



CENTRAL BANK OF  
TRINIDAD & TOBAGO

# Monetary Policy Report

October 2005

Volume V Number 2



# **MONETARY POLICY REPORT**

**OCTOBER 2005**

**VOLUME V NUMBER 2**

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

# MONETARY POLICY REPORT

## OCTOBER 2005

### 1. Overview

#### The International Context

Despite two hurricanes, economic activity in the **United States** increased by 3.8 per cent in the third quarter indicating that underlying growth remained, in line with the projection of 3.5 per cent for 2005 as a whole. Energy prices pushed **headline inflation** to 4.7 per cent in October (year-on-year), the highest rate recorded since 1991. **Core inflation** i.e. excluding fuel and food remained subdued at 2 per cent. In its November 1 2005 statement, the Federal Reserve pointed to the risk that the feedback from energy price increases could soon begin a strong pass-through to core inflation. Accordingly, the Federal funds rate was raised from 3.75 per cent to 4 per cent. This was the 12<sup>th</sup> step increase in federal funds rate since June 2004.

In the **Euro-zone area**, in the face of soaring energy costs, inflation is currently running at 2.5 per cent, above the official target of just under 2 per cent. So far, the European Central Bank has been reluctant to raise interest rates because of continuing weak economic activity. However, the Bank has kept the door open for a possible rise in interest rates in coming months, if the incipient recovery in the Euro-zone

economy strengthens and inflation remains outside of the target band.

**Energy prices** for 2005 to date have risen by 41 per cent to record high levels reflecting strong growth in consumption and tight supply markets. The prognosis, given existing global demand and supply conditions, is that energy prices are likely to remain fairly robust for the remainder of the year and well into 2006.

#### Economic Growth, Inflation and Monetary Policy

##### Real GDP

In Trinidad and Tobago with commodity prices remaining at astronomical levels and with a steady increase in crude oil and natural gas output, **value added in the energy sector** maintained its strong rate of expansion (Table 1). At the same time, the high level of government expenditure and increasing employment fuelled strong activity in the non-energy sector. According to preliminary estimates prepared by the Central Bank, **real GDP growth** in the first half of 2005 was 6.2 per cent. Value-added in the energy sector is estimated to have risen by 8.2 per cent while growth in the non-energy sector is estimated at 5.6 per cent. Charts 1, 2 and 3 show the growth in key commodity prices in international markets.

**Table 1**  
**Production of Selected Commodities**

Period	Crude Oil (bbls/d)	Natural gas (mmcf/d)	Ammonia (tonnes)	Urea (tonnes)	Methanol (tonnes)
<b>2000</b>	119,354	931.0	3,262,432	565,131	2,480,223
<b>2001</b>	113,523	1,600.0	3,694,969	514,101	2,788,954
<b>2002</b>	130,626	1,826.0	3,985,088	674,875	2,828,999
<b>2003</b>	134,089	2,594.0	4,317,786	647,589	2,845,570
<b>2004</b>	122,933	2,929.0	4,714,364	621,236	3,418,422
<b>2004: I</b>	132,354.4	2,787.7	1,134,675	147,719	673,465
<b>II</b>	125,584.5	2,752.3	1,057,050	151,402	731,802
<b>2005: I</b>	140,715.1	3,199.7	1,245,600	183,276	1,133,288
<b>II</b>	147,300.2	3,187.3	1,294,342	184,241	1,083,036

Source: Ministry of Energy; Central Bank of Trinidad and Tobago.

### *Inflation*

Against a background of buoyant domestic demand and agricultural supply shocks, there was a pick-up in inflationary pressures from the beginning of 2005. The retail prices index rose by more than 1 per cent in February 2005 on the strength of a 5 per cent increase in food prices. Another 1 ¼ percent monthly increase was registered in July, also reflecting the movement in food prices.

On a year-on-year basis, **headline inflation** was 6.9 per cent in September 2005, compared with the low point of 3 per cent in December 2003. In September 2005, food prices were 23 per cent higher than a year earlier. **Core inflation**, which excludes the impact of food prices, measured 2.6 per cent in September (year-on-year). This measure of the underlying rate of inflation has increased from 0.8 per cent as at January 2004. The Bank's target is for an annual average inflation rate of between 4 and 5 per cent.

**Food prices** have always been the main driver of the retail prices index, increasing on average by 11.8 per cent over the period 2000-2004. The doubling of the rate of increase in 2005 reflects the heavy rains and flooding which contributed to a shortfall in the supply of fruits and vegetables, while the prices of items such as chicken and other staples seemed to have stabilized. In addition, the reduction in fruits and vegetable imports from neighbouring countries, which were also affected by hurricanes, could have curtailed the supply of these items during the year.

### *Monetary Policy*

At the beginning of the year, in the face of rising inflationary pressures, the Central Bank began a shift away from the accommodating monetary stance that obtained since 2003. Accordingly, in March 2005, the **repo rate** was raised from 5 per cent to 5.25 per cent. Since then, the repo rate has

been increased on two occasions (in July and September) to 5.75 per cent.

In line with increases in the repo rate, the commercial banks increased their **prime lending rates** from 8.75 per cent at the end of 2004 to 9.5 per cent currently. The average discount rates on three-month treasury bill rates at auction also trended upwards rising from 4.78 per cent to 4.99 per cent in July, before receding to 4.92 per cent at the end of September.

**Yields on long term securities** rose sharply, reflecting large financing requirements of the parastatal sector as well as inflationary expectations. Thus while in March, the yield of a ten-year central government bond in the primary auction was 6.11 per cent, the yield of a similar maturity issued by WASA in October was 7.20 per cent.

The continued high level of systemic liquidity has presented challenges for monetary policy by limiting the pass-through of increases in the repo rate to key market rates such as the inter-bank rate and actual commercial bank lending rates, including mortgage interest rate. Thus, for instance, despite an increase of 75 basis points in the repo rate, the inter-bank rate has largely fluctuated in a narrow range between 4.12 per cent and 4.31 per cent. Also, notwithstanding the increase in the prime rate, the weighted average lending rate has remained virtually unchanged at 8.76 per cent. Data for the second quarter of 2005 indicate that two-thirds of commercial bank loans outstanding were contracted at rates under the prime lending rate. The data also indicate that the average mortgage interest rate charged by commercial banks as at August 2005 was 9.38 per cent, below the level of 9.50 per cent for the same period in 2004. In the face of ample liquidity and sticky bank interest rates, bank credit to the private sector has registered strong growth.

## Open Market Operations

The Central Bank has significantly increased the level of open market operations in an effort to address expanding liquidity created by government fiscal operations. The **average monthly fiscal injection**, which is the primary source of liquidity, amounted to about \$586 million in fiscal year 2005 compared with \$262 million in fiscal year 2004. In response, Central Bank net sales of open market securities averaged \$259.3 million a month in fiscal year 2005, compared with \$87.9 million a month in fiscal year 2004. **Central Bank sales of foreign exchange**, amounting to US\$545 million in fiscal year 2005, also contributed to the absorption of excess liquidity.

One measure of excess liquidity in the system is the level of special deposits held by the commercial banks at the Central Bank. The average daily balance in this account was \$556.4 million in fiscal 2004/2005 compared with \$329.2 million in the previous year, an increase of 69 per cent. Subsequent to the reduction in the special deposit rate from 3.50 per cent to 2.50 per cent with effect from September 1 2005, the special deposit balances fell from a daily average of \$638.2 million in September to \$595.4 million in October. This modest decline of 7 per cent seemed to confirm the systemic nature of excess liquidity as well as to underscore the need for a secondary market to provide more options for liquidity management.

## Foreign Exchange Market

The increase in fiscal spending, liquidity conditions and interest rate developments have also contributed to demand pressures in the foreign exchange market. In the first ten months of 2005, **sales of foreign exchange** by the commercial banks (or the demand for foreign exchange) increased by 25.8 per cent compared with the corresponding period of last year. At the same time, (notwithstanding a projected increase of 20 per cent in non-oil exports) foreign exchange purchases from the public (excluding the energy sector) showed hardly any increase. To meet the increasing demands, the Central Bank sold US\$545 million in the period, this was 36 per cent more than that sold for the whole of 2004 (Table 2).

The strong increase in foreign exchange demand reflects (i) an increase in foreign portfolio investment by Trinidad and Tobago citizens; (ii) the expanding foreign exchange requirements of ongoing construction projects by the parastatal sector; and (iii) increasing imports. Excluding the Revenue Stabilisation Fund, the level of official reserves stood at US\$3,339.6 million at the end of October, the equivalent of about 7.2 months of projected 2005 imports.

**Table 2**  
**Foreign Exchange Purchases and Sales**  
*/US\$Million/*

Year	Commercial Banks' Purchases	Commercial Banks' Sales	Central Bank Sales
2000	1,527.0	1,835.0	300.0
2001	2,135.0	2,314.0	(10.0)
2002	2,003.0	2,315.0	310.0
2003	2,070.0	2,625.0	505.0
2004	2,441.0	2,984.0	400.0
Jan – Oct 2004	<b>1,946.0</b>	<b>2,375.0</b>	305.0
Jan - Oct 2005	<b>2,095.0</b>	<b>3,104.0<sup>1</sup></b>	545.0

<sup>1</sup> includes inflows of net interest income and dividends.

Source: Central Bank of Trinidad and Tobago.



## Short-term Outlook

In its last monthly statement on interest rates, the **Federal Reserve** expressed confidence that the US economy and employment would continue to grow at a respectable pace. It noted, however, that the cumulative rise in energy costs has the potential to add to inflation pressures. With higher inflation a tangible threat, it is reasonable to expect the Federal Reserve to continue to raise interest rates, perhaps even beyond the “neutral” level, considered to be 4 ½ per cent.

As for **Trinidad and Tobago**, the projections are for **real GDP** growth of 7 per cent in 2005 and 10.6 per cent in 2006. Next year, the big boost will come from the start of production of Train IV, a full year’s production from the M5000 methanol plant and the ongoing expansion in public sector construction activity.

The short-term outlook for inflation will be critically dependent on the following factors:

- (i) **the response of food prices** to better weather and to the budget measures geared to boost agricultural production and to prevent oligopolistic price adjustments for basic foods;
- (ii) **the actual increase in the non-energy fiscal deficit** and the success of measures to reduce production bottlenecks;
- (iii) **wage developments**; and
- (iv) **the evolution of import prices.**

The greatest impact will come from the level of Government spending as reflected in the non-oil

domestic deficit. The fiscal year 2006 budget provides for almost a doubling of this deficit – from 8 per cent of GDP to 15 per cent of GDP. If expenditure programmes proceed as envisaged, monetary policy will be hard-pressed to achieve the necessary liquidity absorption and inflationary pressures will intensify. The situation could be exacerbated, if as happened during a previous oil boom, wage demands (and private consumption) increase significantly as workers seek to share in the oil dividend and spend rather than save the income increases.

Present liquidity pressures are already presenting serious challenges for monetary policy and foreign exchange management. In particular, the Bank needs to explore novel (and perhaps unconventional) ways of liquidity absorption, to deal with the present overhang and the structural build-up in liquidity that is projected<sup>1</sup>. This is critical in order to ensure the appropriate market interest rate adjustments that are needed to help in the fight against inflation.

Already, the differential between domestic and US short-term interest rates has fallen to below one percentage point, compared with 3.93 percentage points at the end of January 2004 (Chart 4). There is evidence that the reduced differential is prompting large firms to switch from foreign to local funding, while at the same time encouraging capital outflows. Future increases in US interest rate will therefore be clearly unsustainable.

In the final analysis, it is worth underscoring that monetary policy alone cannot successfully address inflation control. In the current environment, the further tightening of monetary policy will need to be accompanied by action directed to phasing the development budget over a longer period and by wage restraint.

<sup>1</sup> To continue to conduct its regular open market operations, the Government debt ceilings would need to be increased by Parliament to increase the availability of short-term paper.

## 2. Recent Economic Developments

### Real GDP

According to the Central Bank's Quarterly **Gross Domestic Product (QGDP)** Index, the economy expanded by 6.2 per cent in the first half of 2005, largely on account of robust growth in both the energy and non-energy sectors (Chart 5). The **energy sector** expanded by 8.2 per cent, reflecting increased output from both the petrochemicals (23.3 per cent) and other petroleum sub-sectors (6.3 per cent). The increased output in the petrochemical sector emanated from two new petrochemical plants, which started production in the second half of 2004.

**The non-energy sector** also experienced robust growth with real output expanding by 5.6 per cent. The main drivers of growth in the non-energy sector were Construction (14.2 per cent), Distribution (11.1 per cent), and Transport, Storage & Communications (5 per cent). Moderate growth was recorded in Electricity and Water (4.3 per cent), Government (3.7 per cent) and Manufacturing (3.7 per cent). However, output in the agricultural sector fell by 2.9 per cent mainly on account of persistent

difficulties experienced by the restructured sugar industry.

### Employment

Conditions in the labour market continued to reflect the prevailing buoyant economic environment. According to the latest data released by the Central Statistical Office (CSO), the **unemployment rate** fell to 8 per cent in the second quarter from 9 per cent in the first quarter (Table 3). The fall in the unemployment rate reflected both a decline in the labour force of 4.4 thousand persons and an increase in the number of persons with jobs (2.6 thousand) (Chart 6). The increase in the number of additional jobs in the Petroleum (2.6 thousand) and construction sectors (5.5 thousand) contributed to the improvement in employment. The upsurge in construction in both the public and private sectors largely explained the increase in employment in that sector while employment in the petroleum sector experienced a boost from increased exploration activity. Job losses were however experienced by the manufacturing and agriculture sectors, which lost 0.5 thousand and 4.9 thousand jobs, respectively.

