

Republic Economic NEWSLETTER

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A Perfect Drought

Overview

The 2.8 percent contraction of the domestic economy in the first quarter exceeded our projection of a 0.5 percent decline, made in our June issue – Off to a Slow Start. Following such a sharp drop, it is unlikely for the ensuing quarter to register negative growth as well, however, a poor performance by the energy sector and somewhat lack lustre output from the non-energy sector, suggest this was the case. Republic Bank estimates that the economy shrank by 1 percent in the second quarter when compared to the first. The unemployment rate is estimated to have inched up to 3.9 percent, while inflation was moderate with average prices just 0.8 percent higher in the second quarter than the first.

Trinidad and Tobago Key Economic Indicators

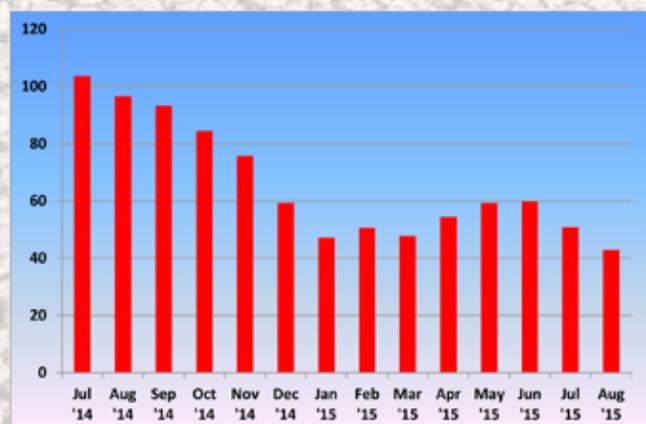
Indicator	2014	2014.2	2015.2 p/e
Real GDP (% change)	0.9	-0.5	-1.0
Retail Prices (% change)	5.7	1.5	0.8
Unemployment Rate (%)	3.3	3.5	3.9
Fiscal Surplus/ Deficit (\$M)	-2,720.0	1,726.5	-1,077.3
Bank Deposits (% change)	8.0	2.8	-0.2
Private Sector Bank Credit (% change)	5.8	1.9	2.0
Net Foreign Reserves (US\$M)	13,592.7	12,758.2	12,942.1
Exchange Rate (TT\$/US\$)	6.36 / 6.41	6.40 / 6.45	6.32 / 6.37
Stock Market Comp. Price Index	1,150.9	1,166.6	1,161.9
Oil Price (WTI) (US\$ per barrel)	93.17	103.35	57.85
Gas Price (Henry Hub)(US\$ per mmbtu)	4.39	4.61	2.75

Source: Central Bank of Trinidad and Tobago, TTSE, EIA
p - Provisional data
e - Republic Bank Limited estimate

Energy Sector

Indications are that energy sector output contracted in the second quarter with gains in exploration activity, outweighed by production declines. Rig days grew by 49 percent in the quarter to 890, while depth drilled surged by 64 percent to 146,835 feet. In the context of this year's low oil prices, the quarter saw a rally of sorts, with average prices of US\$57.85/bl, over US\$9 higher than in the first quarter. The rally was short-lived however, as prices dropped to US\$50.90/bl in July before sinking to US\$42.86/bl in August (Chart 1). This country's revenues would not have even gotten the maximum benefit from the brief price increase, as oil production declined by 3.5 percent from 82,982 bl/d (barrels per day) in quarter one to 80,045 bl/d in quarter two. Production fell further to 78,159 bl/d in July. Natural gas didn't perform any better, as while average prices saw a relatively small decline to US\$2.75 /mmbtu (per million British thermal units), production fell by 6.8 percent in the second quarter to 3,755 million standard cubic feet per day (mmscf/d). It is worth mentioning here that not only has production of this country's two major commodities declined in the second quarter relative to the first, but oil production is just barely (0.17 percent) above the level from quarter two, 2014, while gas production is actually 6 percent lower. Not surprisingly, LNG and petrochemical production were impacted, with methanol production increasing marginally by 1.3 percent and ammonia and LNG output declining by 3.4 percent and 12.3 percent, respectively. While the increase in second quarter exploration activity will surely have improved sentiments within the services sector, the July decision to relocate some aspects of the fabrication of bpTT's Juniper platform to Texas would have been a disappointment.

