Jwala Rambarran: The current state of the Trinidad and Tobago economy and the outlook for 2013

Feature address by Mr Jwala Rambarran, Governor of the Central Bank of Trinidad and Tobago, at the Trinidad and Tobago Chamber of Industry and Commerce Luncheon Meeting, Port-of-Spain, 27 November 2012.

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At the outset, I thank the Chamber of Commerce for inviting me to speak at this luncheon session on the outlook for the Trinidad and Tobago economy. Over the past few years, the Chamber has certainly emerged as a strong advocate for promoting the candid exchange of views on issues of importance to the national and business community.

In particular, I commend the Chamber for its pioneering efforts to develop a national corporate governance code, an issue that revolves around ethical conduct, leadership and better management of our economic wealth, and has the potential to affect the success of every public and private entity in Trinidad and Tobago. I give the assurance that the Central Bank will support the development of such a national governance code.

At a time when genuine partnership and compromise across multiple stakeholders seems to be elusive on matters of national importance, I look forward to the Chamber remaining a strong, respected voice for business in Trinidad and Tobago.

Ladies and Gentlemen, policymakers around the world have been grappling for more than five years with an economic crisis, which has morphed several times over, from its origins as a sub-prime crisis in the United States to a sovereign debt crisis in Europe, to its current manifestation of a political crisis across both sides of the Atlantic. We are certainly witnessing the virtues and spillovers of an increasingly complex and interconnected global economy.

So, this afternoon I want to talk about three things:

- ***First***, some of the key to global growth occupying our attention and which have implications for the pace and strength of the economic recovery in Trinidad and Tobago and in the Caribbean;
- ***Second***, recent developments and prospects for the Trinidad and Tobago economy in 2013; and
- ***Third***, conclude with some brief thoughts on the medium term challenges ahead.

Global and Caribbean economic situation

Ladies and Gentlemen, let me begin with a brief overview of the global growth situation. While the first half of 2012 was characterized by weaker global activity and an escalation of financial stress in the Euro area, incoming data since September suggest that global GDP growth might be stabilizing, albeit slowly, and that financial risk aversion seems to be easing following further policy actions by major central banks.

Among the advanced economies, the U.S. economy continued its moderate pace of recovery, with GDP growing at an annualized rate of 2 per cent in the third quarter of 2012. Although more recent economic indicators have been stronger-than-expected, such as the pick-up in household consumption and the housing market, U.S. employment is still more than 3 per cent below its pre-crisis peak. Industrial production has partly recovered but it is too early to fully gauge the extent to which Hurricane Sandy in late October has affected activity.

Across the Atlantic, the situation remains volatile. Indicators of activity and confidence in the Euro area continue to deteriorate, despite recent improvement in financial market sentiment. Economic conditions remain weakest in Greece, Italy, Portugal and Spain given persistent difficulties in the balance sheets of banks and governments in these countries. Even the stronger economies of the Euro zone are showing signs of deterioration. The French economy has hardly grown since March 2011, and growth in Germany is slowing further.

Major emerging market economies such as China, India and Brazil are experiencing noticeably lower growth rates in 2012 partly due to contagion effects from the European crisis and slower economic growth in the United States.

Policy actions by major central banks have supported an improvement in global financial market sentiment since the middle of 2012. Unconventional monetary measures have been at the heart of the policy response in advanced economies, while central banks in emerging markets and developing countries have either cut policy rates or postponed interest rate hikes.

Conditions in Euro area sovereign debt markets improved markedly following announcements in late July 2012 by the European Central Bank about its willingness to take decisive actions to preserve the euro, and improved further after confirmation of its willingness to purchase shorter term sovereign bonds in secondary markets through the Outright Monetary Transaction (OMT) program.

In the United States, the Federal Reserve announced additional measures in September 2012 to ease monetary policy by expanding its asset purchases until a substantial improvement in the labor market is seen, and emphasized that its exceptionally low level of federal funds rates are likely to be in place until mid-2015.

The picture, Ladies and Gentlemen, is one where policymakers in our major export markets of the United States and Europe are battling weak growth, stubbornly high unemployment, widening fiscal deficits and burgeoning public debt. And what about the Caribbean, which accounts for a substantial share of our exports?

