Jwala Rambarran: Trinidad and Tobago – reinforcing dialogue with the private sector

Feature address by Mr Jwala Rambarran, Governor of the Central Bank of Trinidad and Tobago, at the Inaugural Monetary Policy Forum with the Penal/Debe Chamber of Commerce, Debe, 18 December 2013.

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Ladies and Gentlemen,

Today is another historic day for the region of Penal/Debe. For the first time in nearly 50 years the Central Bank has ventured outside of its traditional comfort zone in Port of Spain, arriving at Penal/Debe to deliver its monetary policy message. I must, therefore, thank the Penal/Debe Chamber of Commerce for graciously agreeing to host our Inaugural Monetary Policy Forum. We intend to meet with other Chambers of Commerce across Trinidad and in Tobago to host similar events.

I strongly believe that, especially in these unusual times, greater dialogue with the private sector is critical. Such insights feed into the Central Bank's understanding of the workings of the Trinidad and Tobago economy, and thus into our policy deliberations. Equally important, these events allow the Bank to explain the thinking behind its monetary policy actions and to account to the national community, who we are here to serve.

So, why did we choose Penal/Debe as our first port of call? On reflection, the answer seems self evident. The region of Penal/Debe is demonstrating the type of self-sustaining economic growth that the entire country requires at this point in time. Such economic growth is being manifested through both the expansion of existing companies and the creation of new ones. It reflects increasing confidence among businesses and entrepreneurs.

As you drive along the SS Erin Road under almost every home is a small business, from furniture shops that I understand supply big furniture chains in Port of Spain, to large home town supermarkets. At least four new outdoor shopping complexes have been constructed in the community.

The construction of one of government's mega project – the UWI South Campus – is expected to drive growth in the area, as government looks to create a second education city centred on this campus in the Penal/Debe area. Construction of a Metal Industries Company training facility on Petrotrin lands a few miles away will also help generate technical and vocational opportunities in the area. This building – the NESC Debe Campus – opened in October 2012 year and has already graduated 72 students in IT and autotronics. It is the only MICROSOFT certified training facility in the country.

And it would be certainly remiss of me if I did not mention "Debe Doubles". Debe is one of the few communities to practically trademark and brand doubles to the wider country, highlighting the innovative nature of the people and the ability to tap into creative capital.

Ladies and Gentlemen, I probably do not need to remind anyone in this audience that we are indeed living in unusual times. Central banks and other policymakers around the world have been grappling for more than half a decade with an economic crisis which has repeatedly mutated, and it is still not clear in what direction the crisis is going to change shape.

Since May 2013, sentiment has shifted dramatically in global financial markets when US Federal Reserve Board Chairman Ben Bernanke made a small announcement that had big unintended consequences. The overreaction of financial markets to an earlier-than-expected start to the reduction of monetary stimulus in the United States resulted in large-scale capital outflows from major emerging markets economies such as India, Indonesia and Brazil, prompting several central banks to take defensive actions. Unexpected backtracking by the US Federal Reserve in September gave global financial markets some temporary comfort.

As I speak the US Federal Reserve's crucial December meeting is underway in Washington DC. Later today after 2 pm, we would get a better sense if and when the US Fed will start reducing its monetary stimulus. Economists are divided over whether the Fed will decide today to begin "tapering", with some saying that recent economic data is strong enough to warrant a move, and others that policymakers need to see more evidence that growth is durable.

Such volatility, however, about the future path of US monetary policy 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 the U.S. Federal Reserve begins to scale back its unconventional monetary policy that has been in place for the past five years or so.

As 2013 comes to an end, it looks like the world economy will be stuck in a subdued growth phase. Economic growth in the United States, while held back unnecessarily by Congress political brinksmanship, has again outpaced that of Europe and Japan, both of which are struggling to cross the 1 per cent annual growth threshold. The main emerging market economies of Brazil, Russia, India and China are all slowing, with Russia practically at a standstill.

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

- First, outline some of the key developments in the Trinidad and Tobago economy over 2013;
- Second, explain the monetary policy actions of the Central Bank in the context of evolving economic conditions; and
- Third, conclude with some thoughts on the short term outlook for Trinidad and Tobago.

