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CENTRAL BANK OF
TRINIDAD & TOBAGO

# Monetary Policy Report

November 2021

Volume XXIII Number 2

# MONETARY POLICY REPORT

## November 2021

## VOLUME XXIII NUMBER 2

The Central Bank of Trinidad and Tobago conducts monetary policy geared towards the promotion of low inflation and a stable foreign exchange market that is conducive to sustained growth in output and employment. This Report provides an account of how monetary policy actions support this objective, in light of recent economic developments.

# PREFACE

The Central Bank's monetary policy framework has three primary objectives. These are the maintenance of low and stable inflation, an orderly foreign exchange market, and an adequate level of foreign exchange reserves. The Central Bank employs a range of instruments (direct and indirect) to effect monetary policy. Prior to the 1990s, the Central Bank utilised direct policy tools such as reserve requirements and direct credit controls. However, the onset of trade and financial liberalisation in the 1990s brought about a greater emphasis on market-based instruments such as open market operations to effect monetary policy. Since mid-2002, the Central Bank's monetary policy framework was revised to include the use of a Repurchase ('Repo') rate as the main monetary policy tool. The Bank utilises the Repo rate to signal to the banking system the direction in which it wishes short-term interest rates, and ultimately, the structure of interest rates, to move. Open market operations involve the purchase and sale of Government securities by the Central Bank and is the main tool for influencing the level of liquidity in the domestic financial system.

The Monetary Policy Committee (MPC) develops and executes the Bank's monetary policy. The MPC comprises members of the Bank's Senior Management and is chaired by the Governor. The Committee calibrates the policy instruments, issues quarterly Monetary Policy Announcements (MPA), which provide insights into the MPC's deliberations, and oversees the preparation of the semi-annual Monetary Policy Report (MPR). The MPC is assisted by the Monetary Policy Secretariat (MPS), which undertakes ongoing economic and financial analysis. The Committee is chaired by the Manager of the Research Department and comprises staff from the Research, Statistics, and Reserves and Domestic Market Management Departments. In addition to the MPA, the Bank utilises the semi-annual MPR to communicate to the public its views on economic and financial developments and the main factors that influence the Bank's monetary policy decisions to meet stated objectives.

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# KEY MESSAGES

- The global economy entered into recovery mode in the first half of 2021, but the recovery has been uneven. Headwinds created by the Delta variant of the novel coronavirus and supply disruptions in key markets caused the International Monetary Fund, in its October 2021 World Economic Outlook, to marginally revise downward its global growth forecast to 5.9 per cent for 2021.

- The advent of the Omicron variant has heightened uncertainty as evidenced by the bout of volatility in international financial markets towards the end of November 2021. However, there is building consensus among economic analysts that the global economy is more resilient to the emergence of new variants. As such, this latest variant is not expected to overly impact economic growth projections.

- Major central banks continued to support their economies from the effects of the pandemic, noting that the recent bout in inflation would likely not persist beyond 2022. However, rising inflationary expectations can prompt faster-than-anticipated monetary normalisation in the United States, leading to a tightening of global financial conditions.

- Based on Central Bank of Trinidad and Tobago estimates, the domestic economy continued to contract in the second quarter of 2021 due to lower energy and non-energy sector activity. However, the gradual reopening of the economy which commenced during the third quarter should be growth-supportive.

- Despite the softening of lending interest rates and elevated market liquidity, the ongoing crisis has caused private sector credit to taper off. Credit expansion was supported by real estate mortgage lending as business and consumer credit continued to be weak.

- The Central Bank maintained an accommodative policy stance to ensure ample liquidity in the domestic financial system to support economic recovery from the effects of the COVID-19 pandemic. Inflation dynamics are likely to dominate monetary policy considerations in the coming months.

# MONETARY POLICY REPORT

## November 2021

## MONETARY POLICY OVERVIEW AND OUTLOOK

### Overview

**The Central Bank maintained an accommodative monetary policy stance with a view to providing monetary support to the domestic economy in light of the effects of the COVID-19 pandemic**. At its meetings in June and September 2021, the Monetary Policy Committee (MPC) of the Central Bank kept the interest rate on its short-term lending to commercial banks, the Repo rate, at 3.50 per cent, unchanged since the reduction at an extraordinary MPC meeting in March 2020. The MPC considered that the international economic environment was improving, energy commodity markets were strengthening, and the risk of early withdrawal of extraordinary policy support by major economies was negligible. The Central Bank also maintained a neutral position concerning open market operations, given that money and financial market indicators pointed to ample liquidity to support a recovery in domestic credit demand in the non-energy sector. Furthermore, the Central Bank intervened in the local foreign exchange market, as necessary, to mitigate imbalances in the supply and demand for foreign exchange.

**The COVID-19 pandemic, which is now in its second year, continues to shape the global economy.** Although many countries generally relaxed containment measures as the year progressed, the rapid spread of new infections and the rise in deaths due to the Delta variant resulted in slowing growth in some economies as early as the second quarter of 2021. Additionally, the recent emergence of the Omicron variant has elevated market uncertainty but economic analysts expect that the global economy can withstand new variants. Even where vaccines are available, addressing COVID-19 and its variants through ramping up inoculation rates are also being hampered by vaccine hesitancy. Further, inflation rates in many countries have been accelerating amid supply chain constraints, surging commodity prices, heightened post lockdown demand, and ongoing fiscal and monetary stimuli. Major central banks have held their accommodative policy stances unchanged as they prioritise supporting economic recovery over rising inflation which, for the most part, has been considered transitory. However, with inflation proving more durable in recent times, several monetary authorities in Emerging Market and Development Economies (EMDEs) have begun raising policy rates as inflation surged past their target levels.

**Domestically, the gradual reopening of the economy concomitant with higher vaccination rates may have provided a positive fillip to the non-energy sector during the third quarter of 2021**. Alongside an estimated uptick in economic activity, supply-side factors have contributed to increases in headline inflation (albeit inflation remains relatively low). The surge in international food prices such as sugar, wheat and vegetable oils, higher shipping costs, transportation delays, and adverse weather conditions led to marked increases in food inflation.

**Financial conditions remain broadly supportive**. The Central Bank's current liquidity management strategy of sustaining high excess reserves has led to the continued reduction of interest rates, but the credit response has been lacklustre. Commercial banks' excess liquidity at the Central Bank rose to $7.7 billion in October 2021 from $7.5 billion in March 2021. This outturn contributed to further reductions in banks' lending interest rates to support private sector credit. However, private sector credit was only marginally positive, mainly due to real estate mortgage lending. Business credit and consumer lending remained depressed. The TT/US short-term (3-month) interest rate differential widened slightly to 29

basis points (bps) in October 2021 from 25 bps in April 2021. In comparison, the long-term benchmark spread (TT/US10-year treasury) fluctuated but widened by 31 bps to 344 bps in October from April 2021.

## Outlook

**While a global economic recovery is anticipated in 2022, several downside risks remain**. Limited access to vaccines, particularly in low-income countries, and vaccine hesitancy coupled with the rapid spread and threat of new variants of the virus increase the uncertainty of economic prospects, while inflation risks are skewed to the upside.

**International and domestic inflation developments will shape the monetary policy considerations of the Central Bank in the near term**. As the domestic economy reopens and aggregate demand recovers, inflationary pressures may increase, especially if supply constraints reduce the utilisation of the spare capacity within the economy. Therefore, prolonged international supply chains disruptions are likely to significantly influence domestic inflationary pressures. The measures proposed in the Budget for fiscal year (FY) 2021-2022 can also either limit (removal of VAT on selected food items) or stoke (reintroduction of VAT on certain luxury goods) inflationary pressures – the net impact of which would become more apparent over the next few months when the measures are fully implemented. The size of their effects will depend on the weights of the affected items in the Retail Price Index (RPI) and on the ability of households and companies to adjust to these measures. Nonetheless, core and food inflation are expected to maintain an upward trend in the short term, especially in light of the announced price hikes for maxi and taxi fares, air conditioning units, newspapers, bread, and local confectionery. Concerning food inflation, the sustained increases in international food prices in 2021 may continue to pass through to local food prices, albeit with a lag. Additionally, local food importers' costs may continue to be impacted by the international shortage of shipping containers and higher shipping costs (freight and insurance).

**Further supply shocks to inflation may force major central banks to tighten monetary policy earlier than anticipated in 2022**. A faster-than-expected tightening of US monetary policy may put an additional drag on the global economic recovery, impacting interest rates, currency values, and capital flows worldwide. Foreign interest rates are expected to increase, but domestic rates are also expected to respond if inflation expectations drift upwards. The TT/US interest rate differentials are expected to remain mostly stable but may narrow rapidly if US interest rates increase at a faster pace amidst a US yield curve that has already shown signs of flattening. Such action can potentially impact foreign exchange flows and domestic credit market conditions. The key domestic monetary policy considerations will oscillate around how to appropriately balance between support for the recovery of the local economy while staving off an inflationary spiral.

# PART I – THE INTERNATIONAL ECONOMIC CONTEXT

*Central banks in major economies continue to maintain accommodative policies to support the ongoing global recovery from the impact of the COVID-19 pandemic. However, disruptions to critical links in the global supply chain, such as the shortage of key intermediate inputs and bottlenecks in international shipping, have pushed consumer prices upward. These factors, coupled with the pickup in global economic activity and rising commodity prices, are anticipated to keep inflation elevated in the near term. Central bank actions to stabilise inflation closer to targets can further slow the global recovery if executed before a durable recovery takes hold.*

## Recent Economic Developments and Outlook

The global economy experienced a strong recovery in the first half of 2021 amidst the COVID-19 pandemic. However, the pace of recovery has been mixed across countries, reflecting varying degrees of success of the various vaccination campaigns and spread of the Delta variant. Towards the end of November 2021 international financial markets reacted to the emergence of the Omicron coronavirus variant, despite this there is growing consensus among economic analysts that the global economy is more resilient to the emergence of new variants. As such this latest variant is not expected to overly impact economic growth projections.