Chart 1: Crude oil (WTI) prices – US\$/bl



Source: Energy Information Administration (EIA)

Non-energy Sector

The non-energy sector contracted in the first quarter and indications are that the sector may have performed only marginally better in the April-June period, judging by the lackluster performances of some of the sector's proxy indicators. New vehicle sales have clearly been slowing. The 4,203 units sold in the quarter, at a monthly average of 1,403, was 2.6 percent less than the first quarter and 7.1 percent less than quarter two 2014. On the other hand, cement sales were encouraging with an 18.6 percent increase in the second quarter, although some level of seasonality would have also factored in the increase. The 62,911 tonne monthly average for the quarter was however, 3.2 percent lower than the similar period last year. With the state undoubtedly pressing during this time to complete most of its projects before the September elections, it will be interesting to see how cement sales and by extension construction activity, trend for the rest of this year.

Fiscal Policy

According to data from the Central Bank of Trinidad and Tobago, in the second quarter, central government's non-energy revenue declined by 8.1 percent to TT\$7,224.2 million while energy revenue contracted by 0.3 percent to \$4,380.6 million. With respect to the overall fiscal balance, a deficit of TT\$ 1,077.3 million was recorded for the April-June period, the third quarter of this country's financial year. With a first quarter surplus of TT\$328.4 million and a second quarter deficit of TT\$281 million, the cumulative overall balance through three quarters is a deficit of TT\$1,029.9 million.

Monetary Policy

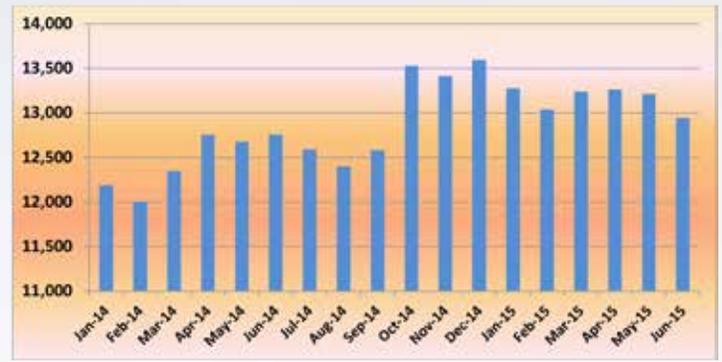
Following a 0.25 percent increase in the 'Repo' rate in May, in July the Central Bank's Monetary Policy Committee (MPC) implemented another 0.25 percent increase, taking the 'Repo' rate to 4.25 percent. Thus far the anticipated developments that spurred the series of rate increases have not yet played out. Despite constant speculation and anxiety, US interest rates are yet to be increased, domestic headline inflation has been steady, with the June rate of 5.5 percent close to those of the previous three months, and non-energy demand now seems set to slow rather than intensify. Influenced as they are by movements in the 'Repo' rate, Commercial Bank's Basic Prime Lending rate ended the quarter at 8.13 percent, up from the previous quarter's 7.75 percent.

Commercial bank deposits averaged TT\$101,489.3 million for the second quarter, 0.2 percent lower than the previous three months. At the end of June, consumer loans stood at TT\$25,943.90 million, marginally (1.5 percent) higher than the balance at the end of the first quarter, but 8.9 percent higher than the year-ago period. With respect to businesses, commercial bank private sector credit closed the second quarter at \$24,863.5 million, a 2 percent improvement on quarter one and 3.2 percent greater than the corresponding period in 2014.

Reserves

This country's foreign reserves, as represented by Net Foreign Position, stood at US\$12,942.1 million in June. As can be seen from Chart 2, following the spike in reserves that accompanied the sale of Methanol Holdings Trinidad Limited (MHTL) for US\$1,175 million on October 9th 2014, reserves have generally been trending down. The demand for US currency however, continues to be very strong. In a May release, the CBTT advised that for April it had sold US\$150 million into the banking system, bringing the 2015 total sold thus far to US\$860 million. For the corresponding January – April period in 2014, foreign exchange sales were US\$515 million.

