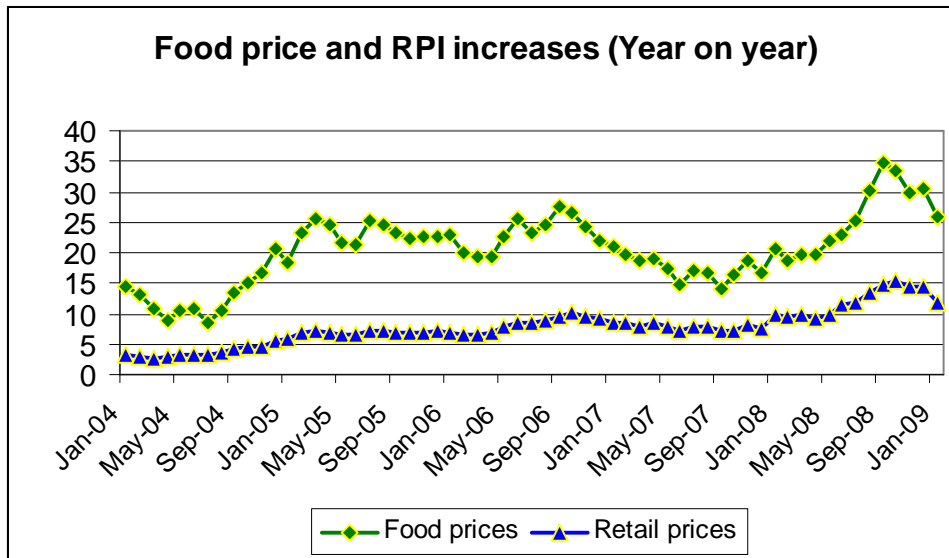


Time for a Policy Change?

The citizens of Trinidad and Tobago had a lot to be boastful about. During the period 2000-2007, the Trinidad and Tobago economy grew on average by approximately 8% each year mainly on account of higher international energy prices. At the end of 2007, the unemployment rate reached a historic low of 4.5% while government revenues soared as oil and natural gas prices rose to unprecedented highs. Net official reserves stood at US\$ 9 billion by the end of 2008 which represented 11 months of import cover for our vibrant twin island state. With rising incomes and falling unemployment, total fiscal expenditure was consistently increased and this was accompanied by an environment of rising consumer prices.



Indeed, the initial spike in the inflation rate (above the Central Bank’s ceiling of 5% in 2004 as measured on a year to year basis) coincided with the dramatic increase in West Texas Intermediate oil and Henry Hub gas prices to above US\$40 per barrel and US\$5.96 per thousand cubic feet respectively in 2004 from US\$31.08 per barrel and US\$5.64 per thousand cubic feet in the previous year.

Since 2005, there have been substantial increases in food prices. This had been a major contributing factor to the rise in headline inflation which first rose to double digits (October 2006) during the five year period January 2004 to January 2009. Food prices have consistently increased since the mid 1990’s but the pace of increase escalated in the past few years due to increased import dependency and a continued reduction in domestic agricultural output.

The persistent and continued rise in global agricultural prices during the period 2005-2007 coupled with Trinidad and Tobago's high import dependency have exerted significant upward pressure on the food component of the Retail Price Index (RPI). Global food prices were rising due to a number of factors namely extreme weather conditions which were affecting crop yields and the shift to grain based ethanol as an alternative source of fuel (which in turn affected the prices of other commodities such as meat, dairy and chicken).

While on the domestic front, agricultural output registered declines in the last three years as farmers struggled with rising costs, labour and raw material shortages, poor drainage systems and praedial larceny placing further strain on domestic price levels. The closure of Caroni 1975 Limited in 2005 seems to have occurred simultaneously with declines in agricultural output. During the period March 2006 to March 2007, agricultural output declined significantly by 19.1% with output contracting even further by 13.5% in the following twelve months. It can therefore be deduced that the closure of this entity had a negative impact on agricultural production and therefore would have contributed to the high inflationary pressures in the domestic economy.

Although the year on year inflation rate started to trend downward after October 2006 (mainly due to the Central Bank's restrictive monetary policies which began a year earlier), it remained above the Central Bank's acceptable limit posing a threat to the macroeconomic stability of the economy. As a result, the Central Bank intensified its efforts using a number of different policy instruments to rein in inflation with incremental increases in the Repo rate being its main policy tool.

Furthermore, at the beginning of 2008 when the inflation rate started trending dangerously upwards again, the Central Bank began using stringent policy measures like raising the reserve requirement applicable to commercial banks to complement its other policy measures. However, despite the fact that core inflation was rising, this monetary policy tightening stance was virtually ineffective since rising prices occurred mainly as a result of output constraints and imported inflation.

By mid 2008, as the global economy sank into a recession, international commodity prices declined dramatically as global demand fell. However, inflation continued its steep ascent in the latter half of 2008 in the domestic economy and peaked in October reaching 15.4% as retailers quoted high inventory levels as the reason for the delay in the “pass through” effects of the decline in international commodity prices.

However, at the beginning of 2009, as global commodity prices continued to decline and the domestic economy continued to display signs of weakening, headline inflation in the local economy also began to soften. In January 2009, headline inflation stood at 11.65% from a year earlier with the Central Bank opting to maintain its tight monetary stance.

In the ensuing months, as the global economy continues to struggle with a deepening recession and local businesses and consumers reduce their spending even further, it can be inferred that there will be further reductions in the rate of increase in the Retail Price Index.

With the economy at this turning point as evidenced by lower inflation and a continued slowing in economic activity, the Central Bank may be forced to adopt a more relaxed monetary policy stance to support growth in the onshore economy. While the Central Bank may be hesitant to reduce the Repo rate due to exchange rate stability concerns in a period of declining export earnings, it is expected that the Bank will adjust its indicative rate in the near future as the need to create an environment that facilitates economic growth becomes more of a priority.