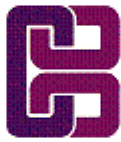

Feature Address
At the
Fourth Monetary Policy Forum

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San Juan Business Association
San Juan

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Governor
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Ladies and Gentlemen,

I thank the San Juan Business Association for graciously agreeing to host this, our fourth Monetary Policy Forum.

For many central banks, communications is now seen as a new monetary policy tool. Events such as this Forum give the Central Bank of Trinidad and Tobago a unique opportunity to explain the economic realities we will face in the coming months and what these realities mean for the business community and for citizens of our country.

The Forum also gives us the opportunity to explain the thinking behind our monetary policy decisions. Our monetary policy works better when you understand what we're doing, and why.

As we head into mid-2015, I think it best to begin this Monetary Policy Forum by placing it in the context of current global developments and the risks still facing the world economy.

More than six years after eruption of the global financial crisis, the world's economic recovery remains moderate and uneven, mostly shifting along North-South lines.

In most advanced economies in the North, growth is just not strong enough, weighed down by legacies of the crisis - high public debt, soaring unemployment and weak business investment. Apart from the United States and the United Kingdom, where the recovery is strengthening gradually, growth remains anemic in the Euro area and fragile in Japan.

Many large emerging markets of the South (with the exception of India) are cooling down. China is slowing to a more sustainable pace. Brazil is stagnating and Russia is in recession territory. India, however, is expected to overtake China as the fastest growing *large* economy this year and next.

The IMF's Managing Director recently warned Central Bank Governors and Finance Ministers about the "new mediocre" - low growth for a long time - becoming the "new reality". Some of my fellow economists call this "secular stagnation" – a fancy way of saying the good times are probably over.

Looking ahead, there are significant risks to this brittle global recovery, despite the boost to oil-importing countries from lower oil prices. Escalation of geopolitical tensions simmering in different parts of the world could exert further downward pressure on global growth prospects. An even stronger U.S. dollar could trigger financial tensions elsewhere, particularly in emerging markets.

But the most immediate and significant risk to global growth prospects is the one which my colleague central bankers in other emerging markets are concerned about, as it is for the Central Bank of Trinidad and Tobago. I am talking about the expected *tightening*, or normalization, of U.S. monetary policy, which is turning out to be the most anticipated monetary policy decision in decades.

The U.S. Federal Reserve is expected to raise its policy interest rate from near zero later this year, for the first time since June 2006. The Fed will become the first central bank among the advanced economies to start the process of tightening monetary policy at a time when the European Central Bank, the Bank of Japan and other major central banks are *easing* monetary conditions. Even if this process is well managed, it may trigger market volatility, with broader implications for the world economy.

Central bank communications is indeed tricky business. Most emerging markets got a taste of these spillovers during the so-called "taper tantrum" in 2013. Merely the first hint by then Fed Chairman Ben Bernanke that U.S. monetary policy would be "tapered" in the near future was enough to trigger sizeable portfolio capital outflows from many vulnerable economies. Thankfully, Trinidad and Tobago was not affected.

History shows this was not a one-off episode. Previous episodes of U.S. monetary tightening helped trigger the Latin American debt crisis in 1982 and the Mexican "Tequila crisis" in 1994. Today, similar forces are at play, compounded by falling oil and other commodity prices.

Although the U.S. Federal Reserve is going to great lengths to clearly communicate its policy intentions and to prepare financial markets for what lies ahead, there will never be complete predictability about the exact timing of interest rate lift-off and the pace of subsequent increases.

Many emerging market economies, such as Trinidad and Tobago, must prepare for the potential negative spillovers that could arise from normalization of U.S. monetary policy. Strong policies and strong fundamentals will help tremendously.

So given these global developments, I want to talk to you about three topics:

- First, outline key developments in Trinidad and Tobago's economy over the past six months;
- Second, explain the monetary policy actions of the Central Bank in the context of evolving economic conditions; and
- Third, conclude with some thoughts on the short-term economic outlook for Trinidad and Tobago.

RECENT ECONOMIC DEVELOPMENTS

I turn to recent economic developments.

Since the release of our last Monetary Policy Report in early December 2014, Trinidad and Tobago's economic performance has been subdued with a rapid succession of negative headline economic news restraining the country's economic outlook.

Gas supply disruptions arising from further upgrade works at major upstream energy producers continued to weigh heavily on energy output into early 2015, even as the non-energy sector, which has kept the economy from veering of its growth trajectory, appeared to be losing some of its momentum.

