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# "The International Financial Crisis: Impact on the Region and Trinidad and Tobago"

## FEATURE ADDRESS

at the

## Couva/Point Lisas Chamber of Commerce

by

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Thanks for inviting me to address you today.

In my remarks I will try to put the current economic difficulties facing Trinidad and Tobago in the broader context of the still unfolding global financial crisis.

The world economy was going along reasonably fine until the third quarter of 2008 when we were suddenly blind-sided with an international financial crisis the likes of which we have not experienced in almost a century. And just when we were beginning to see some stabilization in international financial markets, the world finds itself **catapulting into a global recession** of an intensity that's still not fully appreciated.

There are many theories surrounding the roots of the crisis: I would not go into the polemics, except to say that we are where we are now as a result of several "sins" in the world's major economies, including for example, a prolonged build-up of structural imbalances; inadequate financial sector regulation, excessive risk taking and a fair amount of greed.

The whole world is facing a crisis that is primarily the making of the richer more developed countries and while it was once felt that the damage would have been limited to the culpable, it has now engulfed the entire world, putting a lie to a widely held view that emerging market countries had "de-coupled".

The irony is, since the fourth quarter of 2008 equity markets in the emerging economies have declined by much more than in the developed countries. Moreover, the major emerging market countries, for example Mexico, Brazil, Russia as well as the Asian economies, have also been hit by significant capital outflows and exchange rate depreciation. The poorer developing countries are not being spared as they face the adverse market realities as well as major reductions in foreign aid.

The global recession is undoubtedly turning out to be much worse than was initially expected. There is now a consensus that growth in some of the major economies will be negative in 2009, with **recovery not expected until 2010**. Emerging markets and developing countries are expected to fare slightly better with real GDP growth projected at about 3 per cent, much of which will come from China and India.  Note, however, that in the case of China, real growth is coming down from an average of 11-12 per cent over the past few years to 8 per cent in 2009.

It is widely felt that what we are witnessing now is not so much a crisis in the financial system but a crisis of confidence on the part of household and businesses, and **it is global in nature**.

The data coming out for the developed countries are shocking indeed.  The U.S., for example reported job losses of over half a million in December, pushing the unemployment rate to 7.2 per cent, the highest in 16 years.  It is projected that unemployment in the US could soon reach double-digits.

In **Germany**, the unemployment rate now stands at close to 9 per cent: in the **U.K.,** unemployment has reached (6.0 per cent) and in the **E.U.** it is 8.4 per cent.

To address the deepening recession and mounting job losses, most of the advanced economies are adopting enormous stimulus programs.

- President-elect Barack Obama's economic recovery and investment plan **includes a fiscal stimulus of around US$775** billion, in addition to bank support programmes of another US$1.5 – 2 billion.

- Germany has unveiled a major fiscal stimulus package which includes cuts in taxes and a programme of public investment infrastructure.

- Japan also unveiled a massive economic recovery package.

- Even China recently announced a new fiscal stimulus plan, of around US$586 billion aimed at boosting the rapidly slowing economy.

Our Caribbean neighbours have also been seriously impacted by the financial crisis and the global recession. In **Jamaica** emigrants' remittances (the second largest foreign exchange earner) fell by an estimated 17 per cent last year. An even larger fall is expected in 2009, along with a sharp reduction in tourist arrivals. There have been hotel closures and the postponement of hotel investment projects in the Bahamas, the OECS, Barbados and elsewhere in the region.

Late last year, the **Barbadian Government** unveiled an economic stimulus package aimed at protecting jobs and supporting the tourism industry. Jamaica has also announced a stimulus package involving tax cuts, loan facilities for vulnerable sectors and infrastructural spending.

Here in **Trinidad and Tobago**, we have seen an interesting change in our circumstances over the past few months.

Our once thriving energy sector is facing sharply reduced external demand and anemic prices. Oil prices have plummeted from over US$140 per barrel in June 2008 to around US$40 per barrel currently, while gas prices (Henry Hub) have declined from over of US$12 per mmbtu in June to an average of US$6 per mmbtu in December 2008. Several planned investments in the sector have been postponed because of financing problems or market uncertainties.

We have also seen an otherwise struggling stock market take a sharp drop – by 27 per cent -- between June and December 2008.

Our households, like those elsewhere have observed financial turmoil abroad and have become more cautious – much to the disappointment of the merchants who were depending on Christmas sales for a large part of their income.

There are indications of a **marked slowdown in housing activity**, in part due to high interest rates but perhaps more so as a consequence of the unwinding of the construction and real estate boom of the last years.

In addition, our manufacturing sector has begun to face the impact of the declining external and domestic demand.

It's amazing how it takes difficult times like these to appreciate the inter-connectedness of our economy.

A fall in demand and energy prices affects not only the large energy companies but a whole host of smaller companies and entrepreneurs who provide services to these companies. The energy sector also accounts for an important part of construction and thus the downturn in the sector exerts a downward pull on construction activity.

The manufacturing sector is being affected by a fall in demand from regional markets and the slowdown in tourism and construction. Since the non-energy sector is the major generator of incomes, its fortunes have a ripple effect on private demand and on the overall level of investment and employment.

