Global Economic Shocks: Challenges for the Trinidad and Tobago Economy

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Presented at the

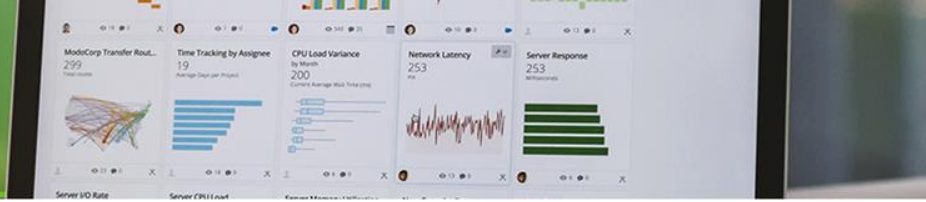
Ministry of Finance

Spotlight on the Economy 2022

September 2, 2022

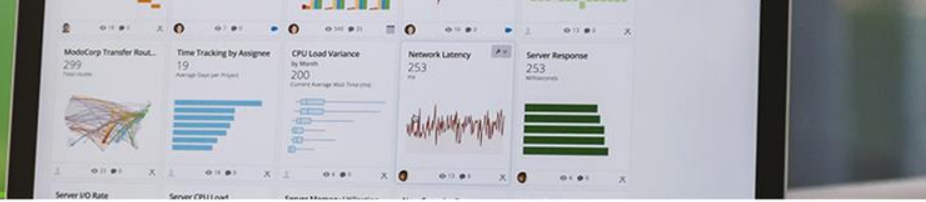
Hyatt Regency Hotel

OVERVIEW OF PRESENTATION



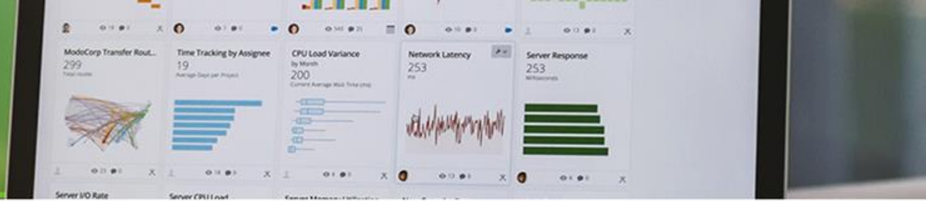
- The Unprecedented Nature of Recent International Shocks
- The Impact on Trinidad and Tobago
- The Policy Response: From Crisis Management and Stabilisation to Recovery and Growth

Recent Global Shocks



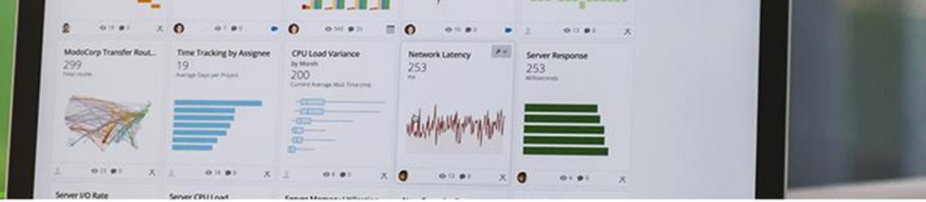
- Over the period 2007-2022 the global economy has experienced the most difficult period since the end of WW2
  1. The global financial crisis (GFC) – Most costly financial crisis since the great depression
     - The fallout from that crisis had a significant negative impact on growth in Caribbean countries
     - This impact was also relatively long-lived since the global economy continued to be plagued by sovereign debt problems in Europe and episodic volatility in financial markets which resulted in a situation where recoveries in growth were prone to reversals
     - CL Financial
  2. The pandemic
     - The pandemic struck when many countries were still plagued by problems related to the legacy of the GFC
     - The unique nature of this crisis - psychological impact manifested in intense risk aversion in key sectors and resulted in a collapse in output in almost every country
     - Unprecedented policies – lockdown costs, government expenditure interventions and the moral obligation to support groups dislocated by the lockdown
  3. The Russia/Ukraine war broke out just as the global economy appeared to be emerging from the shadow of the pandemic, prolonging and accentuating problems with global supply chains, volatility in commodity markets and inflation
- Global growth is now expected to slow to 3.2% in 2022 from 6.1% in the previous year but there are scenarios where growth can fall to 2.6% in 2022 and further to 2.0% in 2023 if certain risks materialize. The economic fallout from these developments include
  - Significant increase in sovereign debt
  - Sharp increases in inflation which is having a serious negative impact on living standards - governments have had to tighten monetary policy while providing targeted support to the vulnerable
  - The long duration of the pandemic, the emergence of new COVID 19 variants and now the impact of the R/K war is causing permanent scarring to productive capacity amongst developing countries
  - There is also a significant probability for financial market volatility caused by rapid shifts in investor sentiments in the context of over-extended international financial asset prices
  - Increasing cyberattacks as automation and virtual work arrangements becomes more entrenched

