Republic Economic Newsletter

Mar 2013 Vol. 21 - No. 2 ISSN 1027-5215

Still Not Quite There

Overview

In the third quarter, the Trinidad and Tobago economy performed better than we anticipated in our last issue *Economic Turnaround? Not Just Yet* – December 2012. According to Central Bank estimates, the economy grew by 1.5 percent year-on-year. Growth was driven by a rebound in the energy sector, following significant oil and gas price declines three months earlier, as well as a surge in non-energy activity following the resumption of cement production at Trinidad Cement Ltd (TCL). A repeat of this performance in the fourth quarter is not expected, as relative conditions have moderated appreciably since then. Republic Bank estimates fourth quarter economic activity contracted by 1 percent compared to the third quarter. While growth continues to be constrained by the recurring problems of declining energy production and slow rollout of major projects, indications suggest some improvements are likely over the short to medium term. Unemployment is estimated to have remained the same at 5.5 percent, with overall credit demand remaining tepid.

Trinidad and Tobago Key Economic Indicators

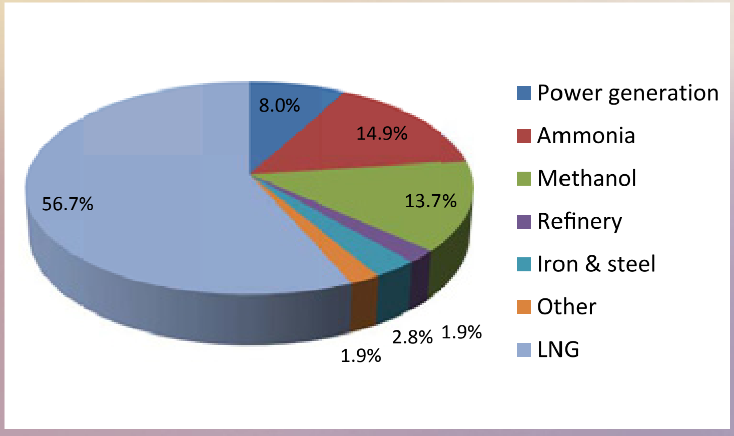
Indicator	2011	2011.4	2012.4 p/e
Real GDP (% change)	-2.6	0.4	-1.0
Retail Prices (% change)	5.2	1.2	1.5
Unemployment Rate (%)	5.3	4.2	5.5
Fiscal Surplus/ Deficit ($M)	-1,039.3	3,018.80	-6.10
Bank Deposits (% change)	13.8	6.6	7.9
Private Sector Bank Credit (% change)	1.9	1.0	-2.4
Net Foreign Reserves (US$M)	11,590.50	11,590.50	11,638.30
Exchange Rate (TT$/US$)	6.37/6.43	6.37/6.43	6.37/6.44
Stock Market Comp. Price Index	1,012.87	1,012.87	1,064.98
Oil Price (WTI) (US$ per barrel)	99.86	93.99	87.96
Gas Price (Henry Hub) (US$ per mmbtu)	4.00	3.32	3.40

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 in the fourth quarter was mixed. However, while its various segments registered different levels of success, the trends that were evident earlier in the year generally held sway. Upstream activity remained strong, with rig days and depth drilled growing by 32.3 percent and 77.8 percent respectively, compared to the third quarter. Natural gas prices increased to US$3.40 per mmbtu (Henry Hub) but oil prices declined noticeably, with the average fourth quarter price of US$87.96 per barrel, over US$4 less than the US$92.24 of the third quarter. At 80,173 barrels per day, oil and condensate production declined by just 1 percent this time around, but gas production fell away by 9.3 percent. The petrochemical production problem persisted with both ammonia and methanol registering double digit declines of 12.1 percent and 10.8 percent, respectively. While methanol exports also suffered (-13.7 percent) ammonia exports grew by 1.5 percent. Interestingly, besides being traditionally the largest consumer of natural gas (Figure 1), LNG was also the quarter's best performer, with a decline in production of just

Figure 1: Natural gas usage in 2012



Source: Ministry of Energy and Energy Affairs

0.4 percent, along with a 7.5 percent increase in sales and deliveries. As disappointing as the energy sector's production and export levels were in the quarter, they were in fact reflective of the year as a whole, as can be seen in the Energy Sector 2012 Scorecard (Table 1).