While the Caribbean region as a whole appears to be gradually recovering from the deep recession caused by the global economic crisis, the twin constraints of low growth and high debt are weighing on regional economic prospects, and the state of affairs in the Eastern Caribbean is not too encouraging.

Some Caribbean countries have approached the International Monetary Fund (IMF) for financial support. Antigua and Barbuda and St. Kitts and Nevis are receiving financial assistance from the IMF in the context of Standby Arrangements, while Grenada and Haiti are under the Extended Credit Facility. In addition, Dominica received IMF financing under the Rapid Credit Facility in early 2012 to help manage the economic fall-out from a series of natural disasters in July–September 2011.

Jamaica is actively negotiating a new IMF program. The Government of Jamaica hopes to conclude a new Standby Agreement with the IMF by the end of 2012. Some of the outstanding issues revolve around Jamaica’s tax and pension reform, and the need for cuts in the public sector payroll.

Other Caribbean countries have delayed or resisted the implementation of harsh austerity measures, preferring to rely mainly on fiscal stimulus to kick-start growth, which, in turn, is elevating the risk of debt distress.

Generally, a public debt ratio of below 50 per cent of GDP is considered comfortable. By this measure, only three countries – Haiti, Suriname and Trinidad & Tobago – have low debt. Another six countries have heightened debt vulnerabilities, averaging in the range of 50 to 90 per cent of GDP. These countries are the Bahamas, Belize, Dominica, Guyana, St. Lucia and St. Vincent and the Grenadines.

Four countries in the Caribbean have accumulated exceptionally high public debt, averaging in excess of 90 per cent of GDP: Jamaica (143 per cent), St. Kitts & Nevis (145 per cent), Grenada (105 per cent), and Antigua & Barbuda (98 per cent).

The gravity of the Caribbean's debt situation is generating debt restructuring or credit events in a few countries, and placing significant pressure on credit ratings. Already in 2012, three Caribbean countries have been downgraded by rating agencies.

Recent economic developments in Trinidad and Tobago

Ladies and Gentlemen, the Trinidad and Tobago economy has shown tremendous resilience against this turbulent backdrop, but we are yet to experience a full and solid recovery from the downturn that started in late 2008.

Let me give a brief summary of our current economic position.

Before I do so, I must engage in a detour. I must emphasize that the Central Statistical Office (CSO) is the official source of real annual GDP data, which is published in the Ministry of Finance and the Economy's "Review of the Economy" and which is also published in the Central Bank's "Annual Economic Survey". On the other hand, the Central Bank, using a different methodology from the CSO, prepares and publishes quarterly real GDP estimates, which are published in its "Economic Bulletin" and "Monetary Policy Report".

It is, therefore, foolhardy to treat these two entirely different sets of GDP data as one consistent source for the purpose of evaluating economic projections, either of the Bank or the CSO. In fact, a simple call to the Research Department of the Central Bank will shed much light on such ignorance.

I now return to the substantive discussion. Based on its revised estimates, the CSO indicates that real GDP in Trinidad and Tobago declined by a much larger than expected 4½ per cent in 2009 and growth was flat in 2010. Real GDP declined further by just over 2½ per cent in 2011. Projections made by the CSO point to a turnaround in 2012, with real GDP increasing by just over 1 per cent.

High frequency data compiled by the Central Bank indicate that economic activity is still quite sluggish but the pace of contraction of the Trinidad and Tobago economy seems to have slowed in the first half of 2012. According to the Bank's Quarterly Index of Real GDP, the domestic economy declined, on average, at a slower rate of 1 ½ per cent in the first six months of 2012, following a deeper contraction of 2¼ per cent over the second half of 2011.

Despite more intense exploration activity, longer-than-expected plant maintenance operations and security upgrades at energy sector companies continued to hinder crude oil and natural gas production. Lower supplies of natural gas impacted the production of petrochemicals. In the first half of 2012, crude oil production fell by 13 per cent, averaging 82,700 barrels per day, while natural gas output was lower by 6 per cent when compared to the same period in 2011.

