Republic Economic NEWSLETTER

September, 2011 Vol. 19 - No. 4 ISSN 1027-5215

Crime in a Stagnant Economy: Will the SoE Help?

Overview

Preliminary indications are that the Trinidad and Tobago (T&T) economy experienced its second quarterly decline in real output to June, 2011. Republic Bank forecasts, the decline of 1.7 percent in the first quarter of the year, was followed by another contraction of 2.7 percent in the following quarter. This performance occurred against a backdrop of lethargic government spending, and a decline in business credit. Notwithstanding this environment, the domestic stock market continued to improve as interest rates on alternative financial assets remained low. Strong energy prices also characterized the quarter. Food inflation contracted further and had a positive impact on the overall inflation rate. Republic Bank projects that the unemployment rate was approximately 6 percent in the second quarter of 2011. While the third quarter is expected to show minimal growth, the State of Emergency (SoE), which was declared by the Government on August 22, 2011, is expected to put a substantial damper on fourth quarter gross domestic product (GDP).

TRINIDAD AND TOBAGO KEY ECONOMIC INDICATORS

INDICATOR	2010	2010.2	2011.2 p/e
Real GDP (% Change)	-0.6	-1.2	-2.7
Retail Prices (% Change)	10.5	9.1	-0.3
Unemployment Rate (%)	6	4.8	6
Fiscal Surplus/ Deficit ($M)	-308.2	3,457.8	Surplus
Bank Deposits (% Change)	4.6	2.8	0.2
Private Sector Bank Credit (% Change)	-7	-2.8	-2.8
Net Foreign Reserves (US$M)	10,709	10,841	10,918
Exchange Rate (TT$/US$)	6.32/6.38	6.32/6.37	6.38/6.43
Stock Market Comp. Price Index	835.64	827.2	950.09
Oil Price (WTI) (US$ per barrel)	79.4	77.79	102.22
Gas Price (Henry-Hub) (US$ per mmbtu)	4.52	4.32	4.37

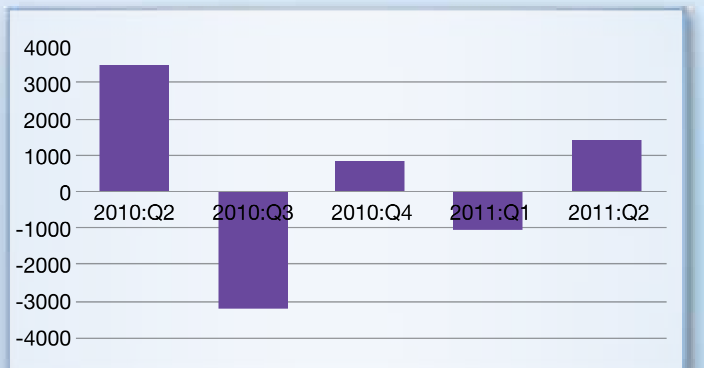
Source: - Central Bank of Trinidad and Tobago, TTSE, EIA
p - Provisional Data
e -Republic Bank Limited Estimate

Energy Sector

While energy prices were high, energy sector output was still weak during the second quarter of 2011. Output of crude oil fell to 93,571 bpd in the second quarter, down from 96,865 bpd in the previous quarter while natural gas output increased from 4.2 bcfpd in the first quarter to 4.4 bcfpd in the second quarter of 2011. Oil prices rose from US$93.50 per barrel in the first quarter of 2011 to average US$102.22 per barrel in the second quarter, due mainly to the political turmoil in the Middle East, where the world's largest energy suppliers are located. Gas prices also increased to US$4.37 per mmbtu in the second quarter, up from US$4.18 per mmbtu in the previous quarter.

