Republic Economic Newsletter

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Increasing Stability and Growth

Overview

Following growth of 2.1 percent in the 4th quarter of 2013, Republic Bank estimates economic activity expanded by 1.5 percent in the first quarter of 2014. Growth was led primarily by the non-energy sector, as construction and distribution activity continued to expand. Output in the energy sector was adversely affected by the interruption of production at BPTT and Petrotrin during the first quarter. However, with exploration activity intensifying, the energy sector is expected to see an improved performance later in the year. Inflationary pressures remain dormant but with government expenditure projected to increase, and given sustained consumer demand, price levels should begin to pick up.

Trinidad and Tobago Key Economic Indicators

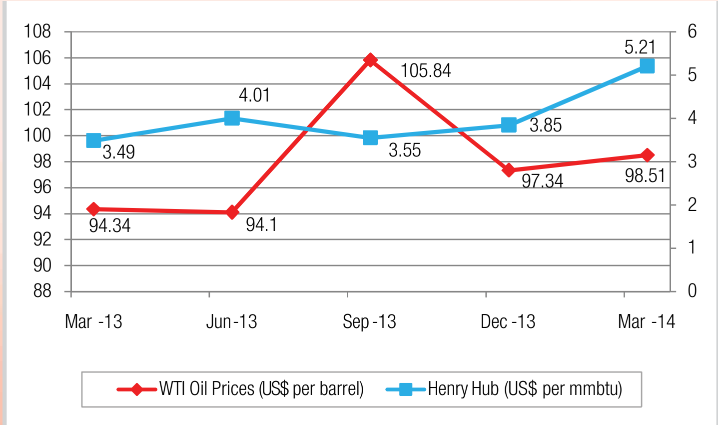
Indicator	2013	2013.1	2014.1 p/e
Real GDP (% change)	1.6	2.3	1.5
Retail Prices (% change)	5.2	6.7	3.76
Unemployment Rate (%)	N.A.	3.7	4.0
Fiscal Surplus/ Deficit ($M)	-4,175.2	-1,752.7	2,570.6
Bank Deposits (% change)	12.4	-3.09	5.69
Private Sector Bank Credit (% change)	3.7	4.6	1.9
Net Foreign Reserves (US$M)	12,334.4	11,531.4	12,351.5
Exchange Rate (TT$/US$)	6.37 / 6.43	6.37 / 6.44	6.40/ 6.45
Stock Market Comp. Price Index	1,185	1,096	1,171.28
Oil Price (WTI) (US$ per barrel)	97.91	94.34	98.75
Gas Price (Henry Hub) (US$ per mmbtu)	3.73	3.49	5.21

Source: Central Bank of Trinidad and Tobago, TTSE, EIA
p - Provisional data
e - Republic Bank Limited estimate

Energy Sector

The temporary disruption of operations at the BPTT and Petrotrin facilities, caused oil production to decline to 74,799 barrels per day (bpd) in January, however crude oil production rebounded by March 2014, increasing to 82,316 bpd. Natural gas production also increased from 4,092 mmscf per day during the last quarter of 2013 to 4,251 mmscf per day during the first quarter of 2014. Energy prices improved marginally in the first quarter, with oil prices rising from US$97 per barrel in the last quarter to US$99 (Figure 1). The sector also benefited from increased exploration activity. In April of this year, Caribbean Rex Limited drilled its first onshore well in its Moruga field. This is the first of five onshore wells that Caribbean Rex is undertaking in its South Erin and Cory Moruga fields for 2014. Additionally, Touchstone Exploration Inc. was expected to begin drilling in Grande Ravine in the second quarter. In total, 20 wells were drilled in the first quarter of the year, with 11 of those wells being completed. In terms of deep water exploration, despite the lacklustre response to the country's latest deep water bid round, with only 2 out of 6 blocks receiving bids, BHP Billiton is set to begin 3D seismic surveys later this year. This augurs well for the future of the industry, with possible discoveries of hydrocarbons adding to the economic potential of the energy sector over the long-term.

