Ewart S Williams: Economic Outlook 2011

Address by Mr Ewart S Williams, Governor of the Central Bank of Trinidad and Tobago, on the occasion of a panel discussion at the Trinidad and Tobago Chamber of Industry and Commerce, Port-of-Spain, 14 January 2011.

* * *

Salutations:

- The Honourable Stephen Cadiz
- Members of the head table
- Distinguished ladies and gentlemen

First, thanks for the invitation.

1. Before talking about the 2011 outlook, a brief word on 2010. Notwithstanding a slight pick-up in the last quarter, for the year as a whole ***the preliminary data shows that the economy was flat – no growth***. This follows a decline of some 3 per cent in 2009. What this means is that while many economies recovered from the global recession of 2008–2009, the Caribbean, including Trinidad and Tobago was not so fortunate.

2. The energy sector continued to register positive growth but activity in the non-energy sector declined for the second consecutive year. For the period 2009–2010, ***activity in the non-energy sector declined by a cumulative 10 per cent***. Now, the non-energy sector accounts for 97 per cent of total employment. If these estimates are correct, therefore, it is ***more than likely that there is a significant increase in unemployment***.

3. The economy and the population cannot afford a third year of economic stagnation and therefore, in my brief statement, ***I have opted not to present*** a passive analytical outlook but ***to identify the many positive characteristics that we could exploit to ensure that we break the current economic malaise***.

4. It is now generally accepted ***that the global recovery in 2011 will be stronger than last year***. This is good news for our energy sector which could expect an increase in demand and in prices for oil and petro-chemicals, in particular. The outlook with respect to gas is less clear – although gas prices faced a sudden jump recently. Unfortunately, the short term outlook is for continued reduction of oil production which has now fallen below 100,000 barrels per day. There is, however, scope for some growth in petro-chemical output following the addition of new productive capacity. We therefore project that energy sector value added would increase by 3.2 per cent in 2011, slightly more than last year.

5. As noted above, a recovery in the non-energy sector is urgently needed; and while ***any pick-up in regional demand will help***, that is not assured, the jolt must come from domestic demand. In my view, many of the pre-conditions for resurgence in domestic demand already exist. We need to take advantage of these.

6. The outturn for FY 2010 indicates that the fiscal impulse was far smaller than had been envisaged (for several reasons). ***The fiscal stance announced in the current year (FY11) is appropriately geared to supporting an economic recovery.*** The challenge is to accelerate the implementation of some of the approved infrastructural projects so as to give a much-needed boost to the construction sector. Obviously, a meaningful resumption in construction activity would be facilitated by steps to clear outstanding arrears to contractors.

7. It is important to stress that we are talking about a ***temporary fiscal stimulus*** for FY 2011, the plan being that Government also devises a fiscal framework to ***return to budget balance as early as possible*** (in the interest of reducing public debt).

8. Monetary conditions are ideal for a long-awaited resumption of private demand. With significant unused productive capacity, considerable excess liquidity and with core inflation expected to remain subdued, the Bank ***sees further room for lowering the policy interest rate***. In turn, we hope to see a much sharper reduction in bank lending rates. Last year, we saw an appreciable reduction in mortgage interest rates but less so in other lending rates. We think that current spreads could more than afford a sizable cut in bank lending rates.

9. Few banks have taken steps to facilitate lending to small businesses. However, data on loan guarantees to small businesses, through the Business Development Company show a continued decline. For the medium term, it will be important for Government, the banks and the business sector to work to enhance small business development programmes.

10. The Central Bank is able to give the assurance that foreign exchange availability would not be a bottleneck to production. As noted earlier, the prospect is for buoyant energy prices. In addition, we expect foreign reserves to be supplemented by inflows related to oil exploration activities and by proceeds of foreign loans. ***With official reserves now equivalent to around 12 months import cover, the Bank is not targeting any additional increase in official reserves in 2011.***

11. A brief word on the foreign exchange market. This table shows that after a period of substantial build-up from 2004 to 2008, the Central Bank has not been accumulating foreign exchange reserves. For 2011, the target is for a slight reduction in official reserves. This means that, excluding the HSF accumulation, the Bank intends to continue its programme of expanded foreign exchange sales to the market.

12. The table also shows that the Central Bank has maintained its level of intervention into the foreign exchange market even in the face of a sharp decline in imports.