### *The United States, Euro Area and China are leading the global recovery*

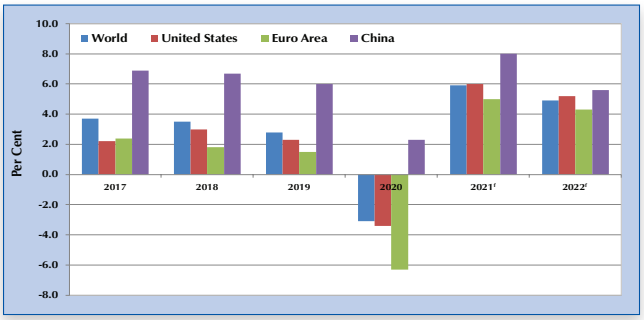
The United States, China, and the Euro Area are leading the global economic recovery despite weaker third-quarter performances in 2021. Economic growth in the United States (US) was stronger than expected, reflective of mass vaccination rollouts and unprecedented fiscal and monetary policy stimuli. In the third quarter of 2021, the US economy advanced 4.9 per cent (year-on-year), following growth of 12.2 per cent in the second quarter. Meanwhile, economic activity in China, the world's second-largest economy, decelerated in the third quarter of 2021 (4.9 per cent from 7.9 per cent in the second quarter) as the economy faced economic challenges, including power shortages and supply chain issues, together with pockets of renewed virus outbreaks in some regions. The Euro Area's economic performance also improved, reflecting a rebound in economic activity and consumer spending following the easing of restrictions. Real GDP in the Euro Area expanded by 3.7 per cent in the quarter ending September 2021, its second consecutive quarterly expansion following five previous quarters of real GDP decline.

### *The performance of other regions was mixed*

In contrast, many other regions, such as Latin American and the Caribbean, have experienced depressed economic performances due, in part, to lower vaccination rates, which affected the reopening of various sectors. The slow lifting of restrictions on international travel and fears of new waves of the virus have acutely affected tourism-based economies. However, commodity-exporting economies in the region have been benefiting from buoyant prices for energy and agricultural commodities.

The ongoing international supply-chain disruptions and COVID-19 dynamics will likely affect the growth outturns for some major economies, such as the US, Euro Area and China. Vaccine access disparities will also put an additional strain on economic activity in low-income economies. However, partially offsetting these declines are expected improvements in the growth performance for commodity exporters. Forecasts by the International Monetary Fund (IMF) in its October 2021 World Economic Outlook (WEO) point to a slower pace of global recovery of 5.9 per cent for 2021 and 4.9 per cent in 2022 **(Chart 1.1)**. The latest forecast for 2021 represents a 0.1 per cent downward revision from the Fund's July 2021 WEO Update.

Chart 1.1
Global Growth: Annual Real GDP Growth

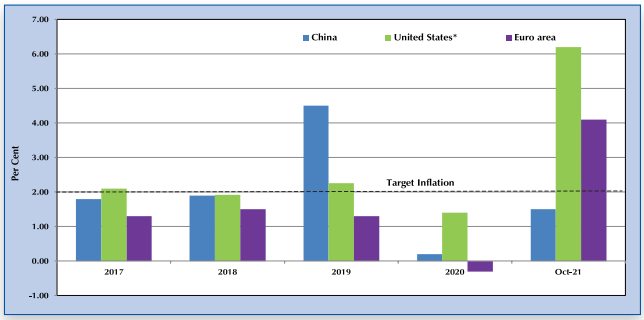



Source: International Monetary Fund, World Economic Outlook, October 2021

### *Inflation is beginning to pick up pace*

Headline inflation rates have been rising worldwide, exceeding some central banks' targets **(Chart 1.2)**. The rise in inflation reflects pandemic-induced supply-demand imbalances and higher energy prices. Further surges in demand in the US, as economic activity normalises, combined with production bottlenecks and supply constraints, have pushed inflation (6.2 per cent year-on-year) above the US Federal Reserve's (the Fed) target in October 2021. The Fed anticipates inflation to remain elevated in the near term before moderating. Higher energy prices kept Euro Area inflation above target in October (4.1 per cent). The European Central Bank (ECB) noted that the current increase in inflation is expected to be temporary, and over the medium term, inflation is expected to remain well below the target of 2 per cent. In contrast, reflective of the slowdown in activity in China, the inflation rate continued to trend below its target of 3.0 per cent, recorded at 1.5 per cent in October 2021.

Chart 1.2
Selected Advanced Economies: Headline Inflation
(Year-on-Year Per Cent Change)




Source:Bloomberg
* Core PCE price index.

### *Energy prices have jumped higher*

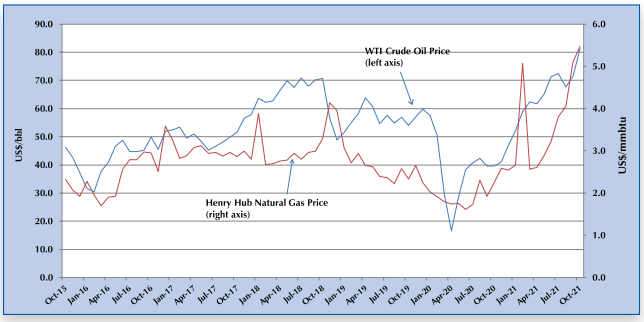
The market for crude oil was buoyed by a combination of increased demand due to the reopening of several economies and tightened supply in the aftermath of Hurricanes Ida and Nicholas, which damaged crude oil infrastructure in the Gulf of Mexico. The demand for crude oil was further bolstered by the rapid increase in natural gas prices, making crude oil a more viable alternative for power generation purposes. The gap between demand and supply was also exacerbated by the inability of OPEC+ to ramp up production to meet recovering demand following a series of production cuts in the earlier part of the year. Crude oil prices continued their resurgence over the period June to October 2021 **(Chart 1.3)**. West Texas Intermediate prices continued surging, rising 81.7 per cent to an average US$72.89 per barrel during the five months to October 2021 compared to the same period a year ago. In comparison, Brent crude prices increased 73.5 per cent to US$73.39 per barrel.

Natural gas prices surged much like crude oil prices, indicative of rampant increases in demand coupled with reduced supply. Price increases reflected a prolonged winter in early 2021 followed by a hotter than usual summer, which resulted in higher demand and a drawdown in natural gas reserves. Prices were bolstered by increased demand from Brazil, where a historic drought reduced hydropower reservoir levels, increasing the need for natural gas imports to aid power generation. US Henry Hub prices averaged US$4.34 per million British Thermal Units (mmbtu) over the period June to October 2021, representing an increase of 121.9 per cent over the corresponding period of 2020. The increased gas prices resulted in higher prices for other energy-based commodities such as ammonia, propane, urea, natural gasoline, and methanol. During the review period, significant price increases were recorded for ammonia (237.6 per cent), urea (139.2 per cent), propane (135.3 per cent), natural gasoline (101.7 per cent) and methanol (77.3 per cent).

### *Food price increases have been rapid and often*

The ongoing supply chain and weather-related disruptions contributed significantly to food prices rising across the world. The Food and Agriculture Organization's Food Price Index hit its highest level in a decade in October 2021, reflecting surging prices for oils, sugar and

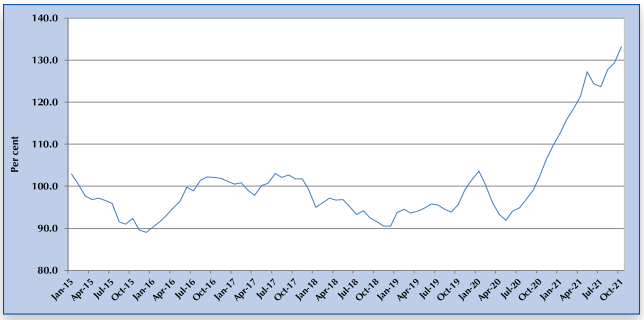
Chart 1.3
Natural Gas and Crude Oil Prices




Source: Bloomberg

cereals, along with high but stable prices for meat and dairy products **(Chart 1.4)**. In October 2021, the index was up 31.3 per cent (year-on-year) and the increase averaged 28.9 per cent over the first ten months of the year. Although food prices were rising pre-COVID-19, the pandemic has intensified the trend **(Box 1)**. The trend in international food prices appears to be feeding into domestic consumer price inflation in economies across the globe.

CHART 1.4
FAO MONTHLY REAL FOOD PRICE INDEX

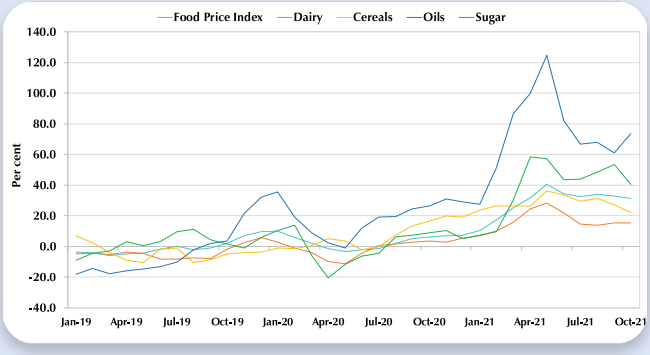



Source: Food and Agriculture Organization
Note: (2014-2016=100)

# BOX 1
# COVID-19 AND ITS EFFECT ON DOMESTIC FOOD PRICES

In examining the international market for food items, the decline in global economic activity did effect food prices despite food being an essential commodity. In the first half of 2020, reduced global incomes that resulted from limits on economic activity brought about a decline in the demand for food. This decline in demand alongside lockdown measures led to a disruption of supply chains and the idling of transportation infrastructure. However, as vaccinated populations increasingly began to emerge from COVID-19 lockdowns, the resurgence of demand for food items has outstripped the recovery of global supply chains. As a result, global food prices, as measured by the Food and Agriculture Organization (FAO) Food Price Index, trended upward by the second half of 2020 and surged in 2021. The COVID-19 pandemic has adversely impacted international food prices which has translated to higher domestic prices, albeit with a lag. Growth in the FAO Food Price Index, which measures the change in the international price of a basket of food commodities, jumped to 31.3 per cent in October 2021 compared to October 2020 (Chart 1). More so, year-on-year growth in the index averaged 28.9 per cent over the first ten months of 2021, much higher than the average of 3.1 per cent for the twelve months of 2020. Pandemic-induced restrictions have caused back-ups, slowdowns and bottlenecks in supply chains across many food-producing countries. Some of these setbacks include crops rotted in fields, scaled-down operations at food processing plants, border controls and freight restrictions in light of COVID-19 protocols. On the other hand, as many economies emerge from pandemic-induced restrictions, soaring demand from major food-importing countries has put upward pressure on food prices, especially for animal feed grains such as corn and soybeans. Relatedly, the pandemic has added significant impetus to shipping rates in 2021. A surge in demand for shipping given delays in mobilising shipping infrastructure has resulted in vast increases in freight rates. In September 2021, Independent Commodity Intelligence Services (ICIS) reported that the cost to ship a 40-foot container from China and East Asia to the United States was over US$20,000, up from roughly US$4,500 twelve months earlier[1]. Industry participants have estimated that these elevated shipping rates may linger until mid-2022.