Meanwhile, the Ryder Scott Audit Report 2010 indicated a 6.6 percent decline in this country's gas reserves to 13,460 bcf. This means that if no new finds are made and at current usage levels, T&T has just over nine years of natural gas left. After

Figure 1. Central Gov't Fiscal Surplus/Deficit (TT$M)

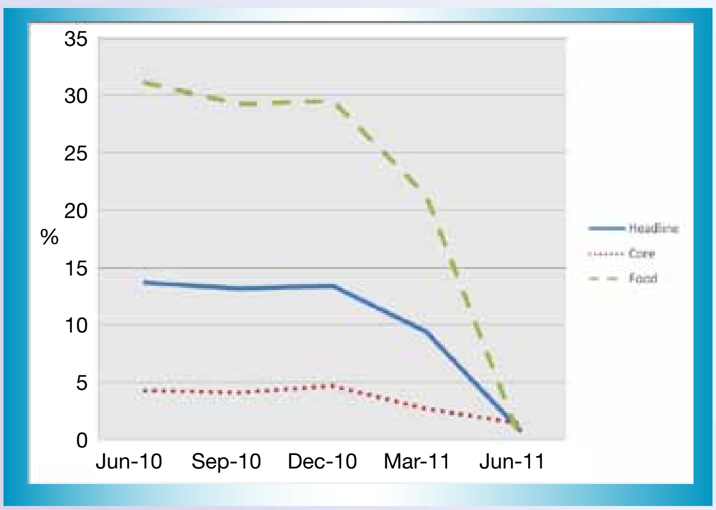


Source: Central Bank of Trinidad & Tobago (CBTT) much delay, the Government awarded 6 contracts for the year so far, and has signaled another bidding round before the end of 2011. Industry sources opined that four gas prone blocks, NCMA 2, NCMA 4, NCMA 3, 4(b) and the two blocks recently awarded to BP Trinidad and Tobago (BPTT) could potentially lead to new gas discoveries.

Fiscal Policy

The central government recorded a fiscal surplus of $1.23 billion for the first three quarters of the 2011 fiscal year, as spending was much lower than anticipated (Figure 1). Lower government spending was due to administrative delays and lower than expected interest payments. However, capital expenditure began to pick up in the months of May and June, with the initiation of works on the extension of the Solomon Hochoy Highway to Point Fortin, among other projects. The Minister of Finance recently stated that the revised budget deficit for the fiscal year 2011 is expected to stand at $8.5 billion or 5.8 percent of GDP. A new national budget is expected in mid-October, 2011 and expenditures could ramp up towards the end of 2011, as capital projects get off the ground. Given the recent increase in the country's debt ceiling, the national debt level (excluding debt issued for open market operations) is likely to rise from the existing $52.2 billion or 35.7 percent of GDP.

Figure 2. Inflation (y-o-y)



Source: CBTT

Monetary Policy

Headline inflation fell unexpectedly to 0.8 percent, year-on-year to June 2011, as food inflation, which is the main contributor to the Retail Prices Index, fell precipitously to 0.1 percent. Inflation rates declined rapidly for the first six months of 2011after remaining high for the latter half of 2010 (Figure 2). However, food inflation rose slightly in July as the price of bread, cereals, fruits and fish all went up. The decline in headline inflation in the context of negative economic growth would no doubt have influenced the Central Bank to reduce the "Repo" rate by another 25 basis points to 3 percent, in the month of July.

Consumer and mortgage credit continued to see growth in June but business credit has been lagging, as this component recorded another contraction of 1.5 percent, year-on-year to June 2011. Looking ahead, borrowings are expected to be adversely affected by the extended State of Emergency, which is expected to end in the first week of December, 2011. The retail sector, which includes distribution, hotels and restaurants, transport, among other non-energy sector businesses, is expected to suffer reduced sales.

Stock Market

The domestic stock market continued to gain momentum, as the Composite Price Index climbed from 872.08 in March to 976.49 in August, a 12.0 percent increase. This steady improvement in trading prices is directly related to the low interest rate environment. However, trading activity has remained surprisingly low, as 45.7 million shares were traded in the first six months of 2011 compared to 46.7 million shares in the same period of 2010. On the other hand, the US stock market did not fare as well, as the NASDAQ declined between March and August of this year by 7.25 percent.

Reserves

The country's stock of net foreign reserves increased marginally to US$10,918 million in the second quarter of this year, up from US$10,800 million in the previous quarter, mainly due to buoyant oil prices. Nevertheless, evidence shows that the demand for foreign currency continues to climb. Central Bank sales of foreign exchange to authorized dealers were 25 percent higher in the first half of 2011 when compared to the same period in 2010. This may partly explain the marginal, nominal exchange rate depreciation from an average selling price of TT$6.37 to US$1.00 in the second quarter of 2010 to TT$6.43 in the second quarter of this year.

