



Dealing with Inflation Dynamics in Trinidad & Tobago



CENTRAL BANK OF
TRINIDAD & TOBAGO

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Inflation Outlook 2023 -
Opportunities and Risks for the Economy and Investment Portfolios
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Key Points

1. Low inflation is good for an economy...
2. ...but high inflation can be devastating.
3. High inflation in Trinidad and Tobago coincided with overheating of the domestic economy...
4. ...although a significant component of headline inflation is generated externally.
5. In general, monetary policy aims at manipulating credit to address inflation.
6. And in the current scenario, central banks across the world raised interest rates.
7. The policy mix to address inflation in Latin America is being developed.
8. With still moderate inflation alongside sluggish growth the CBTT has not yet altered its monetary policy stance...
9. ...however, the situation is very dynamic and could change quickly.
10. The global outlook is daunting.
11. Ultimately, fiscal and structural actions should complement monetary measures in addressing domestic inflation.

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1. Low inflation is good for an economy...

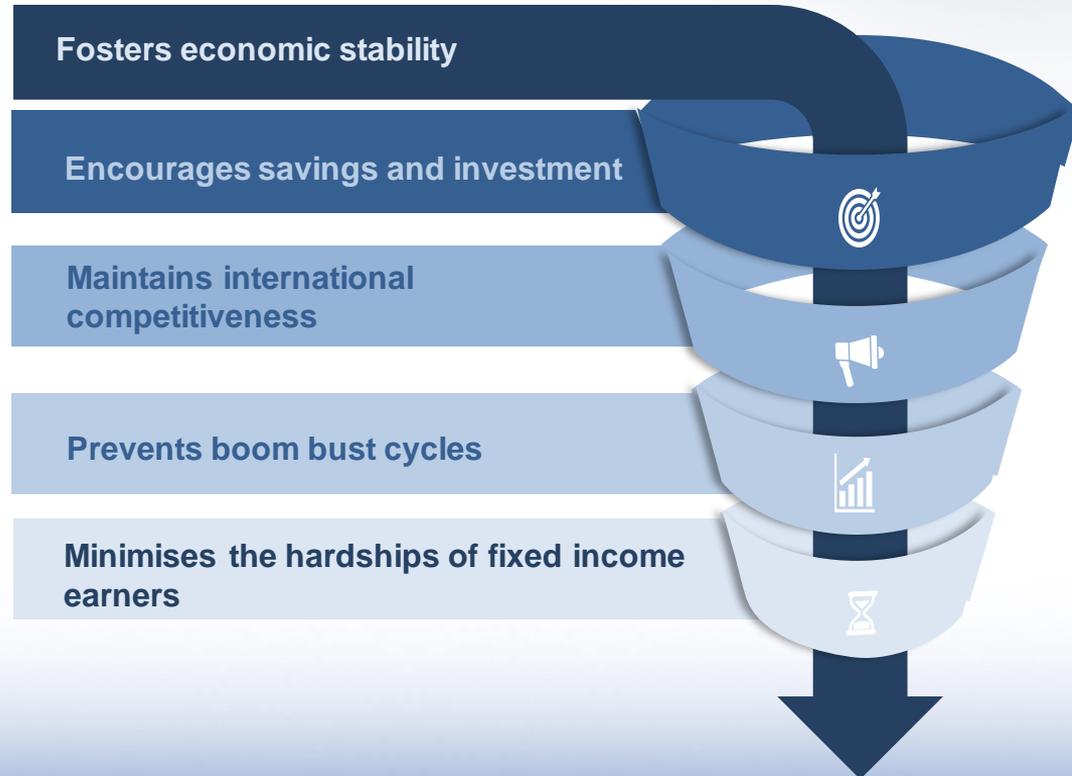
Inflation is the sustained increase in the general price level, and while it can have potentially negative effects for an economy, mild inflation may provide support for resource allocation.