Table 1: 2012 energy sector indicators compared to 2011

Energy Sector 2012 Scorecard	
Up	Down
Depth drilled – Up 2.9%	Oil & condensate prod. – Down 11.1%
Rig days – Up 27.4%	Gas production – Down 1.8%
LNG Production – Up 1.2%	Methanol production – Down 7%
LNG sales and deliveries – Up 3.6%	Methanol exports – Down 4.2%
	Ammonia production – Down 4.1%
	Ammonia exports – Down 4%

Source: Ministry of Energy and Energy Affairs

While the paucity of downstream development and construction continued, a number of initiatives were made public in recent months that augur well for both upstream and downstream activity over the medium term. Work continues behind the scenes on plans to export T&T's gas to Caribbean states. While a definitive decision on the method of transport has not been made, all options are being looked at, with the various interests (pipeline, CNG and LNG) all pressing their case. At the Trinidad and Tobago Energy Conference in January, the National Energy Corporation disclosed plans to enter into an agreement with the Mitsubishi Corporation of Japan and T&T's Neal and Massy, for the construction of a Methanol to Dimethyl Ether (DME) plant in 2014. The company also revealed its intention to market this country's energy services regionally to countries like Guyana and Suriname, as well as to a number of African states. Also, the Energy Minister announced that new land and deep-water bid rounds would be launched in the coming months.

Non-Energy

After a strong showing in the third quarter with growth of 3.4 percent over the second quarter, the non-energy sector is believed to have slowed in the final three months of 2012. The distribution sector likely grew in the fourth quarter, as strong third quarter sales growth in dry goods, household appliances and furniture, would have carried through to December. Anecdotal evidence suggests the third quarter surge in manufacturing and construction activity that would have come about following the return to normal operations at TCL, waned at year's end. A 3.9 percent decline in the Index of Retail Prices of Building Materials in the fourth quarter, points to a reduced level of construction activity.

Fiscal Policy

The state registered a smaller-than-budgeted deficit of $1.78 billion for the 2011/2012 fiscal year, representing just over 1 percent of GDP. While extensive recent data is not yet available, in the first quarter of the 2013 fiscal year (October–December 2012), expenditure marginally exceeded revenue by an estimated $6 million. This was not entirely surprising, given the relatively low revenue that would have resulted from lower oil prices and generally lacklustre production and export levels in the energy sector in the quarter.

Monetary Policy

After peaking in midyear, inflation moderated in the fourth quarter. After a year-on-year increase of 9.4 percent in October, prices increased by 8.1 percent in November and 7.2 percent in December. Overall, average prices in 2012 were 9.3 percent higher than they were in 2011. While this was higher than the Central Bank's revised projection of 7 percent, it appears the Bank found inflationary pressures to be sufficiently contained and as a result maintained the 'Repo' rate at 2.75 percent in its March 22nd media release.

In spite of this, a high-liquidity environment persisted with deposit growth of 7.9 percent in the quarter, occurring in tandem with a 2.4 percent decline in borrowing by the private sector. Nonetheless, the $23,227 million outstanding private sector loan balance in December 2012 was still 1.9 percent higher than the corresponding 2011 figure. Consumer loans remained positive with growth of 4.2 percent in the quarter.

The second phase of payments to HCU stakeholders began in November. As part of its commitment to CLICO depositors, the Government also launched the CLICO Investment Fund (CIF) on November 1st. This facility allowed depositors with outstanding balances above $75,000, to trade their zero coupon bonds for CIF units made up of a minimum of 70 percent Republic Bank shares along with government securities. Activity remained sluggish with the Composite Price Index reaching 1,064.98 at the end of December, virtually unchanged from September, and just 5.1 percent higher than the year-ago figure. Notwithstanding instances of system-wide tight foreign exchange conditions, that arise when strong demand and supply do not occur in sync, net foreign reserves ended the year at a healthy US$11,638.3 million, up from the September balance of US$11,375.2 million.

