Republic Economic Newsletter

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Budgeting in a Weak Economy

Overview

The malaise of the domestic economy continued into the second quarter of 2012, with neither the energy nor non-energy sectors generating any real momentum. Mixed conditions in the energy sector likely led to its contraction, resulting in a fourth consecutive quarter of decline (Figure 1). The non-energy sector faced several challenges during the period, chief of which was the inability of government to get major construction projects off the ground. The tense industrial relations climate between April and June restricted productivity, as several bargaining bodies sought wage increases. In this environment, construction and manufacturing activity remained weak, offsetting the modest growth estimated for distribution. Overall, the domestic economy is projected to have contracted by 0.7 percent in the second quarter. Despite this, the rate of unemployment is estimated to have remained at 5.3 percent while inflation intensified during the period.

Trinidad and Tobago Key Economic Indicators

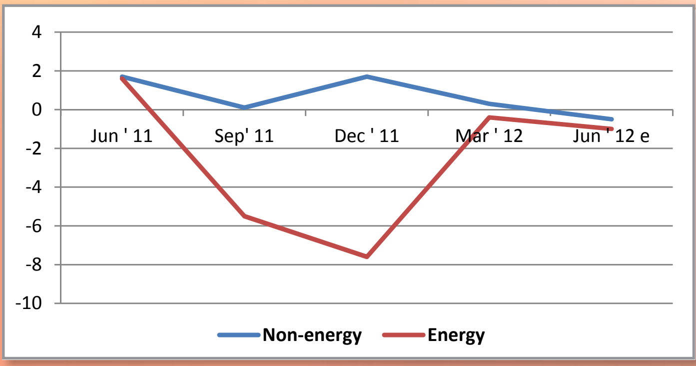
Indicator	2011	2011.2	2012.2 p/e
Real GDP (% change)	-1.4	1.7	-0.7
Retail Prices (% change)	5.2	-0.3	2.8
Unemployment Rate (%)	5.4	5.8	5.3
Fiscal Surplus/ Deficit ($M)	1,153	1,434.1	Surplus
Bank Deposits (% change)	14.1	0.2	0.4
Private Sector Bank Credit (% change)	6.5	-2.1	1
Net Foreign Reserves (US$M)	11,832.3	11,613.5	11,746.8
Exchange Rate (TT$/US$)	6.37 / 6.43	6.38/6.43	6.37/ 6.43
Stock Market Comp. Price Index	1,012.9	950.09	1,022.43
Oil Price (WTI) (US$ per barrel)	94.86	102.22	93.42
Gas Price (Henry Hub) (US$ per mmbtu)	4.00	4.37	2.28

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

Energy sector

The energy sector likely remained flat between April and June 2012, as oil prices fell to an average of US$93.42 per barrel from US$102.88 in the previous quarter. The slight increase in production from 82,480 per day to 83,184 was not sufficient to offset the loss of government revenue due to the fall in price. Gas production fell to an average of 4.1 billion cubic feet per day (Bcf/d) from 4.2 Bcf/d. The Henry Hub gas price averaged US$2.28 per million btu, down slightly from US$2.45 in the first quarter of 2012. Exploration activity cooled somewhat in the second quarter with the number of rig days falling to 678 from 814 in the previous quarter and depth drilled falling by 25 percent. The 2011 Ryder Scott audit of this country's gas reserves revealed that proven reserves fell marginally by 1.5 percent in 2011 to 13,257 Bcf, while probable gas reserves decreased by 21 percent. Based on current utilization rates and without consideration of any new discoveries, the country's reserves of natural gas are expected to last some 9 years. On the positive side, 12 energy companies bid for five of the six blocks on offer in the 2012 deepwater bid round, which closed in September 2012. This represents the most successful bid round in 14 years and injects some optimism into the sector. Successful bids should be announced on or before November 16.

