Republic
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Positive Signs Against a Still Sluggish Economy

Overview

The Trinidad and Tobago economy remained weak during the first three months of 2011, registering only marginal growth estimated at just 0.2 percent. This follows contraction of 3.8 percent during the fourth quarter of 2010. Although the energy sector rebounded, with increased oil production and higher prices, these gains were offset by the poor performance of the non-energy sector, particularly the construction, distribution and manufacturing sub-sectors. Government expenditure fell short of budget but unemployment remained relatively low and was estimated at 6 percent during the first quarter of 2011. Inflation fell significantly to 9.4 percent in March from 13.4 percent in December 2010, while activity on the stock market increased by 4.36 percent. There was also some evidence that credit growth might be picking up.

TRINIDAD AND TOBAGO KEY ECONOMIC INDICATORS

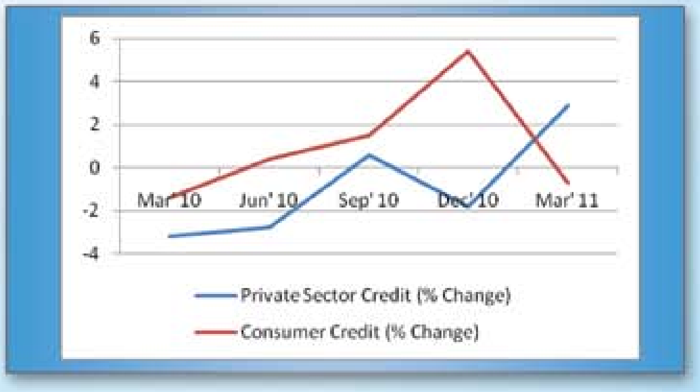
INDICATOR	2010	2010 .1	2011 .1 p/e
Real GDP (% Change)	-0.6	1.9	0.2
Retail Prices (% Change)	10.5	3.4	0.3
Unemployment Rate (%)	6	6.7	6
Fiscal Surplus/ Deficit ($M)	-308.2	-161.5	Deficit
Bank Deposits (% Change)	4.6	-0.6	3.6
Private Sector Bank Credit (% Change)	-7	-3.2	2.9
Net Foreign Reserves (US$M)	10,709	10,861	10,000
Exchange Rate (TT$/US$)	6.32/6.38	6.32/6.37	6.37/6.42
Stock Market Comp. Price Index	835.64	817.72	872.08
Oil Price (WTI) (US$ per barrel)	79.4	78.64	93.50
Gas Price (Henry-Hub) (US$ per mmbtu)	4.52	5.30	4.31

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

Energy Sector

The performance of the energy sector improved during the first quarter of 2011. With the return to production of BHP Billiton's Angostura field, domestic oil output averaged 96,958 bpd, compared to 86,610 bpd in the previous three-month period. Gas production also improved to an average of 4.3 bcfpd, up from 4.2 bcfpd. Oil prices rose steadily during the period to average US$93.50 per barrel, up from US$85.10 bpd in the fourth quarter of 2010. Gas prices also rose moderately to US$4.18 per mmbtu from US$3.80 per mmbtu. The price of oil is expected to remain strong, while gas prices should remain flat in coming months. BHP Billiton recently added to domestic gas production with the completion of the offshore Angostura Gas Project. The new gas export platform has a design capacity of 280 million cubic feet of gas per day.

Figure 1 Credit (% Change)



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Fiscal Policy

The central government's fiscal deficit is much smaller than envisaged in the national budget, estimated at $207.5 million for the first six months of the 2011 fiscal year, compared to the budgeted $3.3 billion. Energy prices remain consistently above budgeted figures, while most of government's major construction projects are yet to kick-off. The People's Partnership government has been able to hold the line on expenditure while paying off debts incurred by the last administration. This is likely to change in the latter half of the year as greater capital spending is expected.