Two reasons low inflation is good:

- Encourages consumers to purchase more now, in anticipation of further price rises. This **increases demand in the short term** thereby boosting economic growth.
- **Reduces risk of deflation.** As deflation occurs consumers hold back demand expecting further price decreases. As a result businesses reduce inventory and production leading to higher unemployment and wage deflation.

While mild inflation can be beneficial in some countries, there is concern if inflation is too low:

- For decades, **Japan** has grappled with **low inflation, slow growth, and deflation.** Inflation in Japan is kept low by a combination of government pricing restrictions, an ageing population, and negative interest rates. *Masterson (2022)*





2. ...but high inflation can be devastating.

It is widely accepted that **inflation beyond single digits is highly distortionary**.

High inflation can have widespread negative effects:

- **Erodes Purchasing Power:** Inflation reduces the quantity of goods that can be purchased with a given amount of money.
- **Discourages Saving:** As purchasing power is eroded over time it encourages consumption.
- **Places Upward Pressure on Wages:** Trade unions tend to insist that wage agreements contain cost of living clauses as a means of protecting workers.
- **Disproportionately Affects Fixed Income Earners:** These groups face major hardships also because a significant part of their income is spent on basic items.

The term “**hyper-inflation**” has been coined to describe a scenario whereby prices rise to very high double-digit rates (usually in excess of 50 per cent). Hyper-inflation seriously erodes purchasing power, completely distorts economic signals and leaves the currency virtually worthless.

Chart 1: Countries with Hyper-inflation rates 2022
(Year-on-Year)



Sources: Bloomberg and selected country websites

* 2020

** 2021



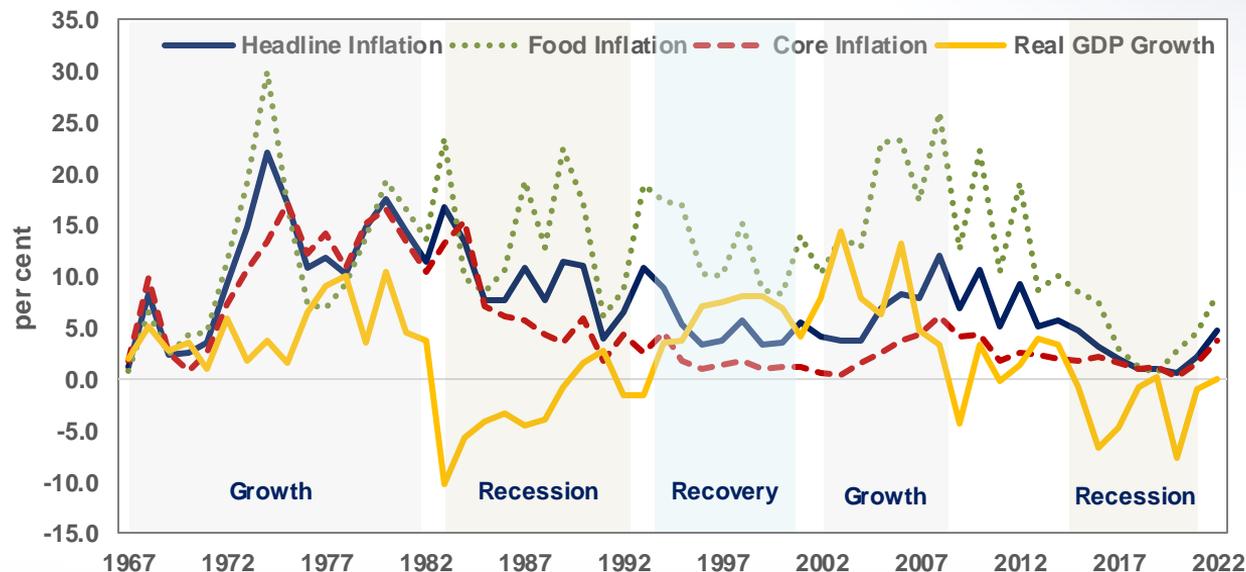
3. High Inflation in Trinidad & Tobago coincided with overheating of the domestic economy...

