

Republic Economic NEWSLETTER

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ELECTION PROMISES IN A BUOYANT ECONOMY BELIE MAJOR CHALLENGES AHEAD

Overview

Against the backdrop of heightened campaigning by political parties, the Trinidad and Tobago economy continues on a steady but slower growth path. The unemployment rate remains low, at a projected 6.8 percent in the second quarter, on account of still upbeat retail and construction sectors. High hydro-carbon prices explain the build-up of net foreign reserves, which rose by US\$1,053.7 million over the twelve-month period to May reaching US\$5,890.4 million (net of the Heritage and Stabilisation Fund). This represents about 8.5 months of import cover. Although headline inflation slowed to average 7.8 percent in the second quarter, by July, year on year inflation rose to 7.95 percent. Indications are that in the context of an anticipated rise in fiscal injections in coming months, the Central bank will be hard-pressed to achieve a lower inflation rate. Neither are interest rates expected to fall in the short-run.

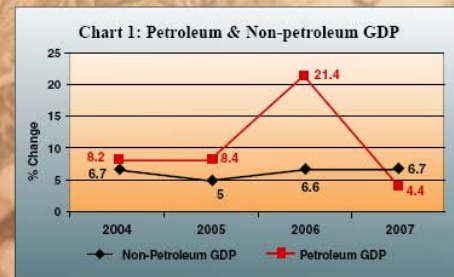
TRINIDAD AND TOBAGO KEY ECONOMIC INDICATORS

INDICATORS	2006	2006Q2	2007Q2 ^{pe}
Real GDP (% Change)	12	4.3	1.7
Retail Prices (% Change)	8.3	2.38	2.1
Unemployment (%)	6.2	7.2	6.8
Fiscal Surplus/Deficit (\$M)	7,426.70	4,412.60	surplus
Bank Deposits (% Change)	18	1.43	0.3
Private Sector Credit (% Change)	16.6	3.42	2.51
Net Foreign Reserves (US\$)	7953.3	6,124.52	6285.39
Exchange Rate (TT\$/US\$)	625/6.31	625/6.32	625/6.33
Stock Market Composite Index	969.19	920.3	918.79
Oil Price (US\$)	66.02	70.41	65.03

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

Energy Sector

The recently released Ryder Scott audit has generated intense debate over the availability of natural gas beyond 2019. While the report is certainly no reason for panic, it does suggest the need for enhanced exploration activities and more focused attention on diversification of the non-energy sector. The Ministry of Finance estimates a sharp deceleration in energy output in 2007 to 4.4 percent from 21.4 percent in 2006 while non-energy output is projected to grow at 6.7 percent – about the same rate as last year (Chart1).



Fiscal Conditions

Surprising to some, the 2007/2008 Budget was fairly conservative given that this is an election year. In presenting the Budget in August, one of the earliest budgets in recent history, Government set expenditure at \$40.29 billion, an increase of 7.7 percent while a marginal decline in revenue is projected to \$40.38 billion. This increase in planned expenditure, which represents 29.7 percent of GDP, remains on par with that of the last fiscal year (Chart 2).

On a positive note, government intends to transfer US\$321.2 million to the Heritage and Stabilisation Fund (HSF), raising the Fund's total value to approximately US\$1,836 million in fiscal 2007. Furthermore, with the intention to place the entire projected fiscal surplus for 2007 (US\$201 million) into the Fund, total transfers to could amount to US\$522 million (Chart 3). Consequently the Fund's estimated value should increase to just over US\$2 billion by the end of the calendar year. However, this only represents 2.9 months of imports and suggests the need for a greater saving effort.