Figure 1 Energy Prices (US$)



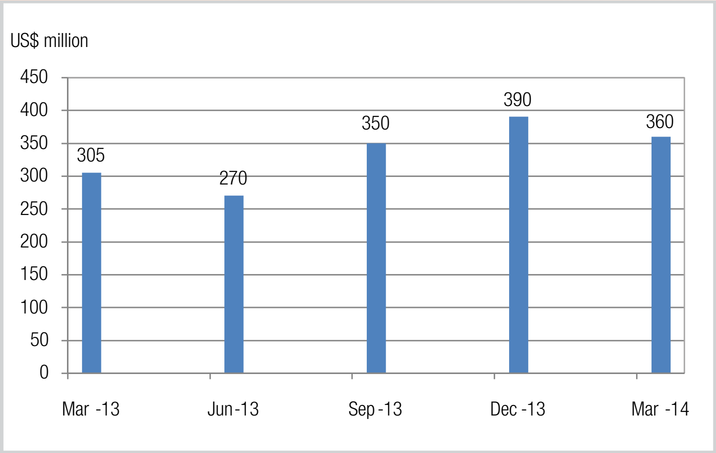
Non-energy Sector

Preliminary information indicates that the non-energy sector continued to expand, with activity in the construction and distribution sectors, intensifying. Increased cement sales of 7.5 percent in the first quarter, as well as new car sales of 12.5 percent, point to buoyant activity in the construction and distribution sub-sectors.

Foreign Reserves

Notwithstanding net foreign reserves of $12,351 million, at the end of March 2014, the new system introduced for sales of foreign exchange by the Central Bank, created a great deal of uncertainty. As a result of the uncertainty, the system was faced with a perfect storm of inequitable supply and demand, panic buying by customers and closer management of foreign exchange positions by financial institutions. The business community experienced challenges in sourcing adequate quantities of US dollars from the banks, negatively affecting relationships with some external suppliers. Recognizing this uncertainty in the market, the Central Bank sought to allay these fears by injecting US$50 million in early May, as well as another US$200 million in the later part of the month. Furthermore, in June the Central Bank gave its assurance that it will meet all the foreign exchange needs of the commercial banks with a US$30 million injection (primarily for retail purposes) and the promise of other injections as necessary. Such guarantees reduced the uncertainty and encouraged most of the players to revert to their normal systems and policies.These injections, along with further amendments to the new auction system, will certainly aid in settling the anxiety created in the market.

Figure 2: Central Bank Foreign Exchange Sales

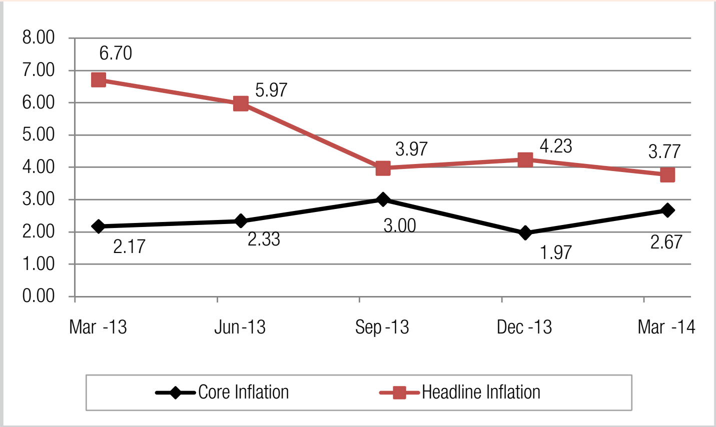


Monetary Policy

Inflationary pressures remained subdued for the first quarter of 2014, averaging 3.77 percent, down from the 4.23 percent recorded in the last quarter of 2013. This can be attributed to moderating food prices, which increased by an average of only 5 percent year-on-year in the first quarter of 2014. Core inflation, on the other hand has been trending upward, averaging 2.77 percent in the first quarter, up from 1.97 percent in the fourth quarter of 2013 (Figure 3). The Central Bank has nevertheless maintained its accommodative monetary policy stance, keeping the “Repo Rate” unchanged at 2.75 percent in the first quarter. However, the Bank continues with its aggressive open market operations. According to the latest Central Bank announcement in May, approximately $1.2 billion was removed from the banking system in April, causing excess liquidity to decline to approximately $6.3 billion. This was short-lived, as the maturity of a billion dollar liquidity bond in April caused liquidity levels to increase once again. Following this, another billion dollar bond was auctioned in June. These measures, along with foreign exchange sales will continue to be utilised by the Central Bank, as a means of controlling liquidity pressures.