13. ***It is still worth noting***, however, that our small country cannot continue to afford the level of foreign exchange leakage (call it capital flight, if you like) that we have been financing in the past few years. Small countries like ours are not expected to be the source of net capital outflows (non-trade related) on a sustainable basis.

14. The scenario that we are putting forward today is for ***real GDP*** growth of about 2 per cent in 2011, led by developments in the energy sector but with the expectation of positive growth in the non-energy sector for the first time in three years. Ordinarily, after a pronounced downturn, employment generation lags economic recovery. However, the nature of the expected fiscal stimulus in 2011 would imply some increase in employment in the construction sector which should, at least, contain the unemployment rate at about 7 percent.

15. This scenario has several downside risks. First, there are the uncertainties related to the expected recovery in the global and regional economy. You may recall that at the beginning of last year, we also thought that the global economy was on the path of a strong recovery, but growth slowed in the second and third quarter only to pick up again in the fourth. In addition, however, there are the domestic factors which could continue to postpone resurgence in business activity. Two such factors are a delay in the resolution of the Clico crisis and a worsening of the industrial relations climate.

16. A word on inflation. In principle, the expected normalization of domestic agricultural output should put downward pressure on food prices. There is now, however, heightened concern ***about a global oil and food price shock*** which could have a significant impact on domestic food prices (corn prices are 94 per cent higher than June 2010 lows: soya beans are up 50 per cent and wheat is up 80 percent). ***At this stage, the Bank sees a reduction in inflation to 7 – 8 per cent as being very feasible***.

In summary, my message is that a much needed resurgence in economic activity in 2011 will be greatly facilitated by a social compact – formal or implied, in which the various parties recognize the urgency of their respective roles whereby for instance:

(i) The Government succeeds in the implementation of the needed fiscal stimulus, including the reduction in arrears to contractors;

(ii) The Central Bank increases its intervention in the foreign exchange market as needed;

(iii) The business sector operates with the needed trust and confidence, avoiding the tendency to warehouse foreign exchange;

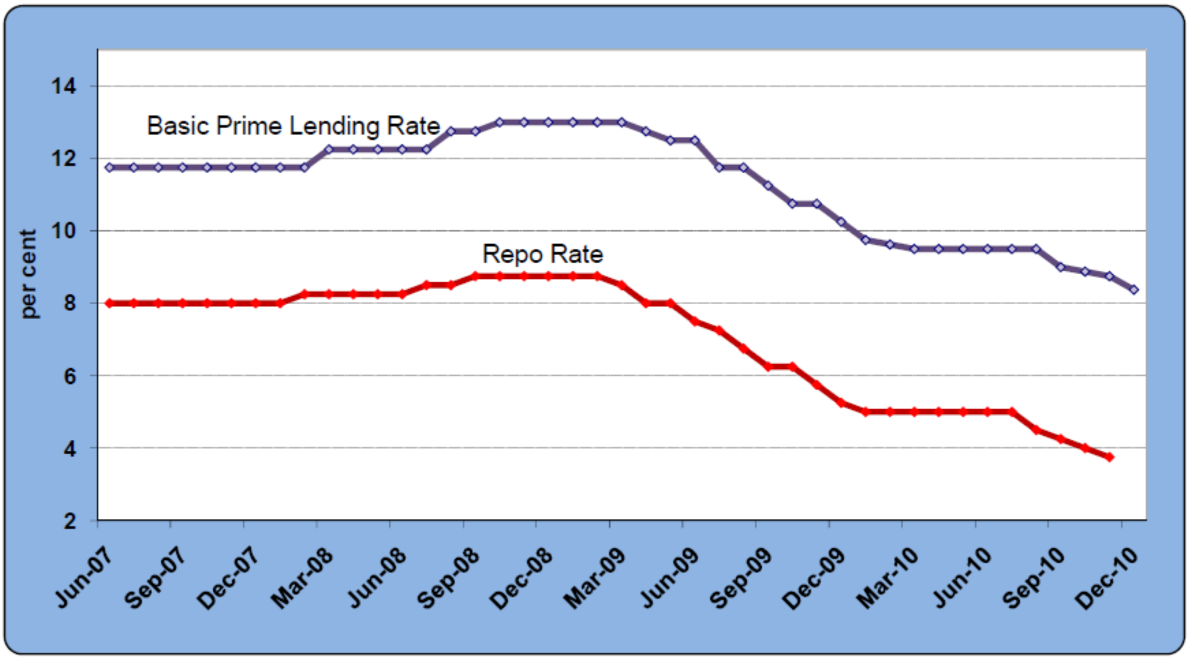
(iv) The banks accept the need for a larger reduction in interest rates and banking spreads; and

(v) Where all the parties contribute to easing the industrial relations climate and generally helping to restore confidence.