Figure 1: GDP Growth (% change)



e -Republic Bank Limited Estimate

Fiscal Policy

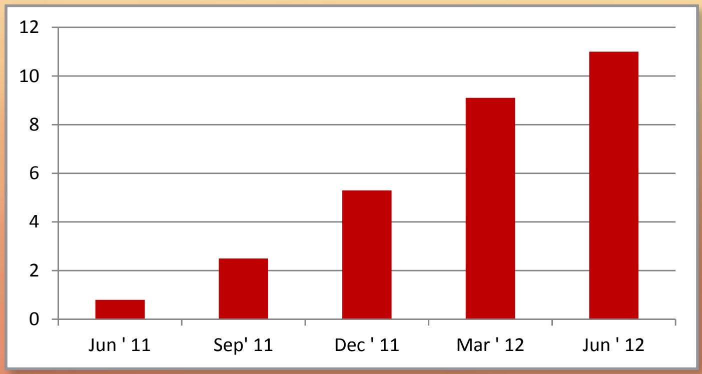
With still high oil prices and slightly improved output, government continued to be the beneficiary of strong energy revenues between April and June 2012. Given that the government has been unable to kick off most of its large projects, public expenditure has struggled to approach budgeted levels. In this regard, a fiscal surplus is expected for the period, following on a $207 million deficit in the first three months of 2012. The Minister of Finance is expected to present the 2012/2013 Budget on October 1st. His stated intention is to minimize waste in the public sector and return the economy to a growth path.

Monetary Policy

After reaching 9.1 percent, year-on-year in March 2012, headline inflation accelerated to 11 percent in June, but came down from its peak of 12.6 percent in May (Figure 2). Food prices, traditionally the largest component of inflation, accelerated by 24.1 percent in June, while core inflation remained fairly stable at 2.3 percent. Headline inflation eased slightly to 10.8 percent in July. However, core moved in the opposite direction to 2.8 percent. The Central Bank remains focused on stoking domestic economic activity and has left the "Repo" rate unchanged at 3 percent. Commercial banks' prime lending rate remained unchanged in the second quarter at 7.75 percent. Notwithstanding low interest rates, private sector credit remained weak, expanding by only 1 percent, up from a 0.4 percent contraction in the previous quarter and a 2 percent fall in the similar period in 2011. Consumer credit recorded fragile growth of 0.4 percent, while real estate mortgages expanded by 2.3 percent during the three-month period ending June 2012.

Unfortunately, the global grain shortages created by the current drought in the U.S. are anticipated to manifest themselves locally in the form of an accelerated rate of food price inflation. Although domestic agricultural output could provide some relief, headline inflation is likely to remain high as we approach the end of the year.

Figure 2: Inflation



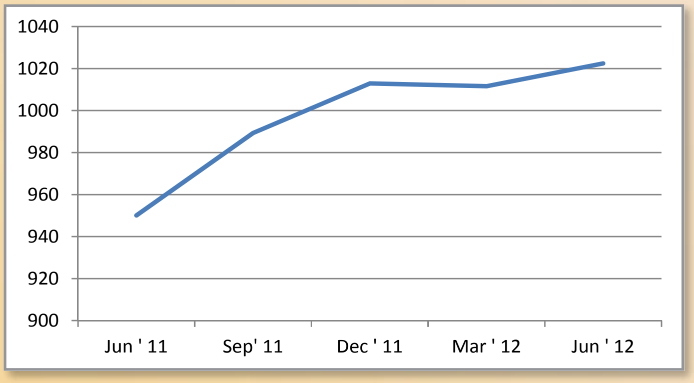
Reserves

The country's reserves of foreign currency remained strong, reaching an estimated US$11.7 billion in June 2012. This represents 11 months of import cover. This favourable position has been largely facilitated by strong energy sector revenues. Net sales of foreign currency rose to US$504 million from US$495 million in the quarter ending March 2012 and US$204 million in second quarter 2011. The TT dollar remained stable at TT$6.43 to US$1 in the second quarter but depreciated slightly against the Canadian dollar.

Stock Market

Uncertainty in the domestic economy continues to restrict activity on the stock market. Nevertheless, the Composite Price Index (CPI) grew marginally by 1 percent to 1,022.43 by the end of June over March 2012 (Figure 3). The Index rose by only 1 percent in the first half of 2012, compared to 13.7 percent for the similar period in 2011. By early September, however, the market showed some sign of improvement, as the Index increased 4.7 percent to 1,070.92, reflecting the low interest rate environment. Nonetheless, presentation of the 2013 National Budget may provide some impetus towards the end of the year, to what is at best, tepid investor confidence.

