is Barbados. That country even has a wages and incomes policy, which was first introduced in 1993. Trinidad and Tobago need not follow the identical route of Barbados. In my view, a social compact should be unique to the circumstances of the particular country. True, various initiatives have been tried in the past such as Compact 2000, with little result. But this is no reason not to try again. Times have changed and the world is a different place.

Is there still support for this in Trinidad and Tobago? The answer is yes. The most recent advocate is the Governor of the Central Bank of Trinidad and Tobago, who has argued that "a much needed resurgence in economic activity in 2011 will be greatly facilitated by a social compact - formal or implied- in which the various parties recognize the urgency of their respective roles..." Several Chambers of Industry and Commerce, the Employers Consultative Association (ECA) and past and present governments are among important groups that have called for a social compact. I have no evidence that trade unions would not want a compact. Indeed some have argued for it. Clearly it is recognized that at the end of the day, a better business environment is characterized by a better industrial relations climate, in which social improvement moves in line with economic growth resulting in higher standard of living for the majority of the population.

The realities of this time however, present fertile ground for the germination of just such a mature approach by all stakeholders.

Why a social compact now? Firstly, a compact will allow for clarification and dialogue on the positions of the key stakeholders i.e. labour, government and business. Secondly and relatedly, it allows for the sharing of what might be considered confidential information. Thirdly, it can be the determining factor in a sustainable growth strategy, something which is badly needed at this time. In a similar vein, the fourth (and perhaps most pertinent) point, is that now is the best time to implement any such compact. One year ago, in the throes of a protracted drought, the authorities were able to bring about a shift to more conservative use of water by the nation's consumers. While this is a good practice to follow generally, the 2010 thrust (which continues in a less aggressive mode to this day) only succeeded because there was a real need for it. Similarly, while a compact may be a good idea as a rule, it involves compromise, sacrifice, commitment and the surrendering of some leverage, all for a greater and/or longer term benefit; things that are less likely to take place in times of plenty. The realities of this time however, present fertile ground for the germination of just such a mature approach by all stakeholders. In any case, a social compact is unlikely to hurt economic growth. Persistent sickouts, strikes, work-to-rule actions and general industrial warring will.

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