Outlook

The Trinidad and Tobago economy is projected to have slowed further in the second quarter of 2011 and this trend might have only marginally improved in the third. As far as non-energy output is concerned, no increase is expected in the final months of this year. Such weak performance is not surprising when considered against the backdrop of weak private investment and a fiscal surplus on the Government's account for much of the earlier part of this year. An accommodative monetary policy, in the form of low interest rates, has been only partly successful in providing some support to consumer and real estate mortgage lendings but not to businesses. The global economy, which seemed to have been emerging from the 2008 financial crisis, is now reeling from the European Union's debt crisis and the recent US debt-rating downgrade, which threaten to precipitate a second recession.

In the context of a high murder rate of 281 as of September 18, 2011 and a recent spike in gang related crime, the Peoples Partnership Government deemed it necessary to impose a State of Emergency. This will adversely impact the non-energy sector in the final months of this year, but hopefully will lead to a considerable reduction in the level of crime, which has itself imposed a major cost on business and society. As the country enters the final three months of this year, the energy sector is expected to benefit from increased exploration activity with six exploration contracts recently awarded. This will certainly provide some welcome stimulus. So too, it is hoped, will the 2011/2012 National Budget, as the country needs to be put on a growth path as soon as possible.

Caribbean Update

Deteriorating International Conditions Point to a Slow-down for Regional States

Overview

With the current high food and commodity prices, Caribbean economies with vibrant agriculture and mining sectors have received an economic fillip, while the net importers of these commodities have struggled in the face of spiraling import costs. With economic growth slowly taking hold in much of the developed world, travel activity began to pick up in the region, and those countries reliant on tourist spending slowly began to recover ground that was lost over the last three years. However, persistent debt problems in Europe and declining consumer confidence in the United States, exacerbated by high unemployment and a humbling credit rating downgrade, have altered both the international and regional outlook for the second half of 2011. The current economic slowdown in the US, UK and Europe has, not surprisingly, dampened short term growth prospects the world over, with worrying consequences for the Caribbean.

Barbados

The Central Bank of Barbados estimates that the island's economy grew by 2.1 percent in the first half of this year, driven largely by a 5 percent growth in tourism. The sector was boosted by increased arrivals from key source markets Germany, the United States and the United Kingdom. Despite this, revenue generation from the sector continues to be challenged by reduced spending by visitors. Barbados' current account deficit increased as imports grew while exports declined in the first half of the year. Corporate tax receipts in April and May were less than half that of the 2010 equivalent, suggesting that some locally domiciled companies are struggling and profits are down. Nonetheless, unemployment declined in the first quarter, falling from 10.5 percent in December 2010 to 10 percent in March. Faced with declining revenues, the authorities have curbed spending, managing to reduce expenditure as a percentage of GDP to 26.1 percent in May. Still, the island's debt situation remains worrying with its debt to GDP ratio at 103 percent in June. During this period, the country's domestic currency sovereign debt rating was lowered to Baa3 by Moody's. Barbados recently received financing from the Caribbean Development Bank for the Urban Renewal Programme that will see closed circuit TV systems installed in Bridgetown and St. Lawrence Gap. The lift provided thus far by tourism may start to fade by year's end as protracted problems in key source markets dampen arrival numbers and restrict spending even further.

Cuba

In early August, Cuba's national assembly passed President Raul Castro's plans to reform the economy, which includes cutting more than 1 million state jobs and relaxing private sector regulations to allow many of the displaced workers to make a living via this route. Despite being in the works for a number of months, the transition has been slower than anticipated, contributing to weak GDP growth. Cuba's economy expanded by 1.9 percent in the first half of 2011, with a solid contribution coming from tourism. Visitors to the island grew by 10.6 percent in the January to June period compared to the 2010 equivalent period, and arrivals are expected to remain strong for the rest of the year. With strong increases in visitors from Russia, Chile and Colombia, Cuba is much less reliant on the Caribbean's traditional tourist source markets and has a much more diversified base than its neighbours. Cuba's main exports, while contributing economically, continue to underperform, hampered by sanctions and years of underinvestment by the authorities. Nickel, the country's largest commodity export continues to enjoy relatively high prices by historical standards. Sugar production has increased, with reports indicating that the 2010/2011 harvest, which ended in May, was much improved compared to the 2009/2010 crop. With government increasing the price received by producers, sugar production is likely to continue rising in the short term. Cuba's tourism sector will be further strengthened over the next six months as increased US-Cuba flights are approved.