- Over the past 50 years, year-on-year inflation rates have exhibited some volatility, with some sudden and steep peaks followed by shallower troughs (Mahabir, et al, 2016).
- Much of this volatility has been due to food inflation**, although the prices of all goods increased steadily over time:

	1974	1991	2022
Doubles	25¢	\$1	\$5
3bdrm house	\$47K	\$210K	\$1.25M (est2018)
Carnival Costume	\$350	\$1.5K	\$6K

- In general, over the period, **inflation has tended to follow a pro-cyclical path**, rising in times of economic boom and falling during recessionary periods.

Chart 2: Inflation and GDP Growth



Source: Central Statistical Office

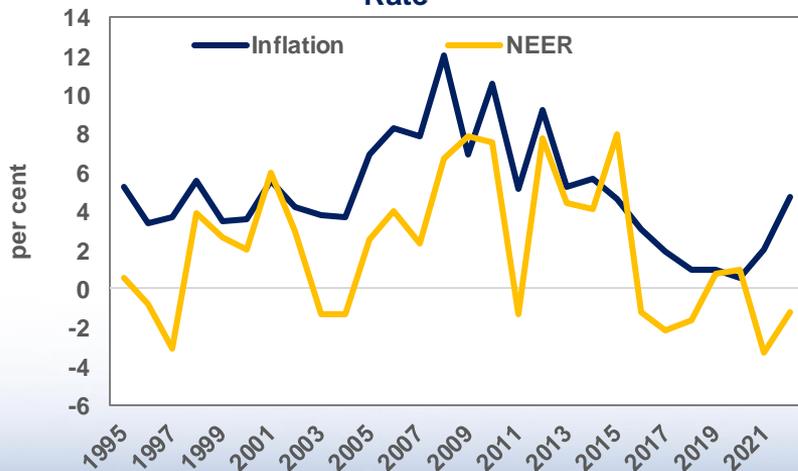


4. ... although a significant amount of inflation is generated externally.

- According to Bobb and Sonnylal (2018), changes in the **exchange rate** influence domestic prices due to changes in the **cost of imported intermediate goods** in the production process.

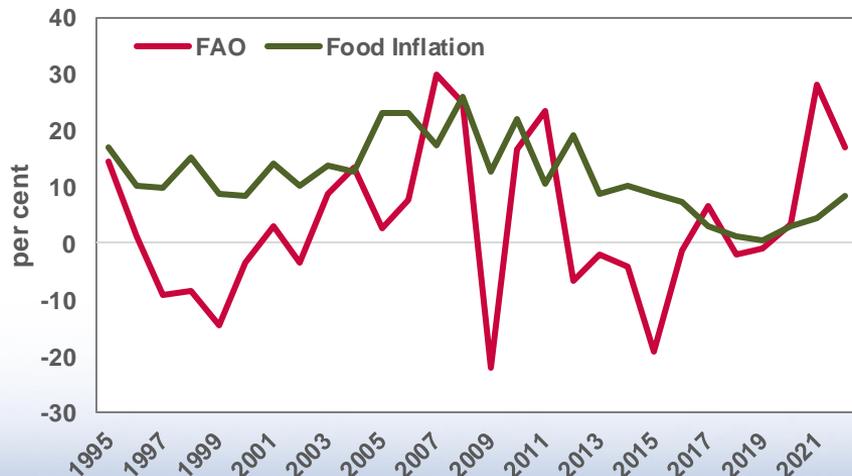
- Additionally, Mahabir and Jagessar (2011), reviewed the transmission of selected **international food prices** to the domestic prices in Trinidad and Tobago which revealed that changes in the international commodity prices have an impact on related domestic items with a 3-6 month lag.

