Republic Economic NEWSLETTER

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Balancing High Expectations in a Challenging Economic Environment

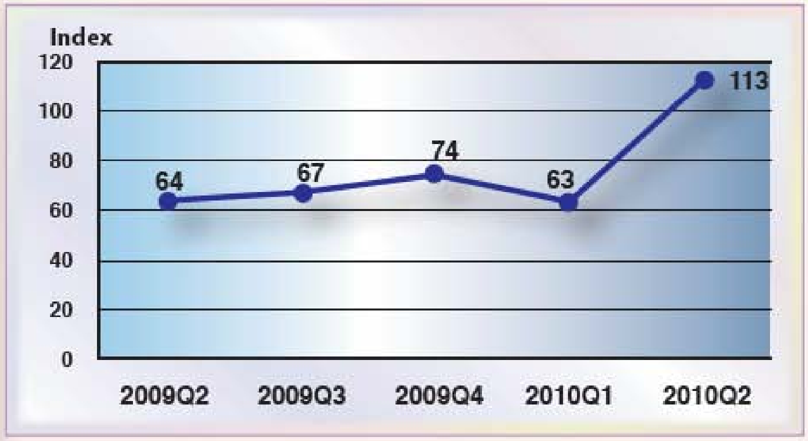
The Trinidad and Tobago economy continues to be challenged by the global slowdown, with most of the developed countries experiencing stagnant growth to marginal recovery. Nevertheless, the economy grew by a projected 1.5 percent in the second quarter, lower than the 2.3 percent growth recorded in the first quarter. High energy prices along with election related spending accounted for much of this improvement. However, economic activity has basically been on standby, with investors holding off on new investments and awaiting the People's Partnership's new policy direction. Confidence levels were high in anticipation, as reflected by the MFO-Republic Bank, Consumer Confidence Index, which jumped by 50 points (from 63 to 113) in the second quarter of the year. Against the backdrop of rising prices and unemployment a $49.0 billion Budget was presented on September 8th. Several incentives were given in both the energy and non-energy sectors. Additionally, the minimum wage was increased from $9 per hour to $12.50 per hour. The fiscal deficit is projected to rise to 5.5 percent of GDP and the public debt to 49 percent of GDP in the new fiscal year ending September 2011.

TRINIDAD AND TOBAGO KEY ECONOMIC INDICATORS

Indicator	2009	2009.2	2010.2e
Real GDP (% Change)	-3.2	0.6	1.5
Retail Prices (% Change)	7.2	10.18	10.2
Unemployment Rate (%)	5.3	5.1	7.0
Fiscal Surplus/ Deficit ($M)	-7,473.6	1,316.70	Surplus
Bank Deposits (% Change)	29.87	5.9	-1
Private Sector Bank Credit (% Change)	-4.3	-3.6	-2.9
Net Foreign Reserves (US$M)	10,882	10,079.9	10,840.7
Exchange Rate (TT$/US$)	6.27/6.33	6.25/6.31	6.31/6.37
Stock Market Comp. Price Index	756.3	779.6	827.2
Oil Price (WTI) (US$ per barrel)	61.66	69.74	73.34
Gas Prices (Henry-Hub) (US$ per mmbtu)	3.95	3.71	4.32

Source: - Central Bank of Trinidad and Tobago, TTSE, Energy Information Administration
p - Provisional Data
e - Republic Bank Limited Estimate

Consumer Confidence Index



Fiscal Policy

The country registered a fiscal surplus of $77.9 million for the first eight months of the fiscal year 2010, much better than anticipated. This helped contribute to a lower deficit of 3.5 percent of GDP, for the entire 2010 fiscal year. Energy revenues increased from $19.4 billion in 2009 to $21.6 billion in 2010. However, going into the next fiscal year, energy revenues are projected to fall to $15.2 billion, contributing to another fiscal deficit of $7.7 billion. Funding for 70 percent of the deficit will be financed through foreign borrowing. Government is also seeking to reduce its gas subsidy expenditures, by encouraging the use of cheaper Compressed Natural Gas (CNG). To this end, they have made budgetary provisions to assist in the switch to CNG.