Chart 1
FAO Food Price Index
(Year-on-Year Per Cent Change)




Source: Food and Agriculture Organization of the United Nations

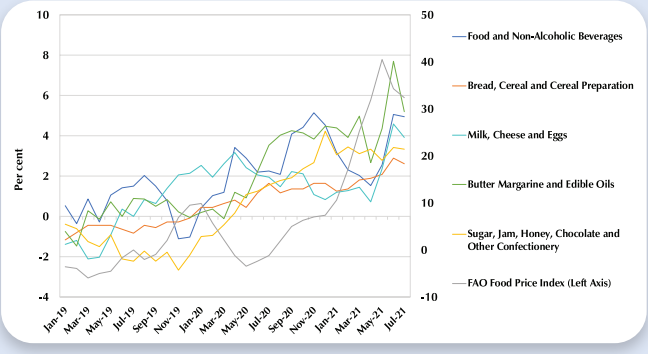
[1] Source: https://www.icis.com/explore/resources/news/2021/09/16/10685630/shipping-container-rates-continue-to-soar-despite-increased-attentio

# BOX 1 (CONT'D)
# COVID-19 AND ITS EFFECT ON DOMESTIC FOOD PRICES

The world's recovery from COVID-19 is also driving significant growth in energy prices, which adversely impacted the global price of food. The West Texas Intermediate (WTI) crude oil price and Henry Hub natural gas price averaged much higher in October 2021 than the same month a year earlier. This surge in energy costs also had adverse effects on the global price of food in several ways. Firstly, natural gas is a main input into the manufacture of fertilisers, directly translating into higher crop prices. Secondly, higher fuel prices provide another impetus for increasing freight rates. Surging energy prices have also resulted in an increase in demand for biofuels as a cheaper alternative, shifting vast amounts of food items such as corn and soybeans away from traditional food markets.

The increase in international food prices has had an effect on the domestic price of food. Upward momentum in food prices began to take hold in late 2020 according to the Retail Price Index calculated by the Central Statistical Office (Chart 2). The data suggests that although the rate of growth is lower, food prices in the local setting seem to track the movement in related international food prices with a lag. Previous research[2] has shown that changes in international food prices begin to affect domestic prices after roughly 2 – 5 months. These lags may have compressed further given the extraordinary events initiated by the pandemic. As a result, the continued growth in international food prices during the second half of 2021 and the expectation of continued elevated international food prices in the short term suggest that domestic food prices may trend higher in the coming months.

Chart 2
Food Inflation in Trinidad and Tobago
(Year-on-Year Per Cent Change)




Source: Central Statistical Office

The evolution of food prices in Trinidad and Tobago is not without its domestic influence. Extreme weather patterns (such as flooding in recent times) continue to influence the supply of vegetables and some fruits. There have been reports of surging vegetable prices over the last few months given weather-related supply shortages. These have coincided with a very active rainy season in 2021, with numerous adverse weather alerts being issued by the Trinidad and Tobago Meteorological Office, compounding the supply-disrupting effects of the COVID-19 pandemic. Increasing food prices locally has resulted in direct Government responses. With effect from November 1, 2021 the list of food items that are VAT exempt (zero-rated), was expanded to include essential food items. This expanded list covers almost all the major food sub-categories. While this measure may provide some ease to the consumer, it may only be a temporary respite given the increasing cost of imported food. The effectiveness of monetary policy in taming inflation that has its origins in a supply-side shock is debatable. As such, fiscal policy may have to continue taking the lead in responding to the current food price challenges.

[2] Primus, K., Jagessar, V., Cox, D. and R. Mahabir (2011). What Accounts for Food Price Inflation in Trinidad and Tobago in Recent Years? in Economic Bulletin January 2011 Vol.XIII No. 1. Available at: https://www.central-bank.org.tt/sites/default/files/page-file-uploads/Economic%20Bulletin%20January%202011%20Article%20IIa.pdf.

## Global Financial Conditions

### *Accommodative monetary policies still proliferate*

Major central banks have continued to adopt accommodative policies to support a sustained global economic recovery, but rising inflation may provoke a change in stance. The Fed signalled its commitment to utilise monetary policy tools to achieve maximum employment and the temporary inflation target that averages 2.0 per cent. At its November 2021 monetary policy meeting, the Fed maintained its federal funds rate at a range of 0.00 to 0.25 per cent and indicated that the tapering process would begin in November with a monthly reduction of US$10 billion in Treasuries and US$5 billion in mortgage-backed securities. At the same time, expectations of the Fed's first interest rate hike have been advanced to late 2022 from earlier projections of sometime in 2023. Similarly, the ECB kept its policy rate unchanged at 0.0 per cent in October 2021. The ECB noted that it would start conducting a moderately lower pace of net asset purchases under the Pandemic Emergency Purchase Programme (PEPP) for the rest of the year due to improved economic and financial conditions.

For the 18th consecutive month, in October 2021, the People's Bank of China (PBoC) kept its benchmark interest rate unchanged and accommodative to promote economic activity. The 1-year Loan Prime Rate (LPR) and the 5-year LPR were left unchanged at 3.85 per cent and 4.65 per cent, respectively. Furthermore, the PBoC injected approximately 120 billion yuan ( US$18.6 billion) into the banking system at the end of August 2021 to maintain stable liquidity conditions. In contrast, central banks in several other regions, such as Latin America, have taken pre-emptive action and increased interest rates to counter excess divergence of inflation from established targets.

Financial markets have been coping with the ongoing pandemic. However, macro-financial conditions worldwide have been marked by widening polarity. While conditions continue to ease in Advanced Economies (AEs) due to tightening credit spreads, rising equity and house prices, in the EMDEs, concerns surrounding rising bond yields and increased inflation in the AEs have contributed to tighter financial conditions. Escalating corporate debt defaults in China, including the country's largest property developer- China Evergrande Group, signal more significant global financial risks and can further dampen financial market sentiments.

Global financial vulnerabilities have been further compounded by debt overhang in the corporate sector, asset and liabilities mismatches of life insurance companies, external financial challenges, and the overvaluation of financial assets due to extraordinary policy measures. These areas continue to be areas of concern for policymakers. In its October 2021 Global Financial Stability Report (GFSR), the IMF cautioned against the premature withdrawal of policy and lending support since this can exacerbate systemic risk. The IMF's historic special drawing rights (SDRs) and related measures could assist economies in insulating themselves from capital flow reversals and increases in funding costs **(Box 2)**. Governments' efforts to manage the pandemic have already resulted in substantially higher sovereign debt and policymakers have expressed fears that the global economy could slip back into recession if fiscal and debt sustainability issues are not adequately addressed.

## BOX 2
## INTERNATIONAL MONETARY FUND RESILIENCE AND SUSTAINABILITY TRUST (RST): POTENTIAL IMPLICATIONS FOR THE CARIBBEAN REGION

In response to the COVID-19 pandemic, the International Monetary Fund (IMF) implemented a general allocation of Special Drawing Rights (SDRs) of 456 billion (equivalent to US$650 billion) in August 2021 to boost global liquidity and support the economic recovery. Of this amount, US$375 billion (SDR 264 billion) was allocated to advanced economies, US$275 billion (SDR 193 billion) to emerging market and developing countries, including about US$21 billion (SDR 15 billion) to low-income countries[1]. To amplify the benefits of this historic SDR allocation, the IMF is encouraging the voluntary channelling of SDRs from countries with strong external positions to more vulnerable member countries to support their pandemic recovery and achieve resilient and sustainable growth. In order to achieve this, the IMF is exploring several options including scaling up resources of its concessional financing through the Poverty Reduction and Growth Trust (PRGT)[2]; lending by multilateral development banks; and the establishment of a new facility – the Resilience and Sustainability Trust (RST).

The IMF noted that there are several long-term challenges in rebuilding the global economy which include climate change, increasing inequality, changing demographics, and the rapid pace of digitalisation. Further, these challenges are often unaddressed due to financial and capacity constraints of countries and therefore, pose risks to external, social, and economic stability. Against that backdrop, the proposed RST will be geared towards supporting low- and middle-income countries that are particularly vulnerable to climate and pandemic-related risks, by supporting recovery, improving financial resilience and promoting balance of payments viability[3]. This facility would allow countries to access more affordable financing with cheaper lending rates and longer maturities than the IMF's traditional lending terms. Currently, work is being done on the design of the RST, including the size of the trust, eligibility parameters, conditionality, lending terms, and the financial operations. The Executive Board of the IMF is expected to deliberate on the RST during the first half of 2022.