Chart 3: Inflation and the Nominal Effective Exchange Rate



Sources: Central Statistical Office and Central Bank of Trinidad and Tobago

Chart 4: Food Inflation and the FAO Price Index

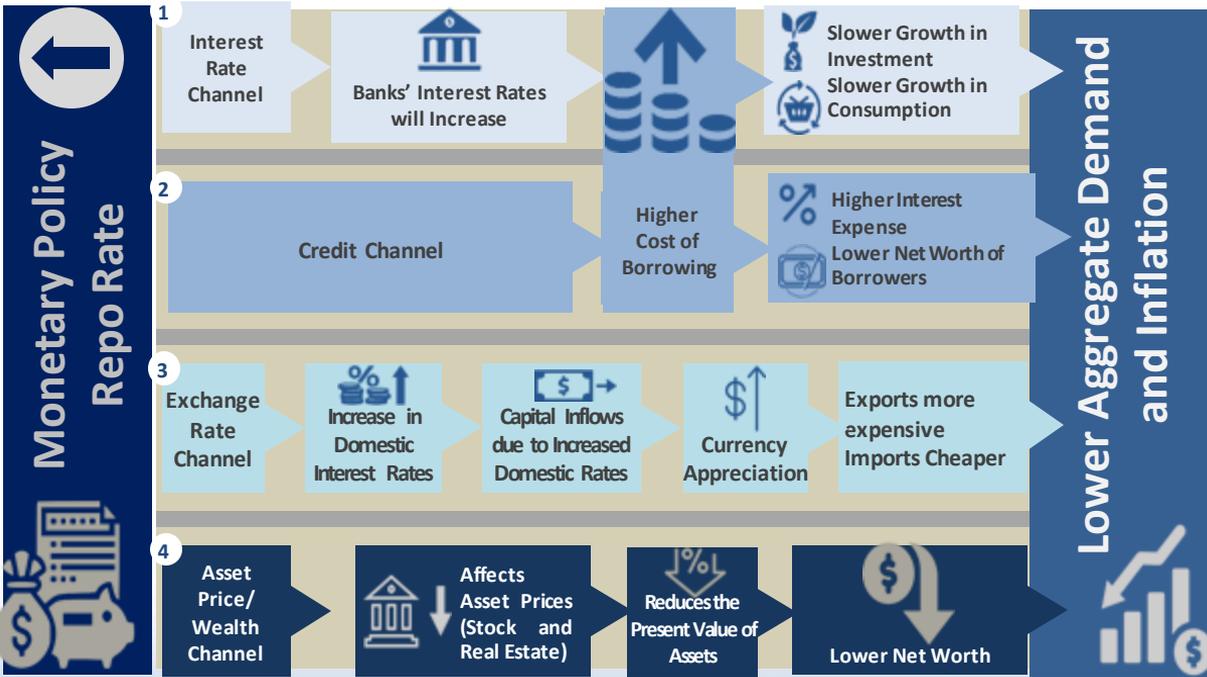


Sources: Central Statistical Office and Food and Agriculture Organization



5. In general, monetary policy aims at manipulating credit to address inflation...

Figure 1: Transmission Mechanism of an Increase in the Monetary Policy Rate



Source: Central Bank of Trinidad and Tobago

1966-Present
Reserve Requirements and Discount Rate
Commercial Banks-14%
NFIs-9%
Discount Rate – Repo Rate + 2%