**Table 3**  
**Unemployment Rates – 1988-2005**

*/Per Cent/*

	March	June	September	December
1988	22.7	21.4	21.6	22.4
1989	22.5	22.3	22.4	20.8
1990	20.1	20.3	20.6	19.2
1991	20.4	17.6	18.5	17.4
1992	19.8	20.6	18.7	19.2
1993	21.1	19.5	19.0	19.4
1994	19.7	18.1	17.9	17.9
1995	18.1	16.5	17.8	16.3
1996	17.1	15.1	16.9	15.9
1997	17.2	14.5	14.9	13.5
1998	14.6	13.4	13.8	15.1
1999	14.1	11.7	13.6	13.2
2000	12.5	..	12.1	11.9
2001	10.7	10.8	10.1	11.7
2002	10.3	10.1	10.6	10.6
2003	11.0	10.2	10.5	10.2
2004	10.2	7.8	7.7	7.8
2005	9.0	8.0	-	-

Source: Central Statistical Office.

## Consumer Prices and the Prices of Building Materials

### *Retail Prices Index*

During the first nine months of 2005, inflationary pressures remained strong as the impact of higher food prices on headline inflation lingered. In the twelve months to March, headline inflation reached 7.3 per cent compared with 2.8 per cent, a year earlier. Headline inflation slowed in April as the rate of increase in food prices decelerated but picked up again in June and July as early seasonal flooding created supply shortages especially in fruits and vegetable production. In the twelve months to August 2005, prices increased by 7.3 per cent, compared with 3.7 per cent, a year ago. The latest data published by the Central Statistical Office indicate that headline inflation has decelerated marginally to 6.9 per cent year-on-year to September (Chart 7). Food prices rose by 23.1 per cent compared with 13.3 per cent in the corresponding period of 2004, **which reflected in the main, significant increases in the prices of fruits (40 per cent) and vegetables (82 per cent).**

On a year-on-year basis to September, core inflation, which excludes food prices, remained relatively steady at 2.6 per cent, unchanged since April 2005, **with the exception of August when the rate was marginally higher at 2.7 per cent.** By comparison, core inflation was 2.1 per cent, a year ago. Contributing to the increase was an 11.1 per cent rise in the Recreation and Culture sub-index. This sharp pick-up reflected the increased cost of packaged holidays, arising from higher airfares. The Meals Out component rose by 7 per cent from 4.4 per cent a year ago on account of rising food prices. The increase in the Rent sub-index stood at 6.1 per cent compared with 4.7 per cent, one year earlier. The growth in the home ownership component, which refers to maintenance and repairs to homes, slowed to 1.6 per cent compared with 3.3 per cent in the twelve months to

September 2004. In addition, clothing and footwear continued to have a dampening effect on core inflation as prices fell by 1.3 per cent (Table 4).

### *Index of Retail Prices of Building Materials*

The Index of Retail Prices (Consumer Price Index) tends to reflect consumption of non-durable goods and services (such as food and clothing), and does not cover durable assets such as housing, which is a core component of the wealth portfolio of many households in Trinidad and Tobago. The Bank has been attempting to trace the evolution of housing prices especially given the sharp pick-up in activity in the real estate and housing market. Official statistics on real estate prices remain relatively sparse. The Bank is working with other agencies involved in the real estate market to develop housing prices indicators.

In the meantime, however, the Central Statistical Office produces, on a quarterly basis, an Index of Retail Prices of Building Materials, covering the prices of building materials and building services. Changes in this index tend to be closely correlated with changes in housing prices. In the absence of official housing price statistics, this index can be viewed as a leading indicator of housing prices.

On a year-on-year basis to June 2005, the price of building materials increased by 11.3 per cent compared with an increase of 6.4 per cent and 4.1 per cent for the corresponding periods of 2004 and 2003, respectively. The increased cost of building materials for site preparation and concrete structure, for walls and roofing and for electrical installation and fixtures were the main components responsible for the sharp upswing in the index (Chart 8). The site preparation, walls and roofing and electrical installation/fixture subcomponents of this index increased year-on-year to June by 7.3 per cent, 9.1 per cent and 46.1 per cent respectively (Table 5).



**Table 4**  
**Index of Retail Prices (January 2003 = 100)**

Date	ALL ITEMS			CORE		FOOD			TRANSPORT	
	Index	Mthly %	Y-o-Y %	Index	Y-o-Y %	Index	Mthly %	Y-o-Y %	Index	Y-o-Y %
Jan-04	103.30	0.19	3.30	100.84	0.84	114.50	1.51	14.50	103.70	3.70
Feb-04	103.40	0.10	3.09	100.90	0.84	114.80	0.26	13.21	103.70	3.70
Mar-04	103.60	0.19	2.78	101.01	0.93	115.40	0.52	10.85	103.70	3.70
Apr-04	104.30	0.68	2.86	101.64	1.45	116.40	0.87	8.89	103.70	3.70
May-04	104.90	0.58	3.15	101.56	1.38	120.10	3.18	10.59	103.70	3.70
Jun-04	105.20	0.29	3.24	101.58	1.43	121.70	1.33	10.74	103.70	3.70
Jul-04	105.80	0.57	3.32	102.44	2.03	121.10	-0.49	8.61	105.90	5.90
Aug-04	106.10	0.28	3.71	102.46	2.08	122.70	1.32	10.44	105.90	5.90
Sep-04	106.70	0.57	4.30	102.51	2.11	125.80	2.53	13.33	105.90	5.90
Oct-04	107.50	0.75	4.47	103.02	1.92	127.90	1.67	15.02	107.70	3.86
Nov-04	108.10	0.56	4.75	102.90	1.81	131.80	3.05	16.74	107.70	3.86
Dec-04	108.90	0.74	5.63	102.95	1.96	136.00	3.19	20.57	107.70	3.86
Jan-05	109.40	0.46	5.91	103.69	2.83	135.40	-0.44	18.25	107.70	3.86
Feb-05	110.50	1.01	6.87	103.70	2.77	141.50	4.51	23.26	107.70	3.86
Mar-05	111.20	0.63	7.34	103.80	2.76	144.90	2.40	25.56	107.70	3.86
Apr-05	111.60	0.36	7.00	104.27	2.58	145.00	0.07	24.57	108.20	4.34
May-05	111.70	0.09	6.48	104.19	2.59	145.90	0.62	21.48	108.20	4.34
Jun-05	112.10	0.36	6.56	104.26	2.64	147.80	1.30	21.45	108.20	4.34
Jul-05	113.50	1.25	7.28	105.09	2.59	151.80	2.71	25.35	108.10	2.08
Aug-05	113.80	0.26	7.26	105.20	2.67	153.00	0.79	24.69	108.10	2.08
Sep-05	114.10	0.26	6.94	105.14	2.57	154.90	1.24	23.13	108.10	2.08

Date	HOUSING		HEALTH		EDUCATION		HOTELS, CAFES, REST.		Rent	Home Ownership
	Index	Y-o-Y %	Index	Y-o-Y %	Index	Y-o-Y %	Index	Y-o-Y %	Y-o-Y %	Y-o-Y %
Jan-04	101.00	1.00	102.50	2.50	103.00	3.00	101.50	1.50	4.80	0.50
Feb-04	101.10	1.00	102.60	2.60	103.00	3.00	101.50	1.50	4.80	0.50
Mar-04	101.20	1.10	102.70	2.80	103.00	3.00	101.50	1.50	4.80	0.50
Apr-04	102.90	2.49	103.00	2.18	103.00	2.79	104.30	4.40	4.99	2.39
May-04	102.80	2.39	103.20	1.67	103.00	2.79	104.30	4.40	4.99	2.39
Jun-04	102.80	2.49	103.70	2.17	103.00	2.79	104.30	4.40	4.99	2.39
Jul-04	103.90	2.97	103.80	1.37	103.00	2.79	104.70	4.39	4.73	3.27
Aug-04	103.90	3.08	104.10	2.06	103.00	2.79	104.70	4.39	4.73	3.27
Sep-04	103.90	2.97	104.30	2.36	103.00	2.79	104.70	4.39	4.73	3.27
Oct-04	105.10	4.37	105.20	3.24	103.30	0.29	106.00	5.47	3.98	5.48
Nov-04	105.10	4.37	105.30	3.13	103.30	0.29	106.00	5.47	3.98	5.48
Dec-04	105.10	4.37	105.30	3.24	103.30	0.29	106.00	5.47	3.98	5.48
Jan-05	105.40	4.36	105.40	2.83	103.30	0.29	108.40	6.80	5.15	5.47
Feb-05	105.40	4.25	105.60	2.92	103.30	0.29	108.40	6.80	5.15	5.47
Mar-05	105.60	4.35	105.60	2.82	103.30	0.29	108.40	6.80	5.15	5.47
Apr-05	105.60	2.62	107.60	4.47	107.10	3.98	108.50	4.03	5.99	2.82
May-05	105.60	2.72	107.60	4.26	107.10	3.98	108.50	4.03	5.99	2.82
Jun-05	105.70	2.82	107.80	3.95	107.10	3.98	108.50	4.03	5.99	2.82
Jul-05	105.80	1.83	108.70	4.72	107.10	3.98	112.00	6.97	6.12	1.63
Aug-05	105.80	1.83	109.20	4.90	107.10	3.98	112.00	6.97	6.12	1.63
Sep-05	105.80	1.83	109.10	4.60	107.10	3.98	112.00	6.97	6.12	1.63

Source: Central Statistical Office

Monthly consumer price surveys are carried out for the sub indices: (i) Food and Non-alcoholic Beverages, (ii) Alcoholic Beverages, and (iii) Clothing and Footwear.

Quarterly consumer price surveys are carried out for the sub indices: (i) Housing, Water, Electricity and Gas (including Rent and Home Ownership), (ii) Furnishings, Household Equipment and Routine Maintenance, (iii) Health, (iv) Transport, (v) Communication, (vi) Recreation and Culture, and (vii) Hotels, Cafes and Restaurants.

Semi annual consumer price surveys are conducted for the sub index: Education.

On the demand side, the acceleration of Government's construction projects (housing programme and other infrastructural works) as well as projects in the energy sector, which resulted in more buoyant activity in the construction industry,

placed upward pressure on the prices of building materials. This situation was further aggravated by intermittent shortages in the supply of key building material (sand and aggregate) following industrial problems at National Quarries Limited.

**Table 5**  
**Index of Retail Prices of Building Materials**  
Base Period: Average of 4 Quarters 1996=100 (REVISED)

Date	ALL SECTIONS			SITE PREPARATION, STRUCTURE & CONCRETE FRAME			WALLS AND ROOF			ELECTRICAL INSTALLATION AND FIXTURES			
	Index	Qtrly %	Y-o-Y %	Index	Qtrly %	Y-o-Y %	Index	Qtrly %	Y-o-Y %	Index	Qtrly %	Y-o-Y %	
2001	I	112.3	2.84	0.99	131.1	-0.53	-1.13	118.6	4.40	2.15	107.3	1.04	-2.28
	II	112.3	0.00	1.45	131.1	0.00	-0.38	118.7	0.08	2.59	107.1	-0.19	-0.65
	III	111.9	-0.36	2.47	130.8	-0.23	0.31	118.6	-0.08	4.40	104.4	-2.52	-2.34
	IV	111.4	-0.45	2.01	130.2	-0.46	-1.21	118.4	-0.17	4.23	103.0	-1.34	-3.01
2002	I	111.5	0.09	-0.71	130.7	0.38	-0.31	118.2	-0.17	-0.34	105.6	2.52	-1.58
	II	110.7	-0.72	-1.42	131.1	0.31	0.00	116.2	-1.69	-2.11	103.8	-1.70	-3.08
	III	112.8	1.90	0.80	135.6	3.43	3.67	119.3	2.67	0.59	104.5	0.67	0.10
	IV	113.8	0.89	2.15	136.4	0.59	4.76	121.8	2.10	2.87	105.0	0.48	1.94
2003	I	114.0	0.18	2.24	137.4	0.73	5.13	122.9	0.90	3.98	103.3	-1.62	-2.18
	II	115.2	1.05	4.07	139.2	1.31	6.18	123.9	0.81	6.63	100.9	-2.32	-2.79
	III	115.1	-0.09	2.04	140.2	0.72	3.39	123.0	-0.73	3.10	100.5	-0.40	-3.83
	IV	114.8	-0.26	0.88	139.9	-0.21	2.57	122.8	-0.16	0.82	99.3	-1.19	-5.43
2004	I	116.3	1.31	2.02	142.6	1.93	3.78	124.9	1.71	1.63	99.4	0.10	-3.78
	II	122.6	5.42	6.42	158.3	11.01	13.72	133.1	6.57	7.43	105.3	5.94	4.36
	III	125.9	2.69	9.38	160	1.07	14.12	136.0	2.18	10.57	114.2	8.45	13.63
	IV	131.7	4.61	14.72	163.9	2.44	17.16	140.3	3.16	14.25	143.7	25.83	44.71
2005	I	133.2	1.1	14.5	164.9	0.6	15.6	141.5	0.86	13.29	151.2	5.22	52.11
	II	136.5	2.5	11.3	169.9	3.0	7.3	145.2	2.61	9.09	153.9	1.79	46.15

Date	PLUMBING & PLUMBING FIXTURES			WINDOWS, DOORS & BALAUSTRADING			FINISHING, JOINERY UNITS AND PAINTING & EXTERNAL WORKS			
	Index	Qtrly %	Y-o-Y %	Index	Qtrly %	Y-o-Y %	Index	Qtrly %	Y-o-Y %	
2001	I	102.9	-2.65	-4.01	108.1	8.10	11.44	90.4	0.00	-3.11
	II	102.7	-0.19	-3.84	108.4	0.28	11.75	90.1	-0.33	-3.53
	III	101.4	-1.27	-4.25	108.5	0.09	12.09	90.2	0.11	-1.53
	IV	99.7	-1.68	-5.68	108.5	0.00	12.20	89.8	-0.44	-0.66
2002	I	103.9	4.21	0.97	105.9	-2.40	-2.04	89.1	-0.78	-1.44
	II	103.8	-0.10	1.07	105.8	-0.09	-2.40	89.8	0.79	-0.33
	III	104.6	0.77	3.16	105.9	0.09	-2.40	90.3	0.56	0.11
	IV	104.7	0.10	5.02	105.9	0.00	-2.40	89.8	-0.55	0.00
2003	I	104.0	-0.67	0.10	102.8	-2.93	-2.93	90.5	0.78	1.57
	II	103.1	-0.87	-0.67	107.9	4.96	1.98	91.5	1.10	1.89
	III	104.6	1.45	0.00	107.4	-0.46	1.42	92.0	0.55	1.88
	IV	105.1	0.48	0.38	107.8	0.37	1.79	91.5	-0.54	1.89
2004	I	105.0	-0.10	0.96	108.0	0.19	5.06	92.7	1.31	2.43
	II	105.7	0.67	2.52	108.1	0.09	0.19	92.8	0.11	1.42
	III	106.9	1.14	2.20	114.2	5.64	6.33	94.0	1.29	2.17
	IV	106.7	-0.19	1.52	114.8	0.53	6.49	97.0	3.19	6.01
2005	I	107.7	0.94	2.57	115.3	0.44	6.76	97.1	0.10	4.75
	II	109.1	1.30	3.22	115.6	0.26	6.94	101.3	4.33	9.16

Source: Central Statistical Office

## Fiscal Developments

In principle, a budget surplus implies an absorption of liquidity from the economy since it is a net withdrawal of purchasing power from the private sector. In Trinidad and Tobago, about 1/3 of tax revenue comes from the energy sector which does not result in a reduction of domestic purchasing power. In these circumstances, it is the size of the domestic budget operations that influences domestic liquidity.