And this brings us to the role of Government in the present scenario. As you know, over the past few years, the Government has taken an active role in promoting economic transformation, **including through a significant increase in expenditure on infrastructure and social services**. In addition to serving as a catalyst to growth and capacity expansion, government expenditure has also contributed to an unacceptable surge in domestic inflation (aided no doubt by an unprecedented increase in international food prices).

Conscious of the need to reduce inflation the **Government initially sought to match a projected reduction** in energy sector revenues by a compensating cut in expenditures. Thus, on November 30, 2008 in response to an expected shortfall in energy sector revenues of TT$5.3 billion, the Government announced expenditure cuts of TT$5.0 billion.

Yesterday the Government announced that as a result of the continuing fall in energy prices the revenue shortfall is likely to be some **$2.3 billion greater than originally envisaged**. It was announced however, that in order to maintain employment and avoid a recession in the local economy, **this shortfall will not be met by further expenditure cuts but rather by borrowing – in the jargon, through deficit financing**.

We are now facing the reality that the intensity of the global recession is such that countries need to take steps less they be drawn into the quagmire; that is the reality of globalization being a part of an integrated world. You need to react to international developments and take defensive steps, as needed, to protect your employment levels and preserve a minimum level of economic activity.

The need for counter-cyclical fiscal policies is now recognized by both developed and developing countries. Most countries are now prepared to accept budget deficits to defend their economies. It's happening all through Latin America, it's happening throughout Asia; it's happening even in the oil rich Gulf States. (A few days ago Saudi Arabia, whose oil revenues have been cut by 50 per cent, unveiled its 2009 budget which carried a record deficit. Dubai announced a fiscal package that converted a fiscal surplus to a deficit of 1.3 per cent of GDP).

Fortunately we are in a better position than most developing countries to withstand the recession and to accommodate a moderate level of deficit financing. Unlike in the 1980's, we have a low and manageable level of debt, our banking system is robust, well-capitalized with a low level of non-performing loans, and we have a more than adequate level of official reserves – about US$ 9 billion.

Our Achilles heel is the high level of inflation **which can reduce fiscal space,** since in principle, too much deficit financing can easily add to inflationary pressures. Fortunately, there are compensating forces that are supporting a reduction in inflation. These include the sharp decline in international food prices; an expected increase in domestic food production and the impact of reduced private demand on the general level of prices. It is also envisaged that the weaker demand and employment environment will reduce wage pressures and reverse inflationary expectations.

In terms of our outlook for 2009 we anticipate that energy sector growth will probably remain flat in 2009 while non-energy sector growth could be about 3 per cent less than one-half that of 2008. We expect the main drivers in the non-energy sector will be agriculture, manufacturing and tourism services, boosted by the upcoming two large international conferences.

On this basis, the Bank is projecting **real GDP growth of 1-2 per cent**; some increase in unemployment, perhaps to 6-7 per cent; an inflation rate of 7-8 per cent and little, if any, increase in official reserves. The non-energy fiscal deficit is projected at around 12 per cent of GDP while the overall deficit is projected to widen to around 1 - 1.5 per cent of GDP.

I would admit that these forecasts are subject to wide margins of error since the global environment is still extremely unstable and thus some of the basic parameters are subject to considerable volatility.

The current economic environment is a nightmare for policymakers. In the U.S. for instance, some commentators are complaining that Obama's massive rescue package is too small, while the traditionalists think that it is far too large.

Here at home, there is a view in some quarters that the Bank should move immediately to lower interest rates. While a reduction in interest rates may contribute to boosting domestic demand and containing the economic slowdown, it's our view that, **with inflation currently at 14.3 per cent**, lowering interest rates without some reasonable indication that inflation is on a downward path, would carry serious risks of further entrenching inflation and an inflationary psychology.

Some people see a depreciation of the currency as being inevitable. I disagree, pointing to our significant foreign reserve cushion which gives us the ability to stabilize our foreign exchange market, if needed.

Let me end with a few words about the opportunities that the current economic setting presents. There is no doubt that the economic situation will be difficult in 2009, but I am confident that we will weather the storm and do just fine.

Calling to mind the old adage that "**behind every dark cloud there is a silver lining**" we should keep reminding ourselves that, even if the crisis is prolonged it would eventually come to an end. What is perhaps most important in all of this is that we should be preparing ourselves for the new opportunities that must arise once the situation stabilizes.

This is the time for the business sector to be introducing productivity enhancing measures which would help tide you through the down-turn and serve you in good stead in the recovery phase.

This is the time to engender a culture of increased productivity among your workers and set the stage for linking wage increases to productivity, when the recovery comes.

If the current economic slowdown brings an end to the unsustainable real estate bubble and the splurge in motor car imports, it would have had a positive impact. If it leads to better project selection, a drive for greater public sector efficiency and a platform for greater public/private sector collaboration, we would have learnt much from the crisis.

Some people argue that we learnt nothing from the crisis of the 1980's. I disagree and I point to the fact that the crisis of the 1980's led to the stronger fundamentals of the 1990's.

Let us use the current crisis to set the basis for an even stronger economy that would improve our resilience and set the stage for sustainable growth and development.

**END**