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SPEAKING NOTES

at the

LAUNCH OF THE MONETARY POLICY REPORT

by

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Good morning, ladies and gentlemen. Thanks for coming. We have circulated advanced copies of the Monetary Policy Report which you have not had the chance to read.

You would notice that we have made some revision to the format of the report which is now organised in three sections.

Firstly, in Section I which focuses on a review of Monetary Policy in the second half of 2003, we try to explain why the Central Bank took a particular monetary policy stance and the impact of the stance adopted.

Secondly, in Section II we discuss the monetary policy stance that the Bank intends to pursue during 2004, the reasons for the particular posture and the risks that arise.

And **thirdly**, Section III is intended to be a summary analysis of recent economic and financial developments.

In changing the format, we are seeking to be more transparent in explaining Central Bank policy and making clear the factors that have been considered and would be considered in making policy adaptations. This is important so that economic agents prepare themselves for possible policy changes. In this way, economic adjustments can be gradual and less disruptive.

As we have provided you with advanced copies. I would simply like to give you the **gist of the report**.

1. **During the second half of 2003**, the Central Bank maintained an accommodating monetary stance and actively sought to reduce domestic interest rates. We did this in an effort to stimulate domestic demand and help promote a recovery in the non-energy sector. You would recall that the non-energy sector has exhibited relatively slow growth since 2002 and the available indicators for 2003 had suggested that this situation was continuing. This slow growth of the non-energy sector is reflected in the relatively sluggish rate of permanent job creation.

2. **The Bank felt that the accommodating monetary stance was appropriate** in view of the low rate of inflation; still sluggish credit demand and the record low interest rate in the U.S. Because of low U.S. interest rates, even the decline in TT dollar rates left a significant margin between domestic and foreign interest rates. In principle, this margin ought to have reduced incentives for capital outflows.

Admittedly, the low interest rate environment, combined with socio-political uncertainties, increased pressure in foreign exchange markets and prompted Central Bank foreign exchange sales to preserve orderly conditions in foreign exchange markets. This did not present major problems because of the strong reserve position.

3. The low interest rate environment has had several effects. **First** there were signs, towards the end of the year, that private sector credit expansion was beginning to pick-up and that could be good for domestic demand and the non-oil economy.

4. A **second consequence**, not unexpected in a low interest rate environment, has been the tendency for some savers to shift to higher risk assets such as equities and mutual funds, and to real estate. This tendency helps to explain the buoyancy of the Trinidad and Tobago stock market, the sharp increase in mutual fund sales and the reported rapid rise in real estate values. I have seen some media commentators refer to this phenomenon as an **equity and housing bubble** with corresponding downside risks. I think this characterisation is a bit of an exaggeration. Firstly, because equity investments are not a sizeable part of total private sector assets (as in the U.S.) and secondly, because a runaway rise in real estate values is confined to a small sector of the market.

5. The solution to these "bubbles" is certainly not to increase interest rates to prohibitive levels as this would undermine the basic objective (growth and unemployment) and would be inconsistent with dealing with the large housing deficit.

Now turning to 2004 :

6. There have been some changes to the economic environment in 2004. **However, in the Bank's view there is not yet a compelling case for an immediate change in the monetary policy stance**.

7. What are these changes? The most important external event is that the recovery in the U.S. economy continues apace, but because of the slow employment response, there are strong hints from the Federal Reserve that an interest rate increase would not be forthcoming until the second half of the year.

8. At home, there are as yet no definitive signs of a pick-up in the non-energy sector and the latest data available from the CSO do not yet show a major rise from inflation.

9. I must concede that there are major uncertainties (risks) in the present economic situation, the most important of which are:-

- √ the current nervousness in the industrial relations climate could have negative short- and medium-term effects on economic activity in both the energy and non-energy sector;

- √ there has certainly been a noted increase in inflationary expectations;

- √ there has been announced increases in certain basic food commodities as well as in fuel and construction materials.

Anecdotal evidence suggests broader increases in food prices. Added to this, annual wage settlements in late 2003 and early 2004 are higher than over the past few years. We are waiting anxiously to see what the CSO data on inflation would show for the first months of 2004.

These data, as well as ongoing developments in foreign exchange markets, will be taken into account before we consider policy changes.

I would now like to move to some other announcements.