For the fiscal years 2001/2002 – 2002/2003, the domestic deficit averaged 4.6 per cent of GDP (Chart 9). In fiscal year 2004/2005, the domestic deficit increased to 8 percent of GDP.

The budget for fiscal year 2005/2006 provides for an overall surplus of \$1.9 billion (Table 6). The bulk of this surplus is allocated to the Revenue Stabilisation Fund.

The non-energy domestic deficit is projected to almost double from about 8 per cent of GDP to 15 per cent of GDP. The increase in the domestic deficit comes partly from the decline in domestic revenues consequent on the reduction in the rate of income and corporate tax and the increase in personal allowances. Domestic expenditures, which averaged about 23 per cent of GDP for fiscal years 2001/2002 – 2003/2004 are projected to increase to about 27 per cent of GDP in fiscal 2005/2006. Much of this increase is expected to arise from higher expenditure on transfers and subsidies (estimated to rise by 34 per cent) and wages and salaries (estimated to increase by 19 per cent).

The financing of the deficit comes largely from the monetization of the oil revenues which are lodged at the Central Bank. Accordingly, Central Government debt outstanding has declined from 28.7 per cent of GDP to 23.8 per cent of GDP in fiscal 2004/2005.

**Table 6**  
**Trinidad and Tobago: Summary of Central Government Operations**  
*/TT\$Million/*

	<b>Actual 2003/04</b>	<b>Budgeted 2004/05</b>	<b>Revised Estimate 2004/05</b>	<b>Budgeted 2005/06</b>
<b>Total Revenue and Grants</b>	<b>20,885.4</b>	<b>23,749.4</b>	<b>27,914.8</b>	<b>33,813.9</b>
<b>Current</b>	<b>20,878.2</b>	<b>23,404.3</b>	<b>27,895.7</b>	<b>33,789.8</b>
Oil	7,691.0	10,370.7	12,754.8	19,643.5
Non-Oil	13,187.2	13,033.6	15,140.9	14,146.3
<b>Capital and grants</b>	<b>7.2</b>	<b>345.1</b>	<b>19.1</b>	<b>24.1</b>
Divestment Proceeds	0.0	314.0	0.0	1.0
<b>Total Expenditure and Net lending*</b>	<b>19,410.7</b>	<b>22,384.9</b>	<b>25,021.9</b>	<b>31,941.3</b>
<b>Current</b>	<b>17,670.4</b>	<b>20,526.0</b>	<b>22,410.8</b>	<b>28,456.2</b>
Wages and salaries	4,814.8	5,672.1	5,445.5	6,520.7
Other goods and services	2,519.8	3,487.4	3,364.7	4,511.6
Interest payments	2,396.3	2,697.2	2,593.8	2,625.3
Transfers & Subsidies	7,939.5	8,669.3	11,006.8	14,798.6
<b>Capital and net lending</b>	<b>1,740.3</b>	<b>1,858.9</b>	<b>2,611.1</b>	<b>3,485.1</b>
<b>Primary Balance</b>	<b>-889.6</b>	<b>-1,332.7</b>	<b>299.1</b>	<b>-752.7</b>
<b>Overall Balance</b>	<b>1,474.7</b>	<b>1,364.5</b>	<b>2,892.9</b>	<b>1,872.6</b>
<b>Overall Balance including transfers to RSF</b>	<b>211.5</b>	<b>7.7</b>	<b>299.8</b>	<b>9.8</b>
<b>Transfers to RSF</b>	1,263.2	1,356.8	2,593.1	1,862.8

Sources: Ministry of Finance and Central Bank of Trinidad and Tobago.

\*Excludes transfers to the Revenue Stabilisation Fund of \$1,263.2 million in fiscal 2004, \$1,356.8 million in fiscal 2005, \$2,593.1 million in revised fiscal 2005 and \$1,862.8 million in fiscal 2006.

## External Accounts

Higher energy prices have bolstered exports resulting in a large surplus on the balance of payments. In 2004, exports rose by US\$1,198 million (23 per cent) outpacing the US\$983 million increase in imports and lifting the current account surplus to about 15 per cent of GDP from 9 per cent in 2003. Whereas energy exports rose by approximately US\$1,007 million (23 per cent) in 2004, non-energy exports grew by only US\$191 million. As regards the direction of trade, the data also indicate that the share of energy exports in total exports to Trinidad and Tobago's major export markets (the US and CARICOM) has been increasing steadily. In contrast, the share of non-energy exports in total exports to CARICOM has declined to 33.3 per cent in 2004 from 37.8 per cent in 2003.

Total imports (US\$4,894.2 million) increased by 25 per cent in 2004 compared with a growth rate of 6 per cent in 2003. Non-energy imports rose by 33 per cent to US\$3,373.5 million reflecting largely a sharp increase in the imports of food (15 per cent) and machinery and transport equipment (43 per cent), which both accounted for 44 per cent of total imports. This country's imports were sourced mainly from the United States (34 per cent), whose share remained relatively steady over the period 2000-2004. When energy imports are excluded, 44 per cent

of non-energy merchandise imports were shipped from the United States. Goods imported from the United Kingdom comprised around 4 per cent over the period, while imports from CARICOM have declined to 2 per cent in 2004.

The large current account surpluses were partially offset by a deficit of US\$1054.1 million on the capital account as the private sector built up balances abroad. Nevertheless the overall balance of payments still climbed to US\$734 million, more than double the surplus achieved in 2003.

Balance of payments estimates for the first six months of 2005 indicate that the surplus on the current account has expanded significantly to US\$1,823.5 (Table 7). Energy and non-energy exports for the first six months of 2005 have increased by 60.8 per cent and 30.2 per cent, respectively compared with the corresponding period in 2005. The capital account is expected to continue to register a deficit as the private sector builds up balances abroad and as foreign direct investment slowed, following the completion of some major projects in the energy sector. Preliminary estimates showed that the capital account posted a deficit of US\$1,189.1 million, compared with a deficit of US\$177.1 million in the corresponding period of 2004. Consequently, the balance of payments registered a surplus of US\$634.4 million in the first half of 2005 (Chart 10).

**Table 7**  
**Trinidad and Tobago: Summary of Balance of Payments**

/US\$Millions/

	2003	2004	Jan- June 2003	Jan - June 2004	Jan- June 2005
<b>Current Account Balance</b>	<b>984.7</b>	<b>1,788.1</b>	<b>587.4</b>	<b>522.2</b>	<b>1,823.5</b>
Trade Balance	1,293.2	1,508.7	535.8	406.7	1,681.1
Exports	5,204.9	6,402.9	2,328.5	2,796.6	4,349.5
Energy	4,377.5	5,384.4	1,932.2	2,325.5	3,736.1
Non-energy	827.4	1,018.5	396.3	471.1	613.4
Imports	3,911.7	4,894.2	1,792.7	2,389.9	2,668.4
Energy	1,374.3	1,520.7	664.2	728.1	1,167.1
Non-energy	2,537.4	3,373.5	1,128.5	1,661.8	1,501.3
Services (Net)	313.8	671.4	161.5	334.3	282.3
Income (Net)	-680.9	-446.2	-136.8	-243.9	-168.6
Current Transfers (Net)	58.6	54.2	26.9	25.1	28.7
<b>Capital and Financial Account</b>	<b>-650.5</b>	<b>-1,054.1</b>	<b>-539.3</b>	<b>-177.1</b>	<b>-1,189.1</b>
<b>Overall Balance</b>	<b>334.2</b>	<b>734.0</b>	<b>48.1</b>	<b>345.1</b>	<b>634.4</b>
Gross Official Reserves	2,258.0	2,993.0	1,971.7	2,604.1	3,567.6
Gross Official Reserves (Net of RSF)	2,094.5	2,539.1	1,803.9	2,354.2	3,113.2
Import Cover (Net of RSF)	5.9	5.9	5.5	5.5	6.7

Source: Central Bank of Trinidad and Tobago.

The relatively slow growth in non-energy exports as well as strong import growth raises questions about the competitiveness of the tradeable goods sector. Non-price measures such as the competitiveness indicators prepared by the World Economic Forum suggest that Trinidad and Tobago has slipped in ranking when other factors such as technology, company sophistication and the business environment are taken into account. However, indicators of competitiveness compiled recently by the Central Bank yielded mixed results.

Price-based measures such as the terms of trade index and the relative unit cost measure suggest some improvement in competitiveness since 2003. However, the real effective exchange rate index, shows that since mid-2004, the economy has become less competitive relative to its major trading partners. Box I presents a more detailed picture of the measures of competitiveness developed by the Central Bank of Trinidad and Tobago's Research and Policy Department.

### Box I

#### Measuring the Competitiveness of the Trinidad and Tobago Economy

##### A. Defining Competitiveness

Competitiveness is a multifaceted concept which encompasses both price and non-price elements. One of the more popular definitions of competitiveness in widespread usage is that developed by the OECD. This definition regards competitiveness as *"the degree to which a country could, under free and fair market conditions, produce goods and services which meet the test of international markets while simultaneously maintaining and expanding the real income of its people over the longer term"* (OECD)<sup>2</sup>. Given the very complex and elusive nature of this phenomenon, it is difficult to rely on any single measure to analyze a country's competitiveness. Most countries, therefore, attempt to gauge competitiveness by using a combination of price and non-price measures.

##### B. Central Bank's Measures of Competitiveness for Trinidad and Tobago

The Central Bank utilizes three quantitative indicators to measure competitiveness in Trinidad and Tobago.

###### (a) Real Effective Exchange Rate Index

The first and most widely utilized measure is the **real effective exchange rate (REER)** index, which the Bank has been producing since the early 1980s. This measure is computed by deflating the nominal effective exchange rate (NEER) index by an index of relative prices (the effective inflation rate, EIR). The NEER reflects the value of the home country's currency relative to the weighted average value of the currencies of the country's major trading partners, with reference to a specific base period. The EIR measures the domestic inflation rate relative to those of the major trading partners. Using simple mathematical notation, this index can be represented as follows:

$$REER_t = \frac{NEER_t}{EIR_t}, \text{ where } t \text{ represents the current time period.}$$

The construction of the REER index allows for changes to be decomposed into two effects: an exchange rate effect which is measured by the NEER and an inflation effect which is measured by the EIR. An increase in the index indicates a loss of competitiveness while a decrease indicates a gain. The Bank has refined this measure over the years and now compiles two real effective exchange rate indices – **the trade weighted real effective exchange rate (TWREER) index and the export-weighted real effective exchange rate (XWREER) index**. The TWREER uses a weighting system that is based on total trade flows (i.e. both exports and imports between Trinidad and Tobago's and its major trading partners) while the XWREER is based solely on export weights. While the general trends are the same for both indices, the TWREER index is the more common indicator reported by the Bank.

<sup>2</sup> Reprinted in the National Competitiveness Council (1998), Annual Competitiveness Report. Website: [www.forfas.ie/ncc/reports/ncc.ann1](http://www.forfas.ie/ncc/reports/ncc.ann1).



**Box I**  
**Measuring the Competitiveness of the Trinidad and Tobago Economy**  
**(Continued)**

(b) *Terms of Trade Index*

The second major indicator of competitiveness is the **terms of trade (TOT) index**. This index is computed as the ratio of export prices to import prices. It is calculated by dividing average export prices by average import prices and can be represented algebraically as follows:

$$\text{TOT}_t = \frac{P_t^x}{P_t^m} \times 100$$

where  $P_t^x$  and  $P_t^m$  represent the average unit value of export and imports, respectively at time  $t$  while TOT refers to the terms of trade. An increase in the index, *ceteris paribus*, suggests an improvement in the terms of trade (an increase in international competitiveness), meaning that fewer exports are needed to pay for a given volume of imports. The converse is true for a decrease in the ratio.

(c) *Unit Labour Cost Index*

The third indicator is based on the unit labour cost (ULC) measure, which gives an indication of cost pressures in a given sector or economy. More specifically, this index can be defined as the ratio of labour compensation to labour productivity (output per man hour). In calculating ULCs, labour compensation was gauged by using an index of real average weekly earnings while productivity was measured by using an index of domestic production divided by an index of hours worked. In the case of Trinidad and Tobago, these input indices are computed quarterly by the Central Statistical Office.