Economic developments in 2013

Ladies and Gentlemen, let me begin with a brief overview of the evolution of domestic economic conditions. Here the news is very encouraging; it is definitely not all doom and gloom.

The Trinidad and Tobago economy has shown tremendous resilience against a turbulent global backdrop, and we are seeing signs of a gradual recovery from the sharp downturn that started in late 2008.

Our preliminary estimates suggest that the Trinidad and Tobago economy grew by 1.3 per cent in the first nine months of 2013, compared with a contraction of 0.3 per cent in the first nine months of 2012.

On-going large scale maintenance and safety upgrades at energy companies posed a considerable drag on the recovery process throughout 2013, especially in the third quarter when the energy sector underwent the largest co-ordinated maintenance effort to date. The subsequent sharp shortfall in natural gas production while anticipated adversely affected both refining activity and output of petrochemicals, generating a decline of 4 per cent in energy output, and an estimated contraction of ½ per cent in real GDP.

Intervention by the Ministry of Energy and Energy Affairs was critical to the maintenance work that involved bpTT and BG taking the bpTT Cassia B hub and BG Dolphin facilities offline. These turnarounds were co-ordinated with Atlantic LNG's Train 3 and nine major plants at the Point Lisas Industrial Estate.

Were it not for the planning and co-ordination of these maintenance events, we estimate that the contraction in energy output would have been severe enough to halt the recovery underway and push the economy back into negative growth territory for all of 2013.

On the other hand, the non-energy sector continued its slow but steady pace of revival, providing support to the overall economy but still not enough to fully offset the drag posed by maintenance activities in the energy sector. In fact, the non-energy sector has registered growth for the past ten quarters to September 2013, supported by the finance, construction and distribution sectors.

Growth in the finance sector was driven mainly by an expansion of commercial bank deposits and loans. The increase in construction activity was likely related to several public sector projects including highway construction and housing, and perhaps to a lesser extent some private sector projects. Local sales of cement – a key indicator of construction activity – were up by 12½ per cent (on a year-on-year basis) in the third quarter of 2013. The performance of the distribution sector reflected increased retail sales in several industries, including dry goods, supermarkets and groceries and motor vehicles. Regarding the latter, sales of new motor vehicles have been running at double digit rates into the third quarter of 2013. The PDA motor vehicle series was ended within a record 3 months.

In the face of still weak private demand, the government budget has served as the main stimulus to economic activity over the past few years. Given the country's strong foreign exchange reserves and low public debt to GDP ratio, I believe that the Government has enough fiscal space to run temporary budget deficits. In fact, since 2010 the central government has realized moderate fiscal deficits not exceeding 3 per cent of GDP. Nevertheless, it is important for the Government to respect its own plan for moving to fiscal balance over the medium term, and to accelerate these plans, once conditions permit.

Ladies and Gentlemen, our public debt remains within manageable levels. After a decade long absence, Trinidad and Tobago successfully returned last week to the international capital markets with international investors demonstrating overwhelming confidence in the country's medium term prospects. We were able to issue a US$550 million Eurobond that was oversubscribed by a factor of almost ten times.

Indeed, I see this tremendous vote of confidence by foreign investors as a much needed wake-up call to the local private sector. The message is clear. The local business community must get back into the game; stop watching and commenting from the sidelines.

Some commentators have questioned the rationale behind this bond issue. One concern relates to the government's decision to access the international capital markets rather than use the ample liquidity available in the domestic financial system. Another concern is that this bond issue could jeopardize our public debt situation. Let me put to rest these concerns.

First, Trinidad and Tobago enjoys the second strongest credit rating in Latin America and the Caribbean, after Chile. We need to leverage our investment grade credit rating to differentiate ourselves from other countries in the region, who are still struggling from the global crisis, and to highlight the quality of our economic management amidst the global uncertainty.

Second, it is true that government could have easily raised this volume of financing on the domestic capital markets but this option would not have allowed us to exploit our credit rating to re-establish a presence on the international capital market by issuing a benchmark bond. Moreover, it is important to note that the 2013/2014 budget, which was approved by Parliament, projected that almost $3 billion of the near $6.4 billion deficit would be financed through foreign borrowing including commercial borrowing.