Energy Sector

Despite high energy prices oil production continues to fall, from an average of 104,863 barrels per day in the first quarter, to 101,480 barrels per day in the second quarter of 2010. Production should fall by another 13,000 barrels per day in the fourth quarter as BHP Billiton closes its Angostura offshore facilities for 3 months to facilitate expansion. The recently released Ryder Scott Report also revealed a decline in proven gas reserves from 15.4 trillion cubic feet in 2008, to 14.4 trillion cubic feet in 2009. Against this background, the government announced a reduction in the petroleum profit tax from 50 percent to 35 percent for wells in water depths of over 400 metres in the east coast, to encourage offshore drilling. Government also reduced the supplemental petroleum tax by 20 percent on small mature oil fields, in an effort to boost production in the short-run. These measures aided the 2010 Competitive Bid Round for 7 shallow water blocks in early September, with successful bids being made for all but one.

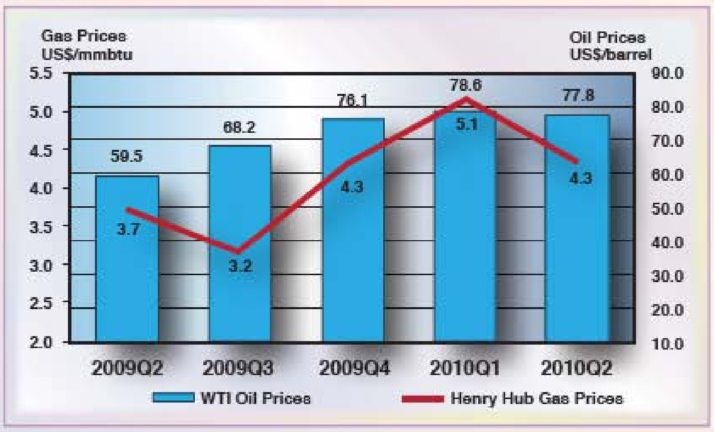
Inflation Rate

Inflationary pressures have once again started to increase. While consumer prices remained relatively subdued in the first quarter, by June 2010 they rose to 13.7 percent, led largely by increases in food prices. This trend continued in July, with headline inflation climbing to 14.1 percent and food prices growing by 33.3 percent. An intense rainy season, preceded by a drought impeded agricultural production, resulting in higher food prices. However, in a move widely welcomed by the business community, the Central Bank lowered its benchmark rate (Repo rate) from 5 percent to 4.5 percent in September. Falling private sector credit and the need to facilitate greater economic activity were the main factors behind this move.

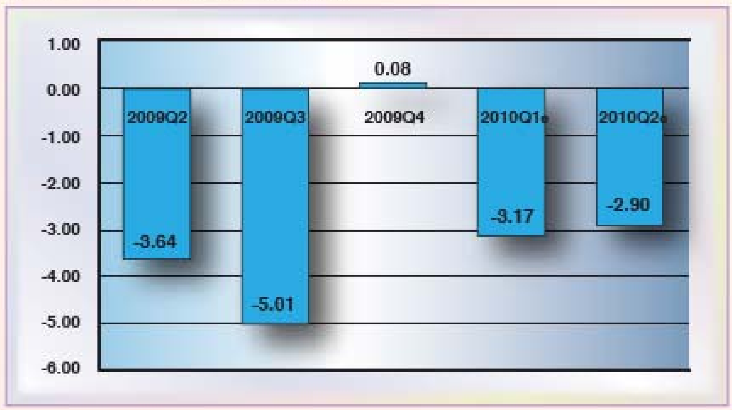
Private Sector Credit

Ongoing volatility in the international market, as well as uncertainty locally, have seen loans to the manufacturing, construction and services sectors all decline. Overall private sector credit has fallen by 2.9 percent for the second quarter of the year. The tight market conditions have spurred even greater competition among financial institutions. Mortgage loan rates by commercial banks have declined significantly over the past year, from 13 percent in 2009 to 9.5 percent at the end of June 2010. Consequently, loans to the mortgage market grew by 5.7 percent in June 2010. The fall in the Repo rate, has already seen Republic Bank lower its prime lending rate to 9 percent in September, with other commercial banks following suit. This should alleviate the cost of borrowing to businesses.