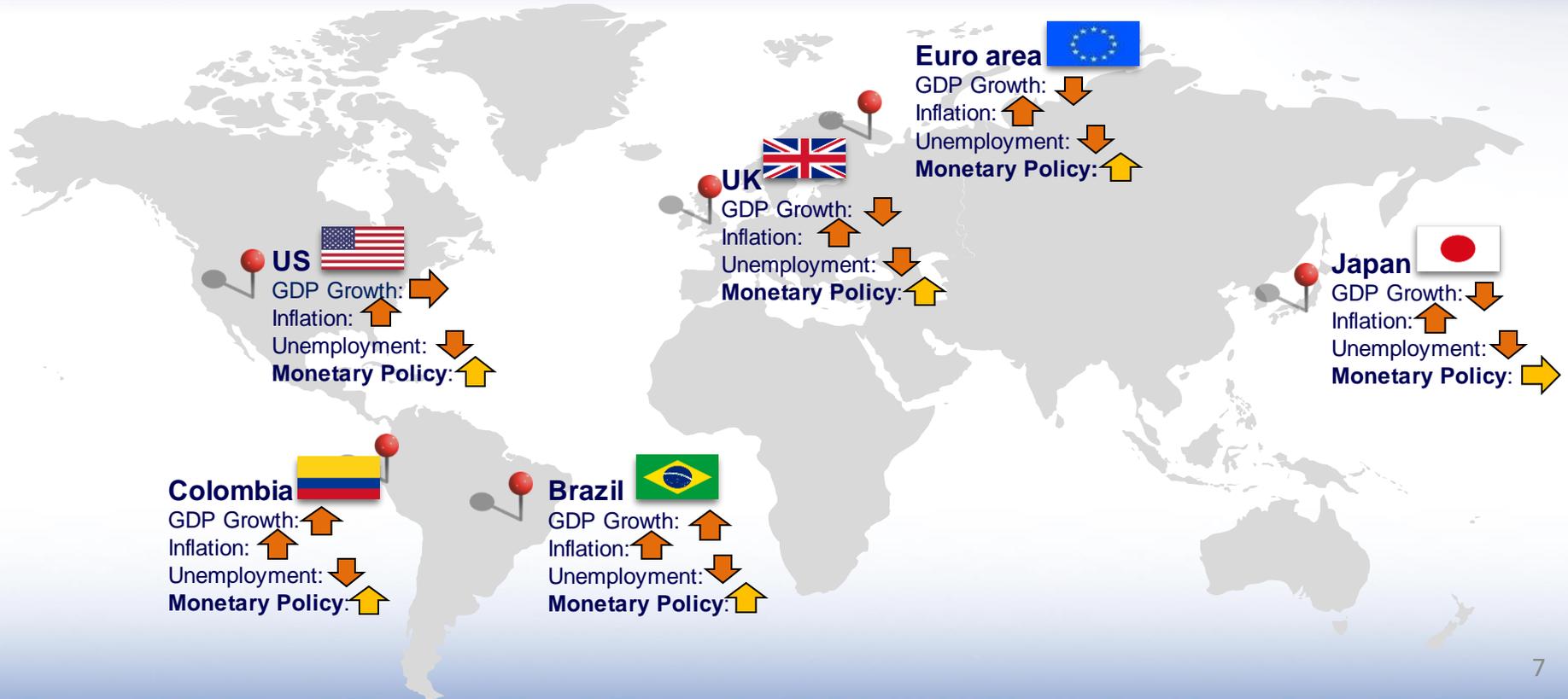
1984-1986
Financial Support to Non-Bank Financial Institutions
Amendments to the CBA
Establishment of DIC in 1986
CBTT provided liquidity support

1970-1994
Selective Credit Controls
Lending to non-residents, state enterprises and statutory bodies
Rediscount facility to agri sector
Installment credit guidelines on consumer credit

1998-Present
Open Market Operations and Repo Rate
System for Primary Dealers est in 1998
Repo rate implemented in 2002



6. And in the current scenario, central banks across the world raised interest rates.





7. The policy mix to address inflation in Latin America is being developed.

- Inflation in the largest **Latin American** economies is at its highest since the inception of inflation-targeting regimes, testing the credibility of the monetary frameworks.
- **Global factors** such as supply-side shocks related to the pandemic and the war in Ukraine explain a significant share of the inflation in Latin America, specifically through the food and energy prices.
- However, **domestic factors** have been increasingly contributing to the inflationary process. With the lifting of mobility restrictions and a recovery in the demand for services and rising nominal wages, **inflation has become more broad-based**.
- The withdrawal of pandemic-related policy stimuli in 2021 and the adoption of a **contractionary monetary stance** in 2022 has helped contain inflationary pressures. Monetary authorities have signaled their commitment to increase policy rates further, if needed, **to ensure that inflation returns to target**.
- With **economic activity slowing**, monetary authorities in the region may face greater obstacles to sustaining a contractionary monetary stance, although sustaining current policy rates for some time is likely to be needed to ensure the return of inflation to their targets.
- Amid this high uncertainty about the path of inflation, **effective communication** on the main policy objectives is critical.