Monetary Policy

Supported by softening of the core inflation rate, the Central Bank maintains its focus on stimulating the flagging domestic economy. Headline inflation fell to 9.4 percent in March after averaging over 10 percent for the previous 9 months. Food prices continue to provide the major impetus for domestic inflation. Core inflation (which excludes the influence of food prices) fell further to 1.3 percent in April 2011 from 4.7 percent at the end of 2010. In February 2011 the Bank reduced the "Repo" rate to 3.25 percent from 3.75 percent at the end of 2010. Consequently, the average prime lending rate of commercial banks continued its downward trend in the first quarter of 2011, falling to 8.25 percent from 8.38 percent. The prime lending rate fell further to 8 percent in April. It seems as if the Central Bank's resolve has began to pay off, as preliminary data suggests private sector credit rose by 3 percent during the period, after a protracted period of contraction. Consumer credit, on the other hand, shrank only marginally by 0.7 percent after encouraging growth in the previous two quarters (Figure 1). This pattern is seasonal as consumer credit usually peaks in the final quarter of the year. With the uptick in credit demand, the Central Bank might not be too anxious to drop rates lower.

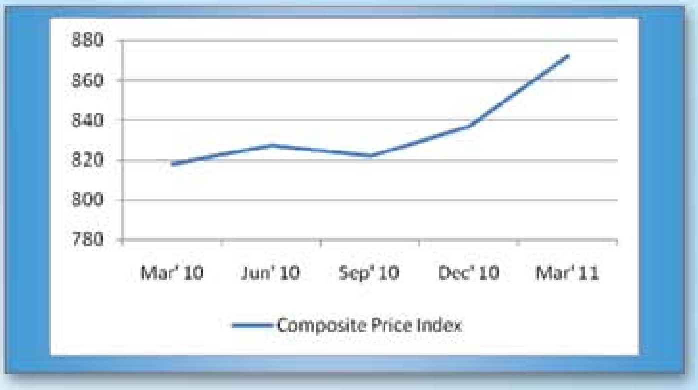
Reserves

Despite the strong demand for foreign currency, the level of foreign reserves remains healthy, estimated at US$10,000 million at the end of March 2011, representing 13 months of import cover. Net sales of foreign currency increased to US$486 million during the first three months of 2011, compared to US$357 million during the same period in 2010. This vigorous demand for foreign currency contributed to a marginal depreciation of the TT dollar against the US and Canadian currencies in early 2011.

Stock Market

Stock market activity improved notably, with the Composite Price Index increasing by 4.36 percent from 835.6 in December to 872.08 in March of 2011 (Figure 2). The rally continued through to May with the index reaching 922.02 at the time of writing. Apart from what seems like the return of some confidence in the market, this increase may be symptomatic of the low interest rate environment, which causes cash to be diverted toward stocks instead of low-yield deposit accounts.

Figure 2 Stock Market



Outlook

Notwithstanding the domestic economy's less than stellar start to 2011, there is reason for some cautious optimism going forward. The start of government's construction projects would provide a much needed stimulus for the sector and the domestic economy as a whole. However, if the government fails to follow through on these projects, growth will be slow in resuming. The current environment of high oil prices and increased exploration activity would also support the expansion of the domestic economy through higher government expenditures. The challenges provided by rising, global, food and fuel prices are expected to persist for some time. In the case of food, planned and ongoing government initiatives, to boost local food production should provide some relief. On the other hand, higher crude prices will increase the size of government's fuel subsidy and consequently add substantially to its expenditures.

Caribbean Update

Tourism Offers Some Hope

According to the IMF, the Caribbean economy (excluding Haiti and the Dominican Republic) is projected to grow by an average 2 percent in 2011 after a contraction of 0.5 percent in 2010, as developed economies are starting to show signs of recovery. However, inflationary pressures and high public debt will continue to provide challenges for growth within the region. This year, there has been a noticeable increase in tourist arrivals for islands including Cuba, Jamaica, St Lucia and Barbados. This follows the improved performance of the sector in 2010 (Table 1). As a result of this heightened activity, the Caribbean Tourism Organisation (CTO) has estimated that arrivals will increase by 5 percent this year, but will be nowhere close to pre-crisis levels. In the meantime, global inflation continues to threaten growth in the Caribbean through higher food and fuel prices. Such that, several countries were forced to increase domestic fuel prices early this year.