After stagnating in 2013, private sector credit is beginning to show signs of recovery, growing by 1.9 percent in the first quarter when compared to the 4th quarter of 2013. For the month of March it grew by 6 percent, up from 2.25 recorded in March 2013. Loans to the distributive sector, as well as real estate mortgages, were the major contributors to this growth. In the consumer segment, loans remained upbeat in the first quarter, growing year-on-year by 5.7 percent, with motor vehicle loans and real estate mortgages experiencing marked increases. Real estate mortgages, recorded double digit growth of 11.4 percent in the first quarter of the year.

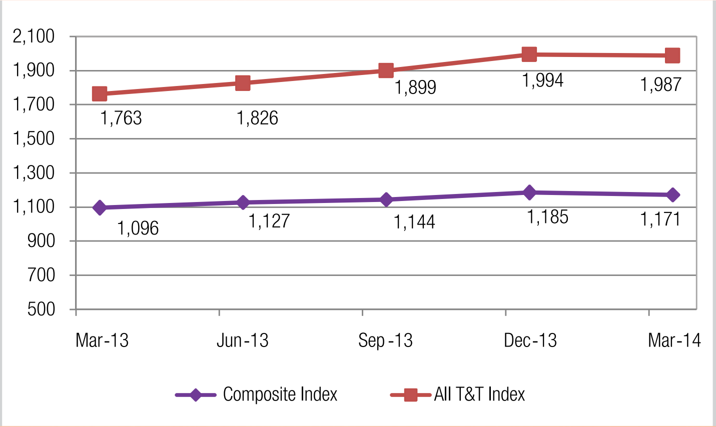
Figure 3: Inflation Rate (%)



Stock Market

For the first quarter of 2014, all three stock market indices declined. The Composite Index fell by 1.16 percent to close at 1,171 points, while the All T&T Index declined by 0.33 percent to close at 1,987 points The Cross-listed Index experienced a 5.7 percent decline reaching 46.6 points for the quarter. In total, 12 stocks saw positive movement, while 15 stocks declined. Despite the declines, the value of shares traded rose by 19.48 percent from $274.4 million in the last quarter to $327.8 million in the first quarter (Figure 4). Looking ahead, activity is expected to pick up with the planned IPO of Phoenix Park Gas Processors Limited later in 2014.

Figure 4: Stock Market Composite Index



Outlook

Overall, the economy is projected to experience stronger growth heading into the second half of the year. Ongoing construction activity, particularly by government, will help drive economic activity. The pickup in exploration activity should add an extra fillip to the economy. On the down side, unless properly scheduled, this activity could cause inflationary pressures to intensify, with the Central Bank being hard-pressed to continue its liquidity absorption policies.

Caribbean Update

Flowers and Rocks

For many years, the phrase – Between a rock and a hard place- aptly described the circumstances of a number of Caribbean states. In the regional context, the rock could easily symbolize the hard, unyielding, inescapable reality of skewed economic fundamentals and economies in need of major restructuring. While the analogy still holds, for some countries, "green shoots" have emerged between the rocks. The flowers of increased investment inflows and tourist arrivals are visible across the region, as economic growth takes root in some countries. The strength and hardiness of the plant cannot be confirmed, because the rocks remain;and flowers do not normally thrive on rocky ground. But for some countries, for now… there are flowers. For others the situation is the opposite. Long accustomed to viewing their world through rose coloured glasses, they only saw the flowers and were blind to the economic realities around them. For these countries, only as the flowers wither, do the rocks they were tenuously attached to become visible…or so we hope.

