Jwala Rambarran: Trinidad and Tobago's economy against the background of global economic developments

Feature address by Mr Jwala Rambarran, Governor of the Central Bank of Trinidad and Tobago, at the Second Monetary Policy Forum, Tobago, 27 May 2014.

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Ladies and Gentlemen,

Today is an historic day for the Central Bank and for the people of Tobago. For just the second time in its 50-year history, the Bank has ventured outside of its traditional comfort zone in Port of Spain to deliver its monetary policy message. Events such as this Monetary Policy Forum give the Bank a platform to explain the thinking behind its monetary policy actions, interact with stakeholders and as far central banking regulations allow, account to the national community, who we are here to serve.

I must, therefore, thank the Tobago House of Assembly and Chief Secretary Orville London for graciously agreeing to host this, our second Monetary Policy Forum. For us Tobago was an almost obvious choice, given the diversification thrust in which tourism is being called upon to play an increasingly important role. In the IMF's Article IV Consultation Report 2011, Tobago is considered as having potential for substantial growth in tourism, owing to its conventional beach resort-type properties and ecotourism. We are aware there are challenges surrounding the Tobago Tourism Development Fund for stimulating new investment in hotel properties, and the Central Bank is working with the banks and the Ministry of Finance to find a solution.

Ladies and Gentlemen, I do not need to remind anyone in this audience that we are living in unusual times. I will start off this Monetary Policy Report, by placing Trinidad and Tobago's economy in relation to the world economy and some of the major economic developments.

Central banks and other policymakers around the world have been grappling for more than five years now with an economic crisis that is constantly mutating, and it's still not clear exactly how the crisis is going to evolve from here.

Although global financial tensions have eased, we are heading into mid-2014, with a world economy that looks like it will be stuck in a subdued growth phase.

Economic performance in the United States was weaker than expected in the first quarter of 2014, even though it outpaced that of Europe and Japan, both of which are struggling to cross a moderate 1 per cent annualised growth threshold.

Economic growth is also slowing in the larger emerging market economies. China, the second largest economy, is slowing below the government's growth target, and this is likely to lead to a drag on the global recovery, giving credence to the trending metaphor – when China sneezes the rest of the world catches a cold. Of course, that used to be said of the U.S.

The Russia-Ukraine conflict, which started early this year, has added a new dimension of uncertainty to global economic prospects, although to date contagion effects have been limited to those countries with direct trade and financial links to the Eastern European region. For Trinidad and Tobago, this is a double-edged sword. On one side any escalation in tensions between Russia and Ukraine could result in an increase in higher crude oil prices. On the other side, wheat prices could increase, which will translate into higher food prices for Trinidad and Tobago.

The changing monetary policy stance in major advanced economies remains a key focus of global financial markets. Of the major central banks, only the United States Federal Reserve, with its new Chairman, Janet Yellen, has started the process of scaling back its unconventional expansionary monetary policy that has been in place for the past five years. This highly anticipated tapering only takes into account U.S. domestic conditions. In other words, emerging market economies, including Trinidad and Tobago, are left to fend for themselves and navigate the spill-overs and policy mistakes that could arise from U.S. monetary tapering.

One year ago, the Fed's announcement that there would be an earlier-than-expected start to the reduction of quantitative easing rattled some large emerging market economies. This resulted in capital outflows, depreciating currencies, and tumbled stock and bond markets.

So, given the global prospects I want to talk to you about three things:

- First, outline some key developments in Trinidad and Tobago's economy over the past six months or so;
- 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 economic outlook for Trinidad and Tobago.

Recent economic developments

Ladies and Gentlemen, I'll begin with a brief overview of domestic economic conditions since the release of our last Monetary Policy Report in November 2013. Here the news continues to be encouraging; Trinidad and Tobago is in recovery mode.

After a few years of sub-par performance, Trinidad and Tobago's economy delivered faster-than-expected growth of almost 2 percent in 2013.

The on-going large-scale maintenance and safety upgrades at energy companies posed a considerable drag on recovery throughout 2013. This impact was concentrated in the third quarter, when the largest coordinated maintenance upgrades occurred.