This is a tall order, but absolutely necessary.

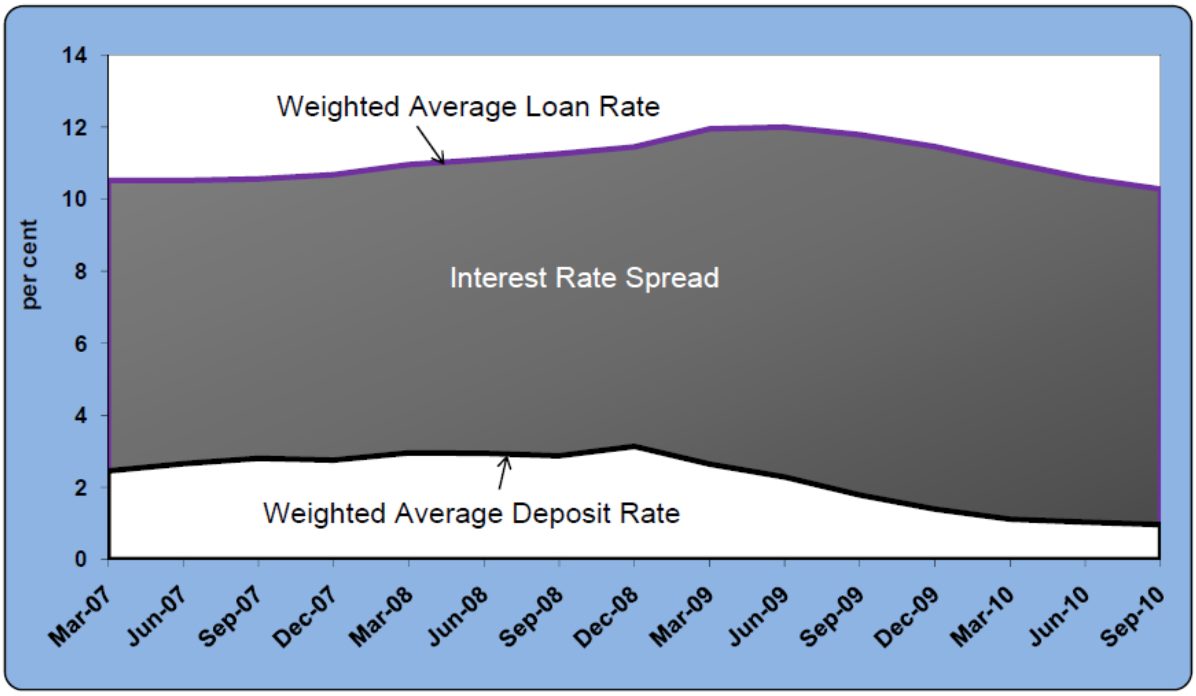
Achieving medium term growth and stability presents even greater challenges, but the immediate reactivation in economic activity will boost confidence and provide the breathing space for this greater challenge.

1. Repo Rate and Prime Lending Rate



Source: Central Bank of Trinidad and Tobago.