Table 1. Tourist (Stop-Over) Arrivals

	2008	2009	2010
Barbados	567,667	518,564	532,180
Grenada	129,605	113,370	106,156
Guyana	132,776	141,053	150,141
Jamaica	1,767,271	1,831,097	1,916,301
St. Kitts-Nevis	106,408	-	-
St. Lucia	295,761	278,491	305,937
St. Vincent & the Grenadines	84,101	75,446	63,444*
Trinidad & Tobago	430,513	413,796	-

*** Jan to Nov**
Source: Caribbean Tourism Organisation (CTO)

Guyana

The Guyana economy faced several set-backs at the beginning of 2011, following an improved performance in 2010. In addition to poor weather conditions and industrial disputes in the sugar industry, the forthcoming election is likely to also adversely affect the economic environment. Although the Guyana Elections Commission (GECOM) is putting measures in place to ensure a smooth election in August, there are still widespread concerns over blatant voter apathy and threats of violence among racially divided voters. Earlier this year, worker disputes at the Guyana Sugar Corporation (GuySuCo) not only slowed sugar production, but also posed a serious threat to social stability. In addition, the agricultural sector was dealt a massive blow when floods destroyed both sugar and rice crops in the first two months in 2011. In spite of these early setbacks, growth is still forecasted at 4.5 percent for 2011. While this seems rather optimistic, some experts believe that the government's incentives for private sugar farmers will help boost production. With respect to the mining sector, the global demand for gold remains high and output is expected to be more than the 308,438 oz. produced in 2010. On the other hand, the gradual depletion of bauxite reserves will continue to be a downside risk for growth in this sector. Going forward, average inflation is projected to increase gradually throughout 2011 but remain within 5 percent for the period. The rapid accumulation of debt over the last three years could pose a risk to Guyana's economy.

Barbados

Recent data released by the Barbados Central Bank (BCB) revealed that growth increased by 2.8 percent year on year (y-o-y) for the first quarter in 2011. This significant turnaround was due to the increase in tourism activity during the winter season, as the number of arrivals from both the UK and US increased by 15 percent y-o-y and 6 percent y-o-y, respectively. Construction, mining and quarrying also showed improvement in the latter half of 2010 and as a result, growth is now estimated at 0.3 percent as opposed to a negative 0.4 percent estimated earlier this year. The unexpected recovery in the tourism industry has led to revised growth forecasts for this year, up from 1.3 to 2 percent. However, the UK - which is Barbados' major source market for tourism – could be one of the downside risks for higher growth in tourism, as that economy continues to battle sluggish growth. Over the next quarter, Barbados will find it challenging to stimulate growth considering its substantially high levels of debt, which stood at around 105 percent of GDP in March, 2011. The banking sector witnessed a slowdown in new credit and an increase in the non-performing loan (NPL) ratio from 4.3 in 2009 to 10.3 in 2010. The positive turnaround in tourism should stimulate activity in the banking sector, due to the strong link between tourism and credit performance. Nevertheless, high global oil prices will place some upward pressure on airline ticket prices. The UK government's postponement of further increases in Air Passenger Duty until April 2012 should encourage UK visitors in the short-term.

Cuba

The tourism industry continues to show signs of improvement, as there was a 10.4 percent y-o-y increase in total tourist arrivals for the first quarter of 2011. This year, with government policies aimed at relaxing strict investment restrictions, we can expect to see an uptick in foreign direct investment (FDI) which could lead to the expansion of tourism infrastructure. Moreover, the devaluation of the convertible peso (CUP) by 8 percent in March, 2011, should help bolster Cuba's tourism sector by lowering the costs for visitors. In addition, the lower CUP would provide more competitive prices and as a result, increase exports as well as remittances. However, Cuba's high food import costs could offset increases in exports. In 2011, it is highly likely that food imports will remain high, as water shortages earlier this year resulted in lower yields in domestic food production. Going forward, Cuba could see some growth in the tourism sector while the sugar industry will continue to struggle with early year setbacks due to drought. Moreover, the devaluation in the CUP should stimulate private consumption via remittances (which are valued at US$1 billion annually). As such, we share the view with the Economist Intelligence Unit (EIU) London, that Cuba should see modest growth of 3.5 percent in 2011, before picking up in 2012 as the world economy begins to recover.