Activity in the non-energy sector was fairly robust although the prolonged strike action at Trinidad Cement Limited led to a severe drop in cement output that curbed growth in the construction and manufacturing sectors.

In fact, the non-energy sector has registered growth in three of the past four quarters to June 2012, supported mainly by the finance and distribution sectors. Growth in the finance sector was driven by an expansion of commercial bank deposits and loans. The performance of the distribution sector reflected increased retail sales in several industries, including dry goods, supermarkets and groceries and motor vehicles.

Some other notable economic developments are:

- ***One***, some tightening in labor market conditions in the face of still weak economic activity. According to the latest official data provided by the Central Statistical Office, the unemployment rate rose to 5.4 per cent in the first quarter of 2012, from a historic low of 4.2 per cent in December 2011.
- Supplemental data on retrenchment notices from the Ministry of Labour and Small and Micro Enterprise Development (MLSMED) suggest that this deterioration in employment might not have extended beyond the first quarter of 2012. These data show that retrenchment notices declined by more than 10 per cent during the first eight months of 2012, from 567 to 503 notices. Over half of these notices originated in the distribution sector; transportation accounted for close to 11 per cent of total retrenchment notices registered in 2012.
- ***Two***, inflationary pressures have retreated from the high double digit rates that were recorded earlier in the year to more moderate levels. Headline inflation slowed to 7.7 per cent in September 2012 from 11 per cent in June 2012. Core inflation has remained low and fairly stable at just under 3 per cent for the past two years. A major factor behind this deceleration has been the sharp slowdown in food prices, as supply shocks resulting from inclement weather have lessened.
- ***Three***, private sector credit continued to grow at a steady but slow pace for much of 2012. On a year-on-year basis, loans granted by the commercial banks grew by almost 5 per cent in September 2012, compared with 6 per cent at the end of December 2011. Among the major categories of credit, consumer lending grew very slowly while loan demand from the business sector, which had been declining for most of 2011, staged a partial recovery in 2012. Real estate mortgage lending by the consolidated system has maintained a strong, steady pace.

In the face of weak private demand, the government budget has served as the main stimulus to economic activity over the past few years. In fiscal 2012, the non-energy fiscal deficit increased to $31.5 billion compared with $28.4 billion in the previous fiscal year, suggesting that the magnitude of the fiscal stimulus was higher than envisaged. At the same time, the overall deficit of central government operations widened from almost $4 billion in FY 2011 to $6.6 billion in FY 2012.

As at end-September 2012, public debt (exclusive of treasury bills and treasury notes issued for open market operations) outstanding increased to TT$71.6 billion (46.6 per cent of GDP) from TT$54.4 billion (36.2 per cent of GDP) for the same period in 2011. The increase in public debt resulted largely from financing of the overall fiscal deficit and financing of payments to CLICO policyholders.

Given the country’s strong foreign exchange reserves and low debt to GDP ratio, I believe that the Government has the fiscal space to promote a strong enough economic recovery by means of a deficit budget.

With headline inflation on a declining trend, the Bank maintained an accommodative monetary stance to support a recovery, especially in the non-energy sector. The repo rate was held steady at 3.00 per cent since July 2011 before being reduced to an all-time low of 2.75 per cent in September 2012. Commercial banks have already started to adjust downwards their prime lending rates in response to the reduction in the Bank’s policy rate.

Significant net fiscal injections along with sluggish credit demand continue to influence the build-up of liquidity in the financial system and helping to suppress interest rates. Commercial banks’ excess reserves peaked at $6.6 billion in March 2012, but fell steadily thereafter following Central Bank action, reaching a daily average of $2.1 billion in June 2012. Since then, continued fiscal injections have steered excess liquidity back on an upward trend. Towards the end of September 2012, excess reserves reached a daily average of $3.8 billion.

On the external side, the demand for imports of goods and services is still quite robust, even in the sluggish economic climate, prompting the Central Bank to intervene consistently in the foreign exchange market. The Bank sold US$1.4 billion to the market over the period January–October 2012, compared with US$1.2 billion for the corresponding period in 2011.