Several benefits can be derived from establishing the RST. Unlike the Fund's existing toolkit which is designed to address urgent external account imbalances, the RST could provide a dedicated tranche of funding to meaningfully tackle structural reforms. In the context of the Caribbean, the RST can contribute to the much-needed resources to address the structural transformation imperatives associated with climate change. The region remains highly susceptible to climate risks due to its size, location and reliance on sectors vulnerable to climate change such as tourism, agriculture and fishing (IDB 2021)[4]. Further, the IMF noted the need for vulnerable countries to access expanded facilities to respond to macro-economic disruptions due to climate risks[5]. For hurricane-susceptible Caribbean countries such as Dominica, climate change costs can exceed 200 per cent of GDP[6] and more importantly, negatively impacts their sustainable development path. In that context, the RST can

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1 International Monetary Fund, 2021. "Guidance Note for Fund Staff on the Treatment and Use of SDR Allocations." Washington D.C., p 7.

2 The Poverty Reduction and Growth Trust (PRGT) provides support to low-income member countries via concessional loan facilities that are currently interest free. The aim of the PRGT is to aid low-income countries (LICs) in achieving and maintaining a stable and sustainable macroeconomic position consistent with lasting poverty reduction and strong growth.

3 IMF Communications Department. 2021. "Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development." https://www.imf.org/en/News/Articles/2021/10/11/communique-intergovernmental-group-of-twenty-four-on-international-monetary-affairs-and-development

4 Office of Evaluation and Oversight. 2021. "What Can We Learn from Past Responses to Public Health Crises?" Inter-American Development Bank, 2021. https://www.iadb.org/en/ove/climate-change-caribbean-small-island-states.

5 Task Force on Climate, Development, and the International Monetary Fund (2021). "Making Special Drawing Rights Work for Climate Action and Development,". https://oecd-development-matters.org/2021/10/07/making-special-drawing-rights-work-for-climate-action-and-development/.

6 Otker, Inci and Krishna Srinivasan. 2018. "Bracing for the Storm: For the Caribbean, Building Resilience is a matter of survival." International Monetary Fund: Finance & Development, March 2018, 55 (1): 48-51. https://www.imf.org/external/pubs/ft/fandd/2018/03/pdf/otker.pdf.

## BOX 2 (CONT'D)
## INTERNATIONAL MONETARY FUND RESILIENCE AND SUSTAINABILITY TRUST (RST): POTENTIAL IMPLICATIONS FOR THE CARIBBEAN REGION

provide both short-term financing and long-term financing to assist in alleviating countries' vulnerability to external shocks and support the move towards a greener economy7. Short-term facilities could be used to support the region's balance of payments needs as countries implement mitigation policies. Meanwhile, access to longer-term financing instruments with a maturity ranging from 15 to 20 years would help build capacity and mobilise finance for climate resilience and adaptation8 as well as enable countries to implement programmes to help transition from fossil fuels into low carbon economies.

Domestically, the ultimate attractiveness of the RST to Trinidad and Tobago would depend on if access is contingent upon consent to a conventional lending program – a design element currently being contemplated by the Fund. Trinidad and Tobago does not have any immediate balance of payments financing needs. Therefore, the facility's eligibility criteria would be a key consideration for country authorities.

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[7] Bhandary, Rishikesh Ram. "How a Well-Designed Resilience and Sustainability Trust Could Foster Climate-Resilient Economies." Global Development Policy Center, 2021. https://www.bu.edu/gdp/2021/09/23/toward-development-centered-climate-policy-at-the-international-monetary-fund/.

[8] Adaptation refers to adjustments in ecological, social, or economic systems in response to actual or expected climatic stimuli and their effects or impacts. It refers to changes in processes, practices, and structures to moderate potential damages or to benefit from opportunities associated with climate change. United Nations Climate Change. 2021. "What Do Adaptation to Climate Change and Climate Resilience Mean?" https://unfccc.int/topics/adaptation-and-resilience/the-big-picture/what-do-adaptation-to-climate-change-and-climate-resilience-mean.

# PART II - DOMESTIC ECONOMIC ACTIVITY AND PRICES

*The COVID-19 pandemic continues to delay a more robust domestic recovery. Public health restrictions to curb the spread of the virus impacted activity in several economic sectors during the second quarter of 2021. The external sector's performance has improved faster than anticipated, as estimates for the first half of 2021 point to a marked pickup in export earnings. Despite a slight uptick during the second half of 2021, headline inflation remained low and stable. However, food inflation is likely to gain momentum due to the lagged transmission of higher international food prices, primarily due to supply-chain disruptions.*

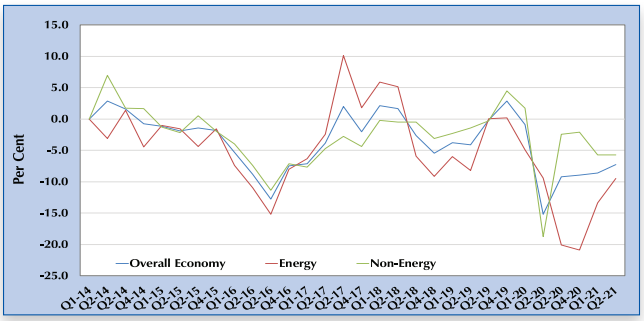
## Recent Economic Developments and Outlook

### *Economic recovery has been slow*

The COVID-19 pandemic continues to dampen production of goods and services. Early estimates point to a contraction of production in the second quarter of 2021 in both energy and non-energy sectors. According to the Central Bank's Quarterly Index of Real Economic Activity[1] (QIEA, 2012=100)[2], domestic production was 7.2 per cent lower in the second quarter of 2021 compared to the year-earlier period. Activity in the energy sector[3] decreased 9.4 per cent, while output in the non-energy sector fell by 5.7 per cent **(Chart 2.1)**.

Reduced natural gas supply continued to plague the energy sector in the second quarter of 2021. The Central Bank's QIEA suggests that activity in the Mining and Quarrying sector recorded a decline of 8.3 per cent (year-on-year). Natural gas production fell by 22.1 per cent, which overshadowed the 6.5 per cent year-on-year increase in crude oil production during the three-month period. The upstream gas supply constraint affected the Refining sub-sector, where activity fell by 39.9 per cent due to a 44.1 per cent falloff in liquefied natural gas (LNG) production, on account of the continued closure of Atlantic Train I during the period. Meanwhile, downtime at the Nutrien complex and the TRINGEN I ammonia facility contributed to an 8.2 per cent drop in ammonia output. However, methanol production grew notably by 29.5 per cent, reflecting better production rates in 2021 following temporary market-related closures stemming from COVID-19 and its effect on markets in 2020. Methanol production was buffered by the addition of output from the Caribbean Gas Chemical Limited facility, which began commercial operations in December 2020. The uptick in methanol production boosted overall Petrochemicals sector activity (7.7 per cent) in the second quarter of 2021.

Chart 2.1
Quarterly Change in Index of Real Economic Activity
(Year-on-Year Per Cent Change)




Source: Central Bank of Trinidad and Tobago

Available indicators show that output in several non-energy sectors was weighed down by public health restrictions to mitigate the spread of the COVID-19 virus. While some sectors showed signs of improvement, large contractions in construction, retail trade, and manufacturing kept overall non-energy activity low. Construction activity was restricted in May and June 2021, leading to a 41.4 per cent decline in construction indicators in the second quarter of 2021. Activity in

1 The Central Statistical Office (CSO) is Trinidad and Tobago's official source for National Accounts (GDP) data. The Central Bank compiles a Quarterly Index of Real Economic Activity (QIEA) to gauge short-term economic activity. The QIEA differs from the CSO's national accounts statistics in terms of methodologies and coverage. The QIEA is based on production indicators, excludes price effects and does not comprehensively cover all sub-industries measured by the CSO.

2 The Central Bank of Trinidad and Tobago rebased its Quarterly Index of Real Economic Activity (QIEA) from a base year of 2010 to 2012 and changed the classification system from the Trinidad and Tobago System of National Accounts (TTSNA) to the International Standard Industrial Classification of All Economic Activities, Revision 4 (ISIC Rev. 4).

3 Energy sector activity comprises the production of crude oil and natural gas, LNG, NGLs and petrochemicals and the retail sale of automotive fuels. Under the ISIC Rev. 4 classification, crude oil and natural gas output are included in Mining and Quarrying, the production of LNG, NGLs and petrochemicals are included in Manufacturing, and the retail sale of automotive fuels is included in Wholesale and Retail Trade.

the Wholesale and Retail Trade (excluding Energy) sub-sector is estimated to have declined 16.6 per cent over the period given the subdued economic landscape **(Chart 2.2)**. Manufacturing (excluding Refining and Petrochemicals) was subdued, registering an estimated decline of 1.5 per cent.

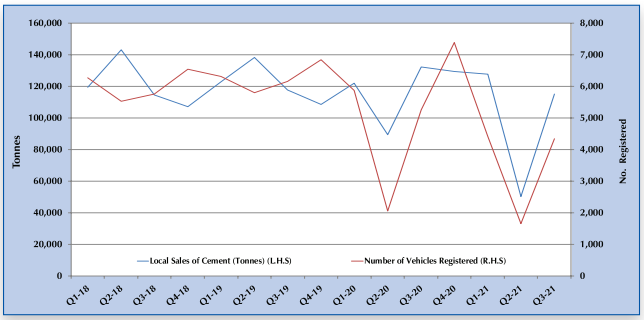
Despite the restrictions, there were improvements in several sectors. Activity in the Electricity and Water (Excluding Gas) sector increased by 7.5 per cent in the second quarter of 2021, representing the fourth consecutive quarter of growth for the sector. Activity in the Financial and Insurance sector expanded by 4.2 per cent, propelled by increased deposits at local financial institutions. The Transportation and Storage sector showed its first signs of recovery in the second quarter of 2021, after two and half years of contractions. Activity in the sector expanded by 2.7 per cent, reflecting an increase in air travel due to more repatriation flights. Real Estate Activity also expanded by 1.1 per cent when compared to the same period last year.

During the third quarter, several sectors were allowed to resume operations, including construction, manufacturing, retail, personal services, and food and restaurant businesses. The anticipated rise in activity is expected to be growth-positive.