Grenada

In 2010 the Grenadian economy contracted by 1.4 percent but is now projected to grow by 2 percent this year, as tourism is set to make a comeback as North American and European economies slowly recover. Once this trend of global recovery continues, Grenada should be able to benefit from tourism-related FDI inflows and subsequently experience growth in 2011. However, high levels of government debt, which is estimated at around US$2.2 billion for 2010 (87 per cent of GDP), could dampen growth in this Caribbean state. In 2011, Grenada will seek to control this debt with higher taxes and less government spending, which will consequently place some downward pressure on private consumption. Another risk to Grenada's economy is its vulnerability to high global commodity prices which could lead to drastic declines in disposable income as both food and fuel are the main components in a consumer's basket of goods. As a result, the Business Monitor International projects that average inflation will increase to 7.2 percent in 2011 from 5.1 percent in 2010.

The Region

Latest data reveal that the Jamaican economy contracted by 1.2 percent in 2010. Nonetheless, real GDP is projected to grow by 1.5 percent in 2011, due to a pick up in tourist arrivals, mining revenues and remittances. Higher bauxite prices should help lift the mining sector which experienced a major decline of 50.5 percent y-o-y in 2009. In 2011, an expected increase in tourism-related FDI should encourage investment in infrastructure and transportation, which will further enhance the chances of long-term growth. Crime continues to be an Achilles heel for the Jamaican economy and although the recent drop in murder rates has improved the island's short-term political risk profile, overall crime rates still remain the highest within the region. In Haiti, incoming President, Michel Martelly will have to find fast solutions for daunting problems including maintaining national unity, accelerating the reconstruction from last year's devastating earthquake and improving economic and social conditions for the population. Some OECS nations have reported improvements in tourist arrivals earlier this year, but growth will be modest, as they continue to struggle with heavy debt service costs.

Outlook

Caribbean economies will continue to see positive signs of recovery as the developed economies begin to record modest growth. While, tourism seems to be one of the main drivers of growth in the region this year, we are mindful of the vulnerability of the tourism sector to adverse weather conditions, as we enter the hurricane season. High oil prices will definitely be a threat to growth in the Caribbean, as many countries are net importers of oil. Already this year airlines have announced higher ticket prices while some countries in the region have raised fuel prices. Furthermore, high food prices will hamper growth as domestic food production suffered from harsh weather conditions last year. Going forward, the tourism sector should provide enough stimuli for growth but local food production needs to be scaled up to avoid further food price shocks.

Investment and Growth in Trinidad and Tobago

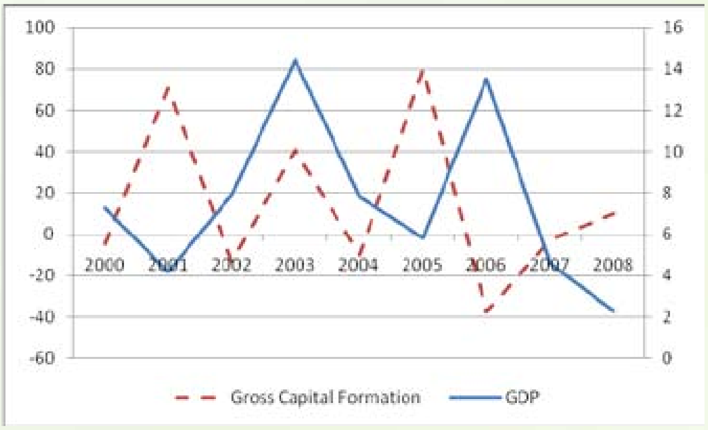
At a time when this country is grappling with how to ignite economic growth once again, it would be useful to examine what drove growth over the last fifteen years or so and what can be done to reignite growth again. While many factors explain growth and while there are many perspectives from which growth might be discussed, this brief note will focus on investment as a key driver of growth. What are the components of investment and how might each be promoted are our main areas of interest.

Investment increases output or income as measured by gross domestic product (GDP). The more investment that is made, the faster the economy is likely to grow. Figure 1 illustrates the relationship between investment and growth in Trinidad and Tobago. Increases in investment (Gross Capital Formation) usually drove growth, sometimes with a lag. A fall in investment often "caused" output to decline.

So how then might investment be disaggregated? Total investment comprises investment by (i) foreigners, (ii) government, including state enterprises and (iii) the domestic private sector. Net foreign direct investment (FDI) in Trinidad and Tobago averaged 7 percent of GDP over the ten-year period 2000 to 2009 according to the United Nations Economic Commission for Latin America and the Caribbean (UNECLAC). Largely as a result of the global financial crisis, this figure fell much lower in 2010 and 2011. Indeed, the importance of FDI to this economy is highlighted when one considers that net inflows of FDI reached one of its lowest levels in 2009 (3.3 percent), the same year that the economy declined by 3.5 percent – the first decline in some 16 years.