The relative unit labour cost (RULC) index is calculated as a ratio of the unit labour cost index of Trinidad and Tobago to a geometric weighted average of the unit labour cost indices of Trinidad and Tobago's  $j^{\text{th}}$  trading partners, all in terms of a common currency (US dollar) at time  $t$ . The weights used are the total trade weights from the REER measure. This formulation is represented algebraically as follows:

$$\text{RULCTT}_t = \frac{\text{ULCTT}_t}{\prod_{j=1}^n \text{ULC}_{jt}^{w_j}}$$

where  $\text{ULC}_{jt}$  is the unit labour cost index of the  $j^{\text{th}}$  trading partner;  $\text{ULCTT}_t$  is the unit labour cost index for Trinidad and Tobago;  $w_j$  represents weights for the  $j^{\text{th}}$  partner countries and  $\text{RULCTT}_t$  is the relative unit cost labour index for Trinidad and Tobago.

The  $\text{RULCTT}_t$  index carries a base period equal to the average of the four quarters of 1995. An increase in the index indicates a loss of competitiveness relative to trading partners while a decrease represents a gain in competitiveness.

**C. The World Economic Forum Measures of Competitiveness**

Whereas the Central Bank's indicators capture more or less the price and cost elements of competitiveness, the Bank is also mindful about the qualitative aspects of competitiveness. The World Economic Forum (WEF) utilizes a number of non-price indicators to compile two composite measures of competitiveness: the growth competitiveness index (GCI) and the business competitiveness index (BCI). These non-price measures are published in the WEF's *Global Competitiveness Report* and are utilised to rank countries.

The GCI measures the capacity of the national economy to achieve sustained economic growth over the medium term and is based on indicators of technological capacity, the quality of public institutions and the quality of the macroeconomic environment. The BCI index, which is based on Porter's "Diamond framework of competitiveness", concentrates on the microeconomic aspects of competitiveness and utilises as key indicators, company sophistication and the quality of the business environment.

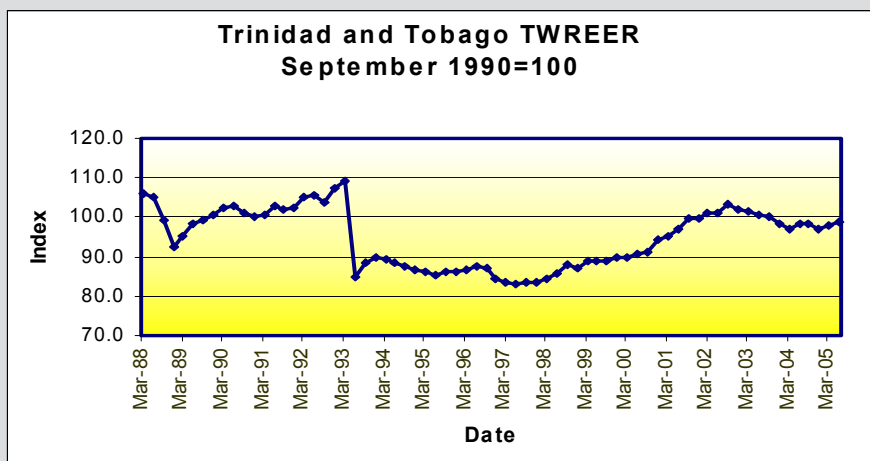
**Box I**  
**Measuring the Competitiveness of the Trinidad and Tobago Economy**  
**(Continued)**

**D. Main Results from the Competitiveness Measures**

*(i) Movements in the TWREER Index, 1988 to 2<sup>nd</sup> Qtr. 2005*

The trade weighted real effective exchange rate index indicates that, with the floatation and subsequent depreciation of the Trinidad and Tobago dollar in April 1993, there was a sharp improvement in Trinidad and Tobago’s level of competitiveness. During the period 2001-2002, the Trinidad and Tobago economy became less competitive following the sharp depreciation in the US dollar relative to the TT dollar as well as the currencies of the Trinidad and Tobago’s trading partners. Since 2004, the TWREER index has been trending upwards suggesting a loss in competitiveness (Chart A).

**Chart A: Trade Weighted Real Effective Exchange Rate Index (TWREER)**

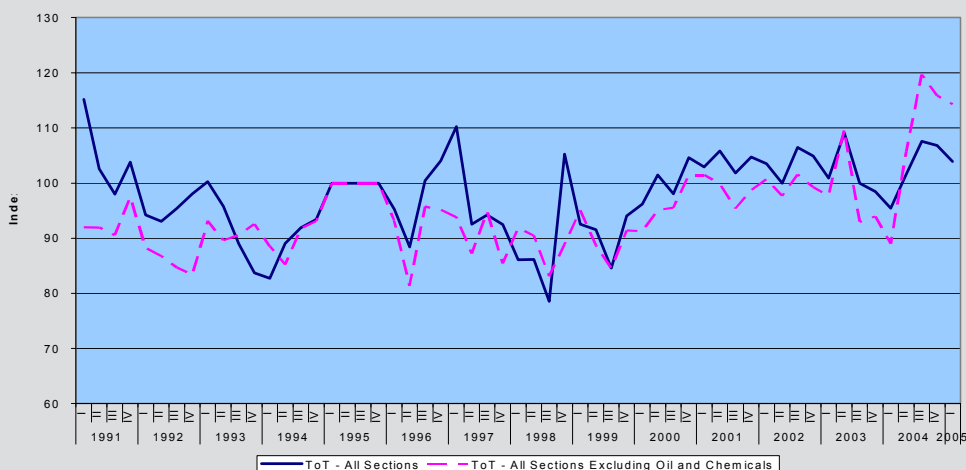


*(ii) Movements in the Terms of Trade Index, 1991 to 1<sup>st</sup> Qtr. 2005*

The terms of trade index for Trinidad and Tobago has displayed much greater volatility over the period 1991 to 2005 reflecting the fluctuations in the prices of the country’s major exports in international markets (Table A). Since 2003, there has been a sharp improvement in the terms of trade following favourable energy prices in international markets (Chart B).

**Chart B: Terms of Trade Index**

Terms of Trade Index of Trinidad and Tobago (1995 = 100)



**Box I**  
**Measuring the Competitiveness of the Trinidad and Tobago Economy**  
**(Continued)**

**Table A**  
**Import Price, Export Price and Terms of Trade Indices (1995 = 100)**  
**All Sections**

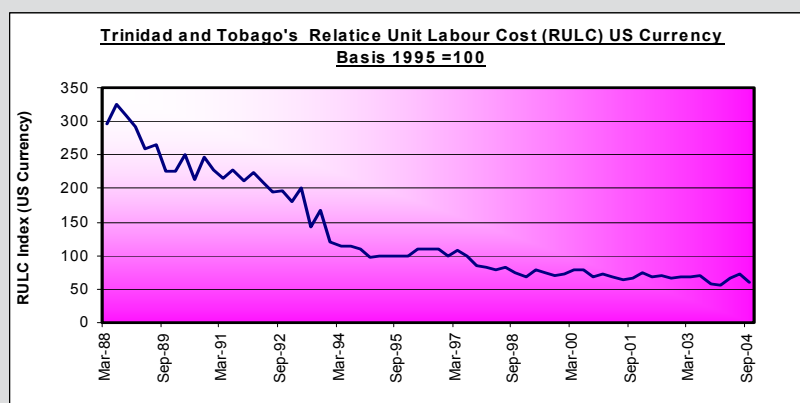
Year	Quarter	Import Price Index	Export Price Index	Terms of Trade Index
2000	I	116.07	111.64	96.19
	II	107.63	109.25	101.50
	III	110.42	108.24	98.03
	IV	104.87	109.70	104.61
2001	I	104.23	107.32	102.96
	II	104.58	110.66	105.82
	III	108.57	110.52	101.80
	IV	105.12	110.09	104.73
2002	I	106.31	110.03	103.50
	II	107.22	107.20	99.98
	III	103.55	110.22	106.44
	IV	106.98	112.24	104.91
2003	I	108.19	109.13	100.87
	II	105.20	114.74	109.07
	III	113.06	113.06	100.01
	IV	115.24	113.50	98.49
2004	I	123.20	117.60	95.45
	II	112.96	114.70	101.54
	III	116.60	125.40	107.55
	IV	121.10	129.40	106.85
2005	I	122.40	127.23	103.95

Source: Central Statistical Office.

(iii) *Movements in the RULC Index, 1988 to 3rd Quarter 2004*

The RULC index has trended downwards, signaling an improvement in Trinidad and Tobago's level of competitiveness (Chart C). Much of this improvement resulted from gains in productivity which in 2004, increased five-fold from 1988, indicating that output has been growing at a faster rate than the number of hours worked.

**Chart C: Relative Unit Labour Cost (RULC) Index**



**Box I**  
**Measuring the Competitiveness of the Trinidad and Tobago Economy**  
**(Continued)**

*(iv) Results from the WEF Global Competitiveness Index*

The Global Competitiveness Report for 2005, which ranks 117 countries based on the GCI and BCI measures, indicates some slippage in Trinidad and Tobago's level of competitiveness<sup>3</sup>. In 2005, Trinidad and Tobago's ranking in the GCI index slipped to 60<sup>th</sup> in 2005, from 51<sup>th</sup> and 49<sup>th</sup> in 2004 and 2003, respectively. While there was an improvement in the performance on the macroeconomic indicators in 2005 relative to 2004, the loss of competitiveness as measured by the GCI index emanated primarily from a fall in both the indices for technology and the quality of public institutions. With regard to the BCI index, Trinidad and Tobago slipped in the rankings to 65<sup>th</sup> place in 2005 from 59<sup>th</sup> in 2004. The fall was due to declines in the indices measuring company sophistication and the quality of the business environment (Table B).

**Table B**  
**Ranking of Trinidad and Tobago using World Economic Forum's GCI and BCI**  
**Competitiveness Indices**

	<b>GCI</b>	<i>Technology Index</i>	<i>Public Institutions</i>	<i>Macroeconomic Environment</i>	<b>BCI</b>	<i>Company Sophistication</i>	<i>Business Environment</i>
2001 <sup>4</sup>	<b>38/75</b>	52	35	25	<b>31/75</b>	27	38
2002	<b>42/80</b>	43	43	41	<b>44/80</b>	44	44
2003	<b>49/102</b>	47	56	47	<b>53/102</b>	54	53
2004	<b>51/104</b>	54	64	44	<b>59/103</b>	55	62
2005	<b>60/117</b>	62	83	40	<b>65/116</b>	62	63

Source: Global Competitiveness Report, Several Issues

<sup>3</sup> The ranking in these indices have to be interpreted with caution since the number of countries participating each year increases and the methodology is subject to revisions from time to time.

<sup>4</sup> The Technology transfer sub-index includes new survey evidence on the licensing of foreign technology as an important source of new technology.

### 3. Financial Sector Developments

#### Money and Credit

Consistent with the generally buoyant conditions in the domestic economy, the money supply registered an increase during the first eight months of 2005. Narrow money (M-1A) grew by 14.3 per cent, as the two components of this monetary aggregate, currency in active circulation and demand deposits rose by 5.9 per cent and 16.9 per cent, respectively, reflecting the rise in disposable incomes and the demand for increased transaction balances. The broader monetary aggregate, M-2, defined as M-1A plus time and savings deposits, registered faster growth since December 2004, increasing by over 12 per cent on a year-on-year basis (Chart 11). In part, this reflected significant expansion of time deposits (an average of 31 per cent) and was due mainly to adjustments to the balance sheets of some banks in light of the transfer of the mortgage portfolios of affiliate non-banks. As a result, quasi money (time and savings deposits) also exhibited strong growth. Foreign currency deposits expanded by 22.9 per cent between January and August, and represented 28 per cent of total deposits marginally below 28.6 per cent, a year ago.

Deposit interest rates have remained at relatively low levels. At the end of the second quarter, the weighted average deposit rate of the commercial banks fell by just 4 basis points to 1.73 per cent from the previous three months. Since the start of the reductions in the reserve requirement, this rate declined by 65 basis points from 2.38 per cent in September 2003. Similarly, the weighted average deposit rate on foreign currency deposits continued on a declining trend to 1.64 per cent at the end of June 2005 from 2.35 per cent at the end of June 2003. However, there has been some increase in the rate since the start of 2005 to 1.96 per cent at the end of March 2005.

Following the reductions in the reserve requirements in October 2003 and September 2004, the weighted average loan rate has fallen to 8.76 per cent at the end of the second quarter of 2005 from 10.97 per cent at the end of September 2003. (Chart 12) The continued downward trend of this rate reflected the greater proportion of outstanding loans of commercial banks (66.6 per cent) that continue to attract rates between 0 and 9 per cent which is below the current prime lending rate of 9.50 per cent (Table 8).

**Table 8**  
**Commercial Banks Distribution of Loans by Interest Rate Bands**  
**as at end of June 2005**

RateBands	Commercial Banks (TT\$ '000)	Distribution (per cent)	Cumulative Distribution (per cent)
0 % - 5 %	2,157,590	11.6	11.6
5 % - 7 %	3,509,807	18.9	30.5
7 % - 8 %	1,995,299	10.7	41.2
8 % - 9 %	4,721,985	25.4	66.6
9 % - 10 %	1,766,573	9.5	76.1
10 % - 12 %	2,321,612	12.5	88.5
Over 12 %	2,131,545	11.5	100.0
<b>Total</b>	<b>18,604,411</b>	<b>100.0</b>	

Source: Central Bank of Trinidad and Tobago.



The growth in private sector credit by the consolidated financial system accelerated to 15.7 per cent in the twelve months to August 2005 from 11.7 per cent, a year earlier. This reflected a pick-up in credit granted by the non-bank financial institutions (15.7 per cent) which had contracted over the period March 2004-June 2005. This decline followed the transfer of the mortgage business of some trust and mortgage companies to affiliate commercial banks in anticipation of the equalization of the reserve requirement for banks and non-banks. Lending by the consolidated financial system to businesses, which accounted for 39.1 per cent of total private sector credit peaked at 26.4 per cent for January but then slowed to an average rate of 16.5 per cent for the period April-August 2005 (Chart 13). Commercial bank credit to the private sector grew by 15.6 per cent in the twelve months to August, with growth of 8.5 per cent in business lending, 26.4 per cent in consumer credit and 40.5 per cent in real estate mortgage lending. Consumer credit, accounting for 27.3 per cent of total private sector credit, has shown the most significant increase on a year-on-year basis since April 2005 growing by 22.9 per cent, and then peaking at 27.4 per cent in the twelve months to July 2005 (Chart 14).