### *Inflation is still contained but is beginning to be impacted by supply-side factors*

Inflation over the first nine months of 2021 was impacted by relatively low aggregate demand due to constraints on economic activity arising from the COVID-19 restrictions and supply-side factors, including a surge in international food prices, higher shipping costs, transportation delays, and adverse weather conditions towards the end of the period. Data from the Central Statistical Office (CSO) showed that headline inflation moved from 0.9 per cent in January 2021 (year-on-year) to 2.4 per cent in September 2021, averaging 1.5 per cent over the period **(Chart 2.3)**. Core inflation, which omits the volatile food component, increased over the period, moving from 0.5 per cent in January 2021 to 1.6 per cent in September 2021. Meanwhile, food inflation jumped to 5.8 per cent in September 2021, up from 3.2 per cent in January 2021.

Chart 2.2
Non-Energy Indicators
(Cement Sales, Vehicle Registrations)




Source: Central Bank of Trinidad and Tobago

Core inflation averaged 1.0 per cent over the first nine months of the year, as faster price increases in some sub-indices were tempered by slower price rises and lower prices in other sub-indices. The sub-indices that recorded faster price increases were housing, transport, communication and alcoholic beverages and tobacco. On the other hand, slower price increases were recorded in the health and hotels, cafes and restaurants sub-indices. Meanwhile, price declines were recorded in the clothing and footwear sub-index. More specifically, higher imputed rental costs for homeownership drove growth in the housing sub-index (4.5 per cent in September). Prices in the transport sub-index rose by 1.5 per cent in September due to faster price increases for foreign-used motor vehicles. Notably, restrictions on car dealership operations were lifted in mid-July.

Domestic food price inflation averaged 3.7 per cent over the period, moving from a low of 1.5 per cent in April 2021 to a high of 5.8 per cent in September 2021. The external environment has heavily affected domestic food prices, including the ongoing surge in international food prices, COVID-19-related shipping delays, and higher shipping costs (freight and insurance). Price movements over the period reflected faster price increases in all but three sub-indices – meat, fish and fruit; these prices slowed to 5.3 per cent, 2.2 per cent, and 3.0 per cent, respectively in September 2021 (from 6.0 per cent, 6.1 per cent and 9.7 per cent, respectively, in January). Faster price increases were recorded in September for milk, cheese and eggs (5.5 per cent), butter, margarine and edible oils (10.0 per cent), sugar, jam and confectionery (7.5 per cent), and bread and cereals (4.8 per cent) sub-categories compared to January, due in part, to the pass-through effects of higher global

prices for these imported food items. The vegetable sub-index accelerated to 6.8 per cent in September. Increased vegetable prices were likely due to supply disruptions brought on by above-average rainfall and associated flooding in some areas.

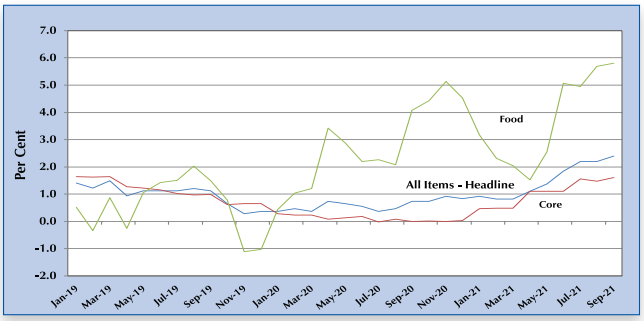
Similar to the first quarter of 2021, producer prices, as measured by the CSO's Producer Price Index (PPI), remained relatively muted in the second quarter of 2021. The PPI measured 0.6 per cent (year-on-year) in the second quarter of 2021, compared to 0.4 per cent in the first quarter of 2021, suggesting that producer prices had little influence on the uptick in retail prices in 2021. The PPI revealed that prices in the drink and tobacco sub-index accelerated to 2.8 per cent in the second quarter of 2021, an increase of 0.3 percentage points from the first quarter of 2021. This upswing in prices was due to faster price growth in the non-alcoholic beverages sub-index in the second quarter of 2021, compared to the previous quarter. Similar to the first quarter of 2021, prices declined in the chemical and non-metallic products sub-index (2.7 per cent) in the second quarter of 2021.

The Index of Retail Prices of Building Materials increased 3.8 per cent (year-on-year) during the first quarter of 2021, compared to 3.2 per cent during the previous quarter. Growth in the index was indicative of higher international prices for steel products during the period. International prices for billets and wire rods rose by 47.2 per cent and 30.6 per cent (year-on-year), respectively, during the first quarter of 2021. Higher prices were noted in the site preparation, structure and concrete frame (4.4 per cent) and electrical installation and fixtures (3.9 per cent) sub-indices. Partially offsetting the growth in these sub-indices were slower price increases in the walls and roof (4.8 per cent); plumbing and plumbing fixtures (4.6 per cent); and finishing, joinery units; and painting and external works (1.0 per cent) sub-indices. However, a price decline was recorded in the windows, doors and balustrading sub-index (0.3 per cent).

### *Exports have performed well*

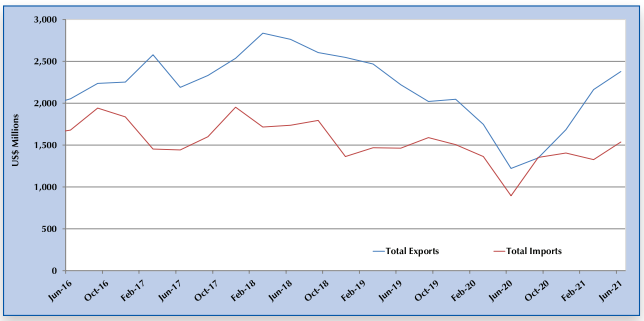
Provisional data show total exports increased by 52.8 per cent (year-on-year) to US$4,541.6 million in the first half of 2021 **(Chart 2.4)**. The improvement was driven mainly by energy sector exports. The uptick in commodity prices amid stronger global demand underpinned the growth in energy receipts. Notable increases were recorded for exports of crude oil, refined products and petrochemicals. Non-energy exports also rose by an estimated US$318.3 million to US$1,055.9 million over the reference period. At the same time, total imports were estimated to have increased to US$2,866 million from US$2,256.6 million in the previous year, reflecting higher fuel and non-fuel imports. Provisional estimates for the first eight months of 2021 suggest exports rose owing to higher commodity prices, while imports may have also increased due to the latter. While the uptick in export earnings compared to pre-pandemic levels is based on increased international energy prices, higher non-energy exports also made a notable contribution. Non-energy exports are anticipated to record improvements as major export destination markets, such as CARICOM, recover alongside dividends from forays into new markets.

Chart 2.3
Retail Price Index
(Year-on-Year Per Cent Change)




Source: Central Statistical Office

Chart 2.4
Trends in Exports/Imports




Source: Central Bank of Trinidad and Tobago

## BOX 3
## IMPLICATIONS OF THE FY2022 BUDGET FOR MONETARY POLICY

The National Budget of Trinidad and Tobago for FY2021/22 was presented to the Parliament on Monday 4, October 2021. Themed "Resilience in the Face of a Global Pandemic", the budget was presented in the context of efforts being made by the Government to emerge from restrictions related to the COVID-19 virus[1]. This box discusses the potential implications of the measures announced in the budget for monetary policy.

The budget outlined several policy measures that could have direct and indirect[2] effects on inflation. However, the size of their impacts will depend on the relevant weights of the affected items in the Retail Price Index (RPI). The most immediate and direct impact to the RPI will come from the pass-through of measures to the food and non-alcoholic beverages and transportation sub-indices. The expansion of the zero-rated Value Added Tax (VAT) list (on items such as biscuits, cooking oil, canned vegetables, cornflakes, canned fish, canned meat, curry, juice, sausages, ham, ketchup, bottled water and pigtail) can help contain food price inflation if retailers reduce prices in tune with the tax policy measure. However, the possible dampening effect on food inflation can be offset if the current surge in international food prices and global logistical challenges, such as the critical shortage of shipping containers, carries over into 2022.

Meanwhile, the announced budgetary measures can affect the transport sub-index in different directions - the removal of customs duties, motor vehicle tax and VAT on battery-powered electric vehicles, may have a downward influence on the prices of new and foreign-used vehicles. In contrast, in an environment of rising fuel costs, further liberalisation of the fuel market could have the opposite effect, increasing transportation costs through various channels such as higher maxi/taxi fares. The net impact on prices within the transport sub-index will therefore depend on the margins set by retailers. Overall, headline inflation is expected to remain relatively contained in the short term; however, the indirect channels and second-round effects could place additional upward pressure on prices.

The Central Government's spending and financing activities will continue to influence the Bank's monetary policy strategy in FY2021/22. Increased spending can potentially translate into higher net domestic fiscal injections (NDFIs). NDFIs, usually considered the main driver of liquidity, amounted to $1.8 billion in FY2020/21, a significant decrease over the $10.4 billion recorded in FY2019/20. Monetary and financial indicators point to ample liquidity in the financial system[3]. Should fiscal injections increase significantly, the liquidity management strategy would have to be delicately balanced in the near to medium term to facilitate the effectiveness of monetary policy transmission. The Government is expected to borrow primarily from the domestic capital market to finance the budget deficit, utilising the Development Loans Act and available headroom under the Miscellaneous Provisions Act. Frequently utilising the domestic capital market, while a positive for improving market depth, can increase competition for funds within the financial system, especially if there are factors which constrain the sufficiency of market liquidity. This can also lead to higher borrowing costs and crowding out of private sector credit.

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[1] The fiscal package was based on an estimated crude oil price of US$65.00 per barrel (WTI) and a gas price of US$3.75 per million British Thermal Units (mmbtu).

[2] Direct impact relates to those policy measures that directly impact the price of items captured in the retail price index (RPI). The impact of such measures can be more easily captured by applying relevant shocks to the respective indices of the RPI. Indirect impacts are those measures that cannot be directly applied to the RPI but can be simulated via pass-through to some specific variable captured in the index.

[3] At the end of FY2020/21, excess reserves averaged $9.7 billion from $7.3 billion during FY2019/20.