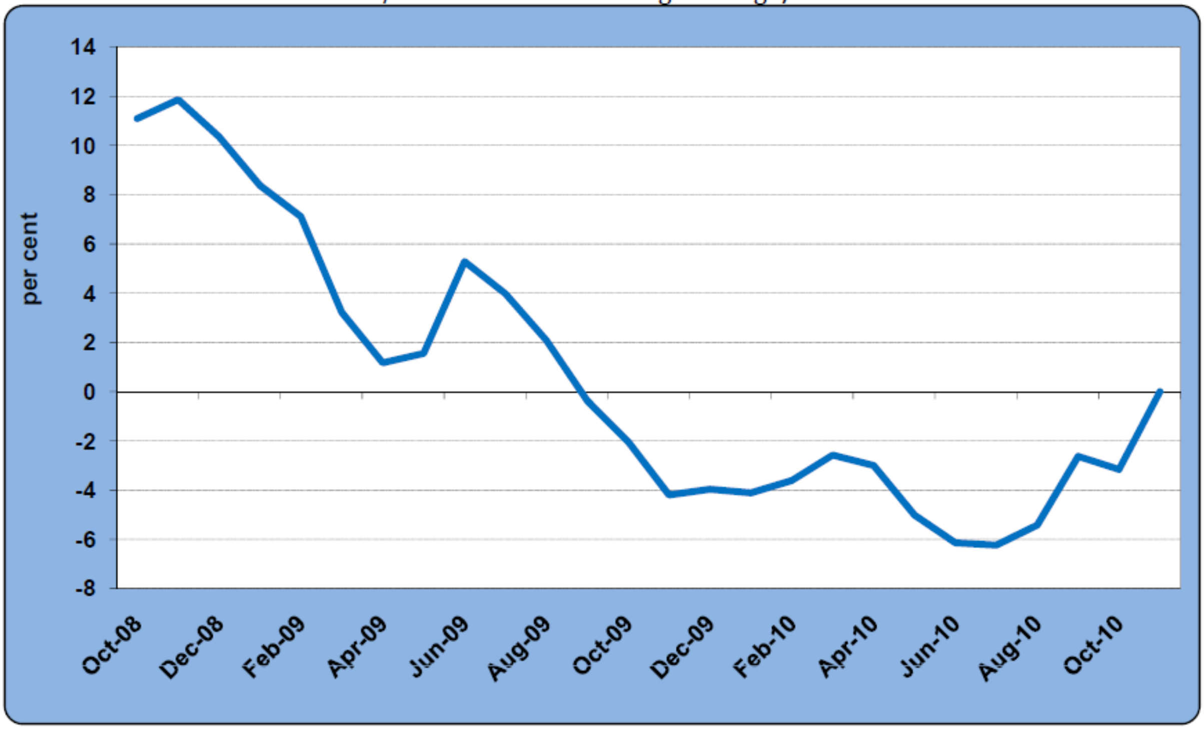
2. Weighted Average Loan and Deposit Rates and Interest Rate Spread



Source: Central Bank of Trinidad and Tobago.

3. Credit to the Private Sector by the Consolidated Financial System

/Year-on-Year Percentage Change/



Source: Central Bank of Trinidad and Tobago.

4. Trinidad and Tobago Foreign Reserves

/US$ Millions/

(End of Period)

	2004	2005	2006	2007	2008	2009	2010	2011P
Gross Official Reserves	2,993.0	4,885.8	6,530.8	6,673.5	9,380.3	8,651.5	9,070.0	9,002.0
Change in Reserves (increase -/decrease +)	-735.2	-1,892.8	-1,645.0	-142.7	-2,706.8	728.8	-418.5	68.0
Memo Item:								
Heritage and Stabilization Fund (HSF)	453.9	870.8	1,396.8	1,788.3	2,895.8	2,996.9	3,701.9	…

Source: Central Bank of Trinidad and Tobago.

