MONETARY POLICY ANNOUNCEMENT

June 1st, 2015

At its May 2015 meeting, Central Bank's Monetary Policy Committee (MPC) agreed to raise the 'Repo' rate for a fifth consecutive time by 25 basis points to 4 percent. The MPC based its decision on three main factors. The first and most influential factor was recent forward guidance from the US Federal Open Market Committee (FOMC) on the start of normalization of U.S. monetary policy. The second factor was the potential for rising domestic inflationary pressures in the rest of 2015. The third factor the MPC deliberated upon was the still relatively positive growth outlook for the non-energy sector in 2015.

Regarding the start of U.S. monetary policy normalization, mixed economic data on the performance of the U.S. economy for the second quarter of 2015 has cast a fresh wave of uncertainty about the timing of this widely anticipated event. Recent statements by the Fed's Chairwoman Janet Yellen, however, seem to suggest the FOMC would definitely hike interest rates in 2015. Yellen warned that delaying action to tighten monetary policy until U.S. employment and inflation reach the Fed's targets would risk overheating the U.S. economy. Financial markets now expect the first increase in the Fed funds rate to occur in mid-September 2015 or early 2016. Regardless of the exact timing, the MPC viewed the Fed's path towards monetary policy normalization as imminent.

In making its own interest rate decision, the MPC was also concerned about rising inflationary pressures. Based on the recently rebased Retail Prices Index (January 2015 = 100), headline inflation stood at almost 6 percent in April 2015. Core inflation accelerated to a 10-month high of around 2 per cent in April 2015. The MPC expects inflationary pressures to further pick up in the rest of 2015 due to a number of factors:

- The rainy season has begun with the possibility of flooding causing disruptions to agricultural supplies and the attendant effect on food price inflation, which continue to drive overall headline inflation. As at April 2015, food inflation stood at 9 per cent, close to double-digit territory.
- Growth of consumer credit remains strong, suggesting consumers are still willing to borrow to finance the purchase of new motor vehicles and other consumer durables, despite subdued economic conditions. We expect recently concluded wage agreements with teachers and civil servants as well as successful settlement of outstanding negotiations with the Police, Fire and Prisons Services to increase consumer spending and inflationary pressures.

- Central Government's expansionary fiscal stimulus remains on track. In the first half of fiscal 2015, the non-energy fiscal deficit was unchanged at just over 10 ½ per cent of GDP. Capital expenditure was also higher. We expect the pace of public spending to pick up in the second half of fiscal 2015, boosted by the settlement of outstanding public sector wage negotiations and ongoing capital infrastructure projects.

Even though the Repo rate has increased by a cumulative 125 basis points since September 2014, the MPC believes monetary policy still remains accommodative to economic growth. The non-energy sector has registered 16 consecutive quarters of fairly respectable growth to March 2015, and the MPC expects continued steady performance in non-energy output during the rest of 2015. Strengthening growth in the United States and lower oil prices are likely to help fortify the tourism-based economies of CARICOM, providing further support to Trinidad and Tobago's non-energy exports.

The MPC also agreed to maintain an aggressive programme to absorb excess liquidity to strengthen the impact of higher interest rates throughout the financial system. With the strength of the Central Bank's monetary policy signal improving on account of lower liquidity levels, commercial banks began to increase their prime lending rates. The median commercial bank prime lending rate rose to 8 percent in May 2015 from 7 ½ percent in September 2014, before the cycle of Repo rate increases began.

The next Monetary Policy Announcement is scheduled for July 31st, 2015.

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