Activity in the non-energy sector, though slow and steady, provided critical support which kept the economy from veering off track.

This performance continued into the first three months of 2014, although the rebound in the energy sector in the fourth quarter of 2013 did not fully carry over into early 2014.

Two events temporarily affected energy production in the first two months of 2014 – BPTT took down its Savonette Platform to accommodate drilling at another well and Petrotrin undertook planned maintenance at its Pointe-a-Pierre oil refinery. However, energy output bounced back by March 2014.

The non-energy sector maintained its growth momentum into 2014. Local sales of cement – a key indicator of construction activity – showed a favorable outturn. The increase in construction activity reflected several on-going, large public sector projects, including the highway to Point Fortin, and, perhaps to a lesser extent, some private sector projects breaking ground, such as... the "C3" movie and shopping complex in Corinth, South Trinidad. New car sales are still hitting double-digit rates. Also, higher crop production under the Caroni Green Initiative is supporting growth in the agricultural sector.

A key mandate of the Central Bank is price stability, which roughly translates into keeping underlying inflationary pressures well contained. Inflationary pressures have remained subdued so far in 2014. Headline inflation slowed to just under 3½ percent by April 2014. This ease in inflation was largely associated with a steady fall in food price inflation to single digit territory.

Falling food prices reflected improved domestic agricultural output, better domestic weather conditions, and an easing of global food prices.

Meanwhile core inflation, which excludes food prices, picked up slightly, to around 2½ percent, but remained stable in the first four months of 2014. This is indicative of improving economic activity.

We are also starting to see a pick-up in business lending. After contracting for an entire year, business loans granted by the banking system rose by a little over 2 percent in February this year and further increased by almost 3½ percent in March.

We have also seen relatively robust growth in consumer lending, especially for purchases of motor vehicles, home renovation and debt consolidation.

Record low mortgage rates continue to spur demand for real estate mortgage financing. Although such loans continue to record double-digit growth to March 2014, and there has been an increase in property prices, there is no compelling evidence to suggest overheating in the residential property market. More importantly, commercial banks have maintained their prudent mortgage lending standards.

Over the past few years, ***the Government's budget*** has been the main stimulus supporting economic recovery. The non-energy budget deficit is the key indicator of whether Government is engaged in fiscal stimulus activity.

After running a non-energy fiscal deficit of just over $19 billion in 2012/2013, the central government ran a non-energy budget deficit of $12 billion in the first six months of fiscal 2013/2014. At this pace the government is likely to meet its projected budgeted stimulus for the entire fiscal year.

Foreign exchange

Ladies and Gentlemen, I now turn to a matter grabbing headlines and generating intense interest in the country over the past few months, and the reason I suspect most reporters are here this morning ….. to grill me about-***foreign exchange.*** There have been many opinions circulating on this topic and I will say in most cases these opinions are uninformed. The foreign exchange matter came to a head last week when this sensitive issue entered the political domain with comments made by those who displayed little knowledge and understanding about the Central Bank's role in the domestic foreign exchange market.

So please allow me say a few words about the Central Bank's actual role in the foreign exchange market.

First, the Bank seeks to foster orderly conditions in the market, mainly by meeting the gap between the demand for, and the supply of, foreign exchange. This gap arises because the general public and the business community usually consume more foreign exchange than is generated by companies in the energy sector which are our main suppliers of foreign exchange. Demand for foreign exchange is continuous throughout the year but the supplies come in at discrete intervals.

This leads to periodic tightness in the domestic foreign exchange market which the Central Bank alleviates by selling foreign exchange from its stock of official reserves to the banks.

Second, until April 2014, the Central Bank was using a twenty year-old system to sell and distribute foreign exchange to the banks. As an aside, I was part of the team at the Central Bank that instituted this distribution system following liberalization of the foreign exchange market in April 1993. This system served the market well, particularly in the early years. Over the past 20-odd years, however, there was little, if any, modification this arrangement even though the economy experienced various episodes of stabilization, growth its third energy boom, stagnation, and now recovery that fundamentally altered the foreign exchange demand/supply equation.