### **Mutual Funds**

In the six months to June 2005, funds under management grew by \$3.1 billion or 11.6 per cent to \$29.8 billion, almost level with commercial bank deposits (\$30.9 billion) (Chart 15 and Chart 16). This provided compelling evidence of the demand for this attractive investment alternative and perhaps a shift away from stocks given the weak performance of the stock market during this period. In the first quarter, 83.4 per cent of net incremental sales were invested in the income and growth funds. However, in the second quarter, when the equities market was relatively bearish, investors switched to the money market funds which accounted for 89.5 per cent of net incremental sales. Money market funds also provided investors with higher returns (a range of 5.51-7.29 per cent) than the

income and growth funds which posted annualized returns ranging between 0.43-14.21 per cent, with TT dollar money market funds marginally outperforming its US dollar counterparts (Chart 17).

### **Bond Market**

During the first ten months of 2005, the bond market was not as active with 16 placements compared with 24 and 34 placements in the corresponding periods of 2004 and 2003, respectively. These issues totalled \$4,754.7 million with four denominated in US dollars (US\$156.6 million) and one regional issue (US\$22.5 million). All but five bonds were of ten-year duration, while the other bonds had maturities of between 9-20 years. Of the 14 placements, two were issued by the Government of Trinidad and Tobago in the amount of TT\$400 million each, with yields ranging between 6.05-6.11 per cent. The WASA bond was issued in three tranches, posting yields of 6.40 per cent, 6.99 per cent and 7.20 per cent, respectively. There were four public sector issues by statutory corporations totalling TT\$1,023.1 million. The major highlight during the period was a TT\$1 billion placement by the Telecommunications Services of Trinidad and Tobago (TSTT).

### **Stock Market**

During the first six months of 2005, the performance of the stock market was less robust than in 2004 (Chart 18). The Composite Stock Price Index (1983=100) increased by 7.7 per cent, about one quarter of the gains (25.6 per cent) registered in the same period of 2004. Weak growth was reported in the Banking (4.2 per cent) and Property (1.8 per cent) sub-indices, while the Trading sub-index fell by 8.1 per cent. The monthly average number of shares traded was 18.6 million, compared with an average of 25.6 million traded in the first six months of 2004. Market capitalization was \$117.4 billion, an increase of 9 per cent from 2004. Previously, investors were moving savings into mutual funds and shares, but in the second

quarter of 2005, there has been a decline in securities trading which could be linked to increases in interest rates.

### **Real Estate Mortgage Market**

The lowering of the reserve requirement in October 2003 and September 2004 resulted in lower prime lending rates and by extension lower mortgage rates offered by commercial banks and trust and mortgage companies for the purchase of real estate. Between October 2003 and December 2004, mortgage rates of the trust and mortgage companies fell by 212 basis points from 12.00 per cent to 9.88 per cent, while those of the commercial banks fell by 300 basis points from 12.50 per cent to 9.50 per cent. However, since March 2005, the prime lending rates of the commercial banks have trended upwards following the increases in the

'Repo' rate. Consequently, mortgage rates of commercial banks have inched up to 9.38 per cent in August 2005 from 9.13 per cent in March 2005 and those offered by the trust and mortgage companies increased by 50 basis points to 10.38 per cent (Chart 19).

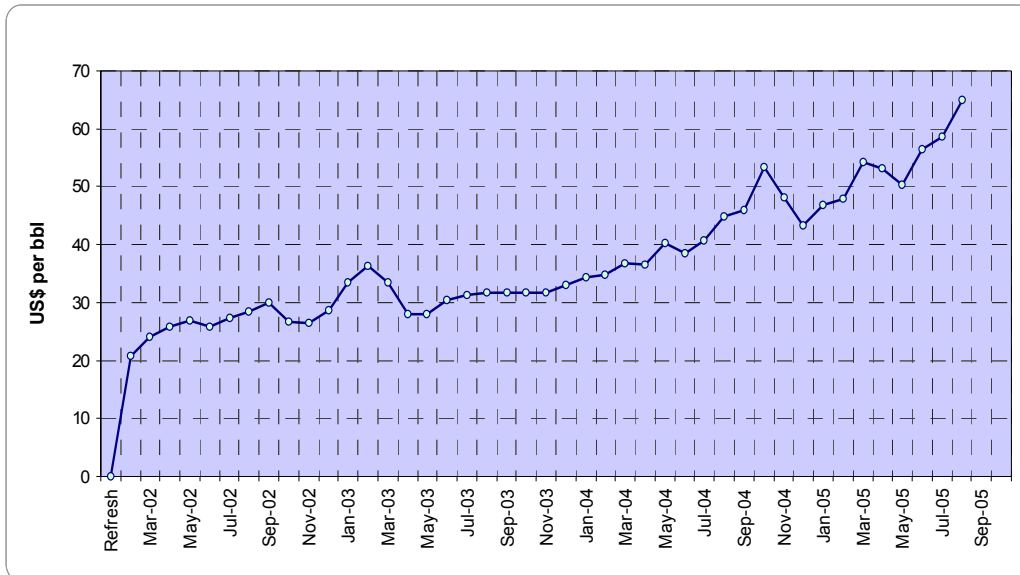
The softer environment for interest rates has led to a sharp increase in the demand for mortgage financing from deposit-taking institutions (commercial banks and trust and mortgage finance companies) over the last three years. The value of mortgage loans outstanding for deposit-taking institutions grew from \$4,503.9 million in September 2003 to \$5,480.8 million at the end of August 2005, an increase of 21.7 per cent (Chart 20). In addition, new mortgage approvals fluctuated but generally trended upwards over the last 2 to 3 years (Chart 21).

# Monetary Policy Report

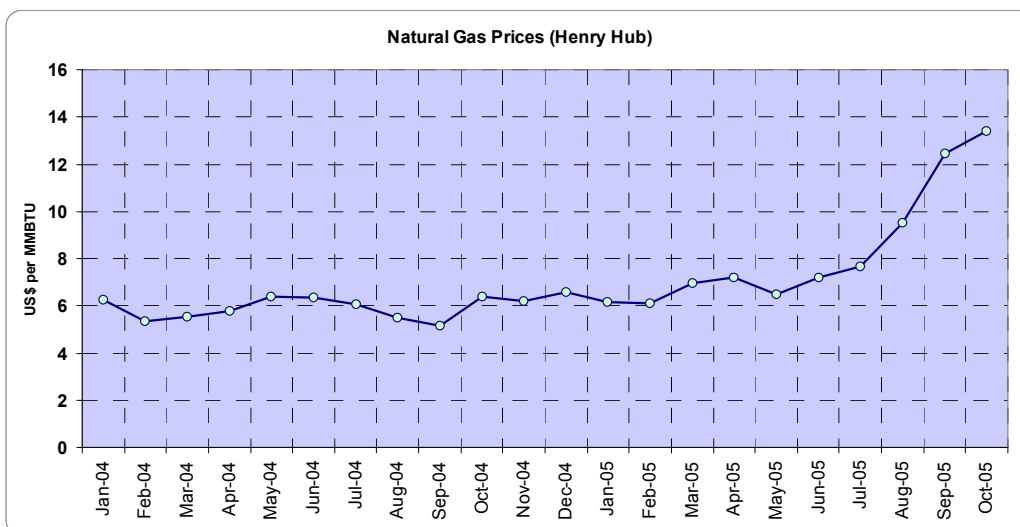
## List of Charts

- 1 Crude Oil Prices (WTI)
- 2 Natural Gas Prices (Henry Hub)
- 3 Methanol Prices (fob Rotterdam)
- 4 Comparative 90-Day Treasury Bill Rates: Trinidad and Tobago and United States
- 5 Changes in Real GDP
- 6 Trends in Labour Force and Unemployment
- 7 Index of Retail Prices - 12-month per cent change
- 8 Index of Retail Prices of Building Materials
- 9 Domestic Budget Deficit and Overall Fiscal Balance to GDP
- 10 Gross Official Reserves and Import Cover
- 11 Monetary Aggregates (Year-on-Year per cent changes)
- 12 Selected Interest Rates
- 13 Deposit Taking Institutions: Credit to Consumers and Business Firms
- 14 Commercial Banks: Credit to Business and Consumers
- 15 Mutual Funds under Management and Commercial Banks' Deposits
- 16 Mutual Funds: Aggregate Fund Value
- 17 Mutual Funds by Currency Denomination
- 18 Trinidad and Tobago Stock Price Indices
- 19 Commercial Banks and Trust Companies Real Estate Mortgage Loan Rates
- 20 Deposit Taking Institutions Mortgage Loans Outstanding (\$000s)
- 21 New Real Estate Mortgage Approvals: Commercial Banks and Trust and Mortgage Companies

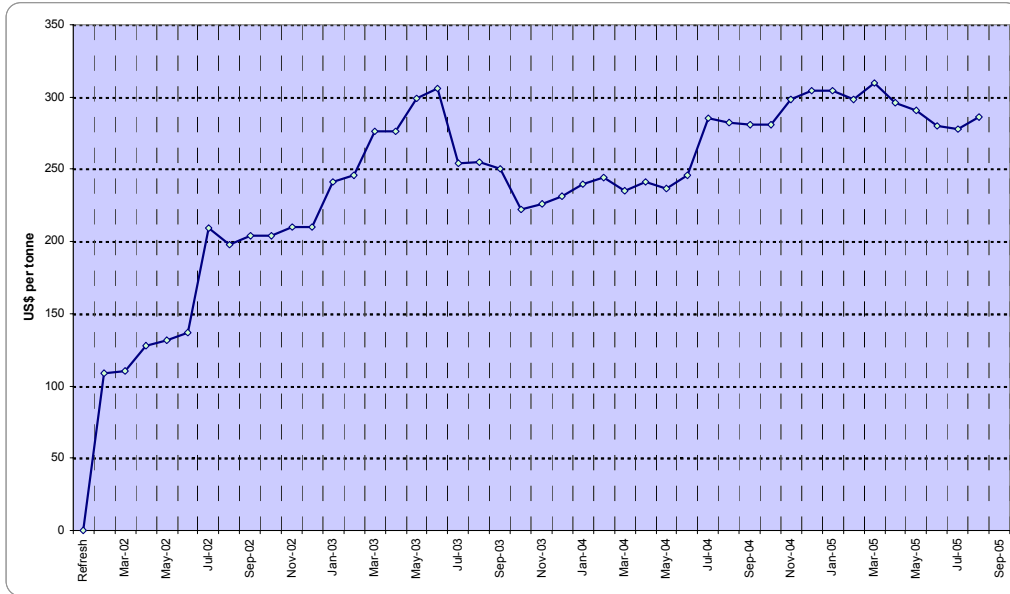
**Chart 1:  
Crude Oil Prices (WTI)**



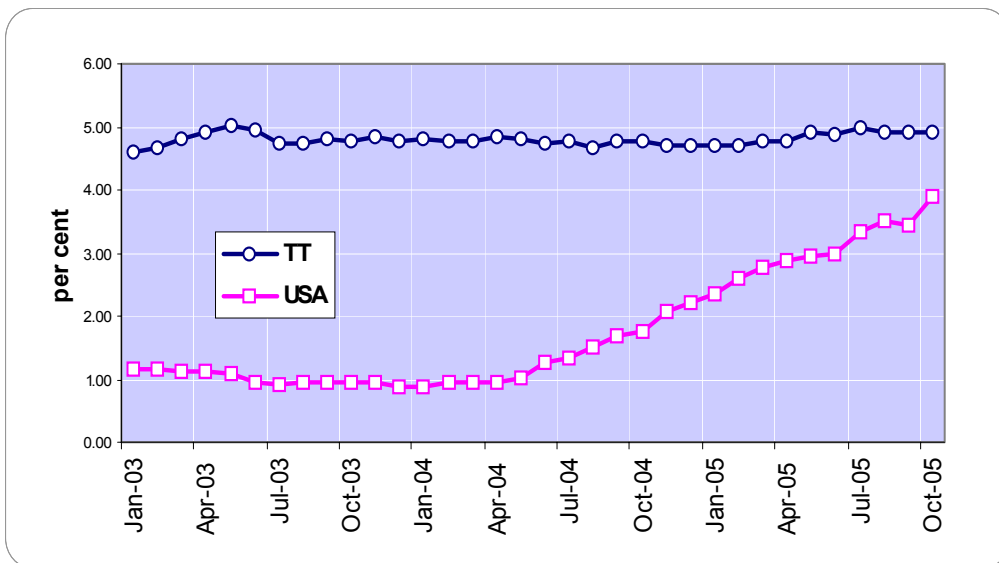
**Chart 2:  
Natural Gas Prices (Henry Hub)**