Chart 5: Inflation Rates – Selected Latin American Economies



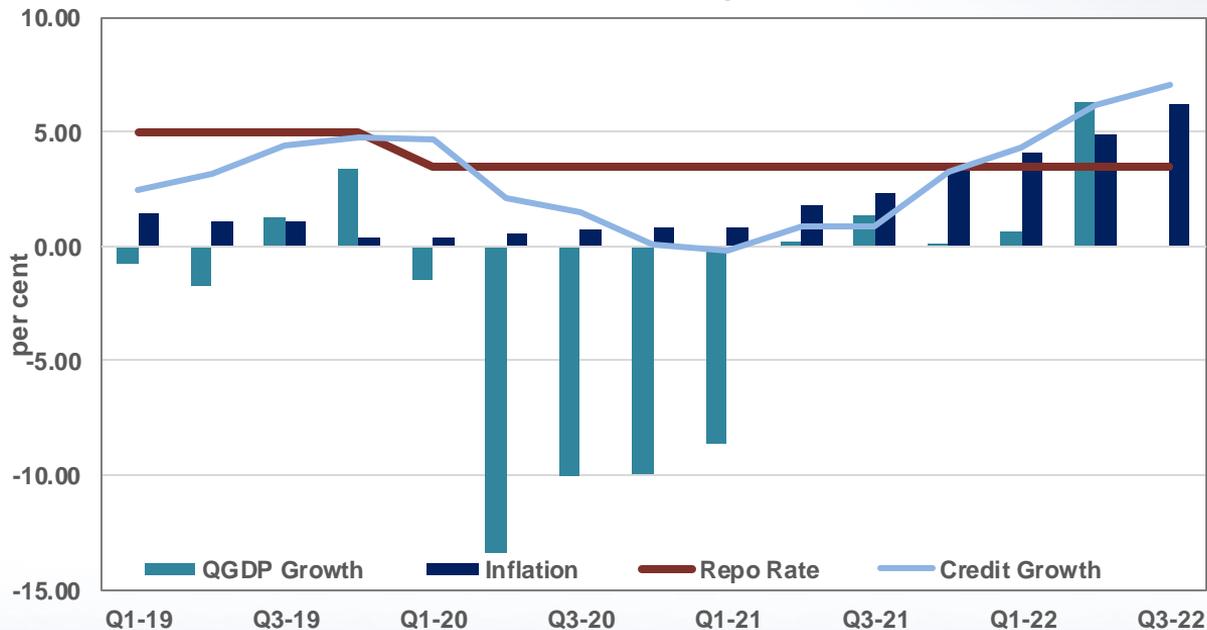
Source: Bloomberg



8. With still moderate inflation alongside sluggish growth the CBTT has not yet altered its monetary policy stance...

- Following the introduction of the Repo rate in May 2002, the Bank has made decisions to increase, decrease or hold steady in response to the macro financial environment at the time.
- More recently, following the **150 bps reduction of the Repo rate in March 2020**, coupled with other expansionary monetary policy measures, the Bank has held the rate constant to date.
- The December 2022 Monetary Policy Announcement stated, “*In balancing all considerations, the Committee decided to maintain the repo rate ... At the same time, the Bank should be prepared to further employ other monetary tools in addressing the inflationary situation in a flexible manner.*”

Chart 6: Inflation, GDP Growth, Private Sector Credit Growth and the Repo Rate



Sources: Central Statistical Office and Central Bank of Trinidad and Tobago

* Latest data for QGDP Growth is Q2-22.



9. ...however, the situation is very dynamic and could change quickly.

