Republic Economic Newsletter

September 2008 Vol.16 No. 4 ISSN 1027-5215

NAVIGATING CHANGING CONDITIONS

Overview

The Trinidad and Tobago economy continued to motor along with GDP growth for the 2nd quarter estimated at 2.9 percent and unemployment at 5.0 percent. The period saw extremely high energy prices along with sharp increases in food prices. Continued strong revenue inflows from the energy sector led to a sturdy government fiscal position. However, the ongoing inability to curb challenges of inflation and high crime levels continued to depress consumer sentiment. Worsening global conditions lie ahead and suggest that the sustainability of this country's economic well-being must receive top priority.

TRINIDAD AND TOBAGO KEY ECONOMIC INDICATORS

INDICATORS	2007	2007.2	2008.2 p/e
Real GDP (% Change)	5.5	1.7	2.9
Retail Prices (% Change)	7.9	2.1	2.5
Unemployment Rate (%)	5.6	6	5
Fiscal Surplus/ Deficit ($M)	5,100.00	3,780.50	7,582.80
Bank Deposits (% Change)	13	5.1	5.9
Private Sector Bank Credit (% Change)	20.3	2.9	1.6
Net Foreign Reserves (US$M)	8,143.00	7,505.00	10,865.00
Exchange Rate (TT$/US$)	6.27/6.30	6.27/6.32	6.20/6.28
Stock Market Comp. Price Index	982.03	918.79	1,150.24
Oil Price (WTI) (US$ per barrel)	72.32	65.03	123.95

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

Global Environment

The economic slowdown being experienced by the US for the better part of a year has spread to other major economies such as Japan, Great Britain and Europe. Their respective central banks are presently walking a high-stakes, tightrope trying to keep their benchmark lending rates high enough to curb inflation but low enough to facilitate economic growth. Much speculation has surrounded the future direction of the US Federal Funds rate (2.0 percent), the U.K benchmark rate (5.0 percent) and the European Central Bank – ECB rate (4.25 percent), with indications of a possible rise in the US rate and reductions in the UK and ECB rates contributing to the recent rally of the US dollar relative to the pound and the euro. The recent collapse in the USA of financial giant Lehman Brothers, and the dire position of others such as Merrill Lynch and AIG, because of the deepening US credit crisis only worsen the downside risks to growth in Trinidad and Tobago and in this region.

Energy Sector

The trend of declining energy production continued in the second quarter with levels of 111,792 b/d and 3.9 bcf/d recorded for oil and gas, respectively. Petrochemical production was mixed with ammonia slightly better and methanol significantly lower than 2nd quarter 2007 levels. Despite lower production levels of energy commodities, the prevailing buoyancy across energy and chemical commodities ensured continued strong revenue inflows for the sector. From April to June the Henry Hub spot price for natural gas registered US$11.73 per thousand cubic feet while crude oil averaged a staggering US$123.95 per barrel, almost double the corresponding 2007 figure of US$64.97. More recently though, reduced crude oil demand due to the global slowdown and the high cost of the commodity itself, has resulted in a decline in oil prices from the historic high of US$147 per barrel in July to US$94 in mid-September.

The Ryder Scott Gas Audit released in July indicated that proven gas reserves were held stable at 17 trillion cubic feet for a 12-year supply. The recent find by Canadian Superior of between 0.6 – 1.3 tcf suggests that stability in this country's reserves position may yet continue. Oil reserves will certainly not mirror the current stability of its gas counterpart. With fields that can certainly be described as mature, and no significant finds in years, a decline is the only result that can be expected by the soon-to-be commissioned oil audit.

Fiscal Conditions

In the April-June quarter, boosted by strong increases in non-oil returns, government's current revenues were $18.7 billion. Current expenditure of $7.2 billion was lower than the previous two quarters of the fiscal year and contributed to an overall surplus of $9.4 billion. This strong showing boosted the cumulative figures for the 2007/2008 fiscal year to June with revenue of $40.5 billion and an overall surplus of $11.4 billion. While this is positive going forward, the current global environment demands far greater weight be given to prudent fiscal management.

Monetary Conditions

The global surge in food commodity prices provided strong upward inflationary pressure. Sharp increases in the prices of staples such as rice, wheat and corn in international markets impacted locally, contributing to a 21.5 percent increase in 2nd quarter food prices over the same period in 2007. With this impetus, overall inflation increased steadily, with year on year increases moving from 9.3 percent in April, to 10 percent in May, 11.3 percent in June and climbing to 11.9 percent in July. In its continuing attempts to head off price increases, the Central Bank raised the 'Repo' rate from 8.25 percent to 8.50 percent in July. Also, the cash reserve requirement applicable to commercial banks was increased from 13 percent to 15 percent. This action had the desired result of increasing the cost of credit, with the prime lending rate at commercial banks moving from 12.25 percent to 12.75 percent in August. These initiatives will not be adequate to bring about a permanent reversal in upward trending inflation rates.