**Chart 3:  
Methanol Prices (fob Rotterdam)**

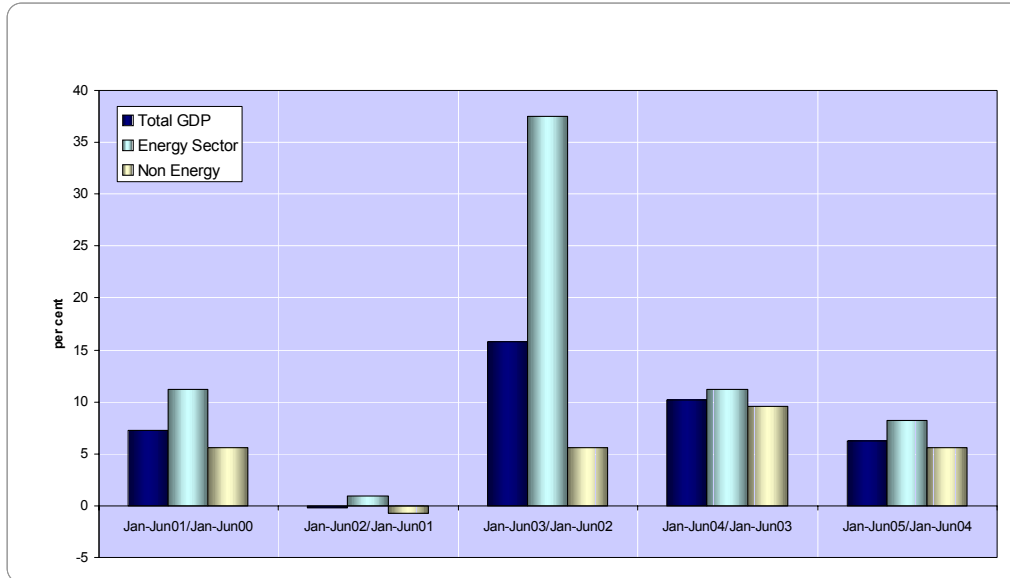


**Chart 4:  
Comparative 90-Day Treasury Bill Rates:  
Trinidad and Tobago and United States**

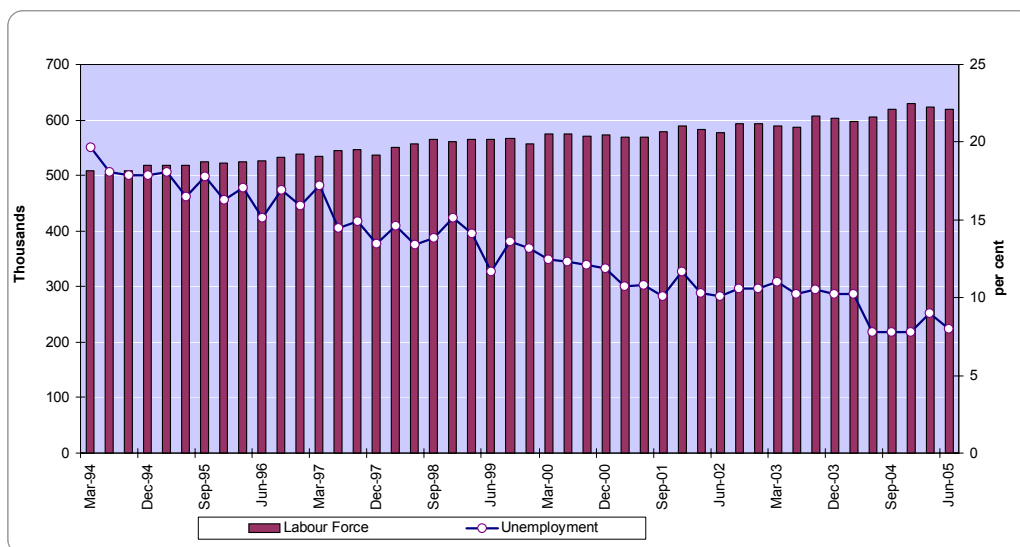




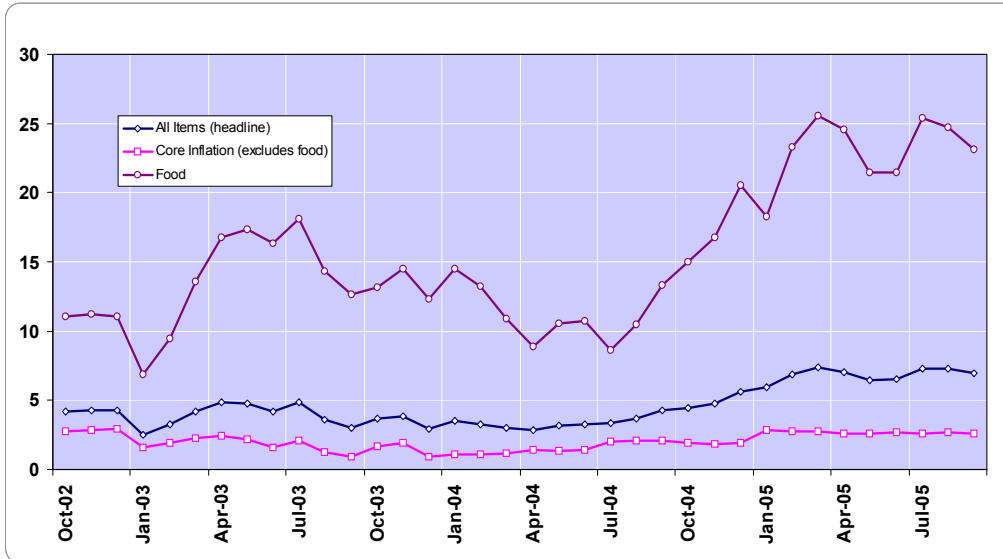
**Chart 5:  
Changes in Real GDP**



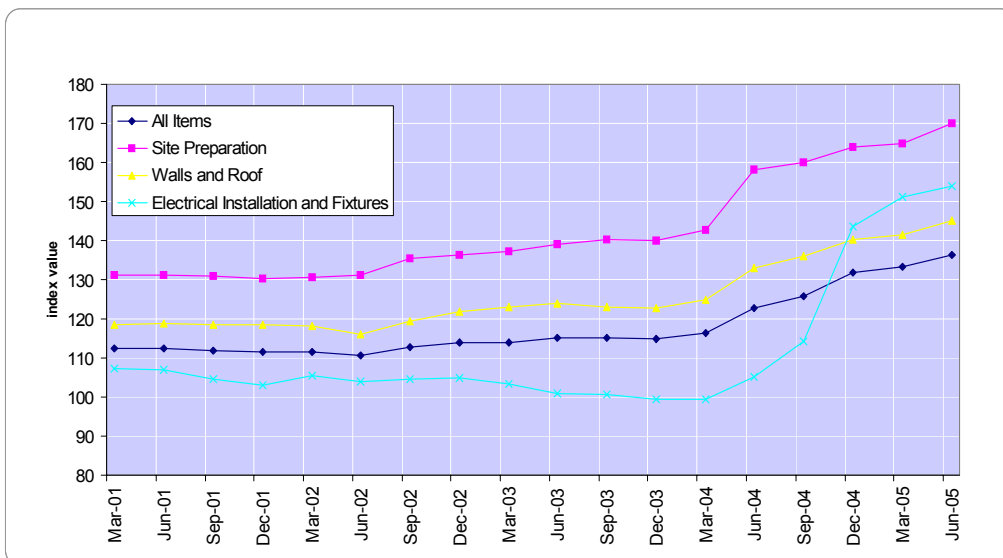
**Chart 6:  
Trends in Labour Force and Unemployment**



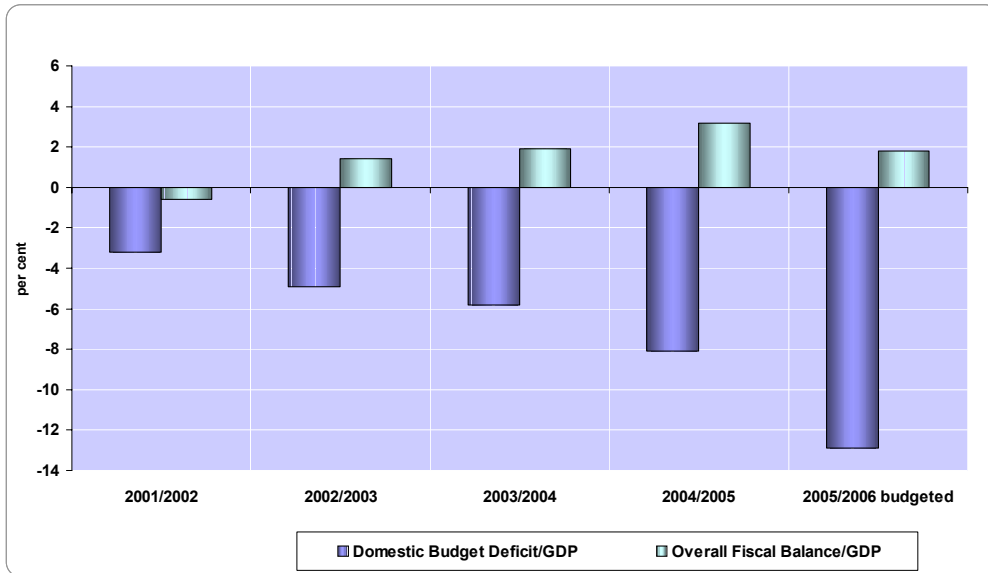
**Chart 7:  
Index of Retail Prices - 12-month per cent change**



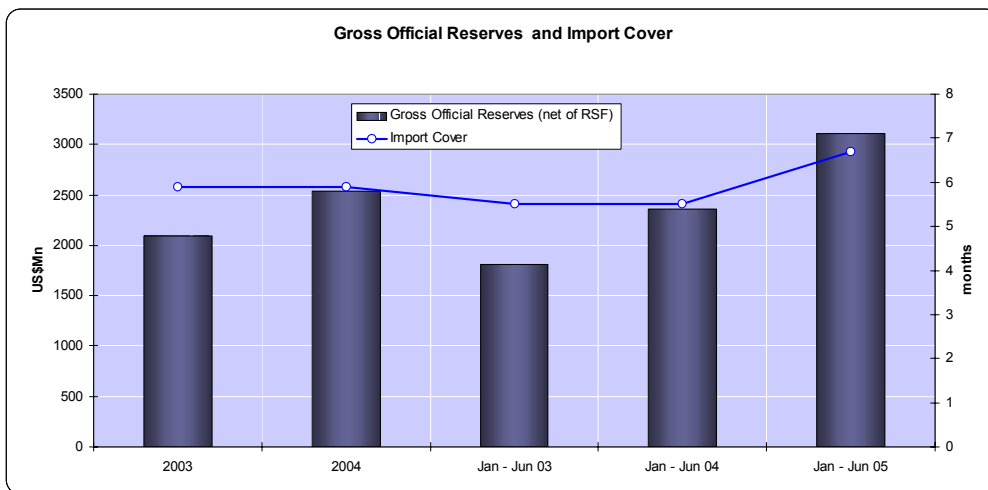
**Chart 8:  
Index of Retail Prices of Building Materials**



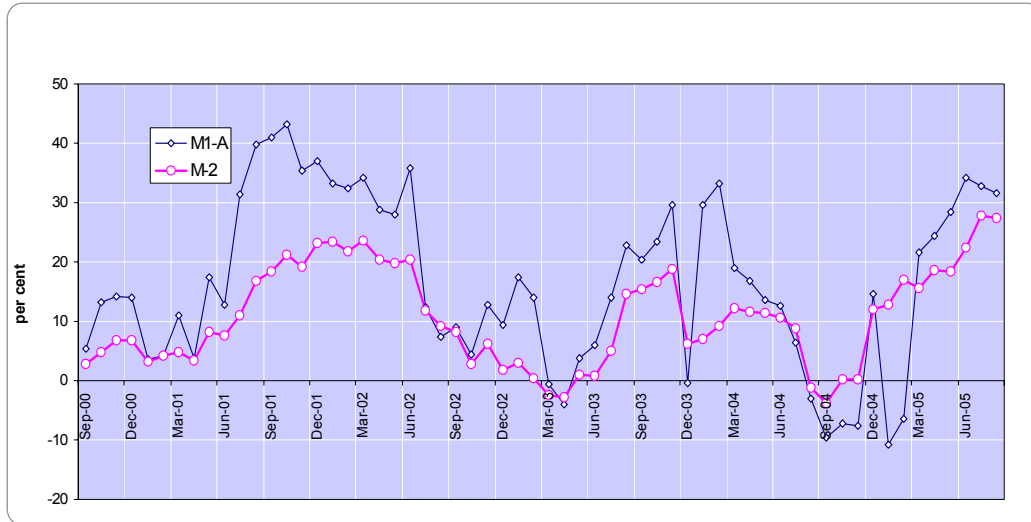
**Chart 9:  
Domestic Budget Deficit and Overall Fiscal Balance to GDP**



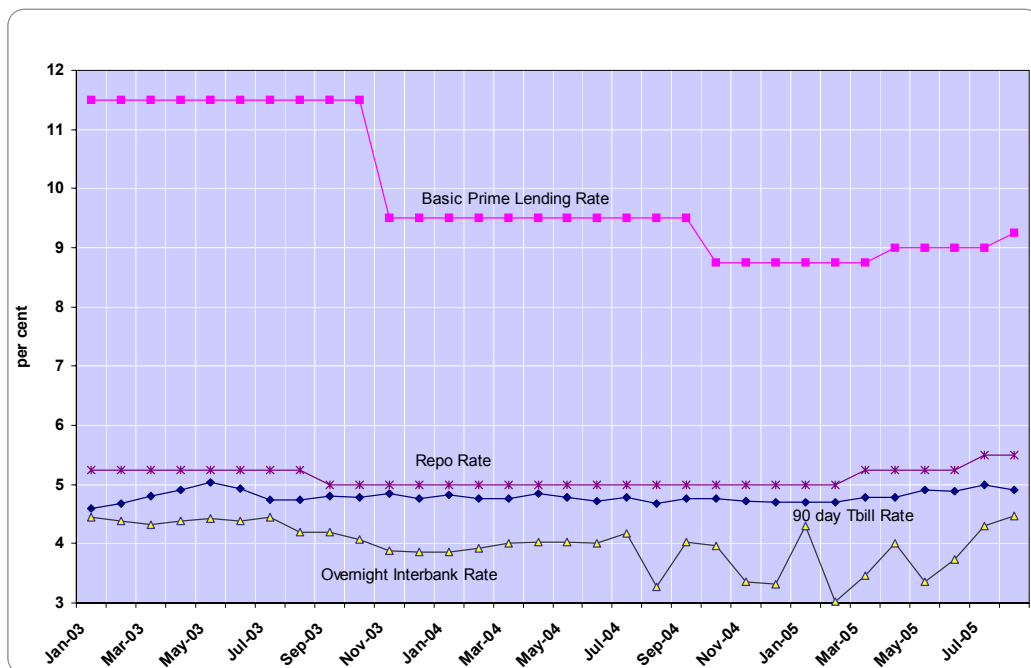
**Chart 10:  
Gross Official Reserves and Import Cover**



