Vol. 1, No.1

# ROAD TO PROSPERITY NEWSLETTER

## Statement

The Center for Economic Renewal, Growth and Excellence (CRECE, for its Spanish acronym) and Intelligent Economics© have partnered to bring to CRECE's members a bimonthly newsletter with economic analysis needed to make informed policy decisions that advance free entrepreneurship and economic freedom. ***The Road to Prosperity Newsletter*** offers concise yet comprehensive analyses to help you make sense of the intricate factors influencing Puerto Rico's economy. From industry overviews to policy impacts, each issue is crafted to be an essential source of information focused on global and United States' trends, but mainly on Puerto Rico's recovery efforts post-Maria and post-COVID.

## Puerto Rico's Macroeconomic Context

The main economic indicators for the first six months of 2023 point to a stable economy. Certain sectors are starting to experience a normalization after two atypical years due to the boost of COVID-19-related financial incentives. Economists and observers have paid close attention to when the island's economy will enter a normalization phase, or whether there will be a recession.

So far, both the mainland and local economies have been able to maneuver towards a "soft landing," a term used by the Federal Reserve (FED) as part of their effort to control inflation without causing a recession.

Since mid-2022, the FED has raised the interest rate eleven times to contain inflation. It is the fastest rate hike in the history of the United States. From its level of 0.75% to 1% in 2021, the FED's benchmark rate currently stands at 5.25%, while the prime rate is at 8.25%. This is the rate that banks use to lend to their customers.

Thanks to these aggressive increases, inflation in the U.S. has been subsiding and is currently at the level of 3.9%. While in Puerto Rico, data from May indicates that inflation has leveled off to 3.5%. In the summer of 2022, inflation reached 9%, the highest point in four decades. It is estimated that inflation will reach its normal historical level of 2% during the second half of 2024.

In the short term, macroeconomic data portrays an economy with some dynamism. Employment is at its highest level since 2012, with a total of 950,000 people employed (adjusted wage employment), and the unemployment rate stands at 6%.

Retail sales have slowed down slightly, as accumulated sales for the first quarter of 2023 have

grown to $6.72 billion, a decrease of 1.8% compared to 2022. However, sectors such as restaurant sales experienced a 6.6% growth to reach $465 million in cumulative sales. Similarly, department store sales are in positive territory with sales of $2.27 billion, representing a 1% increase.

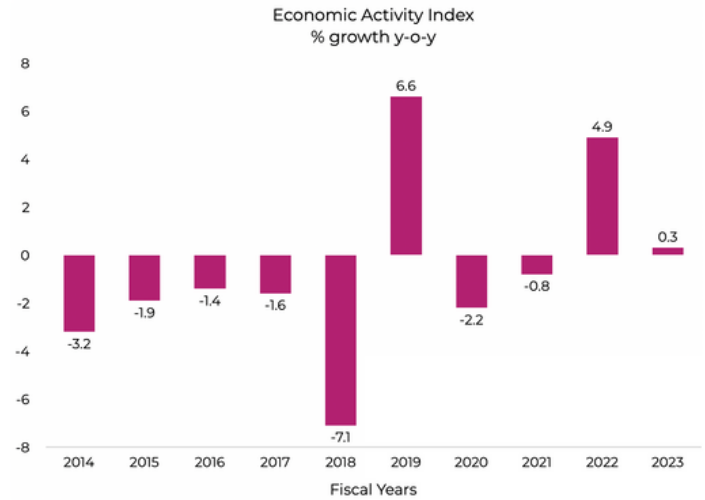
Durable goods sectors such as car and housing sales, have declined due to the increase in interest rates. The cumulative sale of new cars through May 2023 amounted to 51,575, a decrease of 4.3% compared to the same period in 2022 when 53,869 cars had been sold.