As a result, Central Bank estimates real GDP contracted by a modest ½ percent in the first quarter of 2015, the first such decline since the second quarter of 2012 when real GDP fell by a deeper 2 ½ percent.

News of the sharp drop in oil prices, Moody's downgrade of Trinidad and Tobago's credit rating, and uncertainty associated with impending general elections worsened economic confidence.

Results from Central Bank's Business Confidence Survey for the first quarter of 2015 were not surprising. The local business community tempered its outlook for the economy to neutral from generally optimistic in the fourth quarter of 2014.

In early January 2015, Government outlined several measures to mitigate the impact of falling energy prices on the fiscal accounts. Government indicated it would cut capital spending on infrastructure projects for which funding had not yet been confirmed and it would postpone current expenditure on non-essential goods and services. Government, however, indicated it would maintain planned spending on healthcare, education, housing and national security.

Any additional revenue shortfall would be offset by proceeds from the Initial Public Offering (IPO) of Phoenix Park Gas Processors Limited. Government also planned to use about three-quarter of the proceeds from the sale of CLICO's assets to pay down debt and the remaining one-quarter to offset the drop in energy revenue.

Despite weaker economic performance and lower energy prices, Trinidad and Tobago's fiscal position did not deteriorate. In fact, the Central Government recorded a broadly balanced position in the first half of fiscal 2015, compared with a small surplus of a ¼ percent of GDP in the first half of the previous fiscal year.

More importantly, energy revenues were 3 percent higher in the first half of fiscal 2015 than in the first half of the previous fiscal year. It seems the

diversification of our LNG export market helped cushion the impact of falling oil prices on energy revenues.

Over the past few years, Trinidad and Tobago's LNG exports have shifted away from a heavy reliance on the United States to more lucrative markets in South America, Europe and Asia. We currently export less than one-tenth of our LNG cargoes to the United States where the benchmark Henry Hub natural gas price is depressed. We do expect weaker oil prices to eventually affect those gas markets whose contracts are indexed to oil prices.

Even though Government said it would cut public spending, this wasn't done. Capital spending was in fact 2 ½ percent higher in the first six months of fiscal 2015 compared with the first six months of the previous fiscal year, while recurrent spending was 2 percent higher over the same period.

Towards the end of March 2015, Central Bank announced its resolution plan for CLICO, the failed insurance giant. For CLICO creditors and policyholders the end of this traumatic experience is finally drawing near.

Six years after CLICO collapsed, the company made its first payment of just over $4 billion to its single largest creditor - the Government of Trinidad and Tobago. CLICO is currently processing the payout of about $950 million dollars to some 1,500 policyholders, who've endured unimaginable hurt and pain as a result of the CLICO crisis.

These two creditors are receiving an equal 85 per cent payout in the first distribution. The remaining payments are targeted to be made in two subsequent distributions pending the sale of certain CLICO assets.

In the coming year, Government stands to receive some $10 billion from CLICO which if used to reduce public debt will help to reverse some of the deterioration in the Government's balance sheet. Since 2008, over half of the increase in public debt - about 13 percent of GDP- was due to domestic debt arising from the bailout of CLICO.

Let me say a few words on the foreign exchange market. Central Bank's foreign exchange intervention program in 2015 is framed in the context of our medium-term balance of payments outlook, which prudently assumes lower energy prices will prevail over the next three years. This year's programme is aimed at easing foreign exchange shortfalls through larger and more frequent monthly interventions.

For the first five months of 2015, total demand in the foreign exchange market amounted to nearly US$3.1 billion while total supply stood at US$2.1 billion, resulting in a shortfall of just under US$1 billion.

Central Bank sold US$995 million to support the domestic foreign market, completely offsetting the shortfall. Our sales of foreign exchange in the first five months of 2015 were equivalent to one-third of the total foreign exchange supply to the market.

The rapid succession of negative economic news seems to have aggravated unsatisfied demand for foreign exchange. Some members of the public and business community are bringing forward their future demands for foreign exchange. Current demand for foreign exchange has jumped to about US$25 million per day, from US$20 million per day early in 2015.

As we move into the busy summer season, Central Bank has already put measures in place to deal with the anticipated higher demand for foreign exchange, particularly US cash for travel purposes.

We requested commercial banks to raise their branch limits for US cash beyond US$500 per person. We also established an intervention system for selling US cash to commercial banks, as we do for selling foreign exchange to authorized dealers. So, if commercial banks or the banking system itself runs low on US cash, Central Bank will meet the shortfall.