Barbados

Following a difficult year, Barbados' travails, not surprisingly, continued into 2014. According to the Central Bank of Barbados, the economy shrank by 0.4 percent in the first quarter of 2014. While most sectors registered weak performances, the decline was largely due to a 1.1 percent fall off in tourist arrivals for the period. The island's foreign reserves fell marginally from US$573.5 million in December to US$571.5 million in March, representing 15.5 weeks of import cover. There is reason to believe that the reserves position is even more troubling than at first glance, as reports indicate the already low March balance, was bolstered by two loans of US$150 million and US$75 million. This, along with factors such as the country's large debt stock, fiscal inflexibility and widening fiscal deficit, prompted the international ratings agency, Moody's, to downgrade Barbados' sovereign credit rating three notches, from Ba3 to B3 in early June. Similar concerns were also raised by International Monetary Fund (IMF) officials, following a series of recent meetings. The officials estimated that the fiscal deficit for the recently concluded 2013/2014 year reached 12 percent, and suggested that private sector credit demand would continue to be weak, while inflation will remain low (it averaged 1.8 percent for 2013).

Nonetheless, Barbadian authorities are optimistic about prospects going forward. Finance Minister, Chris Sinckler highlighted the pickup in investment in the tourism sector, with facilities such as the Almond Resort and the Four Seasons Hotel recently being acquired by international investors. The next six months are likely to be extremely testing, as the unemployment rate (already starting 2014 at 13.2 percent) will face strong upward pressure, with the retrenchment of 3,000 public sector workers. The expected high jobless rate has negative implications for commercial bank credit growth, non-performing loans, domestic demand and overall economic growth.

Grenada

Having implemented a number of initiatives from its 2014 National Budget and its 'Homegrown' recovery programme, Grenada's government is currently in discussions with those that it owes and those from whom it wants to borrow. In the meantime, in the absence of recent data, the country seemed to have had mixed fortunes thus far in 2014. In agriculture, the cocoa sub-sector continues to benefit from government's farm support programme and would no doubt receive a fillip with the launch of the Diamond Chocolate Factory in March 2014. Any prospects for economic growth in the first quarter however, are sure to be dampened by the weak performance in tourism. The Spice Isle received 35,535 stay-over visitors in the period, a 5.5 percent contraction compared to the same period in 2013. With Caribbean Tourism Organisation (CTO) data showing a 6 percent rise in arrivals to the region, the authorities need to give serious thought to why Grenada appears to be falling behind other Caribbean destinations.

On a positive note, government's finances are currently benefitting from some of the recently implemented tax measures. In May, it was disclosed that the average tax receipt for the first four months of this year was EC$40 million compared to EC$35 million last year, with both the Customs and Inland Revenue divisions meeting their targets. Having engaged the IMF in discussions over a number of months, the government remains confident that it will be able to reach an agreement with the body, for the implementation of the full assistance package, including a comprehensive debt restructuring programme. Related to this, the Grenadian government has begun the process to resolve its year-old default on US$193 million of bonds, with two restructuring proposals put forward during discussions with creditors.

Guyana

Guyana's socio-political challenges, while by no means new, constituted a persistent but sometimes overlooked backdrop, as the country's decade-long economic growth took centre stage. The constant contention between the government and opposition however, now increasingly threatens Guyana's economy, which is currently facing threats of its own. In March the government presented the 2014/2015 National Budget. The Gy$220 billion package, with a projected fiscal deficit of 4.9 percent, was almost not passed in parliament in the wake of a Supreme Court ruling in January that the National Assembly could only accept or reject the proposed budget, but not amend it, as has been done last two years by the opposition controlled legislature. Other important legislation has also fallen victim to the seemingly perpetual impasse. The Caribbean Financial Action Task Force (CFATF) felt the need to issue a second advisory to member countries about the increased money laundering and terrorist financing risks emanating from Guyana, as a result of its failure to amend its anti-money laundering laws. Guyana's relationship with neighbouring Suriname, has also deteriorated somewhat, with the escalation of a dispute between the two countries over the mineral-rich Tigri area.