Chart 2: Net Foreign Position – US\$ Mn



Source: Central Bank of Trinidad and Tobago (CBTT)

Capital Market

The domestic stock market continued to lack dynamism, with the average number of monthly transactions falling by 17 percent from 975,000 in the first quarter to 806,600 between April and June. The Composite Price Index increased incrementally over the quarter by 0.6 percent to end June at 1,161.9, still below the year-ago mark of 1,166.6. There is however some hope that the recent Trinidad and Tobago Natural Gas Limited (TTNGL) initial public offering (IPO) will bring some life to the market. Popularly known as the Phoenix Park IPO, 75.8 million shares of Phoenix Park Gas Processors Ltd. (which were vested in TTNGL) went on sale from August 9th - September 9th. At \$20 a share, the IPO is expected to raise over TT\$1.5 billion if fully subscribed, with the shares to be listed on the stock exchange on October 12th.

Outlook

Over the next six months, along with protracted low oil prices, this country's production of oil, gas and some related downstream product are likely to continue declining. As a corollary, the downward pressure on energy sector revenue and foreign reserves will persist, in a context of strong demand for US currency. Non-energy sector revenue is expected to continue falling as well, as key sectors such as distribution are likely to suffer from reduced consumer demand while the widely expected post-election construction slump almost certainly will be a protracted one, as the new PNM administration will of necessity take some time to initiate and execute its infrastructure projects.

It is tempting to see this confluence of negative trends as akin to a perfect storm, but that would be wrong. Storms are generally formed quickly, while many of the aforementioned trends developed over time. Further, as our neighbours in Dominica can attest to (and we commiserate with them in their time of suffering and loss) despite the widespread havoc that they can wreak, storms either dissipate or move on quickly, quite unlike the current conditions facing this country, which are likely to persist for a while. What forms over time and persists, as some of our other Caribbean friends to the North-West can also attest to, is drought; a season of shortage, conservation and sacrifice. Despite the perfect drought that seems to be unfolding, it is not all doom and gloom for Trinidad and Tobago. The thousands of housing units allotted over the last four months, represent increased demand for furniture, as well as the services of welders, masons and home security experts over time. More importantly, the behaviours one is forced to adopt during a drought, such as conservation, sacrifice, ingenuity and the elimination of wastage, can lead to even greater gains if maintained after the drought ends. With a new administration with some latitude and a population apprised of the difficulties that lie ahead, the next six months present a real opportunity for change. Will the opportunity be seized or spurned?

Caribbean Update

SHIFTING GROWTH PATTERNS

Looking at the performance of the region in the second quarter of 2015, not much has changed from the previous quarter. In order to truly assess the current situation, it would be prudent to draw comparisons from the same period last year. “High Debt Burden”, “High Fiscal Deficit” and “High Unemployment” are phrases that have all become clichéd in describing the Caribbean economy and unfortunately these problems continue to linger. However, there have been some signs of improvement. Grenada and Jamaica are both benefitting from International Monetary Fund (IMF) assistance and are working arduously towards lowering their fiscal deficits and public sector debt. Barbados is also taking the bull by the horns with its fiscal consolidation programme, while the relaxing of US sanctions would only bode well for Cuba’s tourism sector. Nevertheless, the most noticeable change within the region is the shifting growth patterns, as tourism dependent economies are performing better, while commodity exporters are beginning to feel the pinch of low prices (refer to Table 1).

Table 1: Real GDP Growth Caribbean

	2013	2014	2015 (Projection)
Tourism Dependent	1.1	1.5	2.0
Commodity Exporters	3.1	2.8	2.4

Source: IMF Regional Economic Outlook Western Hemisphere

Barbados

During the first half of 2015, Barbados recorded minimal growth of 0.5 percent. The tourism sector expanded by 3 percent as tourist arrivals increased by 14 percent year-on-year. The UK (14 percent), Canada (23 percent) and U.S. (24 percent) were the main source markets for growth in tourist arrivals. The non-tradable sector grew by 0.6 percent, with mining and quarrying expanding by 27 percent. Lower commodity prices caused inflation to fall by 0.7 percent (year-on-year) in May, the fourth consecutive month of decline. Conditions in the banking sector improved, as loans and advances increased by 1.4 percent in March 2015 compared to a contraction of 2.5 percent in 2014.

In its latest budget, the government proposed tax reforms that are expected to generate \$200 million in revenue, while the fiscal deficit is budgeted to be 4 percent of GDP for 2016. Going forward, the government will continue to

face challenges presented by high public sector debt, which stood at 108.5 percent of GDP in June. Foreign reserves fell by 11.4 percent in June 2015 to \$968.3 million from \$1,092.8 million in June 2014.