## BOX 3 (CONT'D)
## IMPLICATIONS OF THE FY2022 BUDGET FOR MONETARY POLICY

Favourable financial conditions would be required to support accompanying private and public fund-raising efforts. Considering that many of the announced measures are geared at expanding the country's productive capacity over the medium to long run, ample system liquidity and relatively low interest rates would be required to support the Government's financing activities. A key downside risk is the potential monetary policy actions of advanced economies. For example, should inflation prove more durable in the United States and inflationary expectations become unanchored, the Federal Reserve may have to tighten interest rates sooner than anticipated. This can lead to higher borrowing costs in international capital markets and generally tighter financial conditions. Domestically, this has implications for capital market activity, system liquidity and the term structure of interest rates. Monetary policy may have to balance the threat of higher inflation, maintaining favourable financial conditions while continuing to support the nascent economic recovery. This is likely to involve trade-offs and will require the Central Bank to effectively communicate its monetary objectives and actions.

# PART III - DOMESTIC FINANCIAL CONDITIONS

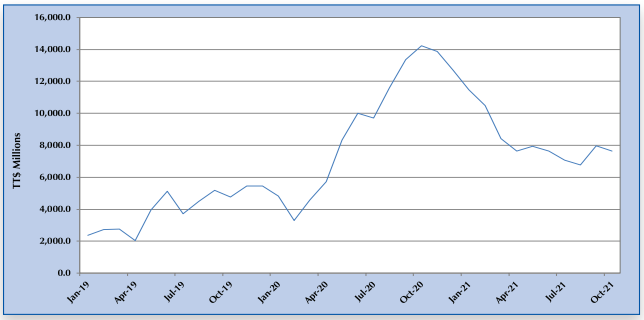
*The ongoing pandemic and its associated challenges have caused consolidated private sector credit to deteriorate, although commercial banks' lending rates have declined and liquidity levels remain more than adequate. Business credit was impacted negatively by broad-based contractions across the economic sectors, while consumer credit abated as labour market weakness weighed heavily on consumer lending. On the other hand, despite generally persistent tightness in the foreign currency market, elevated energy prices allowed some decompression of the market thus far in 2021 as conversions by energy companies increased. Furthermore, the domestic equity market continued to improve, supported by the low interest rate environment. Government borrowing also continued to be strong on the primary bond market, pushing up longer-term yields on government-issued bonds.*

## Liquidity Conditions and Interest Rates

### *Financial system liquidity remains ample*

Liquidity levels in the financial system increased by October 2021 after declining over April to August 2021. Net domestic fiscal injections (NDFIs)[4], usually the main driver of excess liquidity[5], decreased to $4,338.4 million over April to October 2021 compared to $9,021.3 million in the same period one year earlier. Net Open Market Operations (OMOs) remained neutral over April to October 2021, compared to an injection of $5,742.0 million for the same period one year earlier. At the same time, the Bank's foreign exchange sales to authorised dealers indirectly removed $4,677.8 million from the system, compared to $4,578.1 million in the same period a year earlier. Excess liquidity trended downward to August 2021, reaching $6,774.3 million, before fiscal injections increased late in the month and persisted into September and October. The boost to fiscal injections prompted an observed increase in daily average excess liquidity to $7,654.1 million by October 2021, compared to $7,628.3 million in April 2021 **(Chart 3.1)**.

Chart 3.1
Commercial Banks' Excess Reserves




Source: Central Bank of Trinidad and Tobago

The only interbank borrowing activity in 2021 took place on April 14, 2021 for a total of $230 million at 0.50 per cent. This resulted in daily average interbank borrowing reaching $1.6 million over April to October 2021 compared to $1.2 million over the same period in 2020. Given ample liquidity conditions, banks did not access the Repurchase Facility at the Central Bank.

Treasury differentials recorded mixed performances thus far in 2021. The TT 91-day OMO Treasury Bill rate increased by six basis points over the period April to October 2021, settling at 0.34 per cent. Higher inflation combined with the US Federal Reserve signalling its intention to slowly exit its extremely accommodative monetary policy resulted in a slight uptick in yields on US short-term instruments. The US 91-day short-term benchmark yield reached 0.05 per cent by the end of October, increasing four basis points since April. Nevertheless, the TT-US 91-day differential increased to 29 basis points in October 2021, compared with 25 basis points in April. The TT 1-year Treasury rate declined by 12 basis points over April to October 2021 to 0.42 per cent, while the US 1-year Treasury rate increased by 10 basis points to 0.09 per cent. These movements resulted in a TT-US 1-year differential of 27 basis points in October, down 22 basis points from April.

4 Net domestic fiscal injections refer to the excess of government domestic expenditure over domestic revenue, including net redemption of bonds.
5 Excess liquidity refers to commercial banks' holdings of reserves at the Central Bank in excess of the statutory requirement.

Despite fluctuations, the US 10-year Treasury rate declined over April to October 2021, losing 10 basis points over the period to reach 1.55 per cent. This mainly reflected flight to safety effects following disturbances in international asset markets. The rate on the TT 10-year Treasury gained 21 basis points over the period to reach 4.99 per cent, resulting in a long term differential that widened by 31 basis points over April to October 2020 to reach 344 basis points.

Notwithstanding a widening of TT/US interest rate differentials in favour of domestic interest rates, Trinidad and Tobago's external financial account recorded net outflows of US$394.5 million during the second quarter of 2021. Portfolio investment registered a net outflow of US$323.6 million over the period April to June 2021 due to an increase in the holdings of foreign assets by domestic financial institutions - mainly in the form of debt securities, and to a lesser extent, equity securities. Meanwhile, a net outflow of US$97.3 million was recorded for other investments over the second quarter of 2021. Partially offsetting these outflows was the small net inflow of US$26.3 million recorded for foreign direct investment (FDI).

Commercial banks' interest rates declined, as did bank interest spreads, up to September 2021. The commercial banks' weighted average lending rate (WALR) declined to 7.04 per cent in September 2021, 17 basis points lower than in March 2021. The decline in the WALR mainly reflected the effect of amplified liquidity in response to the fallout from COVID-19. The weighted average deposit rate declined by one basis point to 0.58 per cent over the same period. As a result, the banking interest spread decreased by 15 basis points from March to September 2021 to reach 6.47 per cent. The median prime lending rate of commercial banks declined from 9.25 per cent in February to 7.50 per cent in March, where it still remains, after the monetary measures to address COVID-19 were implemented.

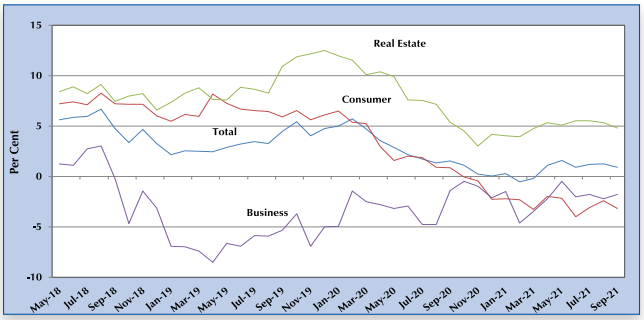
## Private Sector Credit

### *Private sector credit remains weak*

Growing uncertainty due to the ongoing health crisis caused consolidated financial system credit growth to taper off. Private sector credit grew by 0.9 per cent in September 2021 (year-on-year), compared to expansions of 1.5 per cent in September 2020 and 4.4 per cent in September 2019 **(Chart 3.2)**. Real estate mortgage lending continued to shore up credit growth, despite declines in consumer and business lending. The low and declining interest rate environment continued to support the growth of real estate mortgage lending, helping to turn consolidated credit positive in April 2021.

Prior to the COVID-19 pandemic, economic challenges adversely affected resident business lending. Energy and non-energy sector activity remained lethargic since the second half of 2018, resulting in tightened business lending. The emergence of the pandemic in early 2020 in Trinidad and Tobago further depressed economic activity and propagated additional deteriorations in business lending. Businesses credit[6] contracted by 1.8 per cent (year-on-year) in September, compared to a decline of 1.4 per cent one year earlier as lockdown measures instituted in the second quarter of 2021 adversely impacted the non-energy sector. Lending to the manufacturing sector also declined in September 2021 (3.7 per cent year-

Chart 3.2
Private Sector Credit Overall and Type
(Year-on-Year Per Cent Change)




Source: Central Bank of Trinidad and Tobago

6 Data based on monthly returns submitted by banks and non-banks for residents. Sectoral data is based on quarterly returns submitted by banks and non-banks for residents and non-residents.

on-year). Subdued activity in wholesale and retail trade supported the 5.1 per cent contraction in credit to this sector. Curtailment of activity in the personal services and transportation sub-sectors resulted in declines in credit to these sectors of 7.9 per cent and 2.4 per cent, respectively. On the other hand, lending to construction bumped up 9.5 per cent while lending to the finance, insurance and real estate sector expanded by 6.4 per cent year-on-year.

The wider labour market implications of the COVID-19 pandemic weighed heavily on consumer lending. The re-imposition of restrictions in May 2021 adversely impacted households earning potential and disposal income, which may have had an adverse effect on credit demand. On a year-on-year basis, lending to consumers contracted by 3.2 per cent in September 2021 compared to growth of 0.8 per cent one year earlier.

The pandemic has affected a wide array of consumer loans categories. Data to September 2021 suggests that year-on-year lending for the purchase of motor vehicles - which represents 24.1 per cent of the total consumer loan portfolio - declined by 7.5 per cent. Lending fell for the purchase of both new and used cars. For the second quarter since 2014, lending for debt consolidation fell, declining by 3.8 per cent as banks continue to implement alternative measures to assist customers, including deferral of payments. Loans for bridging finance, and home improvement/renovation all declined in September 2021 (16.6 per cent and 9.3 per cent, respectively).

Since June 2020, credit card loans, a consistently strong growth category before the pandemic, has narrowed, declining by 3.6 per cent year-on-year in September 2021. On the other hand, lending for refinancing and loans for medical, insurance and electrical and non-electrical appliances were the only loan categories to register increases (24.4 per cent, 1.5 per cent, 12.4 per cent and 13.8 per cent, respectively).