Figure 3: Composite Price Index



Outlook

In the absence of strong and sustained impetus from the energy and non-energy sector, the domestic economy has limped along so far. Government's major public projects are critical to the short and medium-term prospects of the economy. Given that at the time of writing, the third quarter was almost over, one hopes that the presentation of the 2013 National Budget would build on whatever seasonal stimulus exists at the end of the year. Exploration activity in the energy sector is expected to remain high heading into the fourth quarter of 2012. Nonetheless, growth in the non-energy sector must begin in earnest to complement whatever growth comes from oil and gas exploration, if the economy is to return to growth in 2013.

Caribbean Update

No Light Yet

Some, who optimistically saw the encouraging first quarter tourism gains as the proverbial light at the end of the tunnel, would have been undoubtedly disappointed by the second and third quarters of 2012. Deteriorating conditions in leading economies, with high food and fuel prices thrown in for good measure, meant there was no abatement of the challenges facing most Caribbean states. While there were some occasions to celebrate, the realities presented by a difficult global environment and a worrying domestic debt situation formed a permanent backdrop to economic management in most regional states.

Barbados

Following its marginal expansion of 0.4 percent in 2011, the Barbados economy is estimated to have grown by 0.6 percent for the first half of 2012 with the major impetus coming from a 1.8 percent growth in tourism output. This was driven by an increase in the length of visitor stay, as actual arrivals from January to May shrunk by 1.5 percent. This decline, due largely to a reduction in US and UK arrivals of 3.9 and 10.2 percent respectively, was mitigated by a 35 percent increase in visitors from Trinidad and Tobago. Inflation, which averaged 9.5 percent in 2011, moderated somewhat to 8.9 percent for the first quarter of 2012. According to the Barbados Central Bank, the unemployment rate climbed to 11.8 percent in this period, up from the 2011 average of 11.2 percent. In the island's National Budget presented in June, some of the key measures announced were the reduction of the personal income tax payable in the lowest income band, from 20 percent to 17.5 percent and the planned divestment of the Grantley Adams International Airport, the Barbados National Oil Company and the Barbados Port Authority by way of public offerings. The next two quarters are unlikely to bring about improved economic conditions for Barbados as negative regional and international trends are expected to persist or even worsen. This does not bode well for Prime Minister Freundel Stewart and the ruling Democratic Labour Party (DLP). Facing rising voter dissatisfaction over the state of the economy, the DLP will be hard-pressed to win the confidence of the electorate with elections due by January 2013.

Grenada

Grenada's agriculture sector is poised to register another solid performance this year as a result of the relatively benign weather conditions the island has enjoyed thus far in 2012. The other key sector, tourism, is likely to have struggled, ruled as it is by the fortunes of its key source markets. Faltering economic growth in the US, England's recent economic contraction and the London Olympics are all likely to have lowered Grenada's visitor arrival figures in 2012. In August, Grenada's population of 103,328 people (as recorded by the 2011 census) was united in celebration as its favorite son, Kirani James, continued his dominance in the 400 metre event, giving the island its first ever Olympic gold medal to add to the World Championship title he won a year earlier. On the political front, testing times lie ahead however, as divisions in the ruling National Democratic Congress (NDC) widen. In May the NDC leader and incumbent Prime Minister, Tillman Thomas survived a no confidence vote that saw some of his own party members voting against him. The deterioration continued in July when a government sponsored bill was defeated in parliament with some NDC members absent and two voting against their own party. In the existing environment, economic activity over the short to medium term could be negatively affected as policy-making and governing in general are likely to be arduous for the ruling party right up to the next general election due by July 2013.

