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**MONETARY POLICY ANNOUNCEMENT**

**July 25, 2014**

**CORE INFLATION REMAINS STABLE;  
CENTRAL BANK MAINTAINS REPO RATE AT 2.75 PER CENT**

**With core inflationary pressures well contained, the Central Bank is maintaining the ‘Repo’ rate at 2.75 per cent which remains supportive of current economic conditions. However, as the pace of economic activity strengthens, the Central Bank is giving greater consideration to managing inflationary expectations in calibrating its monetary policy instruments.**

As of late July 2014, signals are mixed regarding the outlook for global growth. In its latest World Economic Outlook (WEO) Update, the IMF indicates that the global recovery continues but at an uneven pace, and that downside risks remain. In the United States, earlier optimism about growth prospects has moderated following an unanticipated sharp contraction in the first quarter of 2014, even though a rebound in activity is already underway. Growth is improving for some economies in the Euro zone, while the economic recovery in the United Kingdom appears to be sustainable. Growth in most emerging markets, including China, remains at a slower pace than before, partly due to softer external demand.

Although geopolitical tensions are escalating in several regions around the world, expectations of changes in monetary policy in the major industrial economies dominate sentiment in global financial markets. The United Kingdom is expected to be the first advanced economy to raise interest rates, albeit at a moderate pace, while the US Federal Reserve is not anticipated to raise interest rates until later in 2015. By contrast, the European Central Bank (ECB) recently announced a package of policy measures to stimulate bank lending and to address the risk of a prolonged period of low inflation in the Euro area.

At home, the corporate sector is still cautiously optimistic in its outlook for business activity and economic strength. Results from the Central Bank’s second Business Confidence Survey, conducted in the second quarter of 2014 in conjunction with the Arthur Lok Jack Graduate School of Business, showed that almost 80 per cent of firms expect to increase their production

levels over the next six months. More firms were also confident that the local economy would improve over the next 12 months than in the first survey. On the other hand, 66 per cent of all businesses expect their financial position to improve in the next 12 months, down from 75 per cent of firms in the first quarter of 2014.

A recovery in business lending and steady growth in consumer loans provide support to the positive business sentiment. On a year-on-year basis, private sector credit granted by the consolidated financial system expanded by more than 6 ½ per cent in May 2014 – the fastest rate since February 2009. Business lending grew for the fourth consecutive month, also, by around 6 ½ per cent in May 2014, from just over 3 ½ per cent in April 2014. Consumer lending remained robust, growing at around 7 ½ per cent in May 2014. Meanwhile, the pace of real estate mortgage loans slowed to just over 10.0 per cent in May 2014 from 14 ½ per cent at the start of the year.

Core inflation remained relatively stable in the first half of 2014. On a year-on-year basis, core inflation stood at 2 ½ per cent by the end of June 2014. Headline inflation slowed to 3.0 per cent while food inflation eased for the third consecutive month to 3 ½ per cent in June 2014. Rising consumer demand, higher Government spending and second round effects from the recent increase in cement prices could help to accelerate inflationary pressure later in the year.

Excess liquidity in the banking system fell below \$5 billion in the first three weeks of July 2014. Commercial banks' excess reserves dropped to a daily average of around \$5.0 billion over the period July 1 – 21, 2014 from a little over \$7.5 billion in June and close to \$8.5 billion in May 2014. In June 2014, the Central Bank issued a seven-year, 2.2 per cent coupon, liquidity sterilization Treasury bond, which removed approximately \$1.0 billion from the financial system. In addition, Central Government's operations, which are usually the main source of banking system liquidity, resulted in a net domestic withdrawal of roughly \$1.3 billion in the first three weeks of July 2014. Further, Central Bank's support to the foreign exchange market in July also indirectly withdrew \$1.1 billion from the system.

Interest rate differentials between TT and US Treasury securities, though still low, have stabilized in positive territory over the past few months, particularly at shorter tenors. The three-month domestic Treasury Bill rate increased marginally to 0.13 per cent in mid-July 2014 from 0.12 per cent at the end of June 2014. With the three-month US Treasury Bill rate holding at 0.03 per cent, the TT-US interest differential widened slightly to 10 basis points as at July 21, 2014 from 9 basis points at the end of June 2014. Meanwhile, despite the on-going reduction in the US Federal Reserve's quantitative easing programme, strong external demand has placed some downward pressure on longer term US Treasury yields in recent months. As such, the interest rate differential between TT and US 10-year Treasury yields remained in positive territory at around 14 basis points as at July 21, 2014 from 10 basis points at the end of June 2014.

The Central Bank will continue to closely monitor economic conditions and is prepared to take further action, if necessary.

The next Monetary Policy Announcement is scheduled for September 26, 2014.