While FDI is important for the promotion of economic growth, the greater portion of total investment in this country is domestic investment. This might be surprising, at first, until we remember that domestic investment comprises both public and private investment. The relative size of domestic investment vis-a-vis FDI is seen in Figure 2. Public investment includes investment by central government and state enterprises. Domestic

Figure 1
Total Investment and GDP (% change)

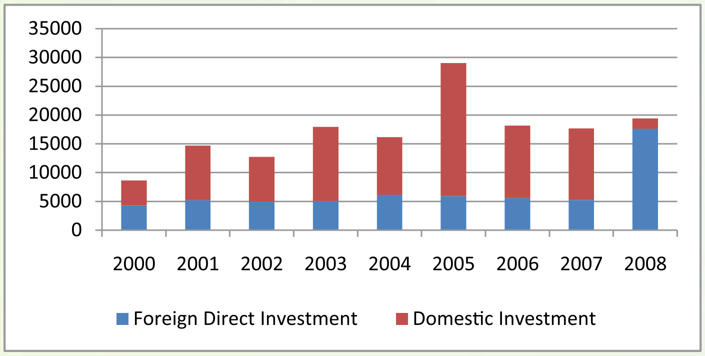


investment averaged approximately 12 percent of GDP over the period 2000 to 2009.

By far, the largest component of domestic investment comprises investment by the public sector, compared to the private sector. Unfortunately, available data does not disaggregate total domestic investment into public sector investment and private sector investment. However, if one uses national budget expenditures by the total public sector, a good picture is gleaned. Central government capital investment averaged $4.1 billion over the 2000-2009 period. However, one finds that average central government's capital expenditure alone was almost as large as FDI over the period.

While data on domestic private investment is not readily available, it is traditionally the smallest of the three components. Unfortunately, the potential of this component of investment remains largely unlocked. This is because in Trinidad and Tobago, like the rest of the region, have not worked hard enough at identifying and removing the constraints to growth. Action that would stimulate domestic private investment can be expected to pay the greatest dividends in employment, taxes and more.

Figure 2
Investment (TT$ Millions)



Let us now consider the prospects for reigniting investment and consequently economic growth. Foreign investment in Trinidad and Tobago has largely been in the energy and petrochemical sectors. This explains much of the growth of this economy for decades. With the global financial crisis and the recent fall in commodity prices, foreign investment fell off considerably. Carefully crafted strategies, including international investment fora, to attract FDI, can play a useful role.

Since the change in government last year, the delay in getting new capital projects, such as, the south highway extension off the ground has not helped the situation. Prospects should improve with recent initiatives and as global conditions gradually improve. Because government's portion of total investment is the largest component, the recent calls for greater capital expenditure on the part of the government, are not misplaced. In the context of the slow growth of FDI, public sector investment has a critical role to play in restarting growth. One would hope that these expenditures get off the ground as quickly as possible.

The point should not be lost. Government capital expenditure often "crowds in" private investment. This means that domestic private sector investment often depends on government expenditure on infrastructure, say. Contrary to some comments on the domestic situation relating to the presumably risk averse domestic private sector, the pattern of government expenditure leading private investment expenditure obtains globally. Witness the current debate in the USA, where that country's government continues to spend in order to "crowd in" private sector investment in that economy.

It is not too difficult to see that each component of investment has its own unique drivers. For example, foreign investment depends on the specific energy tax regime and perhaps more importantly, global demand as well. Domestic private sector investment depends essentially on domestic demand. Government investment expenditure depends on government revenues or the cost of borrowing. But there are some cross-cutting issues as well, such as, the quality of the overall business environment. A friendly business climate will promote investment while a hostile one discourages it. A proactive approach compared to a laid-back approach will have the same positive effect on investment.

Much of the above relates to other Caribbean states as well. Small economies, with or without mineral resources and small domestic markets, are at a particular disadvantage in the competitive world of investment attraction. But we are not without hope. We however need to be far more appreciative, creative and strategic in our approach to investment if we are to re-ignite growth and ameliorate the social conditions which are dependent on strong growth.

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