



CENTRAL BANK OF
TRINIDAD & TOBAGO

**ASPECTS OF TRINIDAD AND TOBAGO'S GLOBAL ECONOMIC
INTERACTIONS**

by

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1. *Trinidad and Tobago is deeply embedded in world economic affairs.* Trading in goods has always been significant, with exports of food crops (sugar, cocoa) giving way to energy and energy-based commodities (oil, natural gas, methanol, urea etc.) in exchange for a wide range of imports. Over time, with advances in transportation, communication and technology more services began to be traded, either directly (for example tourism or insurance) or via the movement of seasoned professionals or less skilled workers. Nowadays, with an open external capital account, financial flows also feature prominently. Foreign direct investment is attracted by comparative long term prospects, while portfolio flows often move rapidly in response to perceived short term changes in risk and profit opportunities. Against this backdrop it is evident that changes in international energy prices or a recession in the United States would directly affect the local economy. But seemingly remote developments—such as migration patterns in Europe, the integration of

the renminbi as a reserve asset, or the loss of correspondent banking relationships by Belizean banks—can likewise have deep repercussions for Trinidad and Tobago. Moreover domestic economic policies and performance can have extensive consequences for neighboring territories, with feedback effects on Trinidad and Tobago itself.

2. *The characteristics of the economy and the relationships built over time necessitate constant attention to external dynamics.* Comparatively speaking, Trinidad and Tobago is tiny, with land space of just 5,131 square kilometers and population of 1.3 million, a small fraction of the number of persons in many Latin American cities. Nonetheless, per capita GDP of over US\$16,000 puts the country in the World Bank's high income category, while its energy base has attracted major multinational companies. It is widely considered as the financial capital of the Caribbean, with Trinidad and Tobago companies setting up shop or investing directly in other territories. A relatively low unemployment rate has served to attract other Caribbean nationals, and depending on the fiscal position, the state has been able to provide project or grant funds to neighboring nations. In terms of economic influence in the international arena, Trinidad and Tobago has generally punched above its weight, being a founding member and the only Caribbean country in the G-24¹ and often taking leadership roles in issues raised at the Boards of the International Monetary Fund and World Bank. In light of this perspective, I'd like to take the opportunity to highlight five aspects of the country's interactions with the rest of the world and the associated implications for public policy and private sector behavior. These are: (i) dependence on commodity cycles; (ii) financial interconnections; (iii) interest parity and capital movements; (iv) the current global economic outlook, particularly for emerging markets; and (v) labor mobility and remittances.

3. *The clearest expression of our external dependence is in exposure to commodity cycles.* As a small producer, Trinidad and Tobago does not have the clout to directly influence global energy prices. With the bulk of exports derived from energy, or energy-based products, the balance of payments and fiscal operations move largely to the rhythm of externally determined prices. Between 2000 and 2015, energy exports accounted for 83 per cent of export values, while taxes on the energy sector made up 39

¹ The Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development (G-24) coordinates the position of developing countries in the deliberations and decisions of the International Monetary Fund and World Bank.

per cent of fiscal income. Oscillations in oil/natural gas prices have largely shaped the boom-bust cycles over the last half century, despite attempts to smooth consumption by saving during years of windfall. The latest episode of depressed energy prices is significant—oil prices dropped from US\$100 per barrel in 2008 to a low of around US\$48 in 2015—and this was exacerbated by declines in domestic energy production. However, significant buffers in the form of fiscal space due to relatively low public sector debt, high international reserves (close to a year of import cover) and savings in the form of a Heritage and Stabilization Fund (just over half of the level of official international reserves) have provided some breathing room from the need for immediate full scale economic adjustment.

4. ***But there is a very real possibility that recent energy price movements could reflect secular, as opposed to cyclical, trends.***² Swings in energy prices have often been characterized as components of a broader pattern of cyclical commodity price fluctuations. This analysis relates the combination of periodic changes in demand (associated with regional or global macroeconomic conditions) and alterations in supply (due to weather patterns, decisions of suppliers or technical factors) with alternating up and down price patterns. The present situation in the energy markets may be different. Most analysts expect oil prices to remain low for a long time for several reasons: on the supply side, the advent and relative resilience of shale oil production and increased oil production by OPEC members play an important role. As regards demand, lower GDP growth in emerging markets has tended to reduce oil demand growth, especially in light of the secular increase in global oil efficiency. Natural gas price declines also appear to be long lived in light of the North American shale gas boom, recent discoveries of vast gas fields in developing countries and the resumption of nuclear-powered electricity generation in Japan. If this assessment holds true, a permanent shift in energy prices would require not only short term stabilization efforts to deal with initial balance of payments and fiscal difficulties, but a more fundamental reengineering of the Trinidad and Tobago economy to deal with lower energy export and fiscal earnings.

² In its latest *World Oil Outlook*, the Organization of Petroleum Exporting Countries (OPEC) assumes its OPEC Reference Basket will average US\$45 in 2017 and gradually increase by US\$5 per year through 2021. That implies it will not be until 2020 that crude reaches US\$60 per barrel, substantially lower than the US\$80 forecast in its 2015 *Outlook*.

