Jwala Rambarran: Imperatives for competitiveness and sustainable development

Address by Mr Jwala Rambarran, Governor of the Central Bank of Trinidad and Tobago, at the meeting of the American Chamber of Commerce of Trinidad & Tobago, Port of Spain, 8 July 2013.

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At the outset, I thank the American Chamber of Commerce for inviting me to share my views on Trinidad and Tobago's economic outlook, and to listen to the views of business leaders on imperatives for competitiveness and sustainable development.

Such insights feed importantly into the Central Bank's understanding of the workings of the Trinidad and Tobago economy, and thus into the policy deliberations of the Bank. I strongly believe that, especially in these unusual times, this kind of dialogue with the private sector is critical.

I probably do not need to tell anyone in this room that we are indeed living in unusual times. Policymakers around the world have been grappling for the past six years with an economic crisis, which has repeatedly mutated, and it is still not clear what direction the crisis is going to take next.

From its origins as a sub-prime crisis in the United States to its morphing into a sovereign debt crisis in Europe, to its current manifestation of fiscal/political gridlocks across both sides of the Atlantic, various measures taken to address each mutation of the crisis have led to unintended consequences.

Just about three months ago, the IMF Managing Director was talking about a three-speed global economy in which emerging markets and developing countries were generally doing well, while some advanced economies like the United States were on the mend. Others such as Japan and those in the Euro area still had some distance to travel.

During the last few weeks, sentiment has changed dramatically in global financial markets, again with unintended consequences. Markets overreacted to an earlier-than-expected start to the reduction of monetary stimulus in the United States, even though the Federal Reserve clearly stated that should this commence, it would be done very slowly and would be highly conditional.

The surprising intensity of market reaction to the potential end of quantitative easing contributed to a sudden reversal of capital flows in many emerging market economies, sending their currencies tumbling and their stock markets into decline.

Such volatility may well signal the start of a new mutation of the ongoing global financial crisis. It may well be a forerunner to the new risks that could materialize when unconventional U.S. monetary policy begins to unwind in earnest.

At the same time, it is important to note that many "old" tail risks (low probability, high-impact events) in the global economy – a breakup of the Euro zone, the United States going over the fiscal cliff, a hard landing in China – still remain unresolved.

The domestic economy

Ladies and Gentlemen, the Trinidad and Tobago economy has weathered the turbulence of the global financial crisis fairly well, but we are yet to experience a sustained recovery from the downturn that started in late 2008.

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

Economic growth was considerably weaker-than-anticipated in 2012, as maintenance and safety upgrades at energy companies extended further into the year than originally envisaged, leading to a larger-than-expected decline in natural gas production. The sharp shortfall in natural gas production adversely affected both refining activity and output of petrochemicals. Crude oil production continued its secular decline on account of aging oil fields and lower condensate output.

On the other hand, the non-energy sector continued its slow but steady pace of revival, but could not fully offset the contraction in energy output. Accordingly, estimates from the Central Bank's Quarterly Real GDP Index indicated that the domestic economy grew by a mere 0.2 per cent in 2012.

So far into 2013, there are encouraging signs of a gradual recovery. Our preliminary estimates indicate that the Trinidad and Tobago economy grew by 1.7 per cent (year-on-year) in the first three months of 2013. This was the third consecutive quarter of overall economic growth and suggests that some degree of consolidation is taking place, albeit at a gradual pace.

As in 2012, the non-energy sector continued to provide support to the overall economy, strengthening further by 2½ per cent in the first quarter of 2013. This marked the eighth consecutive quarter of expansion in non-energy activity.

Furthermore, robust growth in local sales of cement, production of mined aggregates and new motor vehicle sales in the first five months of 2013 suggested that the non-energy sector had fully recovered from the negative spillovers associated with last year's protracted strike in the cement industry. It is also indicative of more broad-based growth in the non-energy sector.

On the other hand, like last year, continuing maintenance and security upgrades by energy companies are holding back the energy sector from delivering an improved performance this year. Although there was a marginal increase of ½ per cent in energy sector activity in the first quarter of 2013, following flat output in the previous quarter, growth was still lacklustre.

According to the latest labor market data from the Central Statistical Office, the unemployment rate fell to 4.9 per cent in the second quarter of 2012 from 5.8 per cent in the second quarter of 2011. More recent data on retrenchment notices suggest that employment conditions may have subsequently deteriorated. Retrenchment notices filed with the Ministry of Labor, Small and Micro-Enterprises increased almost 16 per cent in the first five months of 2013 when compared with the corresponding period in 2012.

The central government continues to conduct expansionary fiscal policy aimed at stimulating domestic economic activity. Latest data from the Ministry of Finance and the Economy indicate that the Central Government recorded a deficit of $1.4 billion during the first eight months of Fiscal Year (FY) 2012/2013, compared with a surplus of $1.3 billion for the same period one year earlier.

Capital expenditure, which is the main instrument of the government's investment programme to spur economic growth, reached $3.4 billion and was slightly above levels recorded in October 2011 to May 2012. Unless government significantly picks up the pace of capital spending, its overall budgetary stance could prove only mildly expansionary at the end of the fiscal year, which is just three months away.

