Ewart S Williams: The current state of the economy and the outlook for 2012

Feature address by Mr Ewart S Williams, Governor of the Central Bank of Trinidad and Tobago, at the Trinidad and Tobago Chamber of Industry and Commerce Luncheon Meeting, Port-of-Spain, 30 November 2011.

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Let me thank the Chamber of Commerce for inviting me to speak at this luncheon session. Indeed, the Chamber should be complimented for promoting these quarterly sessions as a forum for the exchange of views on matters of importance to the business community.

My remarks will focus on recent developments and prospects for the economy of Trinidad and Tobago in 2012. Unfortunately, one cannot fully understand and address the challenges that we are facing unless one appreciates the ***momentous changes that are currently taking place*** in the international economy. It is no cliché that the global economy is going through a major transformation and that ***economies, large and small, need to adapt to survive***.

As we meet today, the eyes of the world are locked on Europe, since the storm in the euro area is casting a long shadow over the entire global economy.

Essentially, we are witnessing how years of ***fiscal indiscipline*** and its consequence – the unsustainable build-up in sovereign debt – are once again threatening to push the global economy to the brink of the second major crisis in the space of five years.

Currently, Ireland, Greece, Portugal and Italy among others, are facing grave difficulty in servicing their sovereign debt. The crisis has spread from debt markets, to the European banks (which are now facing funding shortfalls similar to those experienced in 2008), to European equity markets, ***and is threatening the viability of the Euro itself***.

It has also had a significant impact on the real economy in Europe.

Real GDP in the Eurozone is projected to contract ***at an annualized rate of 1 per cent*** in the last quarter of 2011 and by a further 0.4 per cent in the first three months of 2012. For 2012 as a whole, the Eurozone economy is projected to grow by at most 0.2 per cent and about 1 per cent in 2013. **Unemployment** in the Eurozone now averages 10.2 per cent but has reached 22.6 per cent and 17.6 per cent in ***Spain*** and ***Greece***, respectively.

Very significantly, the EU leaders are now negotiating new rules that would make ***fiscal discipline legally binding*** and move the currency block closer to a ***fiscal union***.

Across the Atlantic, in the US, the situation is only slightly better. The level of the fiscal deficit and the political difficulty in reaching agreement on an appropriate deficit-reduction plan, resulted in a US downgrade (the first in its history). Earlier this week, Fitch Ratings revised the US ratings outlook, ***from stable to negative***.

The OECD projects that the US economy will grow at a 2 per cent rate next year. It insists, however, that this tepid recovery will only hold if policy makers in Washington break their impasse over the federal budget.

Without action by Congress, the OECD projects that economic growth would be barely measurable at 0.3 per cent next year, and 1.3 per cent in 2013.

I have just painted a situation, ladies and gentlemen, where our major export markets – ***countries that account for more than 65 per cent of our total exports*** – are facing real crisis – perhaps, several years of anemic growth and continued high unemployment levels.

And what about our regional economies, which account for the bulk of the remainder of our exports? They are also facing ***fiscal and debt challenges***, while economic growth continues to suffer from the impact of sluggish tourism activity, a sharp decline in workers' remittances and the slump in direct investment flows. Already in 2011, two Caribbean countries have signed new arrangements with the IMF, and three countries – The Bahamas, Barbados and Jamaica, have been downgraded by rating agencies.

The Caribbean region is projected to grow modestly at around 3 per cent in 2012, with ***Guyana*** and ***Suriname*** being the only countries showing robust growth.

The economy of ***Trinidad and Tobago*** has shown remarkable resilience, thanks to our energy resources and to our much lower public debt position. Unfortunately, ***we are yet to see tangible signs of a solid recovery*** from the downturn that began in late 2008. Moreover, we are now facing a new reality in which we could no longer expect exclusive dependence on the energy sector, now facing a situation in which growth and employment generation will have to depend increasingly on a diversified and competitive non-energy sector.

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

You would recall that, after strong growth in the period 2002–2008, ***real GDP*** declined by 3 per cent in 2009 and stagnated in 2010. Projections made by the CSO point to a further GDP decline of ***1.4 per cent in 2011***.

Production indicators compiled by the Central Bank suggest that there was a decline in real GDP of about 0.9 per cent in the first half of 2011. ***If one tries to reconcile these two sets of the data***, one arrives at the conclusion that there was a continued decline in economic activity in the second half of 2011.