Guyana

Having grown by 5.4 percent in 2011, Guyana's economy grew by 2.8 percent in the first six months of 2012, according to a report issued by Finance Minister, Dr. Ashni Singh in September. During this period the bauxite industry grew by 41.9 percent, gold production increased by 13.2 percent and total export earnings increased by 9.2 percent to US$592 million. The Minister disclosed that non-sugar GDP growth was actually 6.2 percent, suggesting that the contraction of the sugar sector was large enough to drag down the overall growth figure. These developments are in line with the findings of IMF representatives following a visit in July, during which they highlighted the bright spots in the economy but also noted the need to reform state enterprises such as the Guyana Sugar Company and Guyana Power and Light. Oil exploration activity continues. In late June, Guyana signed an agreement with a subsidiary of the US-based Anadarko Petroleum Corporation to undertake offshore exploration. Conversely, the *Latin America Monitor* reported that the UK-based Tullow Oil abandoned the Jaguar 1 well in August due to safety concerns about drilling in the high-pressure well. The impasse between the government and opposition parties over amendments to the 2012 budget continues. With the combined opposition having more seats than the government, these difficulties are a portent of what could lie ahead.

Cuba

Cuba's economy grew by 2.1 percent in the first half of 2012. While there was some reported weakness in the agriculture and service sectors, the island's tourist arrivals stayed strong. June's visitor numbers were 8.2 percent higher than a year ago, and arrivals growth for the 2012 January–June period was 5.8 percent. Prices of Cuba's most valuable export, nickel are expected to moderate in 2013 but should still remain high by historical standards. Economic reforms to expand private sector activity and reduce the state's payroll continue, however progress remains uneven and accompanying reforms such as improved credit provision have lagged. The elections in both the US and Venezuela due in the coming weeks, hold more than a passing interest for Cuban authorities. Victory by the Republican candidate Mitt Romney in the US presidential elections is likely to bring about frostier relations between Washington and Havana given Mr. Romney's announced hard line stance on Cuba, while a loss by President Hugo Chavez in Venezuela could see a significant reduction in aid and assistance from the South American state.

The Region

Following the celebratory highs of its 50th anniversary of independence commemoration and further Olympic successes, the news on the economic front in Jamaica is decidedly downbeat. Recent reports indicate that production of its key mineral exports, alumina and bauxite declined by 2.3 percent and 3.3 percent respectively in the second quarter and its visitor arrivals grew by only 0.3 percent in the first four months of 2012. In April, the unemployment rate climbed to a decade-long high of 14.3 percent. The Planning Institute of Jamaica in August stated the island's economy was flat in the second quarter of 2012 after contracting by 0.1 percent in the first. Growth prospects over the short term are weak, as soon-to-be-implemented austerity measures are likely to further depress growth.

St. Kitts Nevis has made significant progress in bringing its debt situation to a more sustainable position by working with the IMF and the Paris Club over the last year. Like the rest of its fellow Organisation of Eastern Caribbean States (OECS) members however, the country continues to struggle with the herculean task of trying to spur economic growth while implementing austerity (expenditure saving and revenue generating) measures in a context of high debt levels and weak revenue inflows. While the agriculture sectors in most states would have made some progress, aided by comparatively cooperative weather conditions thus far in 2012, their important tourism sectors are undoubtedly struggling as weak economic conditions persist in key source markets the US, UK and Europe.

Outlook

With food, fuel and metals prices all expected to remain relatively high, commodity producers such as Guyana and Cuba should continue to do well over the next six months. Barring any damage from storms or hurricanes over the next three months, the agriculture sector across the region should register solid production and some economic gains. While this will help, it will not be enough to overcome the revenue shortfalls likely to be experienced by most states due to declining tourist arrivals and tourist spending. Mirroring the realities of the leading economies on which they depend, Caribbean countries will continue to struggle with cutting expenditure, generating revenue and paying down debt while at the same time trying to create jobs and spur economic growth. Olympic success almost seems easier by comparison!

The Next 50

A fiftieth anniversary is an important milestone in the life of a country, as it is in the life of an individual. Trinidad and Tobago celebrated its golden anniversary of 50 years of independence from Britain on August 31st 2012. Fifty years is sufficient time for us as a people, to reflect on and evaluate how we have managed our affairs. Reflection allows us to consider what is wrong and ought to be changed over the next 50 years. While this twin-island state has not done badly, several challenges confront it, and if not frontally addressed, can worsen all prospects for this society over the ensuing 50 years. On the other hand, maximum participation and proper leadership at all levels, over the next 50 years can launch us into the ranks of truly highly developed nations. So what are some of the major challenges facing the country and how might we attempt to overcome them over the ensuing period?