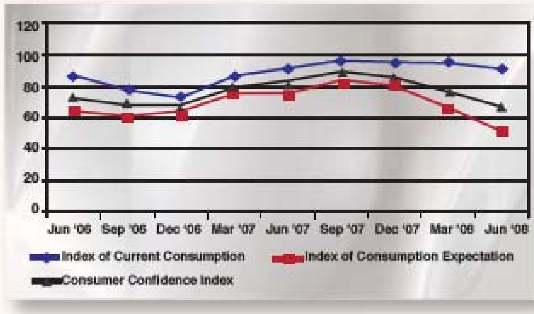
Fig: 1 - Oil and Gas Reserves as at December 2007

	Proven	Probable	Possible	Total
Natural Gas (tcf)	16.9	7.9	5.8	30.6
Crude Oil (mb)	621	404.6	1,688	2,713.6

Tcf – Trillion cubic feet, Mb – Million barrels

Note: **The figures for crude oil reflect 2005 data. The commissioning of a new crude oil audit is imminent, and is expected to last four months.**

Fig: 2 MFO/RBL Consumer Indices June 2006 – 2008



Consumer Confidence

The mood of the consumer was decidedly downbeat in the second quarter and a large part of that had to do with the higher cost of living. The percentage of people who felt that business conditions were better now than in 2007 fell from 43 percent in the 1st quarter to 31 percent by June while conversely the percentage that felt conditions were worse jumped from 31 percent to 54 percent with 34 percent of the negative respondents citing increased prices. Not surprisingly, the consumer confidence index fell by 10 points over the quarter to 67, dragged downwards by a 15-point decline in the index of consumption expectation (Fig 2). To quote the authors of the report "It appears as though the optimism that pervaded 2007 has vanished completely within the first two quarters of this year." While they didn't factor in this survey, it can be safely surmised that for a large percentage of the population, crime and the slow pace of improvement in the delivery of key services such as health, are weighing on consumer sentiment.

Outlook

The cushion provided by protracted high energy prices ensures that Trinidad and Tobago's economy will remain buoyant for the rest of the year, with most key indicators such as the unemployment rate, GDP growth, foreign reserves and external debt continuing to be favourable. The energy sector is expected to continue to benefit from high revenue inflows despite varying levels of output.

By the time this Newsletter is published, the 2008/2009 National Budget would have been presented. One would hope that measures announced would take account of the likely effects of the crisis in the US financial sector on world growth and energy prices. While it is true that the crisis is still unfolding, prudent fiscal management, which some will argue is long overdue, should certainly be the overarching theme of this new Budget.

Correction: The 2007 fuel subsidy commitment by the state is estimated to be $1.7 billion not $6 billion as stated in our previous issue (Vol. 16 No.3).

"Rising Energy Costs & Crime, Take a Toll on Caribbean Tourism"

The region's tourism sector is likely to experience a continuing decline in 2008, when compared to the growth of the previous two years (Table1). A combination of rising energy costs and slowing U.S. demand, have been identified as the main contributory factors. Oil prices climbed to record levels in 2008, increasing to US$123.9 per barrel in the second quarter - a 90.1 percent increase when compared to the same period last year. This has resulted in a number of international airlines cutting back on their services to the Caribbean basin. The cruise industry has also felt the pinch, as southern Caribbean ports have become too expensive to berth. As a result, a number of cruise liners have removed these destinations from their itineraries, choosing to stay closer to the US mainland. Additionally, crime is proving to be a major impediment, as a number of foreign embassies have issued negative travel advisories about the region.

Table 1: Stop Over Tourist Arrivals (%Growth)

	2006	2007p
Antigua & Barbuda	3.4	3.2
Barbados	2.7	2.1
Belize	4.5	1.8
Dominican Republic	7.4	0.4
Grenada	20.6	9.0
Guyana	-2.7	15.9
Jamaica	13.5	1.3
Trinidad & Tobago	-1.0	-4.0

Source: Caribbean Tourism Organisation
www.onecaribbean.org

BARBADOS

Despite the growth in the first quarter of 2008, rising energy prices have resulted in a significant slowdown in the Barbadian economy. The economy experienced a growth rate of 1.4 percent for the first six months of the year, less than half of the 3.6 percent growth recorded for the corresponding period in 2007. Tourist arrivals grew by a modest 2.7 percent, slightly lower than the 3.1 percent recorded for the same period in 2007. The construction sector recorded the largest decline of 6.7 percent, in the absence of the boost provided by the infrastructural projects related to the Cricket World Cup of 2007. With a rising energy bill, and a rising fiscal deficit (B$294.3 million for the first six months of the year) the growth rate for 2008 is projected at 2.5 percent, less than the 4.3 percent recorded in 2007.

