Ewart S Williams: Launch of the Economic Bulletin and the Summary of Economic Indicators

Opening remarks by Mr Ewart S Williams, Governor of the Central Bank of Trinidad and Tobago, at the launch of the Economic Bulletin and the Summary of Economic Indicators, Port-of-Spain, 3 August 2010.

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The international economy

1. More evidence that the US economy is slowing … second quarter growth was ***2.4 per cent*** compared with 3.7 per cent and 5.0 per cent in two previous quarters.

2. In the ***Eurozone***, the first quarter of the year has seen a ***slow tepid recovery*** with real GDP estimated to have increased by ***0.2 per cent***. The situation is ***similar in the UK*** with data showing growth of 0.3 per cent in the first quarter and ***1.1 per cent*** in the second.

3. Meanwhile growth in the ***emerging market economies*** continue apace … in ***China***, growth is pushing ahead at a rate of 10.3 per cent: 8 per cent in ***India*** : 9 per cent in ***Brazil*** : 4 per cent in ***Mexico***.

4. For ***2010 as a whole***, the IMF projects that:

(i) The ***advanced economies (US, UK etc) will grow by 2.6 per cent*** while the ***emerging market economies are projected to grow at a rate of 6.8 per cent***.

(ii) It's worth noting that ***growth in the advanced economies continues to depend on fiscal stimulus***, as private demand has not recovered, even in the face of record-low interest rates. This has resulted in a sharp rise in central government indebtedness which now stands at ***66 per cent of GDP in the US, 72 per cent of GDP in the UK*** and ***122 per cent of GDP in Japan***.

(iii) Additionally, the continued sluggishness of private sector demand has ***delayed job creation*** leaving unemployment rates at uncomfortable highs. In the US, the unemployment rate has remained at 9.5 per cent in June (down from the high of 10 per cent). In the Eurozone, unemployment remains stuck at 10 per cent (there has been some fall in Germany from a high of 8.3 per cent to 7.6 per cent).

5. In the ***CARICOM*** region, there are tentative signs of a slow emergence from a deep recession:

- ***In Barbados***, the economy contracted by 1.1 per cent in the first half of 2010, but this compared with a contraction of 9 per cent in the corresponding period of 2009.
- ***In Jamaica***, the latest data show a decline of 1.1 per cent in the first quarter 2010 compared with 2.2 per cent in the last quarter of 2009.
- ***In the OECS***, it is estimated that there was a decline of 4.1 per cent in the first quarter following upon a decline of 7.3 per cent in 2009.

On the domestic front

Central Bank quarterly indicators suggest ***real GDP growth of 2.3 per cent in the first quarter*** of 2010 … this would sum to two quarters of GDP growth, following four consecutive quarters of decline.

- As in the immediately preceding period, ***growth in the first quarter of 2010 came entirely from the energy sector*** (5.5 per cent), while the ***non-energy sector was flat***, coming out of about –3.7 per cent in the last quarter of 2009.
- Oil production continues to decline but petrochemical output has been boosted by the commissioning of a new ammonia plant at MHTL Complex.
- In the non-energy sector, construction activity continues to languish (both public and private): the manufacturing sector is operating at about two-thirds of capacity and sluggish consumer demand is having a negative impact on the distribution sector.
- The last available employment data is for Quarter IV 2009 which showed an unemployment rate of 5.1 per cent. However, partial indicators including recorded retrenchments submitted to the Industrial Court suggest that the unemployment rate may have increased in the first quarter of 2010.

Wages

Based on collective agreements registered with the Industrial Court, nominal wage increases are averaging 3.5 per cent per year in 2009–2010.

Central government finances

Available data through May, presented on ***a cash basis***, would seem to suggest that the fiscal outturn could be significantly better than budgeted.

Energy revenues are higher than expected because oil prices are higher than budget (oil is averaging $76 per barrel as against the budget figure of US$55 per barrel while gas is averaging about US$2.37 per mmbtu (net back), compared with the budget estimate of US$2.75 mmbtu).

Admittedly, ***non-energy revenue*** is lagging somewhat below budget because of lower than expected imports; depressed sales (affecting VAT) and slower than expected economic growth.

The data through May also show that ***capital expenditure*** has been lower than budgeted because many of the planned projects have not got off the ground.