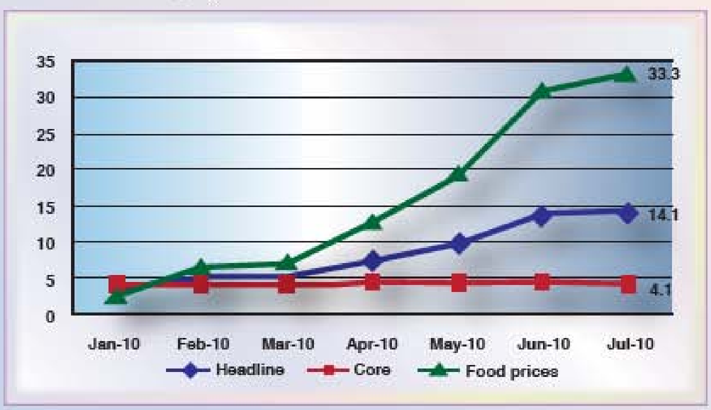
Energy Prices



Private Sector Credit (% Ch.)



Inflation Rate (%)



Outlook

The rest of the year will test the Budget and other initiatives of the new administration. Proper management of the CLICO and Hindu Credit Union (HCU) issues must rank high on the administration's agenda. Business should benefit from the Budget incentives but with activity in both the regional and international markets relatively flat, performance will be subdued. Specifically, announcements of incentives in the energy sector, particularly the new tax concessions for offshore drilling and the recent natural gas agreement with Venezuela, should facilitate some activity in that sector. This coupled with government expenditure should together provide continuing but slow impetus for growth in the domestic economy in coming months. Inflationary and employment pressures are likely to persist for the rest of the year. With relatively low interest rates, capital market activity should pick up but not until next year as government makes public offerings of various state entities.

Caribbean Update

Positive Signs Emerge, but Severe Challenges Linger

The return to growth of several developed economies has injected a moderate level of optimism into the regional economy. Some Caribbean destinations have already benefitted from increased tourist arrivals during the first half of 2010, spurred by increased visitors from North America. Nevertheless, severe challenges continue to confront the region. The slow-down of growth in developed economies such as the US in the second quarter of 2010, has heightened fears of double-dip recession. With unemployment still high in major markets, the recovery of the regional tourism industry is expected to be gradual, while remittances are anticipated to be depressed for some time. Further, fiscal policy has been restrained by high debt levels now plaguing several Caribbean countries. In 2009 foreign direct investment (FDI) plunged, delaying several projects (Table 1). Preliminary data indicate that there has been no significant improvement in FDI inflows during the first half of 2010. The scourge of crime continues to test regional governments and consume substantial amounts of resources.

Table 1 Foreign Direct Investment Inflows (US$ million)

	2007	2008	2009
Antigua & Barbuda	338	173	139
Bahamas	746	839	654
Barbados	338	286	290 e
Grenada	152	144	79
Guyana	152	178	144 e
Jamaica	867	1437	1062 e
St. Vincent & the Grenadines	131	159	125
Trinidad & Tobago	830	2801	709
Caribbean	**57,231**	**60,164**	**44,157**

Source: United Nations, World Investment Report 2010
e - estimate

Barbados

Although tourist arrivals increased by 3 percent for the first half of 2010 compared to 2009, the economy contracted by 1 percent during the period. Increased arrivals from Canada (18.4 percent) and the US (22.6 percent) outweighed the 11 percent decline from Europe, Barbados' main market. The tradable sector (to which tourism belongs) contracted by 0.9 percent, while the non-tradable sector declined by 1 percent. Severe drought conditions suppressed crop yields during the first six months of the year, causing foreign exchange receipts from sugar to decline by 20 percent during the period. Gross central government debt rose to 97 percent of GDP by June 2010 from 96 percent at the end of 2009. Unemployment is suspected to have risen further after reaching 10.6 percent in the first quarter of 2010. On the positive side, the fiscal deficit declined to 8.6 percent of GDP in the first five months of 2010 compared to 10.2 percent for the similar period a year earlier. The economy is expected to register marginal growth by late 2010.