Over the last two decades, demand for foreign exchange not only expanded but its composition changed to reflect new patterns of consumer spending (for example, use of credit cards for making online payments) and new forms of investment (with no capital restrictions, citizens can move money freely to any part of the world).

In 1993 the demand for foreign exchange amounted to $US900 million dollars. Ten years later this demand almost tripled to $US 2.6 billion in 2003. By 2013 demand had risen by more than 2 1/2 times to $US7.0 billion.

At the same time, the supply of foreign exchange increased, but was outstripped by demand. In 1993 the supply of foreign exchange amounted to $US856 million. Ten years later this would increase by almost 2 1/2 times to $US2 billion. In 2013, the supply of foreign exchange almost tripled to $US 5.8 billion. This prompted the Central Bank to intervene with increasing volumes of foreign exchange to quell excess demand pressures. In 1993 the Central Bank sold a mere $US33 million; this jumped to almost $US500 million by 2003 and in 2013 the Central Bank sold $US1.7 billion to the banking system.

So with growing tightness in the domestic foreign exchange market since the start of the year, the Central Bank reviewed its twenty year-old arrangement for distributing foreign exchange to the financial system. Two fundamental changes were made, effective at the start of April 2014. First, we included all 12 licensed authorized dealers in the distribution system, providing everyone with greater access to more evenly distributed supply. Previously, only eight authorized dealers were part of the arrangement. Second, we made more use of the auction system so that supply of foreign exchange could go to where demand was greatest, based on price.

After nearly two months of operating the new foreign exchange distribution system, we made further improvements to the system's internal back-office operations, but we did not alter its fundamental parameters. This enhanced distribution system, coupled with more timely and sizable interventions, is expected to meet all immediate trade related demands: from the foreign-used car dealers to manufacturing companies, small and medium businesses and conglomerates. For the first five months of 2014, we sold US$610 million to the financial system, with the most recent being a sale of US$200 million.

Let me make this clear: the new changes to the foreign exchange distribution system were not ineffective, but change is always difficult to accept. Foreign exchange management is a highly sensitive area of central banking. We are not at liberty to divulge the details of our operations. However we have been regularly communicating as much as we are allowed to under the Central Bank Act on this matter. This central bank is not more secretive than any other.

I am not being defensive, but irresponsible statements on central banking matters pose a real danger to our country. I, therefore, want to assure the country that there is no risk of devaluation of our dollar. We have enough foreign exchange reserves to satisfy demand.

As of mid-May 2014, the stock of foreign exchange reserves is almost US$ 10.5 billion, more than enough to cover over one year of imports.

This is all I can and will say in this matter today.

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 are as follows:

- Inclusion of two external members on the Monetary Policy Committee (MPC), to ensure that the MPC benefits from specialized expertise and diverse viewpoints in its policymaking deliberations;
- Reducing the frequency of the MPC meeting from once a month to every two months, in order to give the Committee 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 stability of core inflationary pressures, the Central Bank has continued to maintain an accommodative monetary stance. This is reflected in the fact that the Bank has maintained its policy rate, the repo rate, at an historical low of 2.75 per cent since September 2012.

Our liquidity management capacity was improved in December 2013 when Parliament approved increased borrowing limits on the issue of Treasury Securities for the purposes of open market operations. The limit under the Treasury Bills Act was doubled to $30 billion, and under the Treasury Notes Act was tripled to $15 billion. We now have an additional $25 billion dollars in Treasury Securities that we can issue to absorb excess liquidity in the banking system.

I again 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.

I must emphasise that these funds are not used to finance the Government's budget or any Government programme.

With elevated liquidity levels, the Central Bank increased its open market operations in April 2014, removing roughly $1.2 billion from the banking system. However, the maturity of a $1 billion Central Government bond at the end of April 2014 pushed liquidity levels even higher. Subsequently, in the first three weeks of May 2014, excess liquidity climbed to an average of $8.3 billion, from an average of $6.3 billion in April.