With the Bank increasing its sales of foreign exchange to address imbalances in the foreign exchange market, the level of official reserves, although still quite substantial, fell slightly to US$9.3 billion at the end of September 2012, the equivalent of 10.7 months of imports.

Outlook for 2013

I would now like to turn to the outlook for 2013.

First, it is evident that uncertainty is weighing heavily on external conditions. Overall, global prospects have weakened and in its October 2012 World Economic Outlook, the IMF lowered its forecasts for world economic growth to just over 3½ per cent in 2013 (from an earlier estimate of almost 4 per cent for 2013). Projections for growth in the United States have been trimmed slightly, with a larger downward revision for the Euro area.

The implications of these external conditions for our regional economies are mixed. Guyana and Suriname are expected to show robust growth. Jamaica and Barbados are likely to experience sluggish growth. What is clear, however, is that policymakers in the Caribbean must begin to rethink their policy strategy and consider more innovative approaches to financing in order to help solve their onerous debt dilemma.

Here at home, certain domestic factors seem to suggest a cautiously optimistic outlook for 2013.

- ***First***, as noted earlier, there are some underlying signs of an incipient recovery this year. Preliminary estimates from the Central Bank suggest a turnaround in the Trinidad and Tobago economy, with real GDP growth expected to be around ¾ per cent in the third quarter of 2012. A revival in the production of natural gas and Liquefied Natural Gas (LNG) is expected to increase activity in the energy sector by some ½ per cent in the third quarter of 2012. A better performance in the finance sector and a slight increase in construction should support overall growth of 1 per cent in the non-energy industrial base. The full completion by firms in the energy sector of their major maintenance operations would provide a further strong boost to growth in 2013.
- ***Second***, there have been indications of a modest improvement in the pace of project implementation at the level of the central government. In FY2010, the below budget Public Sector Investment Program (PSIP) was 10 per cent below budget. This improved to 4 per cent below budget in FY2011 and to around 1½ per cent below budget in FY 2012.
- ***Third***, for the most part businesses should not be facing major credit constraints. The launch of the CLICO Investment Fund (CIF) on November 1 should give a cautious boost to overall confidence and reinforce the economic growth trend.

Based on these underlying assumptions and the turnaround in the third quarter, the Central Bank is maintaining its projection for real GDP growth of around 1 per cent for all of 2012, and growth is expected to strengthen to 2 ½ per cent in 2013.

Let me elaborate a bit on this projection.

If executed as envisaged, the 2012/2013 budget could stimulate a firm recovery in construction activity and, by extension, economic growth through certain public construction projects and tax incentives for construction of residential and commercial buildings. However, contracts would need to be awarded soon and the pace of project execution would need to be accelerated if the planned programs are to be implemented on schedule. Continued delays in settling the long-standing payment of arrears to contractors could dampen these expectations.

In principle, the sluggish recovery should not have a significant impact on employment creation. However, the projects that the Government has targeted for implementation do have a high labour intensive component, and could help to somewhat ease the current tightening we have seen in the labour market.

I should also point out that the revival of growth and substantial fiscal deficit programme for FY 2013 should not re-kindle underlying inflationary pressures because considerable slack still exists in various parts of the economy, as evidenced by excess capacity in manufacturing and other activities. Nonetheless, bottlenecks in key sectors such as construction could lead to escalation of prices in these areas while the level of wage settlements would also influence the pace of household spending.

Barring any weather-related setbacks or a new round of commodity price shocks, inflation is projected to remain below double digits in 2013.

Budget 2013 announced the removal of VAT on food. Based on analysis done at the Central Bank, we estimate that the immediate impact of the removal of VAT on certain food items could reduce by 2½ per cent the cost of food for an average consumer (based on the CSO's basket of goods in the retail price index (RPI)). It should be noted, however, that the most volatile food items driving inflation, fruits and vegetables, are already zero-rated.

Budget 2013 also removed the fuel subsidy on premium gasoline. Again, based on the Bank's analysis, we do not expect the reduction in the subsidy of premium gasoline to significantly impact inflation in the short term. The higher price of premium gasoline could increase the RPI by around ½ per cent in the first round, with the impact concentrated on the users of higher-end vehicles unable to substitute to other fuels. However, as the petroleum subsidy is cut across the board over the next few years, the cost of transportation and some related goods and services will increase.