Cuba

The improved relations with the US and the easing of sanctions contributed to the 17 percent growth in tourism during the first half of 2015. Economic activity also increased in the sugar industry (22.6 percent), construction (8.7 percent), manufacturing (8 percent) and the agriculture sector (4.7 percent). The tourism sector is positioning itself for future growth with the loosening of travel restrictions, the facilitation of credit card usage, the construction of hotels and the development of the Gaviota Varadero Marina. However, improvements in transportation and communication are needed to boost competitiveness.

The Cuban economy could benefit from a boost in foreign direct investment in the future with the recent completion of the deepwater port of Mariel. Five foreign firms have already been granted permission to operate in the special development zone, as amendments in Cuban investment laws over the last two years have made it more attractive for foreign firms to operate in the new port.

Grenada

With the implementation of its home grown economic programme, Grenada has made significant progress under the IMF’s Extended Credit Facility (ECF). The economy has strengthened, based on strong performances in tourism and agriculture in the first half of 2015. Last year, average consumer prices fell by 1 percent due to reductions in telecommunication costs. Declining oil prices and weak demand are expected to produce further price falls this year. In addition, the current account deficit is expected to fall due to a lower fuel-import bill, while transportation and electricity costs are anticipated to decrease.

Under the current IMF programme, Grenada has done well to improve their fiscal stance, as tax revenues are back up to pre-crisis levels and government expenditures are being kept under control. However, the economy faces severe challenges, with contracting credit growth and high unemployment (29.5 percent), especially among the youth.

Guyana

The Guyanese economy registered modest growth of 0.9 percent during the first half of 2015 due to the weak performance of the agriculture and mining sectors. Earnings from bauxite and gold received a double blow due to weak prices and low production which contracted by 14.8 and 16.2 percent, respectively. Rice production decreased by 3.8 percent while the manufacturing sector saw no growth for the same period. Construction activity slowed down due to the reduction in expenditure under the Public Sector Investment Programme.

The Amaila Falls project was officially stopped due to the likelihood that Guyana Power and Light's (GPL) financial burden (US\$130 million annual payments over a 20 year period) will be passed to consumers in the form of tariff increases. Recurrent expenditures are set to increase in fiscal 2016 with increased public sector wages and old age pensions. Value-added tax (VAT) will also be removed from specific commodities. Officials from the United Nations have visited Guyana to help settle the ongoing border dispute with Venezuela. In the meantime, Guyana plans to buy fuel from Trinidad and Tobago to supplement the inconsistent oil shipments from Venezuela, as the PetroCaribe oil-for-rice trade agreement could be threatened by the border dispute.

Suriname

In May, the Nationale Democratische Partij (NDP) won a one seat majority in the legislative election. Desiré Bouterse was reelected as President following a presidential confirmation vote in July and has already hinted that fiscal reform is on the horizon. The 2016 budget will be presented on October 1, 2015 and it is expected that expenditure cuts and tax increases would be implemented to address the widening deficit, which increased by 51 percent during the first five months of 2015. Falling commodity prices have stymied Suriname's growth prospects. Anecdotal evidence suggest that gold earnings declined during the first half of 2015, as the Rosebel gold mine (Suriname's only large-scale gold producer) recorded a 9 percent contraction in output during the first quarter of 2015.

International reserves fell to US\$503.9 million at the end of June 2015, from US\$631.5 million at the end of January 2015, largely because of declining prices for gold and bauxite. Looking ahead, the government will seek to increase its exports and has entered into an agreement with the Caribbean Development Bank (CDB) to boost its trade under

the Caricom Single Market Economy (CSME). In the short-term, gold earnings are expected to remain subdued with falling prices and the imminent increase in mining costs, as higher-grade ores are being depleted.

Region

Having just passed its ninth review under the IMF's Extended Fund Facility (EFF), Jamaica's indicators are improving. Tourism grew by 6.5 percent in the first half of 2015, as the US economy continued to improve. UK arrivals also increased, due in part to the reduction in UK Air Passenger Duty (APD). Unemployment fell to 13.2 percent in April, while inflation reached a 43-year low at 3.8 percent (year-on-year) as at July 31, 2015. The early payoff of its PetroCaribe debt led to a 10 percentage point drop in the country's debt to GDP ratio, while its international reserves stood at a healthy US\$2.4 billion at the end of July. Notwithstanding its positive outlook, a recent drought is likely to hamper Jamaica's agriculture sector.