Grenada

The second review of Grenada's economic programme under the IMF's three-year extended credit facility (ECF) found signs that the island's economy was beginning to recover.Tourism activity picked up in the first quarter of 2011, with reports suggesting a year-on-year increase in arrivals over 2010. Agricultural production was also expected to increase early in 2011 and preliminary reports pointed to a modest GDP increase of 1 percent for the first half of 2011. However, with agriculture yet to return to its former economic size, and with Europe and the United States accounting for 35 percent and 20 percent respectively of the island's tourist arrivals, Grenada is heavily reliant on the fortunes of these leading economies. Prime Minister Tillman Thomas, in a September national address, conceded that despite the country's improved economic management, its public finances are not yet on a sustainable track. He indicated that discussions on this matter with the International Monetary Fund (IMF) are ongoing, with a mission by Fund representatives to St. Georges likely in October. The Government of the People's Republic of China recently agreed to extend the repayment period on a series of loans to the Grenada government. Grenada's fledgling economic recovery is expected to weaken in the 2nd half of 2011, in the wake of deteriorating conditions in leading economies.

Guyana

Led by strong performances in agriculture (rice and sugar) and mining (gold and bauxite), Guyana's economy grew by 5.9 percent over the first 6 months of 2011. According to the Mid-Year Report by Guyana's Ministry of Finance, the first crop of rice and sugar were 23 percent and 30.5 percent, respectively higher than the 2010 equivalent. In the mining and quarrying sector, production of bauxite reached a total of 815,505 tonnes at the half year, an increase of 38.6 percent compared to the same period in 2010. Total gold production in the first half of 2011 was 163,413 ounces, an increase of 14.9 percent over 2010. The full year projection of 320,000 ounces represents 3.7 percent growth for the sub-sector. With gold prices hovering firmly above US$1,600 per ounce, strong revenue inflows are expected for the rest of the year. In the first half of 2011, export earnings expanded by 34.6 percent to US$533.1 million, reflecting stronger output performance in the commodity producing sectors of the economy, along with improvement in world market prices for most export commodities. In June 2011, Guyana's total external public debt amounted to US$1,110.9 million compared to US$1,042.7 million at the end of December 2010. Present conditions favour continued strong performance by Guyana over the short term. Its region-leading agricultural production and export base should be further strengthened by a recent Inter-American Development Bank loan to increase agricultural export diversification. While there is a risk that the local and general elections due later this year could cause some economic disruption, any impact is likely to be minimal.

Rest of the Region

After 13 consecutive quarters of contraction, Jamaica's economy expanded by 1.5 percent for each of the first two quarters this year. This continued growth is largely attributable to the goods-producing sector, which grew by just over 5.0 percent, led by the mining and quarrying sub-sector which grew by 31 percent. This trend is expected to continue throughout 2011. Following a pay increase for public officials agreed in July, the authorities will have to further curb spending in the 2011/2012 fiscal year to meet IMF targets. In August, the Minister of Transport and Works announced that shipping company, CMA CGM will undertake a three-year, US$100 million upgrade of a section of the Port of Kingston. High food and commodity prices continue to present a significant challenge to economic management in the OECS (Organisation of Eastern Caribbean States). Notwithstanding the flood damage suffered by St. Vincent in April, Mother Nature has been relatively benign thus far in 2011, facilitating some recovery in the islands' tourism sectors. While arrivals have not been high by historical standards, they have improved over 2010 levels and played a part in most states registering modest economic growth of 1 to 2 percent in the first half of 2011. Taiwan is increasing its impact in some OECS states, with a donation of 2,400 laptops to St. Kitts Nevis in August and construction of a US$40 million airport in St. Vincent and the Grenadines set to begin by October.