Third, even with the bond issue the country's external debt dynamics stay well within comfortable levels. External debt is projected to rise slightly to a still very manageable 9 per cent of GDP from about 8 per cent of GDP prior to the bond issue. External debt service is expected to consume just about 2 per cent of export earnings from 1 ½ per cent prior to the bond issue. Few countries in the world can boast these impressive debt metrics.

So the Eurobond issue allows us to differentiate ourselves from our neighbours, re-establish a presence on the international markets and does not compromise our hard won prudent debt profile.

A key mandate of the Central Bank is price stability, which roughly translates into keeping underlying inflationary pressures well contained. Inflationary pressures have eased over the course of 2013. After beginning 2013 at just over 7.0 per cent (year-on-year), headline inflation slowed to about 4 ½ per cent by November 2013. The slowdown in inflation was largely associated with a steady fall in food price inflation reflecting increased domestic production of agricultural supplies, more favorable weather conditions, and an easing of global food prices.

Meanwhile core inflation, which excludes food prices, has been low and stable over the first eleven months of the year, ranging between 2–3 per cent, and indicative of relatively subdued demand pressures.

Of concern is that we are yet to see a broader pick up in business lending. Business loans granted by the banking system contracted for eight consecutive months, falling by about 3 per cent in September 2013. In such a situation, small businesses should not be facing a financing constraint. Money is available at very low interest rates to finance business expansion, subject to an evaluation of credit risk.

Meanwhile, we have seen relatively strong growth in consumer lending, especially for purchases of motor vehicles, home renovation and debt consolidation.

Aggressive marketing campaigns and lower mortgage rates continue to contribute to increasing demand for real estate mortgage loans. Although real estate mortgage loans granted by banks have recorded double digit growth for thirteen consecutive months to September 2013, there is no compelling evidence of overheating in the property market. More importantly, commercial banks have maintained their mortgage lending standards, with still conservative loan-to-value and loan service-to-income ratios.

On the external side, the demand for imports of goods and services has been quite robust, prompting the Central Bank to intervene deliberately in the foreign exchange market. In the first eleven months of 2013, the Central Bank sold US$1.3 billion to authorized dealers compared with US$1.7 billion one year ago. With the Bank calibrating its sales of foreign exchange to address imbalances in the foreign exchange market, the level of gross official reserves rose to US$9.3 billion at the end of November 2013. This represented more than 11 months' import cover.

Central Bank monetary policy actions

Before I turn to the Central Bank's monetary policy actions, I would like to reiterate the major changes made over the past year to the Bank's monetary policy decision making framework. These were as follows:

- Inclusion of two external members on the Monetary Policy Committee, to ensure that the MPC benefits from specialized expertise and diverse viewpoints in its policymaking deliberations.
- Changing the MPC meeting frequency from once a month to every two months to give the MPC a better opportunity to fully consider economic and financial conditions, including important issues and policy alternatives; and
- Communication of the Bank's monetary policy decisions, including the setting of the repo rate, to the public in the form of a "Monetary Policy Announcement" on the Friday evening of the week in which the MPC meeting is held.

Given the gradual pace of economic recovery and the stability of core inflation, the Central Bank has maintained a monetary stance geared towards supporting economic activity. This accommodative stance is reflected in the fact that the Bank has maintained its policy rate, the repo rate, at a historical low of 2.75 per cent for the past fifteen months.

However, with liquidity levels in the banking system high, the Central Bank took actions to help curb the excess liquidity. Over the first eleven months of 2013, commercial banks' excess reserves increased to a monthly average of $6.1 billion, up from a monthly average of $3.6 billion in the corresponding period of 2012. The main source of this liquidity is generated from the financing of the government's net domestic budget deficit. These fiscal injections amounted to $9.6 billion over the first eleven months of 2013.

Having reached the legal limit on the issue of treasury securities for the purposes of open market operations, the Central Bank sought and received approval from the Ministry of Finance and the Economy to facilitate the issue of two Treasury bonds, whose proceeds were sterilized. The first Treasury bond was issued in May 2013 at a face value of $1 billion and the second in August 2013 with a face value of $559.3 million taken from a $1 billion offering.

The Bank also rolled over for one year, the commercial banks' fixed deposits held at the Central Bank which matured to date in 2013. In addition, the Bank indirectly removed just over $8.0 billion from the system via the sales of foreign exchange to the banking system in the first eleven months of 2013.