Outlook

The economy's growth prospects hinge on developments in both the energy and non-energy sectors. The upstream segment of the energy sector will continue to be buoyant with ongoing drilling and exploration activity. Petrochemical and energy production will continue to be inconsistent over the short term with no immediate halt to the decline in oil production. While a number of plans and projects are in the pipeline, it is unlikely that any major new project will break ground during the first half of 2013. It seems that the government will have greater success executing its infrastructure development going forward; however, significant activity is unlikely before the second half of this year. In the near-term absence of the major push factors in energy, construction and manufacturing, it is doubtful that current activities will achieve the critical mass needed to realize solid economic growth. Hence the growth prospects for the T&T economy are likely to remain muted over the next four to five months but should improve by year's end.

Caribbean Update

Caribbean Faces Uphill Battle

With the mixed performance of the Caribbean region in 2012, countries continue to grapple with difficult economic conditions. Natural resource dependent countries received a boost in their revenues, as commodity prices remained generally high. Other countries were less fortunate, as the downward trend in their all-important tourism sectors persisted, due to lacklustre performances in major source markets, the US and UK. While the International Monetary Fund (IMF) in its October 2012 *World Economic Outlook* (WEO) estimated a 3.5 percent growth for the Caribbean in 2013, this seems optimistic in the context of the economic challenges and restrictive debt facing some Caribbean countries. The road to recovery seems longer than expected although the IMF in its January 23rd 2013 update to the WEO predicts global growth will strengthen this year.

Guyana

Guyana's economy is expected to register a 3.3 percent real GDP growth for 2012, on the back of improved performances in the rice, bauxite, gold, manufacturing and the services industries over the first three quarters of the year. Gold output for the first nine months of 2012 approximated 9.75 tonnes and represents a 22.28 percent increase from the same period in 2011. Production of gold continued on its upward trend in the fourth quarter, with revenue from this sector also boosted by higher prices. In contrast, output of sugar declined by 22.9 percent in the third quarter and likely continued on the same trend for the rest of 2012. Gross fixed investment is likely to have been boosted as a result of several major mining investments and continuing work on a large hydroelectric project at Amaila Falls in western Guyana. Anecdotal information indicates the sugar industry is likely to be an important driver of growth for 2013, although it performed poorly in 2012. Assuming global commodity prices remain high and major producing sectors are not affected by weather-related hazards, Guyana's economy should continue to deliver a strong performance over the next three to six months.

Barbados

Following growth of 0.2 percent for the first nine months of 2012, economic activity slowed in the fourth quarter as real output for the year remained flat. The main causes were a decline in manufacturing, tourism and other traded services. Tourist arrivals from the US and UK fell by 8.8 percent and 9.0 percent respectively, whereas the manufacturing sector contracted by 4.9 percent in 2012. On a positive note, production of sugar and milk increased by 4.4 and 5 percent, respectively for the same period. While the unemployment rate increased slightly to an average rate of 11.7 percent over the first nine months of 2012, the inflation rate fell to 6.5 percent at the end of September 2012. Barbados' foreign exchange reserves increased to BDS $1,467.1 million representing 18.1 weeks of import cover at the end of December 2012. According to the Central Bank of Barbados (CBB) the government's gross debt-to-GDP ratio is estimated to have increased to 83.1 percent at the end of December 2012 from 80.2 percent at the same point in 2011. Despite ongoing political and economic challenges faced by Prime Minister Freundel Stuart and his Democratic Labour Party (DLP), they emerged victorious by a narrow margin, winning 16 out of 30 seats contested during the February 21st general election. The Barbados government is likely to infuse a stimulus package of BDS $600 million into the economy in April 2013. While this may do little to stimulate growth in the next three months, it should have a strong positive impact towards the end of the year as the stimulus takes effect.

Grenada

According to the Eastern Caribbean Central Bank (ECCB), Grenada's economy grew by less than 1 percent for the first half of 2012. The country's agricultural sector continues to perform strongly with an increased contribution to GDP from 5.2 percent in 2007 to over 7 percent in 2012. In contrast, nutmeg production fell by 41.0 per cent (127.7 tonnes) over the period January to June 2012. Activity in construction and manufacturing declined in the first 2 quarters of 2012 and recent data indicates visitor arrivals also fell by some 19.5 per cent to 231,953 in the same period. Grenada is currently being sued by China's Export-Import Bank over an outstanding loan of US$32 million. This is in addition to the US$30.5 million owed to Taiwan's Export-Import Bank. On the same note, the country was further downgraded by Standard and Poor's (S&P) from CCC+/C to Selective Default (SD) after they failed to make payments on March 15th 2013 towards the US$193 million debt due in 2025. On the political front however, the New National Party (NNP) led by Dr. Keith Mitchell won by a landslide, winning all of the 15 seats in Grenada's general election on February 19th 2013 against the incumbent National Democratic Congress (NDC). Already faced with liquidity problems, Prime Minister Keith Mitchell will also encounter significant challenges in stimulating growth in the next few months.