The Central Bank undertook other liquidity management measures over the past six months, including the rolling over of three commercial banks' special deposits which matured during the period. The Bank also indirectly removed liquidity from the system through its sales of foreign exchange. The Bank will intensify its open market operations as well as use other liquidity absorption measures to rein in excess liquidity in coming months.

Short-term prospects

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

While we expect a strengthening of the global economy over the next few years, it is fairly evident that uncertainty continues to weigh heavily on short-term prospects. Perhaps the most immediate downside risk to emerging market economies, such as Trinidad and Tobago, relates to shifting market expectations about the future path of US monetary policy, as I mentioned earlier.

Here at home, the first Business Confidence Survey, conducted by the Central Bank and Arthur Lok Jack Graduate School of Business found the local business community is cautiously optimistic about the prospects for business activity and the economy for the remainder of 2014.

Several factors support Central Bank's 2014 outlook:

- First, energy production returned to more normal levels in March 2014, providing a strong boost to the economic recovery now underway. Drilling in the shallow water blocks has commenced and some new development wells have been drilled.

Awards for on-shore bid rounds will lead to increased exploration activity in these blocks in late 2014 or early 2015.

- Second, there has been an improvement in the pace of project execution at the level of the central Government. On-going large public sector projects include the Point Fortin Highway, the Children's Hospital and the National Aquatic Centre. These, combined with other projects undertaken by the private sector, are expected to further boost non-energy activity. Improving energy output should also have a positive impact on non-energy growth.
- Third, the Central Bank has begun to implement its resolution strategy for CLICO. This strategy always envisaged the sale of CLICO's traditional book of business to a third party insurance company. As we undertake this sale and transfer of the portfolio, in accordance with legislative requirements, CLICO's traditional policyholders have nothing to worry about. They will continue to be serviced by CLICO. The long-standing CLICO issue, when successfully concluded, should give a further boost to overall confidence, and reinforce the positive economic growth trend.
- On this basis the Central Bank expects real GDP growth to strengthen to at least 2.5 percent in 2014.

Over the past few years, record low domestic interest rates have contributed to consumers borrowing more to finance spending on high priced consumer durables such as motor vehicles. Domestic interest rates have also fallen below or are just above those in the United States, which means investors are more likely to be attracted to seeking higher investment returns in the United States leading to capital outflows.

Looking ahead, the strengthening of our economic recovery, rising consumption and the threat of higher international agricultural commodity prices, all suggest inflationary pressures could increase in the coming year. With a firmly established economic recovery, the Central Bank will start giving more weight in its monetary policy deliberations to managing rising inflationary pressures.

This will initially start with a gradual withdrawal of our accommodative monetary stance. Should the outlook for inflation, growth, or financial stability change, we will take appropriate monetary action.

Conclusion

In conclusion, I wish to reiterate that Trinidad and Tobago has shown tremendous resilience. Yet this is not the message that we continue to absorb as a nation. Instead, it usually tends to be one of negative sentiment.

When I assumed office nearly 2 years ago, I faced the following economic conditions:

- Sharp contraction in economic growth
- Soaring food prices – inflation at 25 percent
- Declining external reserve position
- Weak business confidence

Today:

- Economic recovery is established – the economy is expected to grow is by at least 2.5 percent
- Food price inflation is down to within single digits – standing at 4.0 percent
- The difficulties in the foreign exchange market will dissipate in the coming weeks

- Business confidence is cautiously optimistic and should be bolstered by a successful conclusion to the CLICO resolution, which is underway.

Therefore it's not all doom and gloom. At the same time, we at the Central Bank are not complacent.

We recognize the significant threats faced by emerging markets such as Trinidad and Tobago's in the still uncertain global economy. We see the obstacles that are on our road to recovery.

The Central Bank continues to monitor the economic landscape and exercise our monetary options. As business leaders and stakeholders, we encourage you to take your place and be the positive change you want to see in Trinidad and in Tobago. I thank you.