Provisional data from the Ministry of Finance and the Economy show that gross public sector debt remains within manageable levels. At the end of March 2013, public debt (excluding securities issued for treasury bills and open market operations) increased to 45 per cent of GDP, but still well within the 50 per cent limit considered a prudent debt burden.

The increase in public debt resulted mainly from the issuance of bonds to compensate former policyholders of CLICO. I wish to point out that as policyholders convert their bonds to equity holdings in the CLICO Investment Fund, the government can retire this part of public debt, lowering the overall public debt stock.

After reaching double digits around the middle of 2012, headline inflation moderated in the latter part of the year, and eased further to around 5½ per cent in May 2013. The slowdown in inflation was largely associated with a steady fall in food price inflation, especially as softening global grain and cereal prices eased the inflationary impetus from abroad. The removal of Value Added Tax (VAT) on selected non-luxury food items in mid-November 2012 had a one-off impact on reducing food price inflation. Core inflation, which excludes food prices, remains low and stable, indicative of relatively subdued demand pressures.

Buoyant liquidity conditions, poor credit appetite and the cut in the repo rate have pushed interest rates to historical lows. However, we are yet to see a broader pick up in business lending. Credit granted by the consolidated financial system to the private sector grew slowly throughout 2012 and at a fairly gradual clip of 2–3 per cent in the first four months of 2013. Of concern is that business credit, which showed hopeful signs of recovery in the first half of 2012, has subsequently lost momentum.

Meanwhile, we have seen strengthened consumer lending, with increases in borrowing recorded for motor vehicles, home renovation and educational purposes.

Even though real estate mortgage lending remains the only credit category demonstrating vibrant double digit growth there is no compelling evidence of overheating in the property market. According to data provided by private valuators, the estimated median price of a typical 3-bedoom today is about 10 per cent lower than the peak in median house prices in early 2012. More importantly, commercial banks have maintained their mortgage lending standards, with still conservative loan-to-value and loan service-to-income ratios.

Given the gradual pace of economic recovery and the stability of core inflation, the Central Bank has maintained an accommodative monetary stance. To provide a needed boost to economic activity, the Bank cut its key policy rate, the repo rate, by 25 basis points to a record low of 2¾ per cent in September 2012, following 75 basis points of previous cuts since December 2010.

Lethargic credit demand and high net fiscal injections have led to a considerable build up of excess liquidity in the financial system. Commercial banks' excess reserves held at the Central Bank rose to a daily average of around $5½ billion in the first half of 2013, from a daily average of nearly $4 billion in the first half of 2012.

The Bank continues to absorb some of this excess liquidity through open market operations and through requesting commercial banks to roll over maturing holdings of interest-bearing special deposits held at the Bank. Sales of foreign exchange by the Bank also indirectly removed some excess liquidity from the banking system.

We also facilitated the issue of a $1 billion, seven-year Treasury Bond in May 2013 to support our liquidity absorption efforts. These Treasury Bonds are purely for the purposes of monetary policy, with the proceeds of the bonds sterilized in a blocked account at the Central Bank on behalf of government.

Notwithstanding the gradual pace of recovery, demand for imports of goods and services is quite robust, prompting the Central Bank to intervene consistently in the foreign exchange market. Nonetheless, the country's gross official reserves remain strong at US$9.4 billion at the end of June 2013, or more than 10 months of import cover.

Economic outlook

Ladies and Gentlemen, the recent up-turn in domestic economic activity, particularly in the non-energy sector, indicates that economic sentiment is gradually improving and becoming more widespread.

Perhaps the most fundamental downside risk to the country's improving economic outlook relates to the actions of the two largest natural gas producers (BPTT and BGTT), who are expected to continue major maintenance operations with significant shutdowns scheduled around September 2013. This is a high probability, high impact event.

Failure on the part of both the Ministry of Energy and Energy Affairs and these two energy companies to reach agreement on minimizing the very sharp supply disruptions in energy output would throw off track the economy's current growth mode, resulting in close to zero growth or even contraction for the year as a whole.

For its part, the Central Bank has been advancing a financial program of regulatory reform designed to ensure that a crisis on the scale of CLICO never happens again. I am adamant that marauders at the gate can never again breach the regulatory walls of our fortress at great cost to our citizens and to our economy.

We are placing top priority on a successful passage of the Insurance Bill 2013, which was recently referred to a Joint Select Committee of Parliament. The Bill introduces best practices in the areas of corporate governance, risk management, consolidated supervision and consumer protection to the insurance industry.

Among the measures brought by the Bill will be the strengthening of the powers of the Inspector of Financial Institutions of the Central Bank, which is legally empowered to oversee the operations of the insurance industry and also intervene in the sector where it becomes necessary.

While challenges remain, a final resolution to CLICO's failure seems to be on the horizon. Such a development should positively impact economic confidence.