Cuba

Cuba registered a 4.5 percent year-on-year increase in tourist arrivals amounting to approximately 2.8 million visitors in 2012. This, coupled with increased nickel and rice production, is likely to help the island achieve the 3.1 percent economic growth for 2012 as estimated by the Economic Intelligence Unit (EIU) UK. Tourist arrivals are likely to receive a boost this year, as Chile's PAL Airlines introduced weekly flights to the Cuban tourist centre of Varadero in January 2013. The country stands to benefit from the lease of eight jets worth approximately US$650 million, as well as the partial debt forgiveness of US$30 billion from Russia. While the exit visa for Cubans leaving the country was removed on January 14th 2013, significant barriers to nationals leaving Cuba still exist in the form of high travel costs and entry-visa requirements. In the meantime, President Raul Castro was re-elected by the National Assembly in February 2013, making this his second (five-year) term in office. Following the death of President Hugo Chávez, Cuba and Venezuela should continue to maintain their mutually beneficial relationship in the short-term, however, it is uncertain to what extent this relationship will continue into the long run.

The Region

As the Jamaican economy is estimated to have declined by up to 1 percent in the last quarter of 2012, it is likely this performance was reflective of the entire 2012 period. Following the same trend, production of bauxite and alumina declined by 89.4 percent and 37.7 percent, respectively for the period September to December 2012. The hotel and restaurants sector contracted in the last four months of 2012, largely due to a decrease of 1.8 per cent and 3.7 per cent in total stop-over arrivals and visitor expenditure respectively, compared to similar periods in 2011. The high debt continues to be worrisome, reaching approximately 140 percent of GDP in 2012 and as such, the Jamaican government restructured its domestic debt via a swap of bonds known as the National Debt Exchange (NDX) in February 2013. This is the second such debt exchange in three years and is intended to reduce the government's interest burden by J$17 billion annually on local bonds and, over the long term, ease its debt as a share of GDP. As a result of the NDX, Jamaica's sovereign local and foreign currency credit rating was lowered by S&P from B-/B to SD. After the NDX, however, S&P raised its long-term credit rating to CCC+ from SD while Moody's Investor Services downgraded its foreign currency credit rating from B3 to Caa3 in March 2013.

In Belize, Prime Minister Dean Barrow announced in March 2013 that plans to restructure the country's US$544 million debt, were successful and projected a decrease of approximately US$249.97 million in debt servicing over the next 10 years. This stems from the failure to make a US$23 million coupon payment on its bonds in August 2012, for which Belize was subsequently downgraded by S&P to SD. The OECS countries continue to face severe headwinds as performance in their main sectors declines, amidst weak global economic conditions. Antigua and Barbuda was the only OECS country to record growth over 1 percent, while St Kitts and Nevis, St Lucia, St Vincent and the Grenadines and Dominica were all estimated to have grown ranging between -1.0 to 1.0 percent in 2012. High debt-to-GDP ratios together with high food prices and fuel costs continue to compound the harsh economic realities felt by these countries. Suriname on the other hand continues to perform strongly with an estimated growth of 4 percent for 2012 according to the IMF. This performance is likely to continue over the next three to six months.

Outlook

As the prices of food, minerals and metals are expected to remain high, Cuba, Suriname and Guyana should continue to do well over the next six months. Tourism-dependent countries will continue to be challenged in the short-term, due to decreased tourist arrivals and spending, which is likely to be prolonged because of weak growth in the US and UK. While most countries in the region continue to grapple with heavy debt burdens and high unemployment, it is likely that some of these countries may before long, have to return to the IMF for financial assistance.