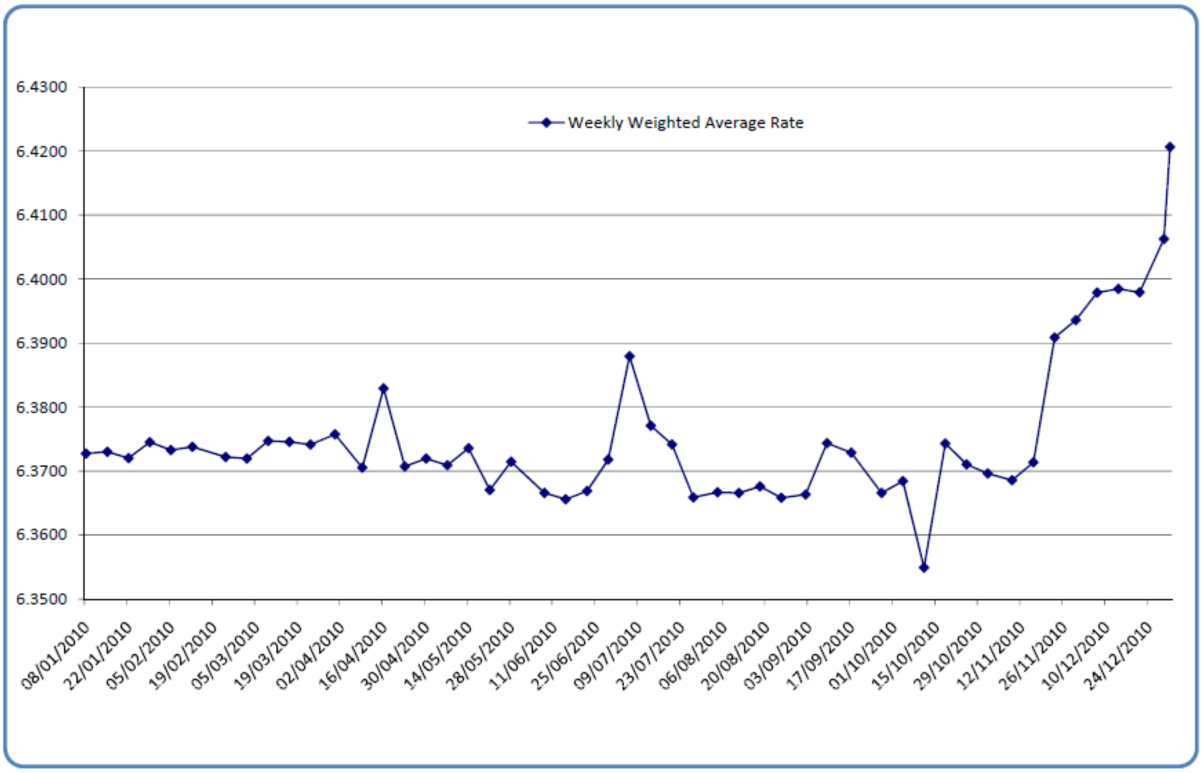
5. Foreign Exchange Market Operations

/US$ Millions/

Year	Purchases from the Public	Sales to the Public	Central Bank Sales to Authorized Dealers	Imports
2002	2,003.1	2,315.4	309.6	3,682.3
2003	2,070.4	2,625.1	487.3	3,911.7
2004	2,441.3	2,984.2	386.0	4,894.2
2005	2,566.5	3,577.6	670.7	5,725.2
2006	3,055.9	4,266.8	1,393.3	6,516.8
2007	4,170.3	5,434.6	1,020.0	7,670.0
2008	5,785.2	6,466.3	822.8	9,626.6
2009	3,808.2	5,637.2	1,899.1	6,972.9
2010	4,043.3	5,533.0	1,550.0	6,850.0*

Source: Central Bank of Trinidad and Tobago.
** - estimate.*

6. The TT$/US$ Exchange Rate



Source: Central Bank of Trinidad and Tobago.

7. Summary Economic Indicators

	Actual			Estimate	Forecast
	2007	2008	2009	2010	2011
Real Sector Activity	(annual percentage changes, unless otherwise stated)				
Real GDP	4.8	2.4	-3.5	0.1	2.3
Energy	1.7	-0.2	2.6	3.0	3.2
Non-energy	7.6	4.2	-7.2	-1.9	1.9
Headline Inflation (end-of-period)	7.6	14.5	1.3	10.0	7.0
Unemployment rate (average)	5.6	4.6	5.3	7.0	7.5
Fiscal Operations	(in percent of GDP, unless otherwise stated)				
Central Government Fiscal balance (TT$Mn)	2,298.5	12,132.7	-6,686.0	-3,807.0	-7,732.2
Central Government Fiscal balance	1.8	7.5	-4.9	-2.8	-5.2
Public sector debt	29.2	25.0	33.0	36.1	37.7
Money and Finance	(annual percentage changes, unless otherwise stated)				
Credit to Private Sector	21.7	13.7	-4.4	-2.6	4.2
Broad Money Supply	13.5	13.0	26.9	19.5	8.4
External Sector	(in percent of GDP, unless otherwise stated)				
Merchandise Exports	61.4	72.1	43.3	55.1	55.0
Merchandise Imports	35.2	37.1	32.9	32.7	32.4
Current Account Balance	24.6	36.2	8.0	20.5	20.5
Net Official Reserves (US$ Million)	6,673.4	9,380.2	8,651.6	9,070.0	9,002.1
(in months of imports)	9.4	11.5	11.9	13.0	12.1

Source: Central Bank of Trinidad and Tobago.