Anecdotal evidence confirms this; pointing to reduced working hours and other dislocations associated with the state of emergency and the curfew which affected, in the main, the distribution, manufacturing and even the energy sectors.

The data for the first half of the year confirm ***a decline in crude oil and natural gas production*** of 7.8 and 1.4 per cent respectively, compared with the corresponding period of last year. As you know, there has been a ***secular decline in crude oil production since 2006***, reflecting the maturation of our oil fields. At the same time, natural gas production has plateaued over the past few years reflecting (a lack of new gas-based projects) as well as capacity constraints. In addition to these structural factors, since the beginning of the year, there have been disruptions to oil and natural gas production because of ***ongoing safety upgrades and maintenance work*** at some of our production facilities. Moreover, a shortage of gas supplies has also impacted output of the petro-chemical sector.

In the non-energy sector, construction activity has remained at very depressed levels, reflecting the delayed start-up of several government projects and the virtual absence of new private sector construction projects. Cement sales declined by 10.5 per cent in the first half of 2011 compared to January to June 2010. Latest unemployment statistics also show that the construction sector lost about 15,500 jobs between the third quarter of 2009 and the corresponding period of 2010.

Some other notable economic developments are:

- One, ***the employment impact of the continued economic downturn***. According to the latest official data, unemployment rose to 6.3 per cent in the fourth quarter of 2010. While official unemployment figures for 2011 are not yet available, the Bank, also keeps track of the retrenchment notices lodged at the Ministry of Labor and Small and Micro-enterprises. These data show that in the third quarter of 2011 retrenchment notices were ***more than double the amount filed in the corresponding period of 2010*** due, in large part, to the closure of one food processing company. Based on information for October, the spate of retrenchment has continued apace during the last quarter of 2011.

- ***Bank credit data*** have also reflected the depressed economic conditions. Total commercial bank credit outstanding declined steadily since early 2009, ***led by*** a sharp contraction of business credit. A slow turnaround in consumer credit started in October 2010 and there are indications that the decline in business credit may be finally bottoming out.
- Consistent with the pick-up in consumer credit, there were signs of an ***incipient recovery in retail sales*** during the second quarter of 2011, spread over a range of consumer goods categories (dry goods, supermarkets, household appliances, furniture and new motor vehicles).
- Of course, with domestic demand relatively subdued, with abundant spare capacity, and food prices showing only moderate increases, ***inflation*** remained under control, at about a 3.7 per cent rate (year on year) in October 2011.
- ***In the external sector***, after two consecutive years in which non-energy exports to CARICOM declined, ***there was a 25 per cent increase in these exports in the first half of 2011***, compared with 2010. However, reflecting the sluggish domestic demand (noted above), ***non-energy imports*** declined by 18 per cent in the January–June period.
- Interestingly enough, ***notwithstanding the decline in imports***, there was a 12 per cent increase in foreign exchange sales to the public in the first ten months of 2011, (compared with the corresponding period of last year). Over this period, the Central Bank sold US$ 1.3 billion, some 15 per cent more than in 2010.

In the face of lagging private demand, ***the government budget*** served as the main driver of economic activity during 2011. Based on preliminary data, ***the overall balance of central government operations*** shifted from ***near balance in FY2010*** to a ***deficit of $5 billion*** in FY2011 (about 3.6 per cent of GDP). If the last few years are a guide, ***the final figures for FY2011*** are likely to show a much smaller deficit, ***as government revenues are revised upwards*** and final government expenditure is revised downwards.

Even so, I believe that the ***overall stance of fiscal policy in 2011*** was appropriate, given the need to promote economic recovery and the country's comfortable public debt position.

I would now like to turn to the outlook for 2012.

First, let's clarify that the ***external conditions are expected to be uncertain, at best***, or ***most likely very unfavorable***. In the case of the ***Eurozone***, the consensus is that the scale of the imbalances would imply a prolonged period of subdued growth. In the US, political stalemate, in the run-up to the Presidential elections, is likely to postpone effective policy action – setting the stage for another year of anemic growth and continued high unemployment.

The implications of these conditions for our regional economies have already been mentioned i.e. – ***no major improvement in economic activity***, and perhaps, the need for more austerity measures to address their high debt burdens.

Here at home, certain domestic factors seem to suggest an improved outlook for 2012.