Although real estate mortgage lending has remained relatively stable in September 2021, the pandemic has occasioned subdued lending to the sector. Real estate mortgage lending expanded by 4.8 per cent in September 2021 (year-on-year), compared with 5.4 per cent one year earlier. Lending for the purchase of existing houses and new houses grew by 6.1 per cent and 3.1 per cent, respectively, as the overall interest rate on new real estate mortgages (both residential and commercial) narrowed from 5.02 per cent in June 2021 to 4.98 per cent in September 2021. On the other hand, real estate mortgages for renovation and the purchase of land declined by 6.9 per cent and 3.4 per cent, respectively, in September 2021.

Tightness in the foreign exchange market persists, potentially leading to a reduction in foreign currency loans. On a year-on-year basis, foreign currency loans declined by 9.4 per cent in September 2021, compared to a reduction of 5.5 per cent in March. Foreign currency business loans, which have generally been decreasing since mid-2018, fell drastically in September 2021 (16.5 per cent), compared to the decline in March (0.3 per cent year on year). Alternative windows to secure foreign exchange outside of commercial banks, particularly for manufacturers, may have contributed to the ongoing decline.

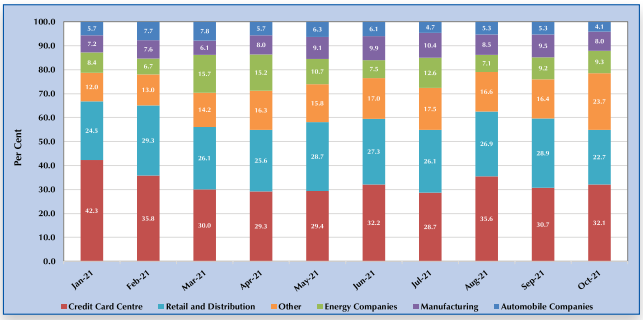
## Foreign Exchange Market

### *Higher market supply, but demand remains robust*

Despite generally persistent tightness, elevated energy prices allowed some decompression of the local foreign market thus far in 2021. Authorised dealers' purchases of foreign exchange from the public increased by 12.8 per cent over January to October 2021 to US$3,149.8 million relative to the same period a year prior **(Table 1)**. Higher purchases were facilitated by a 38.0 per cent increase in conversions by energy companies when compared to the same period in 2020. The improved performance is likely due to an uptick in crude oil and petrochemical production and higher energy prices. As such, purchases from the energy sector accounted for 76.7 per cent of all purchases of foreign currency.

Foreign currency sales also rose thus far in 2021. Authorised dealers' foreign exchange sales to the public reached US$3,992.9 million over January to October 2021, an increase of 6.5 per cent relative to the same period a year prior. Credit cards (32.2 per cent), Retail and Distribution (26.6 per cent), Energy Companies (10.5 per cent) and Manufacturing (8.5 per cent) made up the bulk of foreign exchange sales to the public **(Chart 3.3)**. The net sales gap reached US$843.1 million over January to October 2021. Central Bank sales to the authorised dealers of US$1,012.1 million supported the market over the reference period.

CHART 3.3
SALES OF FOREIGN CURRENCY BY AUTHORISED DEALERS TO THE PUBLIC




Source: Central Bank of Trinidad and Tobago

**Table I: Foreign Currency Aggregates of Authorised Dealers (US$ Million)**

| Date | Purchases from Public | Sales to Public | Net Sales | Purchases from CBTT[1] |
|---|---|---|---|---|
| 2015 | 4,930.8 | 7,382.2 | 2,451.4 | 2,640.9 |
| 2016 | 4,274.7 | 5,776.8 | 1,502.1 | 1,811.6 |
| 2017 | 3,606.9 | 5,195.3 | 1,588.4 | 1,816.0 |
| 2018 | 4,101.4 | 5,677.4 | 1,576.0 | 1,501.0 |
| 2019 | 4,285.6 | 5,939.8 | 1,654.2 | 1,504.0 |
| 2020 | 3,298.2 | 4,504.1 | 1,206.0 | 1,292.2 |
| Jan - Oct 2020 | 2,793.0 | 3,749.8 | 956.8 | 1,069.5 |
| Jan - Oct 2021 | 3,149.8 | 3,992.9 | 843.1 | 1,012.1 |
| **Y-o-Y Per cent Change** | **12.8** | **6.5** | **-11.9** | **-5.4** |

Source: Central Bank of Trinidad and Tobago

1 Purchases from the Central Bank of Trinidad and Tobago include transactions under the Foreign Exchange Liquidity Guarantee facility and excludes sales under the EXIM Bank and other Public Sector provisional facilities.

## CAPITAL MARKETS

***Primary bond market activity was negligibly lower despite robust Government issuances***

Activity in the local bond market slipped slightly over the six months ending September 2021, with nine bonds being issued at $7,526.4 million **(Table 2)**. The Central Government was the main borrower in the primary market, raising $6,725.0 million via six issues for budgetary support and refinancing outstanding bonds. Furthermore, the state enterprise sector raised three bonds totalling $801.4 million, while the private sector was absent from the market over the period. Primary bond market activity was slightly lower than the same period one year prior, where nine private placements occurred, raising $7,536.1 million.

Over the period April to October 2021, eight trades occurred at a total face value of just $5.4 million in the secondary government bond market. Notably, the market was dormant in the period May to August 2021. In the same period one year prior, a total of 13 trades were recorded at a face value of $417.6 million. Additionally,

**Table II: Primary Debt Security Activity**

| Period issued | Borrower | Face value (TT$ M) | Period to Maturity | Coupon rate Per annum (Per cent) | Placement Type |
|---|---|---|---|---|---|
| Apr-21 | Central Government of Trinidad and Tobago | 800.0 | 11.0 years | Fixed Rate 4.94% | Private |
| May-21 | Central Government of Trinidad and Tobago | | | | |
| | Tranche 1 | 500.0 | 5.0 years | Fixed Rate 2.96% | Private |
| | Tranche 2 | 800.0 | 20.0 years | Fixed Rate 6.21% | Private |
| | Central Government of Trinidad and Tobago | | | | Private |
| | Tranche 1 | 400.0 | 6.0 years | Fixed Rate 2.75% | Private |
| | Tranche 2 | 725.0 | 17.0 years | Fixed Rate 6.12% | Private |
| | Tobago House of Assembly (THA) | 164.2 | 6.0 years | Fixed Rate 5.20% | Private |
| Jun-21 | Central Government of Trinidad and Tobago | 500.0 | 10.0 years | Fixed Rate 4.31% | Private |
| | Caribbean Airlines | 337.3 (US$50.0Mn) | 8.0 years | Fixed Rate 5.50% | Private |
| Jul-21 | Central Government of Trinidad and Tobago | | | | |
| | Tranche 1 | 400.0 | 5.0 years | Fixed Rate 2.40% | Private |
| | Tranche 2 | 600.0 | 20.0 years | Fixed Rate 6.45% | Private |
| Aug-21 | Trinidad and Tobago Housing Development Corporation (HDC) | 300.0 | 5.0 years | Fixed Rate 4.92% | Private |
| Sep-21 | Central Government of Trinidad and Tobago | | | | |
| | Tranche 1 | 800.0 | 6.0 years | Fixed Rate 2.94% | Private |
| | Tranche 2 | 700.0 | 12.0 years | Fixed Rate 4.50% | Private |
| | Tranche 3 | 500.0 | 20.0 years | Fixed Rate 6.49% | Private |

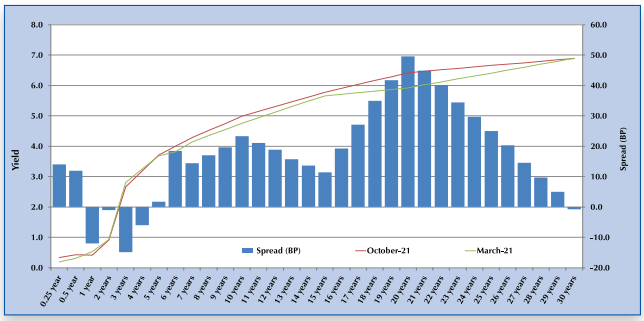
Source: Central Bank of Trinidad and Tobago

activity on the secondary corporate bond market[7] jumped over the seven-month period ending October 2021 with 104 trades at a face value of $35.6 million, compared to 75 trades at a face value of $11.4 million in the comparable period in 2020.

Rising domestic debt levels and a challenging fiscal position affected risk and term premiums on long-term government securities, resulting in rising long-term treasury rates. However, excess liquidity conditions continued to place downward pressure on some short-term treasury rates over the seven months to October 2021. Similarly, some medium-term yields observed declines, likely due to the still elevated liquidity conditions working through to these tenors. These movements resulted in the Central Government yield curve generally displaying a steepening trend over the seven months ending October 2021 **(Chart 3.4)**.

7 The Trinidad and Tobago Stock Exchange (TTSE) Secondary Corporate Bond Market currently monitors the trading activity of the National Investment Fund Holding Company Limited (NIFHCL) bonds which were listed in September 2018.

CHART 3.4
YIELD CURVE TREND




Source: Central Bank of Trinidad and Tobago

### *The domestic stock market maintained its recovery*

Despite COVID-19 containment measures which inhibited business activity, the domestic stock market recorded a recovery in early 2021 and continued that trend over the five months ending October 2021. The Composite Price Index (CPI) increased by 3.3 per cent, driven by a 3.0 per cent expansion in the Cross Listed Index (CLI) and 3.4 per cent growth in the All Trinidad and Tobago Index (ATI). As a result, total stock market capitalisation grew 3.3 per cent to $135.7 billion at the end of October 2021 **(Chart 3.5)**. Conversely, the primary regional exchanges recorded declines as the Jamaican Stock Exchange (JSE) index recorded a 4.3 per cent fall, while the Barbados Stock Exchange (BSE) index slipped negligibly by 0.6 per cent. While pandemic conditions and associated containment measures negatively affected the valuations of some equities, many displayed resilience over the period. Furthermore, in light of the current low interest rate environment, several listed companies may have benefitted from reduced interest expense, while investors would have sought out higher returns offered on the stock market.