Full re-opening
of China



Social unrest/
protests

Global
supply chain re-ordering



Geopolitical
tensions

High
inflationary
conditions



Russia-
Ukraine War

Further monetary
tightening in AEs



Pandemic
biological virus

Climate
extremes



Digital virus/
Cyber attacks



10. The global outlook is daunting.

“Global economic activity is experiencing a broad-based and sharper-than-expected slowdown, with inflation higher than seen in several decades.” International Monetary Fund, World Economic Forecast, October 2022

Chart 7: Global Growth Forecast

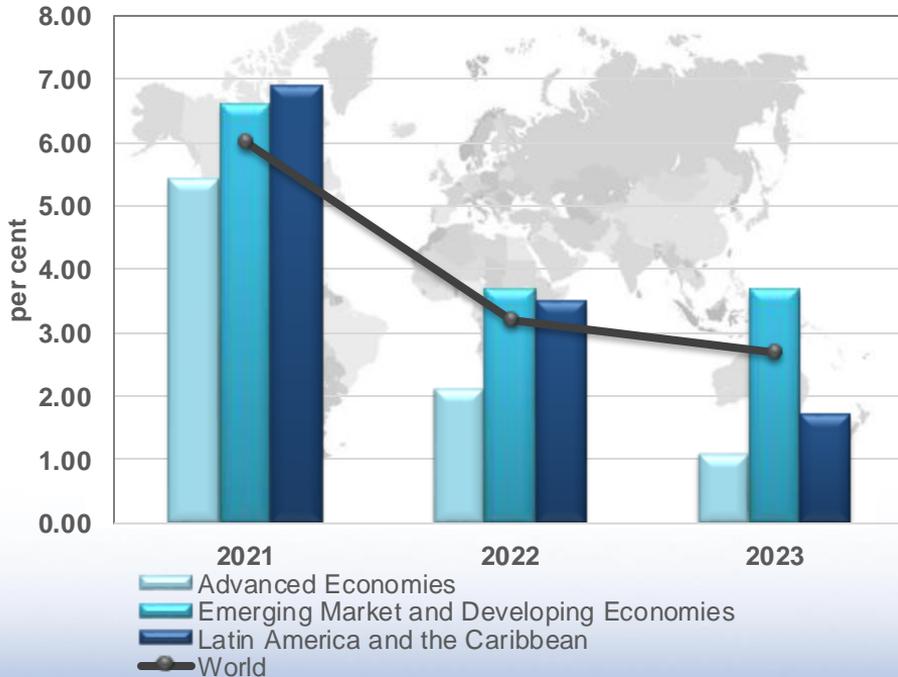
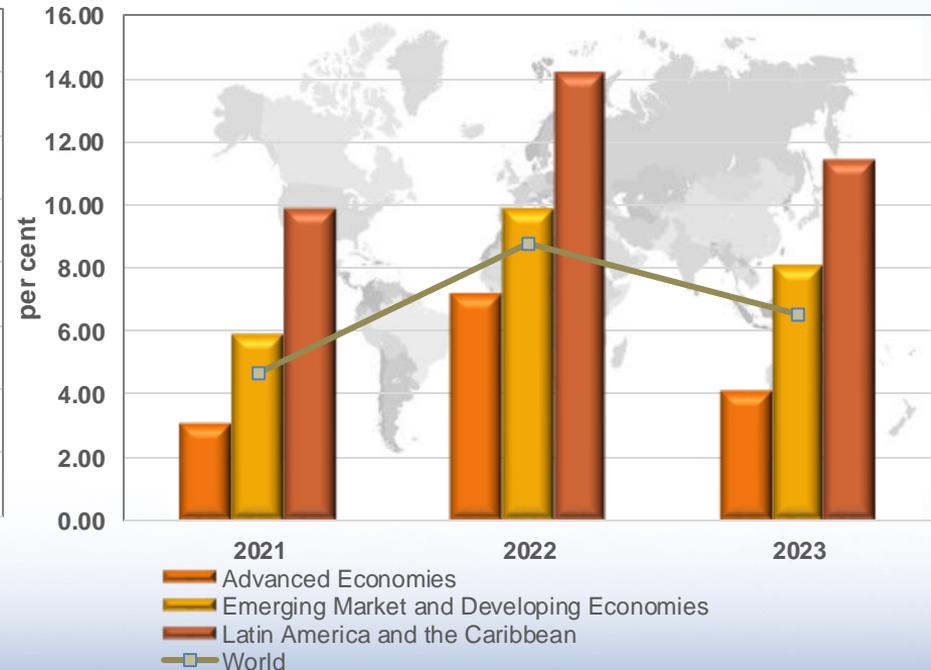