Given these two measures, we do not expect the public to experience any difficulty accessing US cash for travel purposes. We also remind travelers they can use alternative methods of payment such as credit cards and can withdraw cash from ATMs abroad with their TT debit cards.

I assure the business community and the public we have enough foreign exchange reserves to satisfy demand. There is no need to ramp up or bring forward your foreign exchange demand. As of mid-May 2015, the stock of foreign exchange reserves stood at US$ 10.7 billion, more than enough to cover over one year of imports.

Moody's Report

Ladies and Gentlemen, I turn to a matter which grabbed headlines and generated intense interest in the country in the past month – **Moody's downgrade of Trinidad and Tobago's credit rating.**

On April 29 2015, Moody's downgraded Trinidad and Tobago's investment grade credit rating one notch and changed the outlook to negative from stable. Moody's cited three reasons for its decision.

1. Persistent fiscal deficits and challenging prospects for fiscal reform;
2. Declining oil prices and limited economic diversification; and
3. Weak macroeconomic policy framework and inadequate provision of vital macroeconomic data.

While this rating action reflects Moody's opinion Trinidad and Tobago is in a somewhat weaker position than in the past, its assessment of the country's capacity to meet its debt obligations remains intact.

International markets seemed unresponsive to the downgrade. Trinidad and Tobago's external bonds continue to be priced at a premium, suggesting international investors are willing to accept a lower yield for the risks associated with investing in Trinidad and Tobago.

In fact, the yield on GORTT international 2024 bond fell to 3.26 percent at the end of May 2015 from 3.49 percent at the end of December 2014 and from 4.38 percent at issue in early December 2013.

I, therefore, assure the country and the international community Trinidad and Tobago remains an investment grade destination and is able to meet all its debt obligations in full and on time. Our sovereign balance sheet is strong, benefiting from adequate official reserves equivalent to over 12 months of import cover, moderate external debt at 7 per cent of GDP, and assets equivalent to almost one-fifth of GDP in the Heritage and Stabilization Fund.

We believe the decision by Moody's to downgrade Trinidad and Tobago's credit rating was unjustified. However, Government and Central Bank are cognizant of the concerns highlighted by Moody's and are taking appropriate steps to move back towards a stable outlook and an even more favourable credit rating.

Central Bank's Monetary Policy Actions

I now turn to Central Bank's monetary policy actions.

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. This is the fifth hike in six months, after holding the Repo rate at an historical low of 2 ¾ percent for nearly two years.

The MPC based its decision on three main factors. The first and most influential factor was forward guidance from the US Federal Open Market Committee (FOMC) on the normalization of U.S. 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 still relatively positive growth outlook for the non-energy sector in 2015.

Regarding the start of the Fed'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 Fed 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 Fed's path towards monetary policy normalization is imminent.

For Trinidad and Tobago, the timing and pace of increases in U.S. interest rates have implications for portfolio capital outflows and foreign exchange demand, especially since returns on U.S. dollar assets remain more attractive than TT dollar assets.

For this reason, Central Bank of Trinidad and Tobago began increasing its policy interest rate since September 2014, to insulate our economy, well in advance and as much as possible, from the potential disruptive shocks we are expected to feel from rising U.S. interest rates.

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 making its 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 ten-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 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 so as to strengthen the impact of higher interest rates throughout the financial system.

With the strength of the 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.

Short-Term Prospects

I turn now to the outlook for the rest of 2015.

Global economic growth is expected to pick up slightly in 2015 as the recovery of advanced economies gains momentum but growth weakens in emerging markets and developing economies, especially oil-exporting countries.

As I indicated before, the most immediate downside risk to Trinidad and Tobago stems from market volatility about the future path of U.S. monetary policy. A more medium term risk stems from a prolonged decline in energy prices.

Against this backdrop, Central Bank expects the Trinidad and Tobago economy to remain in its low growth phase for the rest of 2015.

Several factors support Central Bank's short-term outlook:

- First, we expect a flat performance in the energy sector in 2015. Discussions with key energy industry players suggest there may be further gas supply disruptions in the rest of 2015, particularly when bpTT takes down its Immortelle platform for 22 days in mid-September. Gas supply may stabilize if all three wells from BGTT's Starfish gas field become fully operational. Rising crude oil production from small independent producers is likely to firm up the recent stability in oil output.