### *The mutual funds industry continued to grow*

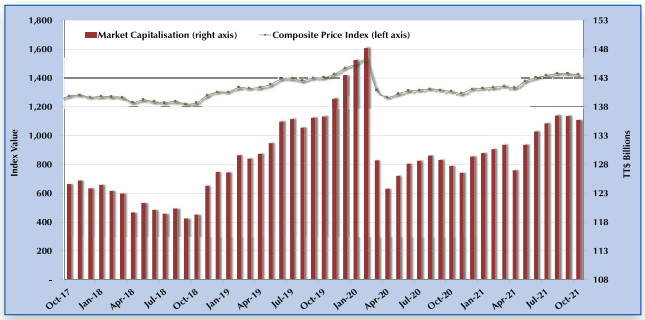
The mutual funds industry experienced sustained growth over the first half of 2021. Aggregate funds under management[8] (AUM) expanded by 3.1 per cent to $52,048.0 million[9], driven by growth in all fund types. Income funds, the largest component, grew by 2.1 per cent to $29,676.7 million; Equity funds increased by 11.6 per cent to $8,206.7 million; and funds classified as 'Other'[10] registered a 7.6 per cent increase to $445.9 million. However, Money Market funds gained only 0.5 per cent to $13,718.6 million **(Chart 3.6)**.

Reflecting the improved performances of the domestic and major international stock markets, in addition to the drive towards higher yields in a global environment of monetary policy accommodation, Equity funds witnessed $462.9 million in net sales over the six-month period. Income funds also recorded $444.5 million in net sales over the period. Conversely, Money Market funds witnessed $80.2 million in net redemptions, confirming the move towards higher-yielding floating NAV[11] funds. The shift towards higher-yielding funds is evident in floating NAV funds, which observed a notable $494.0 million in net sales, while fixed NAV funds recorded $341.9 million in net sales. Furthermore, TT dollar funds accounted for $661.4 million in net sales, while foreign currency funds captured $174.5 million in net sales.

Collective Investment Scheme (CIS) data from the Trinidad and Tobago Securities and Exchange Commission (TTSEC) confirmed that the mutual fund industry expanded over the first eight months of 2021. According to the TTSEC, total assets under management increased by 4.5 per cent to $62,246.1 million. Net sales of $1,556.0 million supported the industry's expansion based on TTSEC's information.

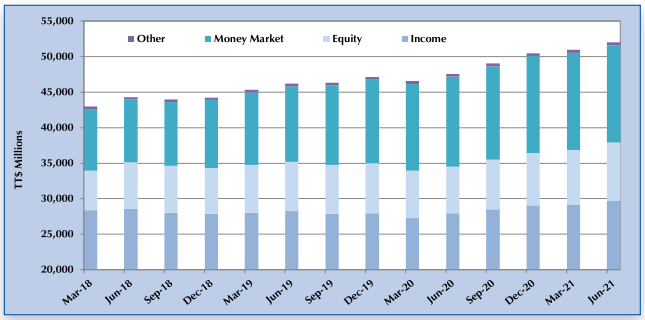
8 Aggregate funds under management refer to mutual fund information collected by the Central Bank of Trinidad and Tobago, including funds managed by the Trinidad and Tobago Unit Trust Corporation, Royal Bank of Trinidad and Tobago, Republic Bank Limited and First Citizens Bank Limited.
9 As at the end of June 2021, this value accounted for 84.7 per cent of the total industry assets under management based on TTSEC CIS data.
10 Other funds represent high yield funds and special purpose funds.
11 Floating Net Asset Value (NAV) funds refers to fund types where the price per unit changes based on market conditions, such as equity funds, some income funds, and 'other' funds. Conversely, the price per unit of fixed NAV funds, such as money market funds and some income funds, remains fixed and unchanged.

CHART 3.5
MOVEMENTS IN THE COMPOSITE PRICE INDEX




Source: Central Bank of Trinidad and Tobago

CHART 3.6
GROWTH IN MUTUAL FINDS: AUM BY FUND TYPE



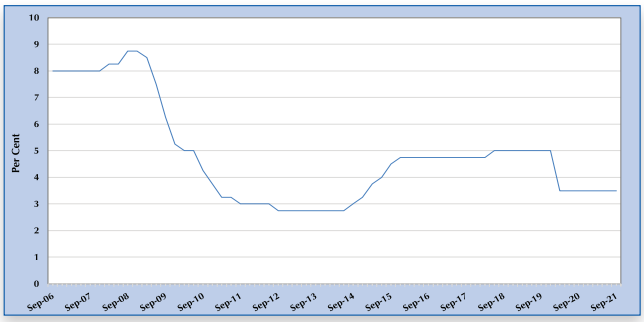

Source: Central Bank of Trinidad and Tobago

# PART IV - MONETARY POLICY ASSESSMENT (MAY – NOVEMBER 2021)

*The evolution of monetary policy thus far in 2021 has primarily been centred around managing the economic fallout from COVID-19. As the pandemic unfolded domestically, the Monetary Policy Committee (MPC) determined that the optimal set of actions would be to continue facilitating ample system liquidity with the aim of ensuring an uninterrupted supply of credit to the economy and to maintain domestic price stability.*

The main policy tool of the Bank is the Repo rate, which has remained at 3.50 per cent after being lowered by 150 basis points in March 2020 **(Chart 4.1).**

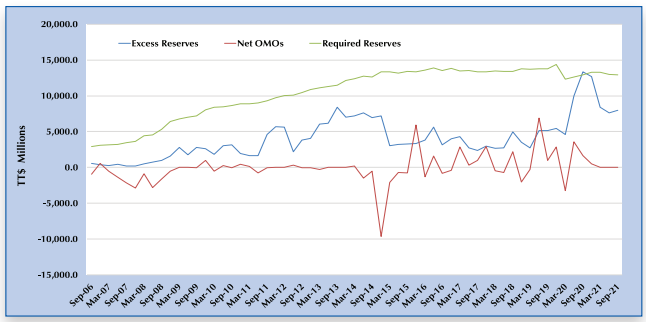
CHART 4.1
REPO RATE




Source: Central Bank of Trinidad and Tobago

The Bank also attempts to influence the economy by managing changes in the money supply, which impact the wider economy through real balance effects. The reserve requirement targets the creation of narrow money through the money multiplier effect and has remained at 14 per cent since a 300 basis points decline in March 2020. This decrease in the reserve requirement allowed $2,630.6 million of commercial bank reserves with the Central Bank to be injected into the financial system, constituting an expansion of narrow money. Over March to October 2020, however, $8,309.0 million in injections via net maturities in OMO instruments was facilitated. OMOs tend to affect broader measures of the money supply than the reserve requirement. However, the net position of OMOs has remained neutral at zero since November 2020 and thus far for 2021. The changes in money supply occurring via changes to the reserve requirement and OMOs tend to manifest as changes to excess liquidity. Since the advent of the pandemic, the Bank has prioritised the maintenance of adequate market liquidity. Excess liquidity reached a historically high daily average of $14,223.8 million in October 2020. While liquidity has declined over 2021, it remains elevated compared to historic trends **(Chart 4.2)**.

CHART 4.2
LIQUIDITY MANAGEMENT




Source: Central Bank of Trinidad and Tobago

### *Bank lending rates shift lower*

Lower commercial banking interest rates are also a target of the policy actions taken in response to the pandemic. With the cut in the repo rate from 5.00 per cent to 3.50 per cent, commercial banks WALR declined from 7.52 per cent in March 2020 to 7.04 per cent in September 2021. The size and direction of the combined effect of the implementation of the Central Bank's monetary policy tools based on the interest rate and money supply channels on commercial banking rates can be related. **Chart 4.3** shows the evolution of the historical forecast error variance decomposition (FEVD) derived from a model[12] estimating the effect of the Repo rate and excess liquidity on the WALR against the WALR itself. When the values of the FEVD are positive, policy exerts pressure on the WALR to increase and vice versa. Notably, after March 2020, the combined effect of monetary policy on the WALR can be observed to have declined significantly and has remained negative since, showing that the impetus for the decline in commercial

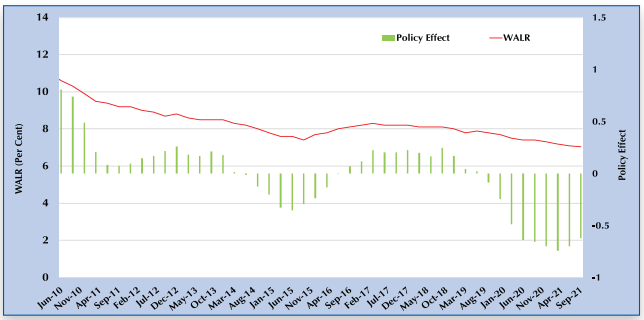
12 Vector auto-regression using quarterly data from March 2006 to September 2021.

banking rates after the pandemic was underpinned by the influence of monetary policy.

The combined effect of the tools employed by the Bank since the advent of the pandemic has thus been accommodative as intended, with lowered short-term policy rates and stimulus provided via narrow and broad money channels driving amplified excess liquidity and lower interest rates in the banking system.

Excess liquidity is expected to remain elevated and further increase towards the end of 2021 if energy revenues continue to drive fiscal injections. This expectation is contingent on neutral borrowing activity by the Central Government, that is, no new borrowings undertaken, and continued neutrality of OMO activity by the Central Bank. Commercial bank lending rates are expected to continue to be impacted by elevated liquidity and generally subdued, though improving economic conditions. Therefore, business credit to some sectors will likely experience an improvement as activity ramps up in line with the gradual reopening s of the economy. Treasury rates may experience some upward pressures given rising inflation expectations both domestically and internationally, implying that the TT-US long and short-term differentials may remain positive and stable. In the short term, given the relaxation of lockdown measures, increased business activity may improve stock market and mutual fund performance. These markets would be further buffeted by the continuation of supportive monetary policy. On the other hand, increasing general government debt levels may continue to place upward pressures on long-term yield.

Chart 4.3
Forecast Error Variance Decomposition




Source: Central Bank of Trinidad and Tobago