Antigua and Barbuda is also facing serious drought and if the situation worsens, more intense water rationing would have to be implemented. Another OECS country, Dominica, would be seriously tested in rebuilding their economy after being hit by Tropical Storm Erika. In the island of Hispaniola, the Haitian government would be challenged to accommodate thousands of Haitians who returned from Dominican Republic, which is seeking to manage the flow of unchecked immigrants. Further north, the Bahamas tourism sector could experience lower-than-expected growth in the upcoming busy winter period, with the stalling of the Baha Mar resort project.

Outlook

Heading into the final quarter of 2015, the current trend is likely to continue as tourism dependent countries are expected to fare better than commodity exporters. Tourism dependent countries are expected to benefit from increased demand in major source markets, particularly the US. Recent data has shown that international tourism improved by 4 percent in the first half of this year and that the Caribbean would have most likely absorbed some travellers who avoided tourist destinations in Africa due to terrorism and the Ebola virus. Commodity exporters will be constrained, as the slowdown in China's consumption is likely to result in lower global consumption and cause commodity prices to further weaken.

Seeking Development?

Don't Overlook the Basic Elements

Given specific structural weaknesses, particularly the country's dependence on one sector for growth and our penchant to mismanage key resources, plans to chart a new course for our nation are continually deliberated. The dialogue generally centres on the challenging, yet necessary goals we have set for our nation, but which unfortunately have proven very elusive. Chief among these objectives are a diversified economy, prudent fiscal management, a more efficient public service and low crime rates. Undoubtedly, the hope of many is that with the 2015 General Elections over, these imposing objectives can be given the requisite amount of attention and more importantly, effort. Indeed, our failure to be further along in these areas has stoked frustration in many quarters of society and has also earned us some dishonourable mention among multilateral organisations such as the IMF. Even as we seek to push through the various initiatives related to these essential national goals, we must ponder whether we are overlooking fundamental factors that are critical to drive a nation toward success. This note identifies a few elements that are essential if our beloved twin-island state is to progress to greater levels of development. Our weaknesses in some or all of these areas may just be the major reason behind Trinidad and Tobago's failure to attain meaningful momentum towards achieving its goals.

As a country seeks to transition from one stage of development to another, visionary leadership would be an invaluable asset to initiate, facilitate and oversee the process. Countries like Trinidad and Tobago need leaders who can envision an enhanced future and who can communicate this future in a way that generates widespread buy-in. Such leaders will also need to develop long-term, cohesive goals that will push the nation to that vision. This type of leader is very careful to safeguard the long term welfare of his/her country and does not view his/her contribution or the consequences thereof, within the narrow confines of an electoral term. This certainly does not mean that one individual is required to oversee the entire process from conception to goal attainment. Rather, what is required is a pattern of leadership that would ensure that national goals transcend the realm of party politics and so, benefit from an acceptable level of continuity. This requires a significant level of maturity on the part of politicians, but also demands commitment and persistence from major stakeholders. Given our history, particularly in the sphere of politics, this may seem a lofty ideal. Nevertheless, the deep-seated changes which are required to accomplish most of our national goals, call for strong, imaginative leaders and a people willing to make the necessary sacrifices.

The type of leadership described above and an attitude which would cause the populace to make short-term sacrifices for long-term gains are the products of a specific kind of culture, one which sadly, is not widespread in Trinidad and Tobago. Firstly, there is a level of myopia existing in our culture that makes long-term planning a very uncomfortable concept. We seem extremely reluctant to delay gratification, even in the face of looming dangers. Nowhere is this expressed more than in the way we consume our resources. There is excessive wastage and inefficiency, with notable portions of the country's resources being directed toward unproductive purposes. Regrettably, this way of managing the nation's wealth has become entrenched and those in the seat of power have to summon a significant amount of courage to even broach the topic. For instance, the national budget has catered for a fiscal deficit in excess of 6 years now, while the authorities have found it difficult to scale back the fuel subsidy, which averaged \$4 billion in recent years. The abundance bestowed upon the nation by its energy resources, has certainly spoiled us and left many with a feeling of entitlement. Refreshingly, there are indications that government is moving to address its shrinking fiscal resources, as the previous People's Partnership administration expanded the programme aimed at boosting the use of compressed natural gas in motor vehicles. Meanwhile, statements from the new People's National Movement government suggest that it intends to manage the nation's finances carefully.