While the economy continues to motor on, a growing number of speed bumps now lie ahead. No doubt as a result of falling international prices, gold output has dropped significantly thus far in 2014. The Chairman of the Guyana Gold Board indicated that gold declarations have fallen by 20 percent for the first five months of the year, with direct negative consequences for the inflow of foreign exchange and receipt of royalties and taxes. On a positive note, Australian company, Troy Resources Limited, plans to invest $90 million in a large-scale gold mine in the Cuyuni region of Guyana this year. Rice production is expected to remain strong, however, recent reports suggest supply may exceed demand. Scores of tonnes of rice from the 2013 season and the early 2014 crop are currently warehoused, partly due to logistical problems in shipping supplies to some Venezuelan ports. It was also indicated that despite production from the larger second crop coming later this year, no new buyers have been secured.

Cuba

Cuba's tourism sector got off to a positive start in 2014. According to the National Statistics and Information Office (ONEI), the island welcomed 1.28 million tourists between January and April this year, 60,804 more than the same period last year, an encouraging indication that the three million visitor target set by authorities for this year may be achieved. Despite this good showing, anecdotal evidence suggests that overall economic growth may be moderate, as other key sectors didn't appear to have performed strongly. With the 2013-2014 season just concluded, sugar production increased by just 3 percent, well short of the 18 percent target, due to a combination of adverse weather conditions and organizational inefficiencies. Also, little or no growth thrust can be expected from the nickel sector, as production this year is expected to be lower due to major maintenance and upgrade work on one of the key nickel plants.

While from all accounts Cuba's economic reforms are proceeding slowly, the government continues with its attempts to attract investors and form alliances. In May, the island hosted the President and CEO of the US Chamber of Commerce, who along with 12 business leaders, comprised the Chamber's first trade mission to Cuba since 1999. Also that month, Cuba signed two oil cooperation agreements with Russia to facilitate more exploration, as well as construction of an oil logistics base at the Mariel Economic Development Zone (ZEDM).

Region

Jamaica came in for high praise from the World Bank for cutting its fiscal deficit at the fastest rate in the region last year. The authorities were commended for improving the country's fiscal position from a deficit of over 4 percent in 2012 to a surplus of 0.1 percent in 2013. The World Bank also increased its growth projections for Jamaica in its June *Global Economic Prospects* report, forecasting growth of 1.1 percent and 1.3 percent for 2014 and 2015 respectively, both 0.1 percent higher than the January forecasts. In more positive developments, Jamaica's economy grew by 1.6 percent in the first quarter and the country is expected to see some J$76 billion spent by hotel developers on projects through 2015.

While the fiscal constraints and high debt levels that characterize several members of the Organisation of Eastern Caribbean States (OECS) persist, a number of these countries saw positive developments in recent months. In June, Antigua and Barbuda's government signed a memorandum agreement with a Chinese company for the construction of a US$740.7 million mixed-use tourism-focused investment project, while St. Kitts Nevis is expected to see the opening of the Belle Mont Farm Hotel in December. The performance of the St. Kitts Nevis economy has improved in recent years, allowing government officials to return approximately US$40 million in loan funds, originally provided as part of an IMF Stand-By Arrangement, as part of the country's debt reduction thrust. Both St. Lucia and Antigua and Barbuda saw increased tourist arrivals of over 5 percent in the first quarter.

Outlook

The next 6 months will be pivotal to the countries of the Caribbean. Overall growth for the region should improve, compared to 2013, with some tourism based economies experiencing "green shoots" of economic activity. However, there are also those countries, with lower-than-expected growth or economic contractions. This latter group, with the rock-like nature of their current circumstances, will face significant challenges as they maneuver themselves towards economic recovery.

RETURN TO STABILITY AND CONFIDENCE

In April of this year, the Central Bank reviewed the 21-year-old foreign currency distribution system. As a result, changes were made to key aspects of the system. Firstly, Central Bank injections now include 12 authorized dealers in the system, compared to only the eight commercial banks, previously. Apart from the Central Bank, dealers in the first tier market, who provide conversion services for the three large energy companies (subsequently reduced to two) that comprise this market, are allowed to keep 25 percent of the funds and distribute the remaining 75 percent, evenly among the other 11 dealers. Another major change relates to the dissolution of the second tier market, which is made up of all the other energy companies and exporters. The foreign currency converted in the tier 2 market was previously shared amongst the commercial banks. With this market no longer governed by the Central Bank's guidelines, commercial banks and other dealers are free to keep all the proceeds converted for these entities. Additionally, Central Bank injections are now much more reliant on the auction process, as 90 percent of these funds are distributed via competitive bid amongst the dealers, while the remaining 10 percent is distributed evenly. Previously, only 50 percent was auctioned. A selling rate cap has also been imposed on all foreign exchange supplied by the Central Bank.