The data need to be interpreted with caution since there are reportedly large payments owed to contractors and suppliers. When these are factored in, the projected overall deficit for the year as a whole could be about $5.8 billion or about 4 per cent of GDP, compared with the budgeted deficit of 5.3 per cent of GDP.

On this basis, ***public sector debt*** (excluding open market operations) would rise to about 38 per cent of GDP.

Inflation has returned to be a major challenge. Headline inflation gathered considerable momentum since the start of 2010, rising from 1.3 per cent (year-on-year) in December 2009 to 13.7 per cent by June 2010. The increase was due principally to initial drought and subsequent flooding which adversely affected supplies of locally grown produce, pushing the increase in the food index to 31 per cent (year-on-year).

While the trend in food prices is not surprising, the ***question is whether there is something about the basket or about data collection*** that aggravates the trend in agricultural prices (both ways).

Core inflation meanwhile was relatively stable in January–June 2010, with the main (year-on-year) price increases related to earlier tax hikes on alcohol and tobacco and rises in the cost of rent and transport.

The rise in headline inflation to double-digits is a cause for concern since it could affect inflationary expectations and future price as well as wage setting behavior.

Monetary policy

The Bank has kept the ***Repo rate*** at 5 per cent since January 2010, trying to balance concerns about rising inflation and a stagnant economy.

Bank credit outstanding to the private sector continues to decline (by 4.5 per cent on a year-on-year basis): banks have significant excess liquidity and with weak credit demand (and perhaps some tightening of loan criteria), there is increasing competition for treasury bills and government securities. Three-month treasury bills rates are now under 1 per cent (0.97 per cent).

The few government securities issues that have come to market have been all over-subscribed at a premium.

While deposit rates are at rock-bottom levels, ***it is the Bank's view that there is significant room for further reductions in bank lending rates***.

The stock market and mutual funds

The record low bank deposit rates may be an important factor behind the improved performance of the stock market. After declining by 9.2 per cent in 2009, the Composite Index increased by 8.1 per cent in the six months to June 2010.

Also in the search for higher yields, there has been a resumption in the growth of mutual funds after the decline in QIV 2009, due to uncertainties about changes in the pricing mechanism.

Balance of payments

The balance of payments data for the first quarter show (relative to the previous quarter):

- A sharp increase in energy exports, largely due to prices
- A reduction in non-energy exports
- Significantly lower imports reflecting soft domestic demand (both consumption and investment)
- ***The external current account*** has returned into surplus and there has been an increase in official reserves of some US$459 million so far this year. As at June 2010, gross official reserves stood at US$9.1 billion (12.5 months of imports). This excludes US$3.1 billion held in the Heritage and Stabilization Fund.

Outlook

The short-term outlook for the economy of Trinidad and Tobago is uncertain and will be dependent on the strength of the ongoing global recovery and the level of fiscal support that the Government will be able to provide. It is reasonable to expect that for the next several months, the level of external demand will continue to facilitate continued expansion of the petrochemical sector at current price levels.

On this basis, even if the non-energy sector remains flat, real GDP growth for the year as a whole should reach 1 to 1.5 per cent. The continued stagnation in the non-energy sector could, however, have adverse consequences for unemployment which could easily rise to the 6 – 6.5 per cent range.

Moving forward, a strong recovery of the non-energy sector will be the key to a faster rate of growth of output and employment in 2011. While monetary conditions could contribute through a much sharper reduction in bank lending rates, the original impulse will need to come from the public sector. In this context the FY 2011 budget will be challenged to secure the right balance between the need for maintaining an adequate level of capital expenditure and stimulating business activity, on the one hand, and the medium term objective of fiscal consolidation on the other. Urgent energy tax reform to encourage oil and gas exploration and the need to incorporate new initiatives, including for poverty alleviation programmes, will further complicate fiscal policy.

As noted above, the sharp rise in headline inflation will present additional challenges for economic policy. Continued increases in food prices will certainly affect wage demands and other price setting behaviour and could soon be reflected in core inflation. In these circumstances, monetary policy would need to be more active in the fight against inflation. Of course, higher interest rates could choke off a recovery that is not well entrenched…and therein lies our dilemma.