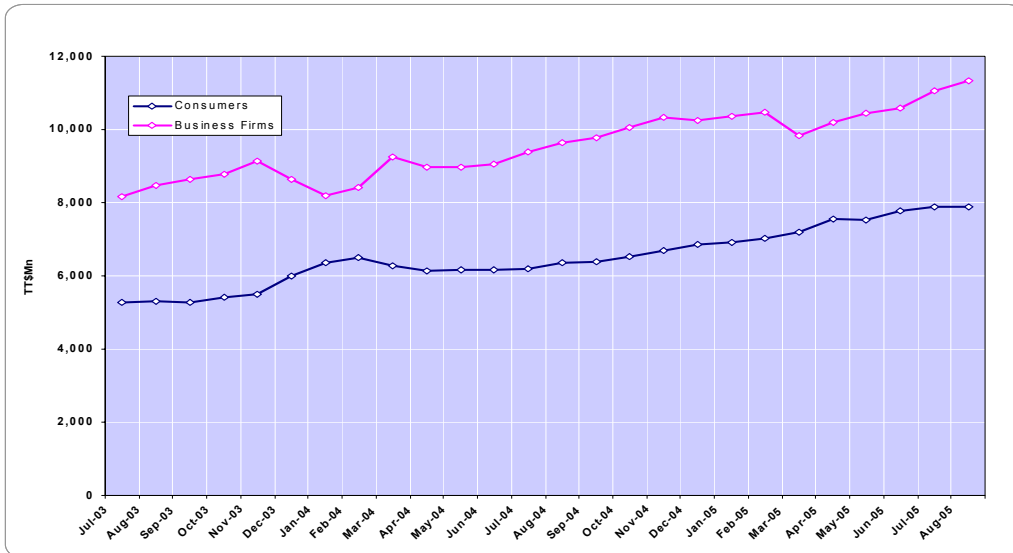
**Chart 11:  
Monetary Aggregates (Year-on-Year per cent changes)**



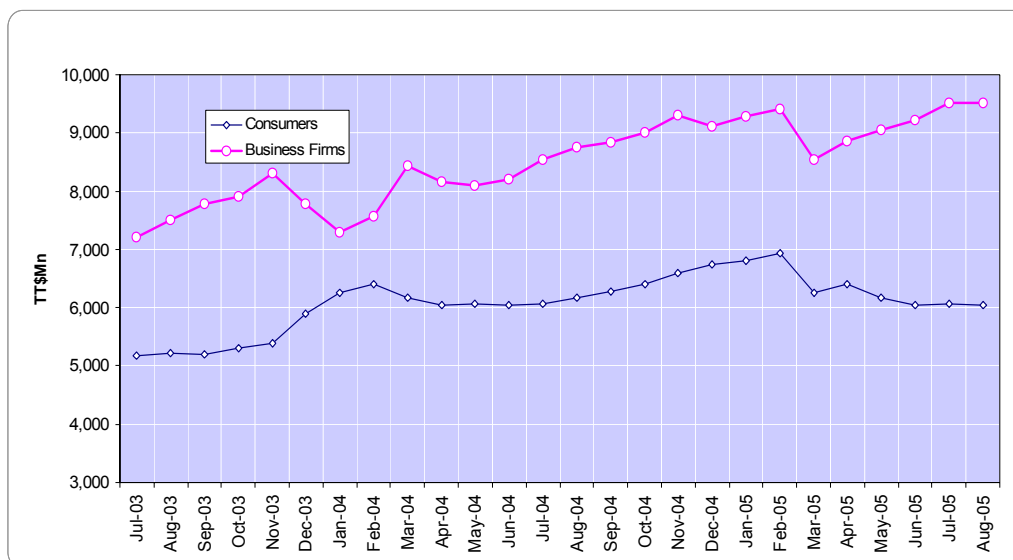
**Chart 12:  
Selected Interest Rates**



**Chart 13:  
Deposit Taking Institutions: Credit to  
Consumers and Business Firms**

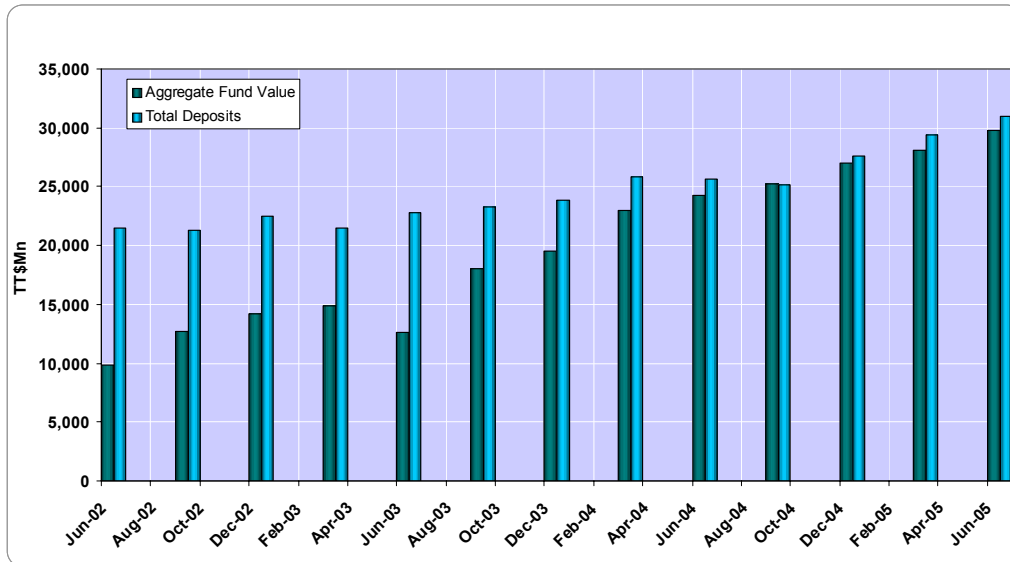


**Chart 14:  
Commercial Banks: Credit to Business and Consumers**

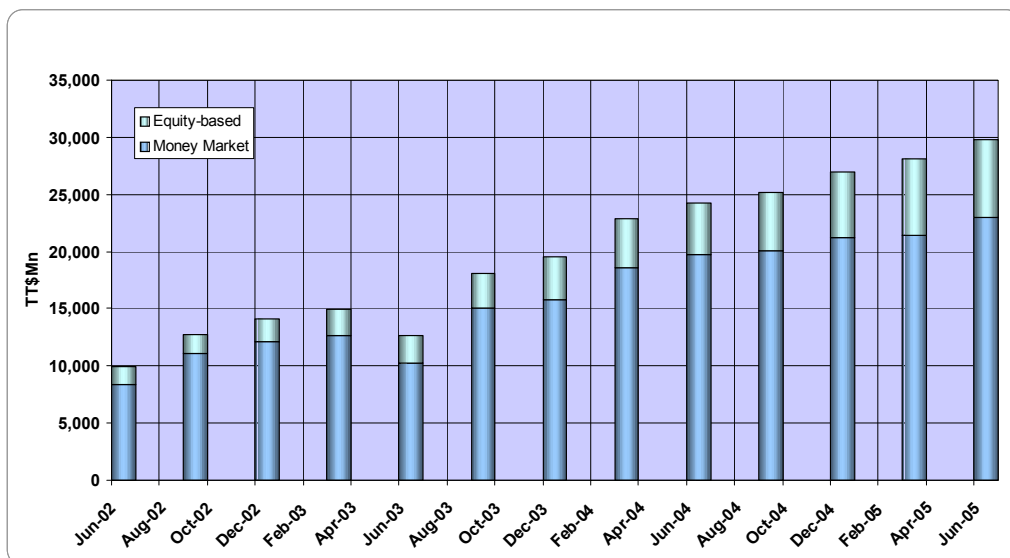




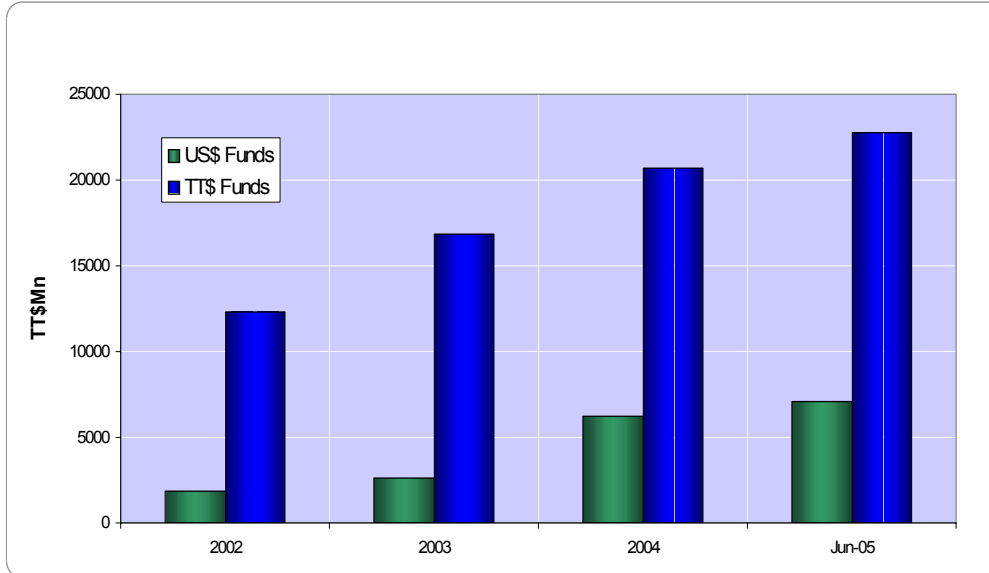
**Chart 15:  
Mutual Funds under Management and  
Commercial Banks' Deposits**



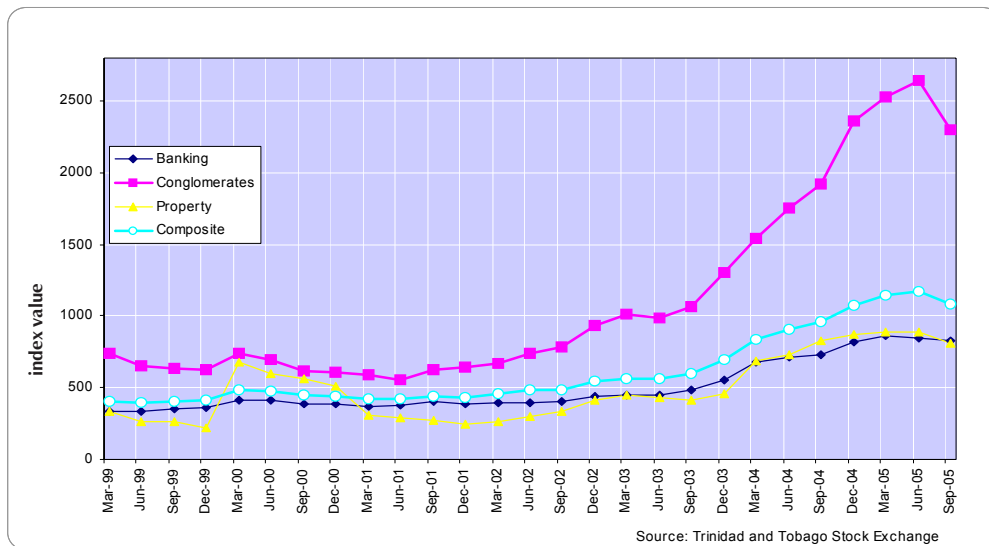
**Chart 16:  
Mutual Funds: Aggregate Fund Value**



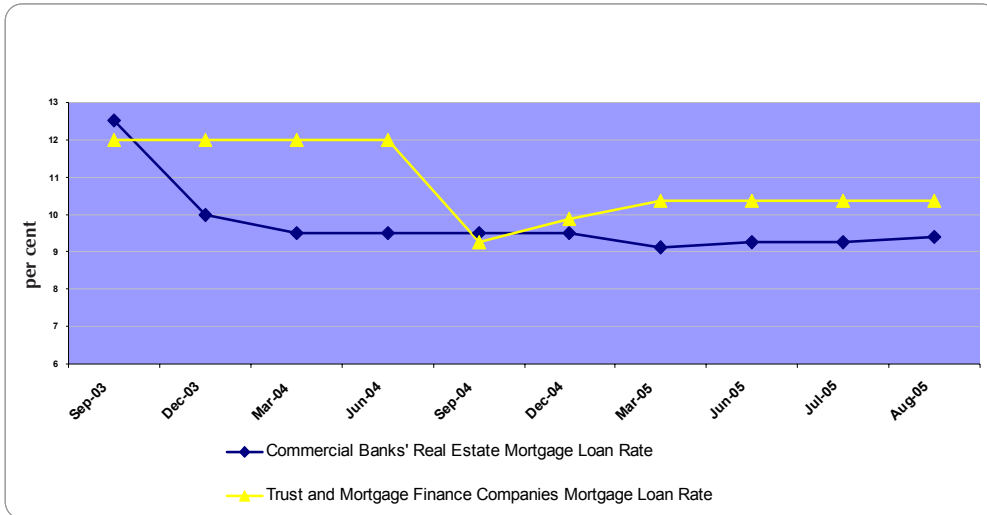
**Chart 17:  
Mutual Funds by Currency Denomination**