Chart 2: Government Expenditure / GDP (%)

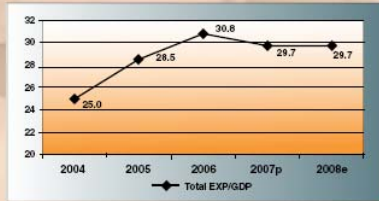
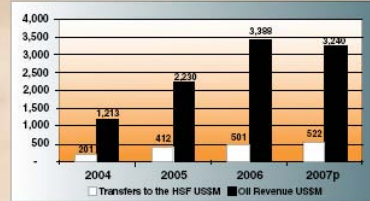


Chart 3: Oil Revenue & H.S.F. (US\$M)



Monetary Policy

Notwithstanding the apparent slowdown in price increases and credit growth in the second quarter of 2007, the root causes of inflation, including large fiscal injections and rising import prices remain. In such an environment, it will be difficult for the Central Bank to reduce interest rates, as it seeks to counter underlying price pressures. Accordingly, the Bank is expected to continue to rely on its entire armoury of policy tools in its attempts at limiting price inflation.

Stock Market

The stock market continued on its downward trend with both the Composite Index and the All T&T Index falling by 2.8 percent and 2.6 percent, respectively. The market is unlikely to rebound soon as existing and potential investors are still wary of the market, based on the poor performance in 2006. New incentives to stimulate activity need to be considered if new life is to be injected into the market. The recent amendment to pension funds legislation is expected to only have a limited effect.

Outlook

As contesting parties strategise and jockey for first place in the election race the country may well find a few surprises both before and after the election bell rings later this year. For better or for worse however, the election is unlikely to bring about any drastic change in economic policy in the short to medium term. Nevertheless, several challenges abound. These include rising prices especially that of food, crime and a population seemingly hooked on a valuable but non-renewable hydrocarbon resource.



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CARIBBEAN UPDATE

Stormy Weather Ahead

At the height of the hurricane season and with life only just beginning to return to normal in Grenada, the region is well aware of the negative impact even a moderately strong storm can impose on the economy. In August, Hurricane Dean displaced roughly 20 thousand banana workers across the region and managed to inflict millions in damage and several deaths, thereby providing a frightening reminder of the region's vulnerability. This is why the World Bank's launch of the Caribbean Catastrophe Risk Insurance Facility (CCRIF) in February 2007 is welcomed. This will allow stricken nations to begin disaster response right away with the guarantee of access to enough money to fund emergency measures. Hurricane damage represents a major cost to Caribbean economies. Table 1 shows the costs of damage caused by certain hurricanes as a percentage of GDP for selected Caribbean countries.

Barbados

With public debt estimated at 87 percent of GDP, Barbados cannot afford to take its eyes off its debt situation. In the first half of 2007 the government incurred a fiscal deficit of B\$101.7 million (roughly 1.5 percent of GDP) compared to a surplus of B\$3.9 million in 2006. The slide was associated with Cricket World Cup expenditures and salary arrears payments to civil servants. According to the Barbados Central Bank, the economy expanded by 4.4 percent during the first half of 2007, while inflation fell to 3.9 percent. This growth rate should continue for the remainder of the year. However, inflation is likely to increase in the latter part of 2007 as rising oil prices and strong demand reign.

Grenada

Reconstruction work in the wake of the destruction caused by Hurricane Ivan is just about complete. This augurs well for the island's tourism sector as the colder months draw closer in North America and Europe. Inflation trended downward in early 2007 and was recorded at just over 2 percent in April. Standard & Poor's has

restored the country's 'B-' rating, from 'CCC+'. However, agriculture is not expected to recover for quite some time and in the absence of pre-Ivan production levels, the economy will rely heavily on tourism. During the first six months of 2007, the government's fiscal deficit widened, indicating the need for fiscal restraint, notwithstanding strong and legitimate demand pressures.

Dominican Republic

Structural reform under a stand-by arrangement with the IMF aimed at improving governance and government fiscal balances has already yielded some successes. Declines are expected in 2007 in the general government deficit (from 3.6 percent of GDP in 2006 to 2.5 percent) and debt (from 43 percent of GDP in 2006 to 40 percent in 2007). The country is expected to post strong growth in the final quarter of the year after growing approximately 7 percent in the second quarter of 2007. In early September, Standard & Poor's Ratings Services raised its long-term sovereign credit rating on the Dominican Republic to 'B+' from 'B' with a stable outlook. On the downside, inflation is expected to rise above 6 percent by year-end after trending downward to approximately 5 percent in July.