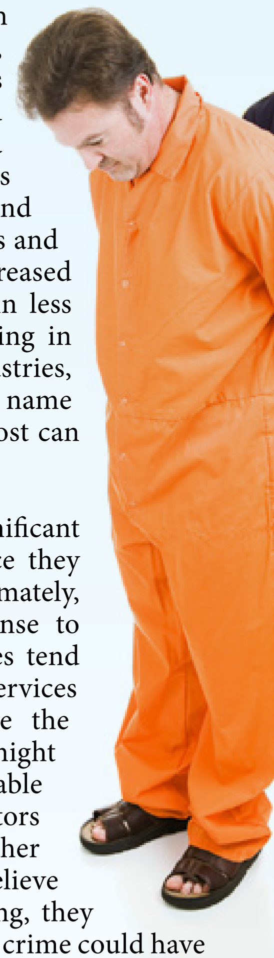
The True Cost of Crime

At the recently concluded CARICOM Inter-Sessional Meeting, Prime Minister Kamla Persad-Bissessar announced that crime results in a $200 million per year loss of tourism revenue for Trinidad and Tobago. While this is alarming, the real terror lies in the fact that this loss pertains to only one sector. Indeed it would be a useful, if not necessary exercise to derive an approximate value for the total losses attributable to criminal activity, in other sectors of the domestic economy.

It has long been recognized that crime imposes huge costs on an economy, since at high levels, it undermines commercial activity and ultimately a country's gross domestic product (GDP). This was highlighted in a 2007 report titled *Crime, Violence, and Development: Trends, Costs, and Policy Options in the Caribbean* produced jointly by the United Nations Office on Drugs and Crime (UNODC) and the Latin America and the Caribbean Region of the World Bank. The report found that Haiti and Jamaica could each boost annual economic growth by 5.4 percent, if they were able to reduce their homicide rates to 8.1 per 100,000 population, the average in Costa Rica during the period 1996 to 2000. Around that time, the homicide rates in Jamaica and Haiti were well over 30 per 100,000 population. The report also asserted that a similar reduction in the homicide rates for Guyana and the Dominican Republic has the potential to boost GDP by 1.7 percent and 1.8 percent, respectively. Although a similar calculation was not done for Trinidad & Tobago, if we apply the same formula and assume a 1.7 percent potential GDP increase, the economy stands to gain $2.6 billion by reducing the murder rate, which was 29 per 100,000 population in 2012 (Table 2).

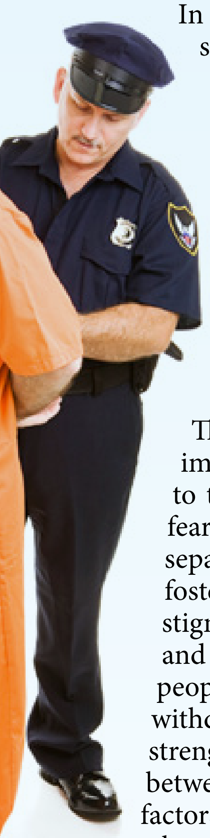
Although the UNODC/World Bank report focused on murder, other forms of illegal activity, including white-collar crime, cause considerable disruption to economic activity. However, loss of GDP alone does not adequately capture all the costs high crime rates inflict on society, since the burden goes beyond financial slippage to include social and psychological costs. This note discusses some of the financial costs to government, business and citizens before evaluating some of the social and psychological costs.

A spiraling crime rate over an extended period would cause government to increase its expenditure on preventative and remedial measures to address crime. This involves augmenting human resources within the protective services, acquiring more vehicles, equipment and the latest technology, while upgrading infrastructure. A high crime rate also places greater demands on hospitals, clinics and medical staff, as well as forensic staff and facilities. As such, government would also need to take action to boost the capacity and resources in these areas as well. Another area of government responsibility that is affected by high crime rates is the social welfare system, which is required to treat with the victims and perpetrators of crime. Increased government expenditure in this area would be associated with such things as the provision of detention centres and rehabilitation programmes for offenders and counseling and shelters for victims. Increased expenditure to combat crime, results in less funds being made available for spending in other areas like developing new industries, education, research and development, to name a few. In this regard, the opportunity cost can be very high.