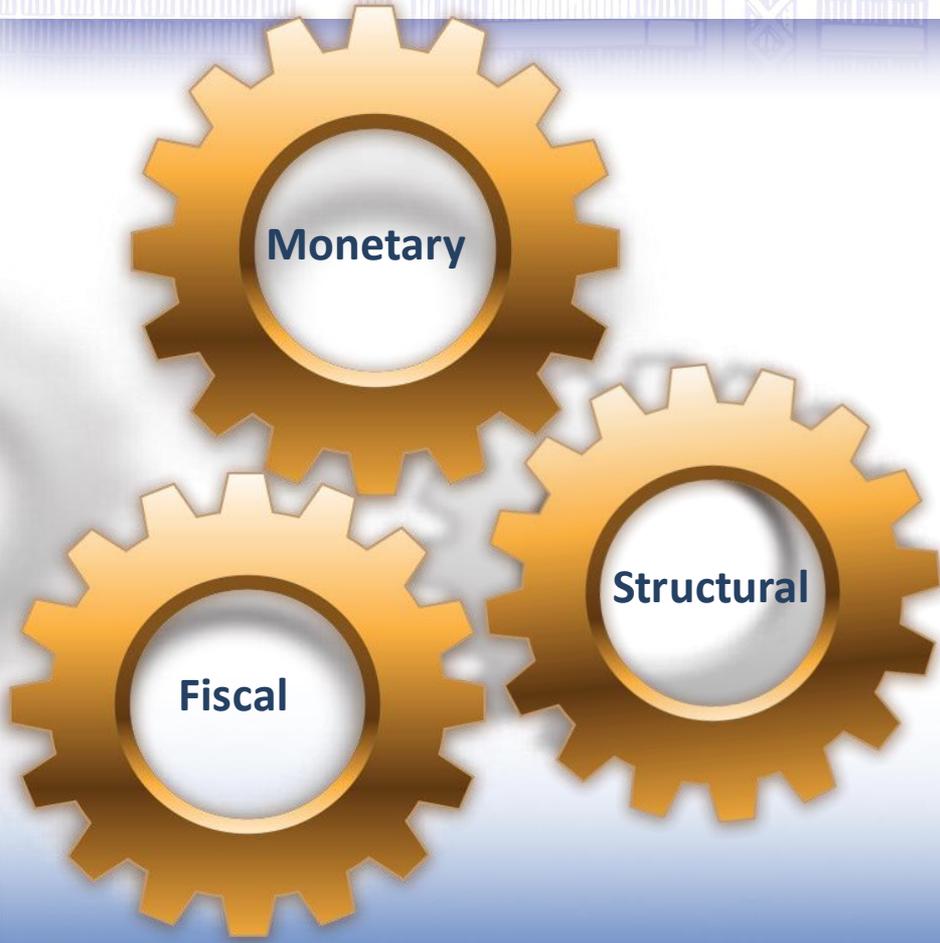


Chart 8: Global Inflation Forecast





11. Ultimately, fiscal and structural actions should complement monetary measures in addressing domestic inflation.



- Monetary policy needs to be closely coordinated with fiscal and structural policies to maintain a low and stable inflation rate.
- Promoting flexible markets through structural policies can strengthen an economy's resilience to shocks that impact price stability.
- The Bank continues to monitor international and domestic developments and adopt a coordinated approach to managing inflation.



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