Grenada

After expanding in the first quarter of 2010, economic activity slowed notably in the following three-month period. This is because the impetus provided by the manufacturing sector (particularly, the re-opening of a soft drinks plant in June 2009) has subsided. Stay-over tourism arrivals decline by 8 percent for the first five months of 2010. Construction sector activity remains anaemic, as large private sector projects have been delayed or placed on hold because of the shortage of foreign financing. Agriculture output was undermined during the first half of the year by drought and the Black Sigatoka disease that ravaged the banana crop. The most recent available data indicate that private sector credit growth slowed to 1 percent in the first quarter compared to 4.5 percent year-on-year in December 2009. The unemployment rate is estimated at over 30 percent. Grenada's economy is expected to contract in the second half of the year, as tourist arrivals are expected to improve only marginally. Grenada's yachting industry received a boost in July, as TUI Marine agreed to base the southern Caribbean operations of its luxury charter in Port Louis Marina owned by Camper & Nicholsons Marina Investments Ltd.

Guyana

Economic conditions in Guyana were mixed in early 2010, with increased output of rice and sugar alongside declines in the mining and quarrying sectors in the first quarter. The manufacturing sector and services sector likely remained flat. As a result, GDP likely contracted in the first quarter. The continued recovery of sugar production, combined with rising rice output may have caused the economy to expand in the subsequent three-month period. As the government strives to complete major projects such as those contained in the ongoing Public Sector Investment Programme (PSIP), rising expenditure has caused the fiscal balance to deteriorate. Private sector credit expanded by 2.3 percent in the first quarter and likely followed a similar path in the second. The economy is expected to register moderate growth for the remainder of the year, supported by the strengthening of agriculture, in particular rice and sugar. In July 2010 Guyana signed five energy and trade agreements with Venezuela.

Cuba

Global economic conditions have severely tested Cuba's economy. Drought conditions in many areas contributed to a significant fall-off in the agriculture sector, with the sugar harvest sliding to a record low and the non-sugar agricultural production index falling by 7.5 percent in the six months to June 2010. Nevertheless, a 3.9 percent rise in tourist earnings to US$959 million helped to cushion the effects. Stay-over tourist arrivals rose slightly by 1.5 percent during the first half of 2010. Significant economic reforms have started to take place with the government's decision to expand the private sector and to rationalize its workforce. The government plans to gradually shed 1 million jobs as part of its initiative to allow private enterprise to absorb a greater portion of the labour force. Modest growth is anticipated for the rest of the year, as agriculture output is expected to improve marginally and tourism continues its slow turnaround.

The Region

Jamaica has seen its economy contract by 0.8 percent in the second quarter of 2010, with only the mining and quarrying sector registering growth (4 percent) during the period. The social unrest that occurred in May contributed to the 5.4 percent and 1.5 percent decline in total tourist arrivals and stay-over arrivals, respectively. Unemployment was recorded at over 12 percent in April. On the bright side, remittances to the island increased during the first half of the year. The government has, thus far, met policy targets set under its stand-by agreement with the IMF.

The global downturn has been especially hard on members of the Organization of Eastern Caribbean States (OECS). The slump in the tourism industry, together with the limitations imposed on global finance, has depressed revenue flows, causing government finances to deteriorate. For instance, the fiscal deficit in Antigua and Barbuda is estimated at around 20 percent of GDP. The unemployment rate in the OECS is also very high, with St. Lucia burdened with a rate in excess of 20 percent. Recovery is anticipated to take place slowly and would involve critical austerity measures.

Outlook

A challenging environment will confront the region in the coming months. Tourism is expected to grow only modestly at best, given slowing economic growth in the US and Europe. Further, the UK is scheduled to increase its Air Passengers Duty (APD) paid by travellers to the region, from £50 to £75 in November, while Germany is set to introduce a similar €45 APD in January 2011. In this regard, the industry could be severely tested going forward. The APD was initially proposed as a "green tax" to have the airline industry pay the cost of environmental damage caused by flying. Although inflation pressures remain subdued for most nations in the region, strong oil prices and the rise of food prices could change this soon. With hurricane activity stepping into record territory this month, the perennial threat posed by this weather phenomenon must not be forgotten.

No More Cause to Pause

First we were waiting on the global financial crisis to play out; then we were waiting on the general elections; then, local government elections and the national budget. There is nothing to wait for again. We have a clearer view of the horizon; we have the information. The significant changes that have occurred both globally and locally, have spawned an avalanche of information and analysis as well as a high level of uncertainty. This has led to a slowdown in economic activity, with everyone from captains of industry to the average consumer 'waiting to see what happens' before they invest or buy. While pressing 'pause' may be a wise approach at times, it shouldn't be a long-term, collective strategy.