Ladies and gentlemen there are, of course, several downside risks to the Central Bank's outlook for 2013. The most obvious is a pronounced deterioration in the global environment, which could constrain our exports and weaken economic confidence, pushing the economy back to scenarios which prevailed during 2009.

The first major setback to the global recovery relates to policy uncertainty surrounding resolution of the sovereign debt crisis in the Euro area. Failure of European policymakers to deliver on their commitments to deeper fiscal and financial integration would not only worsen fears about a black swan scenario in which Greece exits the Euro zone, but also set in motion destabilizing forces in which persistent fiscal and debt problems spread virulently from Euro area periphery to the core.

Another setback revolves around the ability of President Obama and the Republican controlled Congress to resist the temptation for political brinksmanship and to agree on a budget plan that avoids the looming "fiscal cliff". If expiring tax provisions and expenditure cuts come into play, growth in the United States could fall to zero or contract. Moreover, U.S. public debt is rapidly approaching its statutory limit which, if not resolved, would curtail the options available to the U.S. Treasury to stave off a debt default.

A second downside risk is the deterioration in the industrial relations climate. Prolonged industrial action similar to that experienced at the TCL plant could setback the incipient growth trend in the non-energy sector.

Finally, bottlenecks in project implementation (for example, failure to settle contractor payment of arrears or to agree on which projects are suited to the P3 model) also represent a serious downside risk to the envisaged growth outlook. The recovery in 2013 depends heavily on a strong fiscal impulse.

Conclusion

I would like to conclude with some brief thoughts on the economic policy challenges for the medium term.

The first is on fiscal sustainability. As we are all aware, the fiscal programme for 2012/2013 is being implemented against the backdrop of unsettled economic conditions globally and several years of negative or negligible domestic growth. In this context, the Bank supports the Government's approach to maintaining a fiscal stimulus via temporary deficits over the next few years.

At the same time, we firmly believe that it is important for the Government to respect its own plan for moving to fiscal balance over the medium term. Indeed, these plans should be accelerated once conditions permit, in order to avoid a further build-up of national debt.

This brings me to the second thought, which concerns public debt sustainability. The public debt trajectory has important implications for the Government as it would reduce the room for maneuver of fiscal policy (given the need to devote more resources to servicing the debt). It is estimated that the public debt (Central Government plus Government Guaranteed debt, excluding open market operations bills) could reach close to 50 per cent of GDP over the course of FY 2012/13. External debt is projected to increase from just over 8 per cent of GDP to about 10 per cent over FY 2013.

I, therefore, believe that the Central Government has the opportunity to take advantage of the current very low interest rate environment, high liquidity and appetite for government paper to finance its operations cost-effectively on the domestic market. Foreign borrowing also offers the benefit of increasing foreign exchange availability and if financed on the international capital markets, could re-introduce Trinidad and Tobago, which is still a very sound credit, to global investors. In any event, it is crucial that the Ministry of Finance and the Economy coordinate its borrowing schedule with the Central Bank to allow for proper liquidity management.

My final thoughts are on management of the energy wealth. Budget 2013 addresses the issue of falling crude oil production by reducing the Supplemental Petroleum Tax (SPT) rate on shallow water marine exploration and by granting a 5-year tax holiday on deep water exploration. While there could be a boost to exploration and drilling in the near term, the long production lag implies that the positive impact of these tax measures on oil output would be more felt in the medium term.

Meanwhile, three hydrocarbons discoveries have been announced in 2012 which are expected to positively affect energy output in coming years. Bayfield Energy and Petrotrin announced discoveries early in the year while BPTT announced a 1 trillion cubic feet gas find in mid-November.

I must caution against the increasing euphoria that has accompanied these discoveries. The Government must resist the easy seduction of another energy boom. Instead, it must treat any of the associated revenue windfalls from these hydrocarbon discoveries as temporary, placing the windfalls as additional savings in the Heritage and Stabilization Fund, rather than imprudently consuming them. And it must move on with the diversification thrust that it has already kick-started if it wants to secure lasting prosperity for all.

I thank you.