Guyana

In the face of a 36 percent price cut for Caribbean sugar exports to the EU and strong energy prices, Guyana is seeking to modernize its sugar industry and explore its potential in bio-fuels. The soft loan facility provided by the PetroCaribe agreement should alleviate short term energy price pressures. The economy is expected to register a growth rate of around 4 percent in 2007, slightly down from 2006. Of major concern though is the recent elevation of inflation caused by the introduction of Value Added Tax and the expansion in credit. Additionally, the country's debt situation remains worrying at well over 100 percent of GDP. The loan facility provided by the PetroCaribe will expand Guyana's debt stock.

Many Caribbean nations are now faced with debt in excess of 60 percent of their GDP...

Table 1: Hurricane Damage & GDP

Year	Country	Hurricane	Damage in USDS	Damage as % of GDP
1979	Dominica	David, Frederick	\$45 million	Over 100
1988	Jamaica	Gilbert	\$1.1 billion	65
1989	Montserrat	Hugo	\$240 million	200
1995	Saint Maarten	Luis, Marilyn	\$1.8 billion	200
1995	Antigua & Barbuda	Luis, Marilyn	\$350 million ^c	65
2004	Grenada	Ivan	\$885 million	200

*Source: - Caribbean Development Bank, IMF and other articles
e - Estimate*

Cuba

With the continual rise in hydrocarbon production, Cuba will soon be an exporter of petroleum instead of an importer. Some petroleum interests in the US are pushing for a re-evaluation of Cuba/US trade relations in order to allow American companies the opportunity to conduct exploration in Cuba. However, economic growth is expected to slow in 2007 when compared to 2006 and the trade deficit is forecasted to expand. It appears increasingly unlikely that Fidel Castro would once again take control of the country. This may be welcomed in some quarters as Raul Castro is seen as more open to reform than his elder brother.

The Region

Although there has been a regime change in Jamaica, no significant policy changes are envisaged. The focus is likely to remain on reducing public debt currently around 135% of GDP. Growth is expected to be marginally better this year than 2006 and the inflation outlook is stable after measuring 5.6 percent year-on-year in June. In Belize, improvement in government debt to 79 percent of GDP in March 2007 (Economist Intelligence Unit) may be threatened by the deteriorating fiscal deficit. Growth is expected to slow in 2007, as production from the infant oil industry levels off. The country has benefited from an increased sugar quota to the European Union as it inherited part of the sugar quota formerly held by St. Kitts, which ceased production in 2005.

The downturn in the US economy remains a threat to the region's future growth. Tourism is likely to feel the impact of this in the form of decreased arrivals from the US. However, with the fall in the value of the dollar it will be cheaper for Europeans to visit the region. Nevertheless, it remains to be seen if these events cancel out each other, particularly as the winter months approach. Many Caribbean nations are now faced with debt in excess of 60 percent of their GDP and will therefore need to employ disciplined policies going forward. On the trade front, regional leaders have agreed to implement the Caribbean Single Economy by 2015, while President Bush has promised to push for the renewal of the Caribbean Basin Initiative. The region is expected to register solid growth in the final quarter of 2007.

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The Trinidad and Tobago Stock Market: What Are We Waiting On?

