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MONETARY POLICY ANNOUNCEMENT

March 27th 2015

Interest rate hike needed to protect TT economy

At its March 2015 meeting, Central Bank's Monetary Policy Committee (MPC) agreed to raise the 'Repo' rate for a fourth consecutive time by 25 basis points to 3 ¾ per cent. The MPC also agreed to continue with an aggressive programme to absorb excess liquidity so as to strengthen the impact higher interest rates are expected to have throughout the financial system. The MPC based its decision on three factors. The first factor was recent forward guidance from the US Federal Open Market Committee (FOMC) on the medium-term path of US monetary policy. The second factor was the potential for higher domestic inflation in the medium term. The third factor the MPC deliberated upon was the relatively positive growth outlook for 2015.

As widely anticipated, at its March 2015 meeting, the FOMC dropped the word "patient" from its forward guidance on the future path of US monetary policy, suggesting no increases in its policy interest rate would occur for at least the next two subsequent meetings in April and June 2015. The FOMC anticipates it will be appropriate to raise the target range for the Federal funds rate when it has seen further improvement in the labour market and is reasonably confident core inflation will move back to its target over the medium term. Markets are now expecting the first increase in the Fed funds rate to occur between July and September 2015 with US policy rates likely to rise at a gradual pace thereafter. This normalization of US monetary policy has implications for portfolio capital outflows and foreign exchange demand in Trinidad and Tobago, especially since returns on US dollar assets remain more attractive than TT dollar assets. By mid-March 2015, the TT$-US$ differential on benchmark 10-year Treasuries had narrowed to 64 basis points, from 87 basis points since the end of January 2015. Higher domestic interest rates are necessary to enhance returns on TT$-denominated assets, helping to curb portfolio capital movements out of Trinidad and Tobago.

In its January 2015 Monetary Policy Announcement, the MPC noted the domestic economy appears to be approaching full capacity. This situation remains unchanged, even though headline inflation slowed for the third consecutive month in February 2015 to just over 6 per cent from 9 per cent in November 2014. The slowdown in food inflation, as a result of higher food supply and favourable weather conditions, contributed to the deceleration in headline inflation. This easing in headline inflation may be short lived, as inflationary pressures are expected to pick up in the rest of 2015 due to a number of factors.

Growth of consumer credit remains robust, increasing by nearly 8 ½ per cent in January 2015, suggesting consumers are still willing to spend despite negative sentiment surrounding falling oil prices.

Current and expected settlement of wage negotiations for teachers, civil servants and other public sector workers with considerably large retroactive payments and salary increments will boost consumer spending and further stoke inflationary pressures.

The expansionary fiscal stimulus remains on track. Central Government's spending on its capital programme was higher by 7 per cent in the first four months of FY2014/2015 when compared to the corresponding period one year ago.

Over the final quarter of 2014, economic growth was buoyed by further positive momentum in the non-energy sector, even as activity in the energy sector was marred by maintenance work. Discussions with upstream energy producers suggest there was no carry-over of maintenance-related activity into early 2015 and the start-up of BGTT's Starfish well is expected to provide a fillip to upstream gas production in 2015. Both natural gas and crude oil output were higher by almost 2 per cent and 12 ½ per cent, respectively, in January 2015. The near-term outlook for the non-energy sector is for continued steady performance, albeit at a slower pace than in 2014.

Central Bank's aggressive liquidity management programme contributed to a significant reduction in commercial banks' excess reserves in the first quarter 2015. Tighter liquidity levels prompted inter-bank activity in February 2015, the first time since 2013. The Bank will maintain this programme to keep banking system liquidity at an appropriate level to support the monetary transmission of increases in the Repo rate.

Central Bank is prepared to further position its monetary policy stance to address any challenges that may arise in the coming months.

The next Monetary Policy Announcement is scheduled for May 29th 2015.

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