The sum total of efforts by government and people of this twin-island state over the last 50 years is a relatively high standard of living when compared to many other developing countries, notwithstanding all the challenges which presently abound. This is confirmed by all major international rankings including the UNDP's Human Development Index in which Trinidad and Tobago is ranked 62 in the "High Human Development" category of 187 countries. Further, let us not forget our recent graduation to the ranks of "developed country" in the recent Organization for Economic Cooperation and Development's (OECD) listing. This relatively high standard of living is largely based on the revenues that have been derived from one sector — the ever-dominant hydrocarbon sector — and is manifested in access by the majority of the population to most basic necessities including shelter, food, education, electricity, water, telecommunications and transport. Most of these are paid for by the individuals themselves or through the numerous state interventions of one form or the other.

Notwithstanding this achievement however, intractable challenges include: increased criminal activity and the breakdown of law and order; flooding; dwindling hydrocarbon resources and the failure of successive governments to at least begin the transformation of this economy; and, at best, questionable governance practices. This list is far from exhaustive but captures what we consider some of this country's major and current challenges.

So what, in our view, should be done about these challenges and indeed how should we position ourselves as a country to deal with the new ones that would undoubtedly arise over the next 50 years.

In the case of the economy, diversification and treatment of oil windfalls stand out as issues to be addressed with some sense of urgency. To put it simply, the key to diversification and to the release of our "creative juices" is to treat windfalls largely as lottery earnings to be hived off and invested in hard currency assets which can only be accessed through stringent laws. Another important aspect of the strategy must be a carefully thought out fiscal incentives programme, of which the promotion of strategic research and development must be a critical ingredient. Under this heading, as well, we may place the development of a more innovative and dynamic set of businesses with particular attention to growth of small and medium-sized businesses. In this context, consolidation of support agencies with a far greater private sector orientation is still missing. Additionally, the present policy of not supporting domestic energy businesses is misdirected and should be discontinued. Relatedly, the availability (or lack thereof) of finance to a wider cross-section of viable activities is another issue. This might be best addressed by the establishment of appropriate funding institutions to complement commercial banks and which should include a more dynamic stock and bond market. Certainly, actions which improve the business environment and which consequently mitigate lending risks would positively impact borrowing costs.

In respect of governance, the rules which relate to how state institutions function, how our leaders are elected, and how we are governed are in need of overhaul, and constitutional reform is rightly on the cards. Related issues such as campaign funding and local government reform cry out for attention. The end result must be a democratic system of government that promotes all-round, sustainable development suited to a small, progressive, multi-cultural society in the 21st century.

Crime is of particular concern. Existing institutions whose job it is to control crime, appear powerless. The society is facing the threat of a complete breakdown of law and order at all levels. If not halted this country can descend into the ranks of some of the most backward and unfortunate, so-called failed states. We do not have 50 years to find answers. The population must now more stridently demand greater accountability and performance from those responsible, before it is too late.

The failure to enforce existing land laws and building codes and to pass new ones where necessary has resulted in poor land management, hillside denudation, clogging of waterways and, ultimately, landslides and flooding. These have brought untold suffering and costs to a wide cross-section of the population. The lack of commitment to civic duty, to good environmental practices and the failure to properly police infringements are all too common. These can still be fixed but we must start now, at the individual level and at the level of government.

On this our fiftieth anniversary, we have identified above, four major areas in which we are found wanting. These areas are crime, the environment, the economy and governance. The threats which are posed in these areas are partly the consequences of; at best, years of neglect and at worst, deliberate acts of commission or omission on the part of citizens, regulatory institutions and policy makers. Together, these threaten to overwhelm this society at this juncture, in a negative way. Interestingly, these challenges seem to be at their worst just as we are about to cross over from the first 50 years into the next 50. If this is a significant observation, then what are we going to do about it? Will we make the same mistakes over and over or can this 50th anniversary be an opportunity for a turnaround?

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