- First, as noted earlier there is some evidence of a ***slow recovery*** in the demand for bank credit, including by business firms.
- Second, since the end of the last fiscal year, there are indications of ***a modest improvement in central government project implementation***.
- Third, while we cannot claim to have conducted a scientific survey, ***our discussions with several private sector representatives***, suggest that the latest

budget (along with the attempts to deal with security concerns) have given a cautious boost to private sector confidence.

Based on these underlying assumptions and a modest turnaround in the energy sector, the Central Bank's projection is for ***real GDP growth of around 1.5 per cent*** in 2012, although the balance of risks are tilted on the downside.

Let me elaborate a bit on this projection.

In the energy sector,

- The expectation is for a continued decline in crude oil production, largely because of the ageing of the oil fields. However increased exploration is expected to stimulate activity in the energy services sector.
- According to industry sources, the ongoing safety upgrades and maintenance work that affected output in 2011, should be completed ***by the first quarter of 2012***. This would allow for gas production and petro-chemical output to return to 2010 levels. The projections provide for no new plants coming on stream.

In the non-energy sector, we make the ***aggressive*** assumption that construction activity will finally begin to recover, based on the implementation of certain public sector projects – the highway to Point Fortin, the HDC housing repair programme, the three mega sport facilities announced in the budget and some smaller construction projects, ***for which contracts are expected to be awarded soon***. Continued delays in settling the arrears to contractors, could however dampen these expectations.

In our discussions with the private sector, we did not get the impression that ***any major new investments*** were on the cards for 2012. Many business people were hopeful, however, that increasing demand, both from the domestic market and from CARICOM, would facilitate a rise in capacity utilization in the manufacturing sector current levels – now about ***66–68 per cent***.

In principle, the tepid recovery, after three years of economic stagnation, should not have a major impact on employment. However, the projects that the Government has targeted for implementation are expected to be highly labour-intensive, a fact which could ease the current unemployment problem somewhat.

I should note also that an increase in real GDP of 1.5 per cent should not, in itself, re-kindle ***inflation pressures*** because of the existence of considerable spare capacity. Barring weather-related setbacks or a new round of commodity price shocks, inflation should remain at around 5 per cent in 2012.

There are several downside risks to the Bank's GDP projection for 2012. The most obvious is a ***pronounced worsening of the international environment***, which would affect our energy and non-energy exports and weaken consumer and business confidence – the kind of scenario, we faced in late 2008 and the first half of 2009.

Moreover because the recovery in 2012 depends so heavily on a strong fiscal impulse, ***bottlenecks in the project implementation*** (for example, arising from problems in the procurement system or delays in raising financing) also represent a serious downside risk to the GDP projection.

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

While the advanced economies have been facing difficult economic times, several Latin American countries – most notably Brazil, Mexico, Peru – are now enjoying high rates of growth with reduced vulnerabilities ***because they have established strong fundamentals, sound policy frameworks and prudent macro-economic policies***. These countries have recognized that in the current volatile global environment, there is need for ***sizeable buffers***, to be achieved ***through prudent fiscal policies, low public debt and adequate savings***.

It is my view, ***and I have said it before***, that we need to move to a ***more sustainable fiscal position***, even as we prepare for a ***gradual reduction in our dependence on energy sector taxes***. This strategy will require a ***combination of measures to increase non-energy tax collections*** and ***concerted efforts to reduce the share of subsidies and transfers in total government expenditures***. This kind of fiscal consolidation will allow a return to fiscal balance, ***while leaving adequate room for productive investment in education, health and infrastructure***. It will also permit an ***increase in the rate of savings in the Heritage and Stabilization Fund***.

We also need to find a way of pursuing a ***meaningful diversification*** of the non-energy sector ***that promotes an expansion in non-energy exports and a broadening of our non-energy export markets***. Currently, the bulk of our exports are directed to the US, the UK, and the Eurozone. The conventional wisdom is that, over the medium term, growth in these traditional markets would continue to lag behind the more dynamic emerging market economies – China, India and Latin America. The greater diversification of regional exports of goods and services towards these new growth poles, would make our non-energy sector less vulnerable to the kinds of shocks experienced in the past few years.

Ladies and Gentlemen

The latest budget has underscored the importance of public-private sector partnerships in the transformation of our economy. It has proposed a new financing mechanism through the Junior Stock Exchange and has again offered Government facilitation to gain entry into new export markets. It is high time that we stop ***talking about diversification*** and actually ***start doing it***. If we are to ensure our country's long-term economic viability and secure its economic future, it needs to happen sooner rather than later.

The time for action is now.