With the constant stream of news and data coming at you on a daily basis, it is easy to become either overwhelmed and tentative or utterly numb to it all. All of which can lead to either the wrong decision or to no decision at all. By focusing on key indicators and trends, this article seeks to simplify the information, explain the results and provide the understanding and confidence needed for investing in the future.

The Outside World

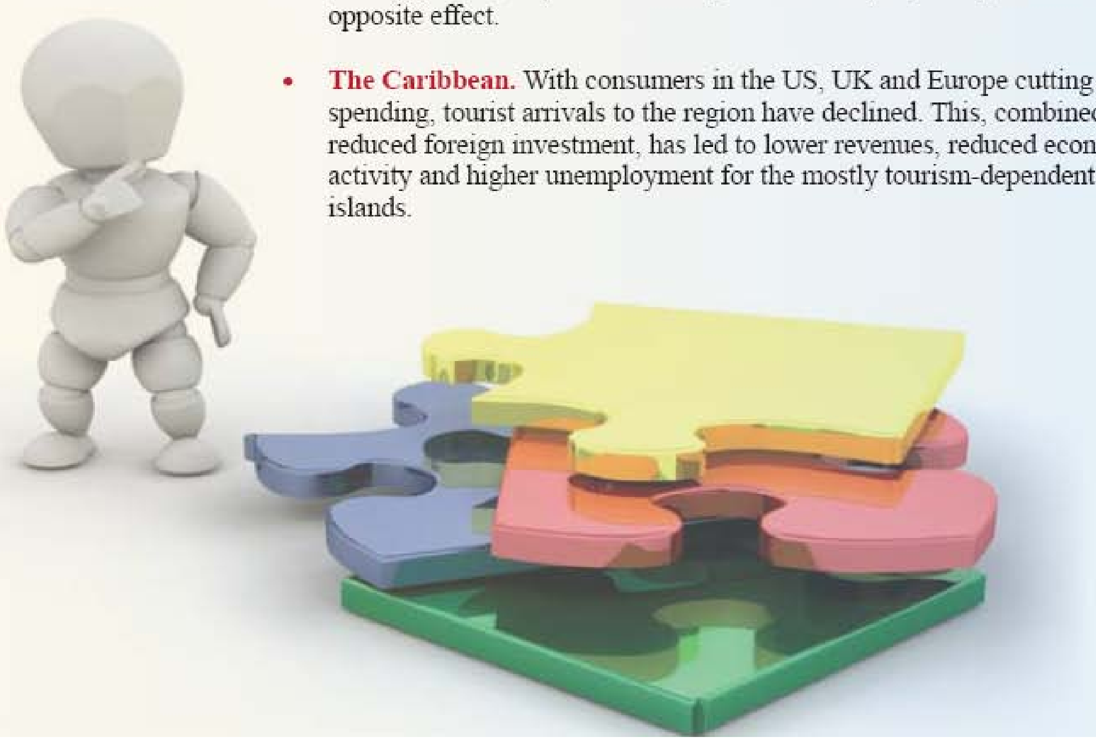
- **Developed countries.** Unemployment in the USA currently stands at 9.6 percent and is expected to stay high, only falling to 7 percent by 2012. Foreclosures remain high as many people cannot or will not pay their mortgages. Consumers are also taking fewer loans and have cut back on spending. Europe and the UK are experiencing similar circumstances while Canada's economy is in somewhat better shape. Overall, most developed countries will have weak growth over the next 2 years, along with low inflation of about 1-3 percent.

- **Developing countries.** Led by China and India, the economies of developing countries are showing healthy activity levels, with Latin America and Africa also showing solid growth. Because these countries weren't as connected to the financial sectors of the developed countries, they didn't suffer as much during the global financial crisis. Also, because their economies are still developing, they have the ability to grow faster (as, for example, the differing growth rates of a teenager and someone in their 20's). These countries will continue to have strong growth but they will also face higher inflation rates than developed countries.

- **Interest rates.** Because of the weak economic growth, low inflation and reduced loan demand, key interest rates should remain low in the leading economies over the next 12 months. Interest rates in developing countries, which are normally higher are not likely to increase by much, if any at all, during this time.