Another aspect of our culture which seems to be affecting the urgency we attach to achieving national goals is the high level of apathy which exists in some quarters of our society. In these critical times, there are too many people who are indifferent to the severe challenges currently confronting the nation and those that lay in wait on the horizon. Some choose to turn a blind eye to such concerns, hoping that the elected officials would take the appropriate actions to surmount the trials, while others for varying reasons, are too concerned with their own short-term needs and wants to care. What a high level of apathy does, is it places little pressure on our leaders to take



actions necessary for the country's long-term wellbeing. Instead, what tends to happen is a situation where elected officials attempt to appease the electorate by expending significant resources on short-term initiatives.

It should be recognized that there needs to be a significant level of cooperation among government, business, key institutions, labour, non-government organizations, and citizens if the goals set for the nation are to be accomplished. Simply put, the attainment of national goals requires action on a national scale. Although the pursuit of long-term developmental goals must be led by the government of the day, the various segments of the wider society should feel compelled to make a meaningful contribution. In this regard, having the right culture in place can play an important role. Contributions could be as simple as citizens putting out their best effort at work and being punctual with few absences. This could help boost productivity and save costs. On a grander scale, universities can provide the necessary research to support activities in the sectors which have been identified for growth under the diversification initiative and also provide a greater number of spaces to students, who wish to pursue studies in the associated fields. The government in turn could help to boost the supply of labour to these sectors through its Government Assistance for Tuition Expense programme (GATE). The government can provide the highest percentage of tuition cover for courses of study related to the identified sectors,

but offer a smaller percentage of coverage for courses not aligned to the diversification thrust.

The various stakeholders must never underestimate how important their roles are in moving the country forward.

It would take a fair amount of discipline to propel Trinidad and Tobago toward the achievement of its goals. The process of attaining each of our national goals must be carefully managed, with adequate time devoted to conduct reviews and to take corrective action. Accordingly, it may be best if a national plan of action is drafted, not only to highlight the roles of the main players, but also to synergize the related activities and streamline the use of resources dedicated to the programme. Nonetheless, a plan by itself will not guarantee sustained effort on behalf of the relevant parties, since in the past we have permitted the riches from the booming energy sector to distract us. In those times of plenty there was little mention of the objectives we have set for ourselves and even less action.

But if the plan is empowered by regulations, the prospects for follow through would drastically improve. For instance, fiscal rules which dictate that a minimum percentage of the national budget should be dedicated to diversification can be introduced. Such rules would send the signal to the society that our leaders are committed to the plan and is thus likely to yield a greater level of participation.

Even if we have all the elements mentioned above in place, the nation would still fall short of its goals without the requisite execution skills. Our failures in this regard, may not necessarily be that we lack or cannot acquire the necessary implementation skills. It is more likely that because of our culture, the wrong criteria and motives (mainly political) were used to fill key roles. It is vital that the right people, institutions and processes are used to execute the various initiatives of the plan. If the implementation process is deficient in any way, the effectiveness of even the best plans would be severely undermined. For this reason, strong leadership is needed to ensure that competence is the principal factor determining which individuals and institutions are used in the various roles. The use of special purpose state institutions and other state enterprises to surmount the execution challenges faced by government ministries, has not yielded the desired results, but has produced additional problems, with corruption topping the list. The people and institutions which have been entrusted with the noble task of transforming the nation must commit to high standards of performance and accountability.

In this, the fifty-third year of our nation's independence and the thirty-ninth anniversary of it becoming a republic, the country finds itself at a crossroad. One road leads to long term growth and development, but requires significant short-term sacrifices. The other only requires that we indulge our appetites now, while we turn a blind eye to imminent pitfalls. This road also requires us to sacrifice the nation's future. It is very encouraging that much of the national conversation at the moment is focused on placing the country on the right path. However, if we want this incarnation of structural reform to be more than just talk accompanied by minimal action, we should do some introspection to see if per chance, we have overlooked some of the basic components necessary to take our nation forward. The good news is, we can work to resolve these fundamental issues, though it may not be easy.

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