Outlook

For most countries, the end of 2011 will be markedly different from the first half. Guyana should continue its strong economic performance into 2012, on the back of high commodity prices and strong production. Jamaica should also receive some support from buoyant bauxite prices. For the tourism-based economies, while visitor arrivals may hold steady for the rest of 2011, Republic Bank forecasts that visitor numbers and spending will fall-off at the start of 2012, although Cuba should continue to do well in this area. Generally, the recovery of economies in the region, not unlike those in other parts of the world, will lose steam over the short term. Selected projects set to start in some countries could provide an economic lift, however it is likely that many Caribbean states could register negative growth in coming months.

Raising T&T's Debt Ceiling: Reason for Concern?

The recent move by the People's Partnership Government to increase the country's debt ceiling from $38.0 billion to $70.0 billion has caused considerable debate and trepidation. Among the issues raised in the debate were the use to which the funds were going to be put, whether the country's debt was already too high, whether the country would be able to repay the debt and the magnitude of the increase in the ceiling of $32 billion. This note attempts to clear up some of the confusion surrounding this country's debt and debt ceiling. It will also highlight Trinidad and Tobago's current debt position. Further, the note argues that once certain principles are followed, debt can be beneficial.

Table 1: Increases in T&T's Debt Ceiling (TT$)

Guaranteed Loans		Developed Loans		External Loans	
Previous Limit	**50 million**	**Previous Limit**	**13 billion**	**Previous Limit**	**50 million**
2003	9 billion	2008	20 billion	1972	75 million
-	-	-	-	1973	125 million
-	-	-	-	1977	1 billion
-	-	-	-	1979	5 billion
-	-	-	-	1989	6 billion
-	-	-	-	1993	9 billion
2011	25 billion	2011	30 billion	2011	15 billion

The debt ceiling refers to the maximum level of new debt that a country is legally permitted to incur. It is separate and apart from the country's stock of outstanding debt at any point in time. This country's debt ceiling was raised from an initial limit of $13.1 billion sometime prior to 2003 to $70 billion in 2011. The amount of the total debt ceiling can be disaggregated into Guaranteed Loans, Development Loans and External Loans (Table 1). This limit is set by Parliament and can only be increased with the appropriate Parliamentary approval. The presence of an official ceiling or level does not mean that the government will necessarily seek to acquire debt up to this point in a short period of time of say, one year. In any case the Government must come to the Parliament every time it seeks to borrow.

According to the Central Bank of Trinidad and Tobago, this country's public debt (excluding debt issued for open market operations) stood at $57.9 billion or 35.7 percent of GDP in March, 2011 and compares favourably to many of its counterparts in the region, the developing world and even with some advanced economies (Table 2). It comprises TT$24,812 million of domestic debt, TT$9,316 million of external debt and TT$23,817 million of contingent liabilities (Table 3). In terms of a threshold, several analysts agree that public debt levels beyond the 85 to 90 percent of GDP range are likely to impede economic growth. However, this does not mean that it is safe to allow public debt to rise to levels just below this point. In fact, policy makers are advised to contain public debt to a figure of not more than 60 percent of GDP. Our objective is merely to point out that there is some room for the government to safely increase its debt.

Debt is not necessarily bad, since it can help a country to enhance economic growth and improve the welfare of its citizens. For example, if borrowed funds are spent on the building of schools, employment and output are created in the construction phase and students are trained for jobs. In this way, their standard of living improves. Government may also use debt as a cushion when revenue inflows fall below desired expenditure. In so doing, the government is able to maintain some level of consistency in the delivery of its services and in the administration of its social programmes. Often however, it is true that expenditures should be cut rather than new debt incurred.

Normally, debt only imposes harsh consequences when it is allowed to reach unsustainable levels. In this instance, the divergence of significant financial resources from productive avenues, in order to make debt repayments can have a substantial negative effect on government's ability to stimulate economic growth.

Nevertheless, established rules of thumb exist, which if employed could significantly guide policy makers in their efforts to make borrowing beneficial rather than burdensome.