The Central Bank has been keen to point out that the amendments were made to alleviate growing tightness in the market, by ensuring that the supply of foreign exchange is more evenly distributed. However, the new measures did not achieve the desired outcome, as the flow of foreign exchange was hindered by structural issues. Even after the Central Bank injected a total of US$250 million in May, market tightness remained acute. This resulted in growing queues at commercial banks and widespread discontent within the business community and among consumers. With fears of a possible devaluation of the local currency being uttered in some quarters, the Central Bank moved to remind the public of the country's strong reserve position, which is expected to provide a significant buffer. In May, foreign currency reserves reached US$10.5 billion, representing more than one year of import cover. Additionally, the Governor revealed that injections totalling US$610 million were made thus far, for 2014.

Mindful of the need to address the issue urgently, the Central Bank also engaged the Bankers Association of Trinidad and Tobago (BATT) and has taken action both parties believe will ensure an adequate supply of US dollars to the market going forward (more on this later).

The implementation of the new system on April 1st created a substantial amount of uncertainty, as major authorized dealers received a smaller quantity of US dollars than they did under the previous arrangement. This negatively affected sales to businesses and consumers, who were therefore not sure when and to what extent their demand would be satisfied. Faced with this situation, purchasers inflated their requests, in the hope that they can acquire an amount that can satisfy their needs for an extended period. On the other hand, many individuals and entities holding excess US dollars were reluctant to sell or used the opportunity to demand higher prices. Given the tightness of the market, customers increasingly acceded to these requests.

Trinidad & Tobago's foreign exchange market is quite unique, in the sense that there isn't a continuous inflow of US dollars throughout the year. This is primarily a "timing issue", with energy companies converting US dollars periodically, in order to meet their tax obligations. It is during these intervals that Central Bank injections become important in maintaining stability in the market. If at this stage, the injections are not effective in reaching the intended target, a black market becomes more likely. Faced with sustained demand, sellers in the black market are able to move quantities of US dollars at prices above the official exchange rate. For manufacturers and importers who have purchased from the black market there are a number of potential challenges. Purchasing of foreign currency from unauthorized dealers is an offense under the Proceeds of Crime Act; and the higher exchange rate represents an increase in the cost of production which may not be transmissible to the final consumer if the shortage is short-lived.

While the temptation to purchase foreign currency from these sources is understandable, it should not be undertaken.

The availability of US dollars will always be a major concern for the business community. Given that most of the final goods sold domestically are imported or are manufactured locally with some import content, foreign currency is critical for domestic commercial enterprise. In this regard, several business owners have indicated that because of the current situation, their accounts with foreign suppliers were settled late or have not been fully paid. This has resulted in some suppliers requesting up-front payments for goods and services. As the situation reverts to normal, some damage control will be required to restore previous relationships. The banking community is certainly available to play a role in this regard.

Given the uncertainty created in the market, the Central Bank has signalled its intention to restore confidence. In June, after consultations with the commercial banks, the Central Bank gave its assurance to satisfy all the genuine requests reflected in the US dollar queues building up at the commercial banks. This resulted in commercial banks returning to the previous system of foreign exchange sales in the market, and removing some of the limitations imposed on sales of US dollars in the market. To assist the commercial banks in reducing these queues, US$30 million was injected in the system to satisfy retail requests, given the upcoming travel season and the need for payments for overseas school fees. The Central Bank has also hinted at other injections within the next couple of months. With energy sector companies expected to make tax payments by the end of June, a substantial amount of US dollars can be expected to enter the market. The net impact of the positive developments during the month of June 2014 was an appreciation of the exchange rate, the antithesis of what might have been expected during the challenging April and May period. Going forward, the Central Bank and BATT seem assured that not only will accumulated demand be cleared, but also that the foreign exchange distribution system will work more smoothly and thus return stability and confidence to the market.