GUYANA

With the country's vast agricultural potential and rising petroleum price, Guyana has the potential to become a prime source for bio-fuel production. Not surprisingly, in April of this year, Japan in conjunction with the Inter American Development Bank announced the provision of a US$925.5 thousand grant for private investment in the country's bio-fuel industry. The funds are primarily geared at providing detailed feasibility studies on agro-energy projects. In trade related issues, Guyana and Haiti are refusing to sign the Economic Partnership Agreement (EPA) in its entirety, asserting that the gradual removal of preferential treatment will negatively impact on the region's long term development, as well as supercede the Caricom Single Market and Economy. Consequently they are only agreeing to sign the "goods only" segment of the agreement in early October 2008.

GRENADA

The outcome of Grenada's general election held on July 8th 2008 was a major surprise to many, as the opposition National Democratic Congress (NDC) won eleven out of fifteen seats in parliament. This has brought an end to the administration of Keith Mitchell's New National Party (NNP), which was seeking an unprecedented fourth consecutive term. However, the new administration has its work cut out, as the island is still recovering from the effects of two devastating hurricanes (Ivan in 2004 and Emily in 2005). The country's public debt remains high, despite a fall in its debt to GDP ratio from 113 percent in 2006 to 108 percent at the end of 2007. The fiscal situation is also precarious, as the government is having problems in meeting its public wage bill. Delayed reform on tax concessions and the imposition of VAT has further complicated the country's fiscal policy. Looking ahead, the new administration has highlighted a number of plans to reinvigorate the economy, including, steps towards oil and gas exploration, tax reforms to help maximize government revenue, as well as new measures to improve the island's tourism product.

DOMINICAN REPUBLIC

As the US economy slows, growth prospects for the Dominican Republic are also projected to fall. The US alone, accounts for approximately 75 percent of the country's exports and is a major source of foreign direct investments and worker remittances. Additionally, the Dominican Republic is one of the prime Caribbean destinations for US tourists but with the recent upsurge in fuel costs and a number of airlines planning to reduce the frequency of their flights to the country, tourist arrivals are projected to fall. Frequent power outages continue to be a hindrance to the manufacturing sector, which is facing ever increasing competition from China.

CUBA

Cuba will continue to benefit from the special arrangement it has with Venezuela, as the economy is projected to grow by a modest 5-6 percent in 2008, slightly lower than the estimated 6.5 percent in 2007. This slowdown is being attributed to rising energy prices, continued US sanctions, and the damage inflicted by hurricanes Gustav and Ike. According to Cuban authorities, total losses are estimated at US$5 billion with more than 444,000 houses damaged or destroyed. Apart from these developments, government has proposed a number of reforms. In an effort to increase agricultural production, the government plans to redistribute under-utilized lands and increase real disposable incomes, through nominal wage increases. These reforms are partly driven by the global push towards bio-fuels, resulting in reduced agricultural produce and rising food prices. Cuba remains in a vulnerable position, according to a recent CNN news report, the communist island imports approximately 80 percent of its food.

REGION

The region will continue to grow for 2008 but the future remains uncertain, particularly with the US economy going through a severe economic crunch, highlighted by the forced sale and failure of some of the countries largest financial institutions. Some of these institutions include: Fannie Mae, Freddie Mac, Bear Stearns, Lehman Brothers and Merrill Lynch. Consequently, tourism is anticipated to be the sector hardest hit. Coupled with rising transportation cost and the negative publicity garnered by the region's crime rate the sector will further be hampered. These developments will only add to the problems of an already fragile industry, which is the economic backbone of many of the islands. Making matters worse, the hurricane season is also negatively impacting on the industry, with already 10 named storms by September 3rd 2008. Hurricanes Gustav and Ike proved to be the most devastating to date, wreaking destruction on Haiti, Jamaica, Cuba and the Cayman Islands and taking lives along the way. Notwithstanding the challenges around us, shining examples of what is possible were provided by the recent triumphs of Jamaica and Trinidad & Tobago at the XXIX Olympics, which highlights for the region its potential for success on the world stage.