Unsustainable crime rates create significant uncertainty and can act as a tax, since they tend to drive up security costs and, ultimately, the cost of doing business. In response to widespread criminal activity, businesses tend to invest more heavily on security services and equipment. The need to enlarge the security budget, in many instances, might mean that less capital would be available for investment purposes, causing investors to forego planned expansion and other opportunities. However, if investors believe the effects of crime are too destabilizing, they may simply go elsewhere. In this regard, crime could have a deleterious effect on domestic investment and, hence, growth.

Crime causes citizens to take on additional expenditure as they seek to protect their two main assets, houses and vehicles. Naturally, there is an opportunity cost to such expenditure. Yet, crime imposes several other opportunity costs on citizens. People may avoid making conspicuous purchases such as jewelry and high-end vehicles in order to avoid attracting criminals. This undermines a person's ability to enjoy the fruits of his/her success. Crime also results in indirect costs for citizens. While some may opt to spend less on some purchases in an attempt to 'fly under the radar' so to speak, pervasive crime can also have the opposite effect of causing some people to spend more than they planned, or would have liked to, on major acquisitions. For instance, many people pay a premium for homes in gated communities or in areas that are perceived to have less criminal activity. On a national level, this often results in developments or even whole communities commanding high prices. On the other hand, communities that are plagued by high levels of crime, tend to have depressed property values and a lingering stigma. To escape all this, some nationals opt to migrate to countries that are deemed safer, hence resulting in loss of skills and knowledge.



In a very warped way, crime does in fact generate some economic activity. As can be gleaned from the costs described above, rising crime increases business for technology companies, security agencies and a host of other commercial enterprises. This increased business activity undoubtedly has benefits for the individuals concerned and contributes to the economy. However, few, if any, would argue with a scenario where expenditure could be shifted from these areas to other more positive and progressive ventures.

The social costs of criminal activity refer to the impact of crime on society. One such cost pertains to the strain crime can put on social cohesion. The fear of crime does not only encourage a geographic separation in terms of where people live, but it also fosters a social dichotomy between the people from stigmatized neighbourhoods (who tend to be poor) and those from other communities. This is because as people feel more threatened, there is the tendency to withdraw within one's perceived group. While this may strengthen intra-community bonds, it widens the gaps between communities. Social cohesion falls away as factors such as class and geographic area, cause citizens to become increasingly wary of each other. In addition to the loss of life, murder inflicts other harsh consequences on society. For instance, children may grow-up parentless or a family may lose its main income earner, thereby subjecting its members to financial hardship. In the case of the murder of the elderly, society is robbed of valuable experience. The abuse of a child could lead to lifelong challenges for the victim and many undesirable consequences for society. By overwhelming the very institutions established to treat with it, high crime levels also can have a self-sustaining component. As the protective services and the justice system become stretched in dealing with higher incidences of criminal activity, inefficiencies increase, which in turn facilitate other criminal activity. Court matters stretch on for years, sometimes leaving the innocent to languish until their name is cleared, and the guilty free to commit other acts. Less attention is paid to perceived lesser crimes as the police grapple with the more serious ones.

Table 2: Murders per 100k population in the Americas

Honduras	92
El Salvador	69
Venezuela	45
Jamaica	40
Guatemala	39
Colombia	31
Trinidad & Tobago	29
Mexico	24
USA	5
Canada	2

Source: Taken from T&T Guardian 17/03/13
Latest year (most are 2010 or 2011)

The psychological costs of crime relate to its negative impact on the mindset of the various segments of society. Many people find it difficult to deal with the pain of having a family member, friend or co-worker injured or killed as a result of a violent attack. Such occurrences, together with a flood of reports on violent criminal activity, can generate immense fear and unease among citizens. Accordingly, many may restrict the time they spend away from their homes, becoming prisoners in a sense, as they forfeit much of their right to freedom of movement.

Crime has many unpleasant direct and indirect consequences, not just for victims, but for the wider society. These undesirable outcomes include loss of income for families, GDP levels that fall below potential and fractures in the social fabric, as communities lose members and restrict contact with each other. Unfortunately, this is by no means an exhaustive list. The cost of crime to the economy is likely to be far more than $200 million. By our estimation, based on the UNODC formula, this country's high murder rate alone could have ostensibly cost some $2.6 billion in 2012. Sadly, without clear leadership and a firm partnership among citizens, government, business and all other institutions, the situation could yet grow worse.