- **Foreign exchange.** Despite recent concerns, the US dollar will remain for some time yet, the world's leading currency against which all others will be measured. At this time, the movement of the Euro, Pound and Canadian dollar relative to the US dollar will be largely influenced by the state of the economies of each currency area. Simply put, bad news coming out of Europe (when compared to the US situation) will lower the value of the Euro, making travel, imports and college tuition cheaper, with good news having the opposite effect.

- **The Caribbean.** With consumers in the US, UK and Europe cutting back on spending, tourist arrivals to the region have declined. This, combined with reduced foreign investment, has led to lower revenues, reduced economic activity and higher unemployment for the mostly tourism-dependent Caribbean islands.



- **Oil and gas.** These commodities are expected to stay at their current price levels of US$70-80 per barrel for crude oil and US$4-6 per mmbtu for natural gas, for the next 2 years. Despite the weak growth in the developed countries the demand for crude oil is being sustained by the faster-growing developing countries.

- **Food.** International food prices are likely to stay on the high side over the next 18 months as global demand remains solid and high energy prices add to the cost of production. Also, extreme weather conditions in major food-producing countries, like the recent drought in Russia, are likely to lead to shortages and price hikes.

Trinidad and Tobago

- **Economy.** This country's economy is likely to grow by 2.5 percent this year after shrinking by 3.5 percent in 2009. With a relatively low unemployment rate of around 6 percent, relatively low debt levels and some savings, T&T is not badly off.

- **Inflation.** Average prices in 2010 are likely to be about 8 percent higher than the average prices of 2009. While food prices are a major part of our inflation, another factor - the relatively low unemployment rate - means that there are still lots of people who can buy lots of things. Also, inasmuch as T&T benefits from high oil prices, after a while these high prices affect the costs of many of the things we import, leading to price increases. Average prices are likely to increase by around 8 percent in 2011 also.

- **Interest rates.** By reducing its key interest rate, the Central Bank has been signaling to commercial banks that it wants interest rates to go down, and the banks have duly complied. Low interest rates make it more attractive for people and companies to borrow money to invest or to buy goods and services, all of which increases economic activity. While it makes sense for our interest rates to be heading lower if international rates (US, UK and Europe) are low, if our prices become too high the Central Bank may be forced to increase interest rates to prevent further price increases.

- **Budget.** The recently presented 2010/2011 National Budget provided insight to the policy intentions of the new administration and listed a number of measures deserving of consideration by those looking to invest. There are initiatives in manufacturing, energy, agriculture, alternative energy and innovation.

What Does It All Mean?

With the information laid out above, charting the way forward should be less daunting. Clearly, most key factors locally and internationally are unlikely to change much over the next 12 months. So, knowing that oil prices are likely to remain high, we can also expect the prices of food and imported goods to stay up as well. What, some might ask, is the use of knowing this? For starters, we should appreciate that this knowledge is relevant to and can be used by everyone; not just business people and investors, as is sometimes thought. Families can plan a purchasing strategy that results in greater savings over the long term, whether it is comparing alternative sources or suppliers, buying in bulk or buying direct. They can also offset the extra money needed for food, fuel and consumer goods, with increased savings or even earnings in other areas. For example, the government's stated thrust towards the use of cheaper and cleaner energy sources presents opportunities for savings by vehicle owners and earnings by investors who can provide services in this area.

With weak conditions likely to persist in the leading economies, their consumers will spend less, regional economies will continue to suffer and will in turn buy less T&T goods and services. This presents challenges and opportunities. The challenge for local exporters is to find new markets in some of the developing countries which are likely to have greater purchasing power at this time. The reduced economic activity in some Caribbean countries translates to higher unemployment, lower demand and lower prices. This may in turn present opportunities for more affordable vacations or for business ventures made more feasible because of lower labour and material costs. With the right approach, consumers and investors alike can develop many other initiatives and strategies.

The information above seeks to describe the likely terrain that lies ahead and illuminate the challenges and opportunities that lie therein. There is no more cause to pause. Anyone and everyone willing to venture forward can use this knowledge to reduce losses, increase savings or even earn greater income. The key is to venture forward and take some risk.

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 Subscriptions, enquiries and other correspondence should be addressed to:
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