

Republic Economic NEWSLETTER

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Domestic Growth in an Uncertain External Economy

Overview

Against the backdrop of a likely recession in the USA, Trinidad and Tobago's largest export market, this economy grew at an estimated 2.8 percent in the 4th quarter of 2007. However, overall growth for the year came in at 5.5 percent from 12.0 percent in 2006. This decline was due largely to a sub par performance in the energy sector. The end of year seasonality was very much in effect with the spike in the Retail Sales Index mirroring a general trend of proportionately increasing consumption. The

unemployment rate is estimated to have dipped to a low 5.0 percent in the 4th quarter, giving a yearly average of 5.7 percent. While the Central Bank achieved a limited measure of success in restricting inflation to 7.9 percent for 2007, any comfort would have disappeared by January 2008. Homicides accelerated during the quarter, giving 2007 an unenviable record in this regard. Notwithstanding this, according to the Arthur Lok Jack Graduate School of Business, Corporate Confidence Index published in January, the business community anticipated favourable financial and investment conditions locally over the short term.

TRINIDAD AND TOBAGO KEY ECONOMIC INDICATORS

INDICATORS	2007	2006.4	2007.4 P/E
Real GDP (% Change)	5.5	-2.6	2.8
Retail Prices (% Change)	7.9	2.2	2.1
Unemployment Rate (%)	5.7	5	5
Fiscal Surplus/Deficit (\$M)	Surplus	1,530.70	Surplus
Bank Deposits (% Change)	13	7.8	8.6
Private Sector Bank Credit (% Change)	20.3	7.5	5.7
Net Foreign Reserves (US\$M)	6,789.60	6,760.60	6,789.60
Exchange Rate (TT\$/US\$)	6.27/6.30	6.26/6.31	6.27/6.30
Stock Market Comp. Price Index	982.03	969.17	982.03
Oil Price (WTI) (US\$ per barrel)	72.32	62	90.75

Source: - Central Bank of Trinidad and Tobago
P - Provisional Data
E - Republic Bank Limited Estimates

Energy Sector

In the 4th quarter, gas prices remained consistent with earlier periods, averaging US\$7.19 per mmscf (Henry Hub) while oil prices shot up to average US\$90.75 per barrel for the quarter, leading to 2007 averages of US\$7.17 and US\$72.32, respectively. In this environment the precipitous fall-off in energy sector growth from 21.4 percent in 2006 to the estimated 4.4 percent last year, merits closer scrutiny. Clearly in the absence of new production from the start-up of any new mega plants, repeating the stellar sector increase of 2006 was not on. But there are other factors at play. Undoubtedly, one is the continued decline in this country's oil production, as some of the benefits of high oil prices would have been foregone with a drop in production from 144,000 barrels per day in 2006 to the estimated 123,000 barrels last year. Additionally, a number of plants experienced various technical and supply problems resulting in shutdowns for various periods of time. The year 2007 therefore, experienced declines in not just crude oil production, but ammonia and methanol as well. On the positive side natural gas output increased modestly and was boosted with new production from BPTT's Mango and Cashima platforms. Also, a reported gas discovery in January by Petro Canada off Tobago's waters offers hope for future additions to reserves.

Fiscal Conditions

For the fiscal year ending 2007, government's total revenue was \$39.6 billion with expenditure of \$34.4 billion, resulting in a strong fiscal surplus of \$5.2 billion. However, the positives represented by a surplus estimated at 3.5 percent of GDP for fiscal 2007 are offset by an increase in the non-energy fiscal deficit to 15.4 percent of GDP, indicating a growing reliance on non-renewable energy revenues with a continually lagging non-energy sector. Reduction of expenditure including that on subsidies ought to be part of the solution. For the current fiscal year, with oil prices presently twice that of the budgeted oil price of US\$50 per barrel, a positive fiscal position is anticipated over the short term with sizeable additions to the Heritage and Stabilisation Fund expected.

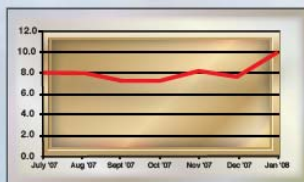
The Stock Market

The continued weak performance of the domestic stock market would have done little to absorb the excess liquidity generated by strong revenue inflows. The Composite Price Index closed the year 2007 at 982.03, a meagre 1.3 percent increase over the 2006 end of year value. Stocks in the United States did not do much better with the S&P 500 rising by 3.5 percent. With investors taking a cautious approach to the stock market at this time, attractive investment instruments are in short supply.

Monetary Policy

The Central Bank achieved moderate success in 2007, as a fourth quarter inflation rate of 2.1 percent was recorded, with the yearly average coming in at 7.9 percent compared to 8.3 percent in 2006.

Figure 1: Price Increases y-o-y (%)



Source: Central Bank of Trinidad and Tobago (CBTT)

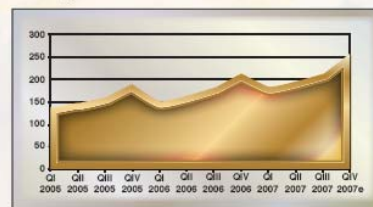
A key factor was the reduction in food price inflation from 23.2 percent to 17.4 percent over the period. This decline was halted however, with the January 2008 Price Index showing a 10 percent increase over that of January 2007 (Figure 1). The Central Bank reacted quickly and aggressively. Wary that this spike may be the beginning of a trend, in February, the Bank increased its benchmark 'repo' rate for the first time in 7 months to 8.25 percent and increased the commercial

bank cash reserve requirement from 11 to 13 percent. The clear intention here being to put the brakes on commercial bank credit, which, according to the CBTT, increased by an estimated 22 percent in 2007. The downside to higher interest rates is that growth in the non-oil sector can slow.

Retail Sales

Many feel that some of these un-invested liquid assets are showing up as increased consumption. Indeed, the Retail Sales Index, notwithstanding its seasonal peaks, shows a clear upward trend (Figure 2). Further, even though consumer goods as a percentage of total imports have been fairly stable, in absolute terms it has risen by 81 percent from US\$636m in 2002 to an estimated US\$1,153m in 2007. This lends credence to the concern expressed in some quarters that not unlike the state, individuals are placing disproportionate weight on consumption, vis a vis investment and savings.

Figure 2: Retail Sales Index



Source: Central Statistical Office (CSO)

Outlook

While there is still debate as to whether the US economy will go into a recession, it is clear that its economic thrust has slowed and will continue to face major challenges over the short term. Due to the significant trade relationship between CARICOM and the USA, this region would undoubtedly be affected by economic conditions 'up north'. Nevertheless, the outlook for Trinidad and Tobago over the next few months is good. Energy revenues should remain buoyant, as commodity prices on the back of strong demand, have held strong thus far and are likely to do so for some time. However, production levels in the energy and petrochemical sub-sectors need to be sustained in order to fully reap the benefits of currently high market prices. Overall, the economic climate will continue to be buoyant in the face of rising credit costs and inflationary pressures. However, there are downside risks associated with the external economy in particular. Businesses must increase their intelligence gathering and remain alert to mitigate any negative fallout.



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