Table 2: Total Public Sector Debt to GDP (%)

	2008	2009	2010
Trinidad & Tobago	25.4	34.4	39.8
Barbados	97.3	110.7	113.7
China	17	17.7	17.7
USA	71.2	84.6	91.6

Source: IMF, World Economic Outlook, April 2011

Table 3: Total Public Sector Debt - TT$Mn

	March 2011
Central Government Domestic	24,812
External	9,316
Contingent	23,817
Total Debt	**57,945**

Source: CBTT (Excludes debt for Open Market Operations)

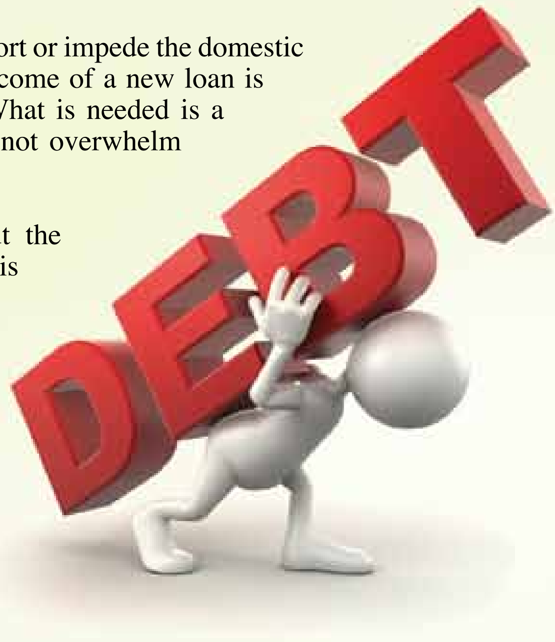
For example, the government's intended purpose for the addition to the country's debt stock is a very important consideration. This is so, since the use of borrowed funds to augment production capacity or to facilitate increased productivity through infrastructure upgrade could expand national income. This expansion of the economy would increase the wealth-earning capacity of Trinidad and Tobago and, as a consequence, allow the country to pay down outstanding loans more comfortably. On the other hand, if the new debt is used for questionable expenditures of a recurrent or capital nature, the economy is unlikely to benefit and would simply be saddled with higher debt levels.

Another factor relates to the projected return on the projects that are to be funded with loan proceeds. For instance, the extension of the South Highway to Pt. Fortin is expected to boost productivity by reducing traffic congestion and commute time in several areas. This should enhance productivity and may even open up new avenues for business activity. If, over time, the boost to productivity outweighs the cost of construction, then such an outlay is justified in economic terms.

A critical concern will be the country's ability to repay loans as they become due. Trinidad and Tobago's debt service ratio fell to 1.1 percent in 2010 from 4.4 percent in 2009. This means that this country pays just 1 cent of every $1.00 of export revenues to service its external debt. This is quite low by international standards. Revenue must be at a level that would facilitate repayment and also allow for the usual recurrent and capital expenditures. Any default on loans would negatively impact the country's credit rating and thereby raise the cost of borrowing for the domestic public and private sectors. Central to this issue is an appropriate scheduling of debt repayments. Proper financial management calls for debt to closely match revenue inflows in the short, medium and long term. Considerable mismatch in the timing of revenue streams and the loan repayment schedule could increase the likelihood of default.

The pace at which government chooses to borrow could also support or impede the domestic economy. If debt levels rise too quickly, and if the intended outcome of a new loan is to foster economic expansion, the opposite result may occur. What is needed is a measured approach that ensures that expenditure on debt does not overwhelm revenue inflows.

It should be clear, that there is nothing inherently bad about the acquisition of debt or increasing the debt ceiling. What is imperative is the prudent management of debt in respect of acquisition, disbursement and settlement. If any country's debt is allowed to rise to unsustainable levels or if debt rises too quickly or out of line with revenue inflows, there is likely to be a significant negative impact on economic growth. Channeling debt funds to productive activity could enhance growth, and the country's ability to meet its debt obligations. It is necessary for the government to ensure that its expenditure encourages the private sector to invest, thereby providing an additional boost to the domestic economy.



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