- Second, we expect the non-energy sector to grow at a slower pace in 2015. In the run-up to general elections, construction activity is likely to remain strong with the continuation of several large, ongoing public sector projects. Further impetus from private sector projects should support non-energy activity. However, the recent upturn in interest rates may dampen consumer spending.

- Third, we expect Trinidad and Tobago's external position to remain healthy with a structural, albeit slightly smaller, current account surplus. Gross official reserves will continue to exceed conventional benchmarks of reserve adequacy (such as import cover and short term debt coverage). A narrowing of the deficit on the capital and financial account will partly reflect gross foreign direct inflows of over US$1 billion associated with construction of bpTT's Juniper platform and BGTT's Starfish projects.

- Fourth, we expect Central Government to realize a moderate fiscal deficit of around $2 ½ billion or 1 ½ percent of GDP in fiscal 2015. Government is expected to receive large extraordinary inflows of almost $8 billion that will boost non-energy revenue. These inflows represent proceeds from the sale of CLICO's assets, receipts from the Phoenix Park IPO and unbudgeted loan repayments from Trinidad Generation Unlimited. We project energy revenues at $25 ½ billion, some $2 ½ billion less than the previous fiscal year due to lower energy prices and higher tax allowances claimed by a large energy producer for increased capital investment. We project Government's wage bill to increase by $3 billion arising from the settlement of all public sector wage negotiations. If we exclude the large extraordinary revenue inflows, the fiscal deficit would widen substantially to around $10 ½ billion or almost 6 percent of GDP.

- Fifth, Central Bank is advancing its resolution strategy for CLICO. As we've started the first phase of the CLICO Resolution Plan, we are moving ahead with the process to sell CLICO's traditional insurance portfolio which comprises its life, group health and pension policies. CLICO's traditional portfolio was independently valued and we will soon appoint an Investment Advisor to lead the portfolio sale. Appropriate assets have been identified to enable the ultimate transfer to a suitable buyer. The long-standing CLICO issue, when successfully concluded, should give a further boost to overall confidence and economic growth.

Conclusion

Let me now conclude.

Clearly, Trinidad and Tobago's immediate economic priority is to restore solid growth. We need bold and courageous actions in the post-election period to ensure the "new mediocre" - low growth for a long time - does not become the "new reality" for Trinidad and Tobago.

The incoming political administration, from whatever side of the political divide, will face many competing economic priorities. So, as economic advisor to Government, I would suggest three areas for immediate attention to help lift growth.

First on my list is transforming the Central Statistical Office (CSO). Without timely and reliable data, Government cannot make well-informed economic decisions and therefore cannot make sound economic policy.

Over the past year, Central Bank provided support to the CSO to improve the quality, timeliness and production of vital economic statistics in national accounts, trade and the labour market. Good progress has been made.

Central Bank is providing further support to the CSO over the next two years, but this support is conditional on Government speeding up its plan to transform the CSO into an independent, fully-funded national statistical agency.

The second area is undertaking durable fiscal reforms. The new Government must initiate politically unattractive but durable fiscal reforms within the first two years of coming into office.

These fiscal reforms must address reduction of fuel subsidies, duplication and poor targeting of social programs, leakages of the VAT caused by extensive exemptions and zero-ratings, and broadening of the non-energy tax base.

The goal must be to arrest and reverse recurring but modest fiscal deficits to put the fiscal accounts on more sound footing.

Third on my list of priorities to help boost growth is amending the fiscal oil and gas regime. Over the past few years, Trinidad and Tobago has been struggling to maintain gas production above 4 billion cubic feet per day. While production from the Starfish well is expected to add to gas supply, it will not eliminate all the supply issues which began almost a decade ago.

Amendments to the fiscal regime have contributed to the recent aggressive exploration and development programs of the major upstream producers and may help to turnaround the gas supply situation by around 2017.

However, we must ensure our oil and gas fiscal regime remains internationally competitive in order to continue attracting investments, especially for treating with small pools of stranded gas.

As I conclude, I remind the national community the Central Bank is an independent institution entrusted with the sacred responsibility of maintaining Trinidad and Tobago's economic and financial stability. We take this responsibility very seriously. Our mandate goes far beyond the medium term horizon of the next parliamentary electoral cycle.

In the coming months, Trinidad and Tobago will be subject to tremendous political uncertainty. As it has done in the past, Central Bank will continue to do in the future, fulfilling its economic and financial stability mandate free from political interference.

I thank you.