In early December 2013, the Central Bank's liquidity management framework was enhanced with an increase in the borrowing limits under the Treasury Bills Act (to $30 billion from $15 billion) and the Treasury Notes Act (to $15 billion from $5 billion).

I wish to emphasize that these Treasury securities are purely for the purposes of monetary policy, not fiscal policy. The proceeds of the securities are locked away in a blocked account at the Central Bank and only re-enter the financial system upon maturity of the existing securities. These funds are not used to finance the government's budget or any government program.

I also wish to emphasize that this practice is not new. In January 2003, Parliament approved an increase in limits for both Treasury bills (from $2 billion to $5 billion) and Treasury notes (from $1 billion to $3 billion). In August 2006, Parliament again approved an increase in limits for both Treasury bills (from $5 billion to $15 billion) and Treasury notes (from $3 billion to $5 billion). By 2008, or within two years, these new limits were already reached and the Central Bank had to resort to rolling over existing maturities to mop up the excess liquidity.

Short-term prospects

I would now like to turn to the outlook for 2014.

It is fairly evident that uncertainty continues to weigh heavily on external conditions. Perhaps the most immediate downside risks to emerging markets, including Trinidad and Tobago, relates to shifting expectations about the future path of US monetary policy.

With firmly anchored inflation expectations, the Central Bank is giving more weight to an accommodative monetary stance until a firm domestic economic turnaround is established. However, we are paying close attention to the possibility of normalization of monetary policy in the United States. Should the outlook for inflation, growth, or financial stability change, we will take appropriate action.

Here at home, certain domestic factors seem to suggest a more optimistic outlook for 2014.

- First, as noted earlier, the significant maintenance work in the energy sector has been completed. Output in the upstream and downstream energy industries is expected to return to more normal levels in 2014, providing a strong boost to overall economic overall growth. In addition, drilling in the shallow water blocks, which were awarded in 2010, should commence in 2014. Further, the recent on-shore bid round attracted 11 bids, representing the highest level of interest in around 30 years. Awards for these bid rounds will lead to increased exploration activity in these blocks in late 2014 or early 2015.

- Second, there have been indications of a modest improvement in the pace of project implementation at the level of the central government. On-going public sector projects include the Point Fortin Highway, the Accelerated Housing Programme, the Education Modernization Programme and the Roads and Bridges Construction and Rehabilitation Project. In addition, the Caroni GREEN Initiative is expected to continue the enhancement of production in the Agriculture sector. Several projects undertaken by both the public and private sectors are expected to boost non-energy activity, while spill over effects from improving energy output should also positively impact non-energy growth.
- Third, for the most part businesses should not be facing major credit constraints. A final resolution to the long-standing CLICO issue, if successfully negotiated, should give a cautious boost to overall confidence and reinforce the positive economic growth trend.

On this basis, the Central Bank is projecting real GDP growth of around 1 ½ per cent for all of 2013. We expect economic growth to strengthen to 2 ½ percent in 2014.

Though increased demand side pressures created by the pick-up in economic activity can lead to some up-tick in inflation, we expect core inflation to remain stable. Recent initiatives to increase domestic food production should continue to help reduce food inflation, barring shocks such as unfavourable weather conditions.

Conclusion

In conclusion, I wish to reiterate that Trinidad and Tobago has been steadily navigating 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 usually tends to be one of negative sentiment.

When I assumed office just over 15 months ago, I faced the following economic conditions:

- Sharp contraction in economic growth
- Soaring food price inflation
- Declining external reserve position
- Weak business confidence

Today:

- Economic growth is slow but steady
- Food price inflation is down to within single digits
- External reserves have stabilized
- Business confidence is returning, albeit slowly

Therefore is not all doom and gloom. At the same time, we are not complacent. We recognize the inflection point faced by the global economy. We recognize the considerable economic challenges facing Trinidad and Tobago, especially diversifying away from the heavy reliance on the energy sector.

The Central Bank is absolutely committed to maintaining macroeconomic stability so the business sector can continue to make longer-term decisions in an environment of increasing 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 strengthen business confidence.

So now it is your turn to be the positive change you want to see in Trinidad and Tobago.

I thank you.