5. *Second, our financial system is closely linked to world markets and this will continue.* Many of Trinidad and Tobago's indigenous and foreign-based banks have branches, headquarters or subsidiaries throughout the Caribbean, North America, Latin America, India and more recently Africa. Ownership and investment patterns of insurance companies are also diverse and there is an increasing incidence of conglomerates combining a wide range of financial service offerings, sometimes alongside other products. This increasing global interconnectedness of diverse financial entities sets the stage for a rise in cross-border mergers and acquisitions, necessitating closer collaboration among regulators in different territories. In this regard, and to treat with the possibility of regulatory arbitrage (where financial companies gravitate to the jurisdiction with the least amount of supervision) the Caribbean Group of Banking Supervisors and related associations in the fields of insurance and securities have already started to beef up their cooperation and information sharing. Moreover, it must be recognized that the risk of contagion—the transmission of problems from other jurisdictions to domestic financial companies—is becoming more apparent due to the intensity of financial linkages.

6. *Trinidad and Tobago must achieve global compliance standards if it is to avoid being 'de-risked'.* A major issue that has emerged in recent years is the threat of the loss of correspondent banking relationships, particularly for small developing countries. Basically, it involves the growing tendency of some large banks in developed countries to end their 'correspondent' relationships with banks in smaller territories; such relationships allow financial transactions to be processed in the developed countries (mainly the United States, United Kingdom and Europe). The consequences of such loss could be severe for the smaller territory, negatively affecting the flow of remittances and all payments for cross border goods and services and pushing transactions outside of the formal financial system. Much discussion is currently underway on the problem and solutions.³ In the case of Trinidad and Tobago, the incidence of withdrawal of correspondent banking services has so far been limited. However, there is an urgency for the country to fully adhere to tax compliance accords and international anti-money laundering/anti-terrorism financing

³ Most recently in October/November 2016 at a Conference at the IMF/World Bank Annual Meetings in Washington, D. C., a Stakeholders Conference in Antigua and Barbuda and a High Level IMF Conference in Trinidad and Tobago.

standards⁴ to forestall the possibility that the jurisdiction (and by extension domestic financial institutions) is characterized as lax in compliance, thereby hindering international financial relationships.

7. ***A third aspect of global interaction involves recognition of the importance of interest parity conditions in the determination of inward and outward capital flows.*** Technically speaking, “interest rate parity” involves a relationship in which interest rate differential between two countries is equal to the differential between the forward exchange rate and the spot exchange rate. In plain English, this means that for Trinidad and Tobago the difference between local interest rates and foreign rates matters in terms of attracting capital or investment, and this has a bearing on exchange rates in the future. Underlying this notion is the understanding that where there are no restrictions on the movement of capital across borders, then investors would place their funds where the returns are highest, taking into account their expectations of exchange rate movements and their perception of the riskiness of the investment climate. This sounds complicated but let me explain what this implies in practical terms.

8. ***Monetary policy must be sensitive to external interest rates while consistent and credible macroeconomic policies help to guide expectations and risk perception.*** As is well known, interest rates across the globe are at all-time lows and the United States has been on an extremely gradual path of raising rates as its economy has improved. In tandem, interest rates in Trinidad and Tobago have slipped over the years—3-month Treasury bill rates averaged 0.97 per cent in 2015 compared to 10.78 per cent in 2000! Taking into account, among other things, the path of US rates, the Central Bank raised the domestic repo rate from 3.25 to 4.75 per cent over the course of 2015 with a subsequent pause in 2016 to date. Moving forward, we can anticipate that the trajectory of external rates would have a bearing on domestic monetary policy actions. Concerning the wider subjects of exchange rate expectations and risk perception, a crucial factor will not only be how monetary policy is conducted but also the comprehensiveness and consistency of the overall macroeconomic adjustment program. As noted earlier the terms of trade shock is large; moreover, an announced fiscal adjustment program is in train within the context of a recently unveiled Central Government budget. Success in coordinating adjustments on the

⁴ Most immediately implementation of the United States Foreign Account Tax Compliance Act (FATCA) conditions and the Financial Action Task Force (FATF) requirements in the sphere of money laundering and countering the financing of terrorism.

fiscal, structural and monetary fronts would be vital in smoothing the way to an economy less reliant on energy exports.

9. *The fourth issue relates to how Trinidad and Tobago fits into the current global economic outlook, particularly for emerging market economies.* The latest IMF's *World Economic Outlook* published in October 2016 is sobering. The organization's Chief Economist summarized it neatly (if not cheerfully) by saying that "the world economy is moving sideways". A number of key factors that are relevant to Trinidad and Tobago were cited as coloring the prognosis, including the response to Brexit and the implications for trade and institutional relations between the United Kingdom and Europe; China's short term economic prospects; some firming of non-energy commodity prices; the risk of subdued growth leading to anti-integration policies gaining more traction in the advanced economies; and the daunting policy challenges faced by emerging market and developing economies in adjusting to weaker commodity prices. The Fund estimated that the probability of a recession in the short run in Latin America was around one in three and in the rest of the world (excluding the US, Europe, Japan and emerging Asia) was about 50:50. A fair summary of the policy message for developing countries and emerging markets is that they should build resilience to deal with a complicated external environment.