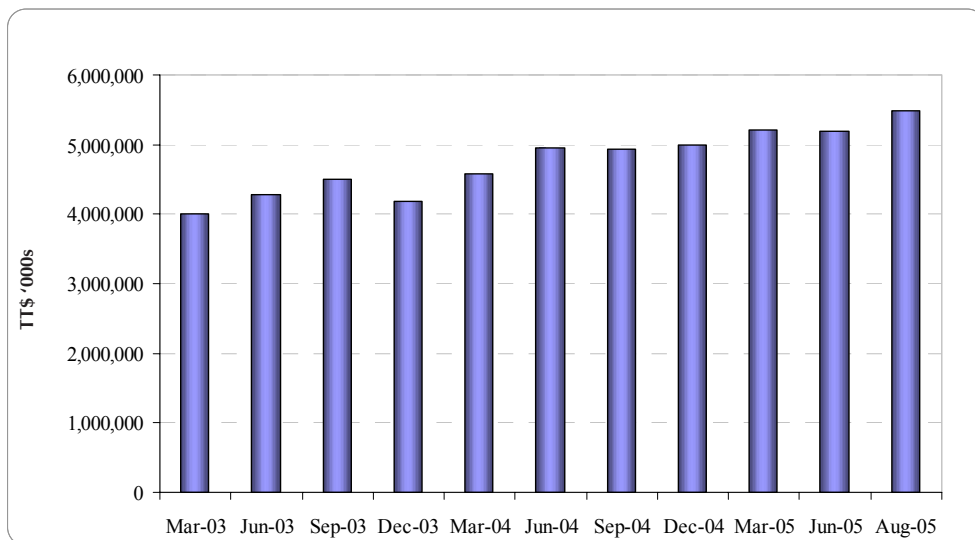
**Chart 18:  
Trinidad and Tobago Stock Price Indices**



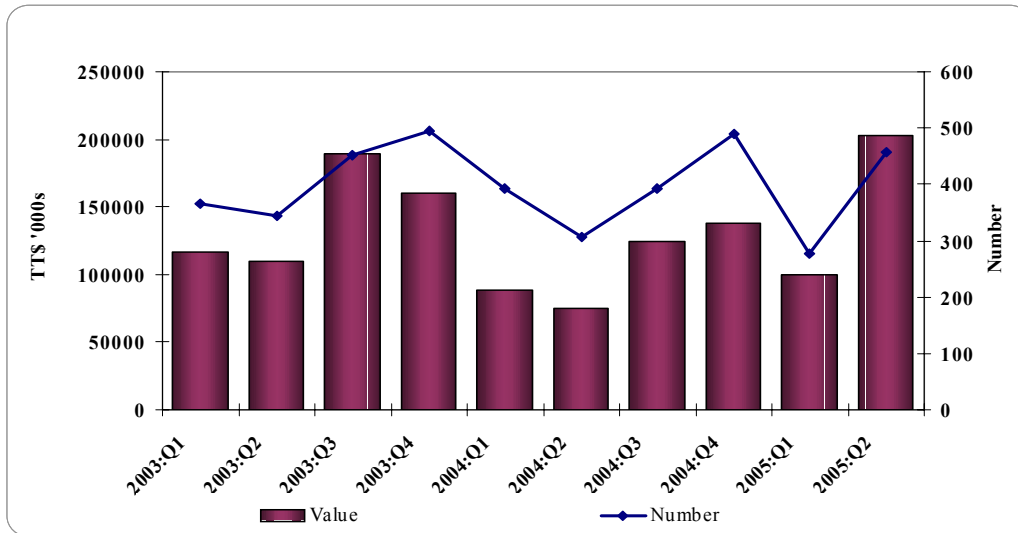
**Chart 19:  
Commercial Banks and Trust Companies  
Real Estate Mortgage Loan Rates**



**Chart 20:  
Deposit Taking Institutions Mortgage Loans Outstanding (\$'000s)**



**Chart 21:  
New Real Estate Mortgage Approvals: Commercial Banks and  
Trust and Mortgage Companies**



# Monetary Policy Report

## Appendices:

### Media Releases on the 'Repo' Rate from June 2005 to October 2005

- 1 *Media Release dated June 17, 2005 -*  
Central Bank Maintains Overnight 'Repo' Rate at 5.25 Per cent
- 2 *Media Release dated July 22, 2005 -*  
Central Bank Raises 'Repo' Rate By 25 Basis Points
- 3 *Media Release dated August 19, 2005 -*  
Central Bank Maintains Overnight 'Repo' Rate At 5.50 Per cent
- 4 *Media Release dated September 23, 2005 -*  
Central Bank Raises 'Repo' Rate To 5.75 Per cent
- 5 *Media Release dated October 21, 2005 -*  
Central Bank Maintains 'Repo' Rate at 5.75 Per cent



CENTRAL BANK OF  
TRINIDAD & TOBAGO

POST OFFICE BOX 1250 PORT-OF-SPAIN, TRINIDAD, WEST INDIES  
TELE: 625-4835, FAX: (868) 623-1955  
E-Mail Address: info@central-bank.org.tt

## Media Release

### CENTRAL BANK MAINTAINS OVERNIGHT 'REPO' RATE AT 5.25 PER CENT

The Central Bank has decided to maintain its 'repo' rate at 5.25 per cent, having increased the rate by 25 basis points in March 2005.

Headline inflation which had risen to 7.34 per cent (year-on-year) in March has declined for two consecutive months to 6.48 per cent in May. The decline reflects the behaviour of food prices whose year-on-year increase has come down from 25.6 per cent in March to 21.5 per cent in May. Vegetable prices, a major component of the food prices sub-index, have declined over the period.

Core inflation, which excludes the impact of food prices, has also demonstrated a slow but steady decline from 2.83 per cent in January 2005 (year-on-year) to 2.59 per cent in May.

The increase in the 'Repo' rate in March 2005 was followed by a corresponding rise in commercial banks' prime rate. The general increase in lending rates seems to have resulted in some levelling off in bank credit growth without any significant slowing down in activity in the non-energy sector.

The net fiscal injection has remained relatively high in May. However, government bond placements combined with Central Bank's open market operations and sales of foreign exchange helped to offset this injection. Under these conditions, short term interest rates remained relatively unchanged with the yield on three-month treasury bills at around 4.8 per cent and the inter-bank rate hovering between 4.15 and 4.25 per cent.

During May, there were intermittent periods of tightness in the foreign exchange market on account of strong demand for capital transactions and delayed inflows. The Central Bank supported the market in the interim by selling US\$50 million. The buying and selling rates for the US dollar averaged 6.2207 and 6.2999 respectively, during May 2005. With the end of the quarter approaching, the foreign exchange market is expected to stabilise as energy sector tax payments come into the system.

The Central Bank will continue to keep monetary conditions under close review.

The next 'Repo' rate announcement is scheduled for July 22, 2005.

**June 17, 2005**

-END-



CENTRAL BANK OF  
TRINIDAD & TOBAGO

POST OFFICE BOX 1250 PORT-OF-SPAIN, TRINIDAD, WEST INDIES  
TELE: 625-4835, FAX: (868) 623-1955  
E-Mail Address: info@central-bank.org.tt

## Media Release

### CENTRAL BANK RAISES 'REPO' RATE BY 25 BASIS POINTS

The Central Bank has decided to increase its 'Repo' rate by 25 basis points from 5.25 per cent to 5.50 per cent with effect from July 22, 2005. This rate was last changed in March 2005.

The most recent data released by the Central Statistical Office indicate that, after two consecutive months of decline, headline inflation in June (year-on-year) edged upwards to 6.58 per cent from 6.48 per cent in the previous month. Core inflation was also slightly higher rising to 2.64 per cent in June (year-on-year) from 2.59 per cent in May. The increase in core inflation was in the housing component of the Retail Prices Index.

The decision to raise the 'Repo' rate was made against the background of the following developments:

- (i) The announced increase in cement prices, adverse weather conditions and the difficulties at the port could create further price pressures in the coming months;
- (ii) While Government spending has been lagging behind budget projections, the recent passage of supplementary expenditures by the Parliament, if fully implemented, could signal an increase in fiscal pressures;
- (iii) Interest rates have continued to rise in the US, reducing the spread with local interest rates;
- (iv) Foreign exchange demand has been stronger than usual in recent weeks, in part, due to identified capital transactions.

The above factors could add to inflationary expectations and justify the need for tightening bank liquidity and provide a corresponding signal through the policy interest rate.

The next 'Repo' rate announcement is scheduled for **August 19, 2005**.

**July 22, 2005**

- END -



## CENTRAL BANK OF TRINIDAD & TOBAGO

POST OFFICE BOX 1250 PORT-OF-SPAIN, TRINIDAD, WEST INDIES  
TELE: 625-4835, FAX: (868) 623-1955  
E-Mail Address: [info@central-bank.org.tt](mailto:info@central-bank.org.tt)

# Media Release

## CENTRAL BANK MAINTAINS OVERNIGHT 'REPO' RATE AT 5.50 PER CENT

The latest available data suggest that the economy continues to experience inflationary pressures.

- Headline inflation in July (on a twelve-month basis) was 7.3 per cent, compared to 3.3 per cent one year earlier. While this increase mainly reflected the surge in food prices, aggravated by the recent floods, there have also been increases in a range of other components of the Retail Prices Index. Core inflation continues to hover around 2.7 per cent in the first seven months of the year, compared to 1.3 per cent in the corresponding period last year.
- As interest rates in the U.S. continue to rise, there has been a narrowing in the spread between US and TT dollar short-term interest rates. As at end of July 2005, the spread was 1.5 per cent, compared to 3.3 per cent one year earlier.
- Net fiscal injections remain high, boosting liquidity in the financial system.
- Pressures in the foreign exchange market persist related to large capital transactions, the liquidity overhang and the declining interest rate spreads.

The Bank is addressing the liquidity and foreign exchange challenges through open market operations and foreign exchange sales.

- MORE -



- 2 -

Notwithstanding the above considerations, the Central Bank has opted to keep the 'Repo' rate at 5.50 per cent, the level to which it was raised in July. Commercial banks have recently adjusted their prime lending rates from 9.00 per cent to 9.25 per cent and the Bank considers it prudent to monitor the effects of these changes as they work their way through the system.

The Bank will continue to keep monetary conditions under close review.

The next 'Repo' rate announcement is scheduled for September 23, 2005.

**August 19, 2005**

- END -



## CENTRAL BANK OF TRINIDAD & TOBAGO

POST OFFICE BOX 1250 PORT-OF-SPAIN, TRINIDAD, WEST INDIES  
TELE: 625-4835, FAX: (868) 623-1955  
E-Mail Address: info@central-bank.org.tt

# Media Release

## CENTRAL BANK RAISES 'REPO' RATE TO 5.75 PER CENT

The Central Bank has decided to increase the 'Repo' rate by 25 basis points from 5.50 per cent to 5.75 per cent with effect from September 23, 2005. This decision has been taken against the background of relatively high liquidity in the domestic economy, further narrowing in the differential between TT and US short term interest rates and signs of persistent inflationary pressures.

The latest available data released by the Central Statistical Office indicate that headline inflation, which measured 7.3 per cent to August 2005 (year-on-year), was relatively unchanged from the previous month. Core inflation, which had been relatively steady for the past four months at around 2.6 per cent, inched up to 2.7 per cent in the twelve months to August 2005. The increase in core inflation was largely in the medical goods and services category.

Liquidity conditions have remained relatively high in the domestic financial system. To absorb this liquidity, the Bank has continued to increase its open market operations. Credit to the private sector, which had been levelling off earlier in the year, increased sharply by 17.1 per cent on a year-on-year basis to July 2005 from 9.3 per cent a year earlier. Consumer credit, which grew by 27.4 per cent year-on-year, was the main factor contributing to this expansion.

The recent increase in the Fed Funds rate has caused the spread between US and TT short term rates to narrow to 1.4 percent compared with 3.1 percent in August 2004. This reduction in the spread is making it more convenient for some firms to borrow locally to fund their acquisition of foreign assets. This factor is contributing to the increasing demand for foreign exchange. The Bank has been supporting the foreign exchange market through increased sales. Following discussions with the commercial banks, the Central Bank is now selling foreign exchange on pre-determined dates in order to provide greater certainty to the market.

The Bank will continue to monitor developments in the external and domestic markets and will keep monetary conditions under close review.

The next 'Repo' rate announcement is scheduled for October 21, 2005.

**September 23, 2005.**

-END-



## CENTRAL BANK OF TRINIDAD & TOBAGO

POST OFFICE BOX 1250 PORT-OF-SPAIN, TRINIDAD, WEST INDIES  
TELE: 625-4835, FAX: (868) 623-1955  
E-Mail Address: info@central-bank.org.tt

# Media Release

## CENTRAL BANK MAINTAINS 'REPO' RATE AT 5.75 PER CENT

The Central Bank will maintain the 'Repo' rate at 5.75 per cent.

The latest statistics released by the Central Statistical Office indicate a slight deceleration in the rate of inflation on a year-on-year basis to September. **Headline inflation** measured 6.9 per cent year-on-year in September 2005, slightly down from the 7.3 per cent figure reported in August 2005. **Food prices** registered a year-on-year increase of 23 per cent, slightly below the increase of 25 per cent recorded for August. **Core inflation** held steady at 2.6 per cent.

Since the beginning of 2005, the Central Bank has started a shift to a less accommodating monetary policy stance. During the year, the Bank increased **its policy interest rate (the 'Repo' rate)** on three occasions from 5.0 per cent to 5.75 per cent.

Correspondingly, the **commercial banks' prime lending rates** have increased from 8.75 per cent to 9.50 per cent. **Money market rates**, as well as **long-term interest rates**, have also increased markedly over the period. While there continues to be signs of strong underlying inflationary pressures, the Central Bank would like to assess the impact of the past changes before taking additional action.

The evolution of monetary policy over the next several months would need to take into account:

- (i) the fiscal stance envisaged in the 2006 budget;
- (ii) the developments in the foreign exchange market;
- (iii) and other factors, such as developments in incomes policy and food prices.

The Bank will continue to monitor developments in the external and domestic markets and will keep monetary conditions under close review.

The next 'Repo' rate announcement is scheduled for **November 25, 2005**.

**October 21, 2005.**

- END -

**Correspondence relating to the Monetary Policy Report should be addressed to:**

**Manager  
Research Department  
Central Bank of Trinidad and Tobago  
P.O. Box 1250  
Port-of-Spain  
Trinidad**

**© Copyright 2005 Central Bank of Trinidad and Tobago**