*by Mr. Ian Narine, Managing Director of Republic Securities Limited
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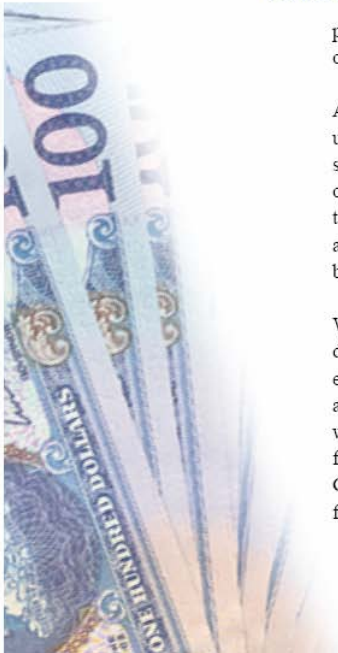
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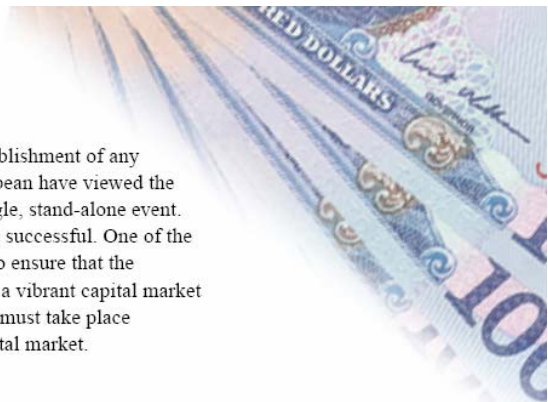
Investors have looked at the headlines and at their portfolios and no doubt are pained at the extent of the declines from the highs of early 2005. This applies to long-term investors who understand that there is the potential for long-term gains from the stock market and to the short-term profit seekers who are in the market for just that. Similarly, policy makers and regulators and those in general who have an interest in a vibrant stock market, all would likely have a common desire to see net worth increase and to see a much more dynamic market that can at least match the higher levels of yesteryear.

It seems to me that the present state of the stock market might be addressed at two levels depending on (i) whether one is an individual investor or (ii) policy maker. At the individual level, one approach is to assess the current state of your portfolio, understand what went wrong and why, establish which investments are no longer relevant or worthwhile to your present circumstances and sell them off. Even if you are crystallizing a loss, you are doing so with the objective of reinvesting the proceeds along with any new funds that might be available in order to recoup the earlier losses. Then move on from there.

At the level of policy maker-regulator, it is necessary to understand very clearly that the lack of depth and breath of our stock market suggests that the market itself is incapable on its own, of coming out of the doldrums – at least not over the short term. It requires the impetus of the fiscal authorities, regulators and other stakeholders to provide the catalyst for a return to buoyancy.

While the private sector has a responsibility to contribute to the development of the capital markets, it is clear that for an emerging capital market to develop, the Government has to play a role. It is well accepted that to develop an industry or sector, whether it be manufacturing, tourism, information technology, financial services or any other requires some incentive from the Government. In fact, one sees exactly that in the form of support for the international financial center that is being proposed.





However, we need to look beyond just the establishment of any specific industry. For too long we in the Caribbean have viewed the establishment of “winning” industries as a single, stand-alone event. This is one reason why we have not been more successful. One of the keys to getting any industry off the ground is to ensure that the necessary financing is available. This is where a vibrant capital market comes in and the development of any industry must take place simultaneously with the development of a capital market.

To this end, it is imperative that there should be a natural progression with the appropriate incentives by government, which will see a start up, from what is considered a strategic industry, progress to the stage of maturity and then a public listing. The government often provides incentives to manage the early risks of these ventures that are essentially funded by taxpayers. It should therefore be a logical step that once these early risks are overcome and the sector has matured that companies are encouraged to invite public participation by virtue of a stock market listing.

This will serve to deepen the local and regional markets, provide increased opportunities for investment and ultimately lower cost of finance for corporations to help them compete internationally. In addition, investors are then able to share in the wealth created by these ventures leading to an all round, win-win situation for all.

Yet the longer the present situation is allowed to continue the more the individual investor will lose patience and either exit or be reluctant to re-enter the market. Of even greater concern would be the impact of a sustained stock market decline on pension plans and other forms of long term investing such as retirement plans as these undertakings would under-perform relative to the current and future levels of inflation and increasing wages. Over time, this slide becomes ever more difficult to reverse with the knock on effect of a reduction in the wealth effect – a feature that takes us further away from developed country status. What are we waiting on?

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