10. *But it is a two-way street, and domestic policies will impact other countries, especially our neighbors in the Caribbean Sea.* It is revealing how closely Caribbean nationals follow economic and other developments in Trinidad and Tobago, via traditional or social media. To a large extent this reflects not simply curiosity but an underlying recognition of how much Trinidad and Tobago affects them. In the economic sphere, the interdependence is easiest to see in episodes when energy prices have surged, positively impacting Trinidad and Tobago but negatively affecting the oil-importing territories. But even currently as energy prices have dropped, many Caribbean countries confront conditions of low growth, high debt and minimal fiscal space. In terms of direct support, Trinidad and Tobago has been able to provide financing to Caribbean countries via, among other things, a Petroleum Fund, a CARICOM Multilateral Clearing Facility and contributions to the CARICOM Development Fund. Fiscal constraints could affect the magnitude and timing of such financing. More generally, other policies have had a direct bearing on the competitiveness of Trinidad and Tobago companies. Energy costs of

manufacturers are a small fraction of costs in other territories; consequently, policies to reduce energy subsidies would lower the comparative advantage of locating plants in Trinidad and Tobago. The main lesson is that the linkages with other Caribbean countries are so tight that domestic economic measures can have regional impacts and eventually feedback on Trinidad and Tobago itself.

11. *Finally, economic factors will remain a dominant consideration in migration decisions.* A concrete repercussion of uneven economic opportunities across countries is the incentive to relocate. Recent data on migration are limited but 2011 statistics show that immigrants to Trinidad and Tobago numbered just under 50,000, with most originating from the Caribbean. For the most part emigration from Trinidad and Tobago has been to North America and the United Kingdom. Over the last decade or so, local businesses have complained about gaps in the labor forces for some highly specialized jobs but more generally for occupations requiring very low specific skills and education, for example basic security services, cleaning assistants and shop workers. The low level skill worker deficiency has tended to encourage nationals from other countries to fill the vacancies; in addition several major construction projects have employed Chinese workers and difficulties in Venezuela led to some migrants from that country. A telling result of the migration dynamics is in the data on remittances by workers to their families abroad. Outward remittances surpassed remittances from abroad in 2014; by 2015 there was a net outflow of remittances from Trinidad and Tobago on the order of US\$43 million.

12. *The migration issue generates latent and potentially substantial medium term implications for public policy.* In principle, the movement of workers across territories would simply help to bring demand and supply of labor into balance and improve efficiency and production. The ongoing struggle with migration in Europe however shows that, on a large scale, the repercussions could be much more complex, spilling into humanitarian, cultural, ethnic, security and other spheres. In the case of Trinidad and Tobago, the most apparent economic consequences of migration relate to: (i) wage rates in the relevant sector; (ii) employment conditions of migrants relative to locals; (iii) the provision of social and other services to migrants; (iv) the portability of national security, pension and other benefits; and (v) taxation of migrants. In essence, therefore, these consequences must be taken into account in the design and implementation of

policies that impinge on the attractiveness of Trinidad and Tobago for migrants, including public sector employment programs that draw workers out of other low skilled jobs. Having brought into the discussion the topic of migration, alongside the earlier subjects of commodity prices, financial interconnections, interest parity and the global outlook, what are the lessons for analysts and decision makers?

13. ***Data and intelligence on Trinidad and Tobago's economic interaction with the rest of the world must be comprehensive, timely and meaningful.*** In order for private and public sector decision makers to effectively deal with the issues related to the country's global economic activities, data is crucial. Detailed and as far as possible real time statistics on energy markets, financial indicators, market sentiment, developments and prospects in other economies, and on migration must be constantly on hand. There are undoubtedly some existing deficiencies that must be immediately addressed. For example, comprehensive trade data is critical in assessing the external accounts but this is now only available with a lag of about a year. A longer term collaborative endeavor to improve collection, the technical basis of the statistics and dissemination of relevant data and market intelligence must be a priority.

14. ***Moreover, domestic policies must formally integrate feedback effects from external reactions.*** The analysis above has shown that Trinidad and Tobago's external interface is quite layered, with a number of complicated and interwoven dimensions. As a result, concerted effort should be put into investigation and explanations of world events and the potential short and long term impact on the domestic economy. Having done this, it would be important to ensure that as policies are developed there is regular and formal assessment of the second or third round feedback effects arising from external factors. Finally, a strengthening of coordination among technicians, public policy makers and private sector agents would help to accelerate the extension of Trinidad and Tobago's influence in economic matters at the regional and world levels.

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