The Impact of Economic Shocks



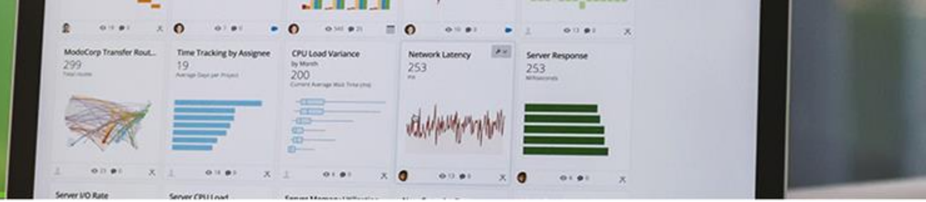
- The economic performance of T&T in the post-GFC era must be viewed in the context of these unprecedented shocks since it’s a small highly open economy heavily influenced by international commodity prices
- The cumulative impact of these global mutually reinforcing economic shocks accentuated pre-existing vulnerabilities in the Caribbean and has led to under-performance relative to earlier periods and to peers
- Trinidad and Tobago is in a similar situation where the cumulative impact of these shocks and challenges in the dominant energy industry have led to a number of macroeconomic problems
  - Weak economic growth for an extended period culminating in a deep recession in 2020
  - The worsening of the government’s financial position
  - The weakening of the balance of payments, higher sovereign debt and a decline in international reserves
  - Elevated risks in the financial sector
  - Rising unemployment
  - Rising inflation caused by increases in commodity prices, supply bottlenecks and increased freight charges

The Policy Response



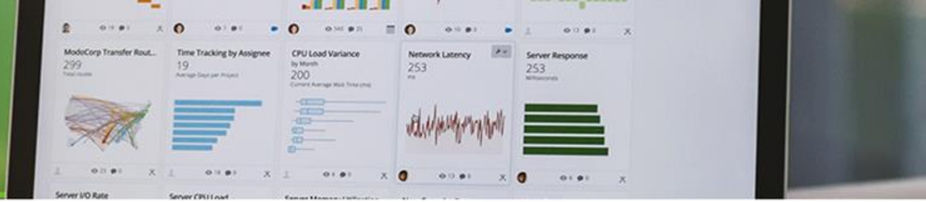
- The policy strategy in response to economic crisis usually involves a stabilisation phase followed by a recovery and growth stage
- Fiscal consolidation was inevitable given the sharp drop in revenue but further cuts are not advisable going forward since expenditure now seems to be at the lowest level compatible with the smooth functioning of a modern economy – further adjustments should now be made on the revenue side by improving the efficiency of the systems for tax collection complemented by better expenditure efficiency
- The decision not to use the exchange rate at this time to drive adjustment is also the right decision since this is subject to high downside risks and this approach may not work as intended, especially during a period when agents are highly risk averse
  - Could actually generate perverse results for growth and welfare
    - Increased income inequality has negative consequences for growth
    - ER changes is unlikely to generate increased exports in T&T given the market for our main exports
    - ER based stabilisation tend to lead to significant reduction in social welfare
  - Would introduce an added complexity making the adjustment process more difficult to manage
  - The physiological and behavioural economics aspects of exchange rate changes and the foreign exchange market would set in train speculative pressures that monetary authorities would find difficult to control
  - A particular ER is optimal conditional on other factors such as fiscal policy, monetary policy, trade policy, capital flows and international economic conditions, especially the policy stance of the dominant economy to which you are anchored - You can change the real exchange rate without necessarily changing the nominal exchange rate

The Policy Response



- Increased levels of debt is unavoidable in the short-term to help sustain aggregate demand
  - Most countries have had to resort to borrowing to smooth the response to the GFC and the pandemic
  - To do otherwise may cause some parts of the economy to atrophy which will hamper the recovery process and add to the structural economic problems faced in the medium to long term
  - The total debt level is above the 60% benchmark but we still have relatively low external debt obligations
  - The latest advice from the IMF to its member countries is to use debt where its still possible to sustain economic activity
  - The development finance community has created many instruments in the wake of the 2007/2008 crisis which can be used for emergency financing with little or no conditionality to meet revenue shortfalls and to boost reserves

The Policy Response



- Very importantly, the domestic financial system has weathered the shocks relatively well because of unprecedented interventions by regulators, governments, international financial institutions and private market participants
- International and regional cooperation has been used to good effect to help deal with the crisis
- A relatively strong international reserve buffer has helped

The Unfinished Reform Agenda

- We have done a relatively good job of stabilisation but we have lagged behind in terms of the supply side response to capitalise on this good foundation – little guidance in this area from multilateral institutions so we need indigenous and innovative solutions
  - Improve the ease of doing business
  - Incentivize entrepreneurial behaviour
  - Systematically reduce import intensity
  - Redouble efforts to increase economic diversification
  - Improve productivity
  - Accelerate Fintech adoption
- Enhance systems for cross-border payments and remittances – Deal with the de-risking threat
- Improved international cooperation and better leveraging of multilateral assistance
- Deal more frontally with inequalities which have serious implications for sustainable growth, as well as, social and political stability – These are sometimes undervalued in economic adjustment discussions but they are key ingredients for a sustainable and robust economy

THANK YOU FOR YOUR ATTENTION

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