With firmly anchored inflation expectations, the Central Bank is giving more weight to an accommodative monetary stance until a firm economic turnaround is established. However, should the outlook for inflation, growth, or financial stability change, we will take appropriate action.

We are paying close attention in particular to the possibility of normalization of monetary policy in the United States, and the consequent impact on emerging market economies, especially Trinidad and Tobago.

Boosting business confidence

Ladies and Gentlemen, let me now turn to an issue that I would like to highlight in the context of this morning's discussion on competitiveness and sustainable development. Many expect central banks to be the ones that can bring back growth. And indeed, over the past few years, the global financial crisis has placed immense demands on monetary policy around the world.

In his Andrew Crockett Memorial Lecture held at the Bank of International Settlements a week ago, Professor Raghuram Rajan from the University of Chicago's Booth School of Business described the situation quite well: "*When the central banker offers himself as the only game in town, in an environment where politicians only have choices between the bad and the worse, he becomes the only game in town*."

But we are not the only game in town. I wish to remind you all that, through its monetary policy, the Central Bank can influence aggregate demand in the economy. But monetary policy cannot solve deeper structural problems or lift the growth potential of the economy.

That requires bringing more balance to fiscal policy and speeding up the implementation of structural policies that eliminate supply-side constraints to private investment in the non-energy sector.

From our frequent conversations with business leaders, we know that one of the most important structural issues facing the Trinidad and Tobago economy at the moment is the need to boost business confidence.

Trinidad and Tobago is looking for a return to self-sustaining, self-generating growth. To realize such economic growth we need to see the rebuilding of capacity, through both the expansion of existing companies and the creation of new ones. This calls for stronger confidence among existing businesses and entrepreneurs.

We are already seeing welcome signs of such confidence. At one end of the business spectrum, small firms have been mushrooming in various clusters around the country including Charlieville, Felicity, Tunapuna, Sangre Grande, Rio Claro, and Penal/Debe. Some of these small firms are in retail and distribution. Others are in construction and energy services.

At the other end of the business spectrum, a few conglomerates have publicly announced major investment projects. These include:

1. A $500 million joint venture between Multicinemas Trinidad Limited and JT Allum Group of Companies to develop the „C3" movie and shopping complex in Corinth, South Trinidad.
2. Ansa McAl's $400 million state of the art clay plant, which is expected to be the single largest investment in the construction this year.
3. A US$600 million joint venture among Neal and Massy, Russian firm Severstal International and Metaldom from the Dominican Republic to build a vertically integrated iron and steel complex on Union Estate, La Brea.
4. Neal and Massy's Project Development Agreement with Mitsubishi Corporation, Mitsubishi Gas Chemicals Company and the Government of Trinidad and Tobago to construct and operate plants to produce Methanol and Dimethyl-Ether (DME) at Union Estate, La Brea. The project is expected to cost roughly US$850 million.

I commend these business leaders for their vote of confidence in the country's economic prospects, but it is not enough. We need the entire business community to stop watching and commenting on the game from the sidelines.

Ladies and Gentlemen, there is a view that business must stop feeding from government. And business must start feeding government.

I remind you of the damning words that Ralph Maraj in his December 31, 2012 column in the Trinidad Express entitled "***The Private Sector Can't Dance***" had for the business community: "*For the past few years, most of our business elite have been sitting on their resources, marking time but still accumulating; only a few venturing to take some measured risk to stimulate the economy; most waiting, as always, for the treasury to provide new feeding. And they continue to absurdly shout to the government 'diversify, diversify', as if they had no responsibility in this critical national need*."

Peter O' Connor in his Sunday June 30 Newsday column entitled *"**Lacking Leadership***" echoed similar concerns. "*Which businessman here, with the banking system drowning in liquidity, has the vision and capability to diversify our economy instead of begging government for 'corporate URP'*"?

Since the Central Bank is not the only game in town, I take this opportunity to remind the entire business community of their responsibilities and urge them back onto the field. My appeal to you is to take a longer term perspective and invest in people and technology to raise our growth level and to make our growth more inclusive.

Play the game passionately, intensely and fearlessly!

Conclusion

In conclusion, I wish to reiterate that Trinidad and Tobago has been navigating well the choppy waters of the global financial crisis, and will continue to do so.

But this is not the message that we seem to be absorbing as a nation. Instead, it is one of a country lurching from one crisis to another.

We seem to have a penchant for self-inflicted wounds, looking at our country from the glass is half empty perspective. I appeal to all of us to look at our economy from a glass half full point of view. This is actually not difficult to do. Growth is consolidating, unemployment is low, public debt is very manageable and our citizens still enjoy a high standard of living.

The Central Bank is absolutely committed to maintaining macroeconomic stability so firms can make longer-term decisions in an environment of confidence. By explaining the cross-currents at work in our economy, our projections for what's ahead, and our monetary policy response, we are doing our part to help mend business confidence.

We are open to meeting with all business groups to better understand your needs and the support required.

I am convinced that we have high calibre business leaders who are smart, professional and innovative. And who are totally committed to this country.

You must be the change you want to see in Trinidad and Tobago.

I thank you.