MAKING USE OF THE EPA

With the Economic Partnership Agreement (EPA) between CARIFORUM and the European Union (EU) due to be signed, there has been a growing disquiet in some quarters about the value of the arrangement to the region. Some commentators and indeed a few Caribbean states seem unconvinced that the Agreement reached with the European Union addresses the needs of the region or that it is the best deal possible in the context of the World Trade Organization rules. This trepidation has caused the September 2nd 2008 signing to be postponed to a date yet to be announced. While we do not share some of the dissenting views expressed in some quarters, there are some concerns that are quite understandable. Such concerns relate to the expected increase in competition emanating from the larger and more efficient European firms and the consequences for small regional economies, of removal of preferential trade. Nevertheless, we take the position in this article that there will be an Agreement, even if modified and that the real question for member countries relates to how best to use the provisions of the Agreement to invest, expand, trade, earn foreign exchange and penetrate the large EU market. Table 1 identifies the previous trade agreements that involved the EU and Caribbean states.

Table 1. Forerunners to the EPA

Agreement	Beginning year
Lomé I Convention	1975
Lomé II Convention	1980
Lomé III Convention	1985
Lomé IV Convention	1990
Revised Lomé IV Convention	1995
Cotonou Agreement	2000
Revised Cotonou Agreement	2005

Many of the new measures contained in the Agreement are scheduled to be implemented on a phased basis. This would allow regional firms some time to prepare for the advent of trade without the luxury of tariff protection. During this time they should seek to streamline their operations, control cost and enhance the quality of their respective products and services. Such activities would go a long way to promote the competitiveness of indigenous firms in the face of the increased presence of international competitors. Additionally, such firms can use the grace period to build regional brand loyalty amongst their customers in an effort to protect market share and preserve their economic viability. Although this may involve some marketing, the key is to enhance goods and services, at least to the point where they are of similar quality to international brands.

One example of the delayed effects of the new policies is represented by the proposed time frame for dismantling regional import tariffs. A significant proportion of these duties are to be phased out within ten years of signing the Agreement, however, the phase out process is not required to start in the first seven years. If regional firms are successful at streamlining their operations within this time frame, they may enjoy a competitive advantage until tariffs are phased out, by which time, they should be in a better position to handle the influx of rival products and services. This is especially so when one considers that most of the region's exports already enjoy tariff-free access to the European market. It cannot be overstated how important it is for the region to maximize whatever grace period is offered by the EU with preparatory work.

With a population of over 491 million, the size of the EU market is of itself a significant opportunity for regional exporters and potential exporters. The vastness of EU aggregate demand suggests that the market is capable of absorbing quite a large quantity and variety of goods and services from the region. This can be contrasted with the relatively small market size of CARIFORUM, which is a mere fraction of the EU market with under 40 million people. In this regard, CARIFORUM has a clear advantage with respect to scope for growth in the export market. However, seizing that advantage would involve significant planning and assertiveness on the part of the business community. For instance, regional firms may have to engage in market research to assess the demand for various products, gauge the competitiveness of their own products and identify opportunities for capturing niche markets. Provisions of the Agreement might help here.

The small and vulnerable nature of Caribbean economies dictates that they achieve deeper political and economic integration amongst themselves in order to fully take advantage of the EPA. In addition to permitting these States to create greater economic opportunities for themselves, integration would enhance political stability within the region and bolster its standing in the world economy. The Agreement recognizes the importance of integration to the plight of CARIFORUM and commits to support such initiatives. The stance of the EPA toward regional integration is contained in Article 4 of the Agreement, which indicates no intention for cooperation with the EU to supersede Caribbean integration initiatives. Caribbean leaders, to some extent, have recognized the need for deeper integration, but their major initiative in this regard, the (CSME), has been delayed.

Throughout the region, it is imperative that the public and private sectors work together in order to mitigate hardships that the EPA may present to the Caribbean. Government must implement policies and initiatives that would foster a spirit of enterprise and entrepreneurship throughout the economy. This can involve, but should not be limited to, educating stakeholders about the opportunities and threats that the EPA may present to the region's economy. Additionally, there is a definite need for government to provide technical support to exporters and to diligently perform its regulatory role in respect of incoming competition. The private sector on the other hand should understand the limits of government intervention and assume ultimate responsibility for its own success.

In an environment where preferential trade is fast becoming a thing of the past, the region must prepare itself to face this inevitability. The main way this can be achieved is by strengthening commercial entities and enhancing the environment in which they operate. The intention of free trade and, in particular, the Economic Partnership Agreement is to allow countries to boost export earnings, create business and job opportunities and to alleviate the scourge of poverty. Admittedly, these are by no means easy tasks and would require considerable investment of entrepreneurial and financial resources. Significant preparatory work is needed to appropriately develop indigenous businesses so that they can withstand the effects of the impending onslaught of international competition and take advantage of opportunities presented.