Meanwhile, the sale of new and existing houses has cooled off. The total accumulated mortgage loans through May 2023 amounted to 4,271, a reduction of 9.7% compared to the same level in 2022 when 4,728 mortgages had been approved. The average price of new and existing homes stood at $191,609.

| Category | YTD 2019 | YTD 2020 | YTD 2021 | YTD 2022 | YTD 2023 |
|---|---|---|---|---|---|
| General Fund Revenue | 5,038 M | 3,041 M | 3,945 M | 5,290 M | 5,225 M |
| Economic Activity Index % | 2.9 | -3.9 | 2.6 | 4.4 | 0.3 |
| Nonfarm Employment | 879,000 | 832,500 | 862,200 | 916,017 | 945,940 |
| Retail sales | 10,298 M | 8,379 M | 11,136 M | 11,590 M | 11,992 M |
| Inflation % Average YTD | -0.1 | 0.1 | 0.9 | 5.3 | 4.8 |
| Occupancy Rate % Hotels | 66.8 | 34.5 | 63.1 | 67.2 | 66.8 |
| Cement sales | 6,846 | 5,742 | 8,184 | 7,676 | 7,645 |
| Car sales | 41,413 | 21,140 | 55,822 | 53,869 | 51,574 |
| Bankruptcies | 3,805 | 2,617 | 2,046 | 1,936 | 2,051 |
| Gasoline Consumption (M of g) | 381.4 | 360.8 | 354.0 | 362.6 | 350.4 |
| Commercial Banks: Loans | 33,484 M | 34,032 M | 32,466 M | 33,988 M | |

## The Economic Activity Index closes at 0.8% FY2023

The Economic Activity Index, which measures economic growth monthly, grew 0.3% in Fiscal Year 2023 (July 2022-June 2023), after having increased 4.9% in FY2022. This shows the economy is cooling off after increased growth in 2021 and 2022.




The Fiscal Oversight and Management Board (FOMB) and the Planning Board have projected economic growth directly tied to the disbursement of federal funds for the following years. They also estimate that increases in cost of living, construction costs, and the slow disbursement of these funds will impact growth. For FY2023, the Planning Board estimates growth of 1.7%, while the FOMB predicts a more moderate growth of 0.6%.

## Consumers' Expectations Remain High

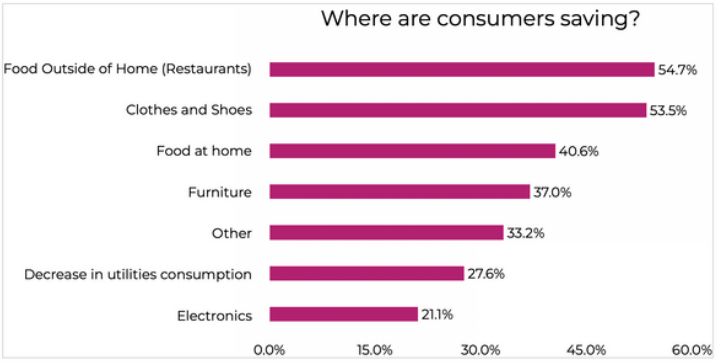
Puerto Rico's consumers have faced financial challenges due to the elevated levels of inflation. A monthly survey of 500 residents conducted by Intelligent Economics & Retail Group assesses consumer expectations about the economy.

The survey shows a positive trend in consumer expectations. In July 2023, 76.3% of Puerto Ricans felt confident about the economy, their finances, and jobs. By contrast, in July 2022, only 58.6% of consumers felt positive, a direct reflection of high inflation levels and fears of recession at the time. Now, inflation seems to be normalizing and the recession averted.

When surveyed by sex, men (77.7%) are generally more confident and positive than women (74.9%). Generationally, 84.6% of Generation Z (18–26-year-olds) are feeling confident compared to their counterparts in Generation X (43-58 years old) where only 67.3% feel positive.

## Where are consumers saving?

Restaurants and entertainment outside of the home continue to be the primary category where consumers cut costs. In July 2022, the top three categories were Clothes and Shoes (44.4%); Restaurants (43.6%); and Other (42%).

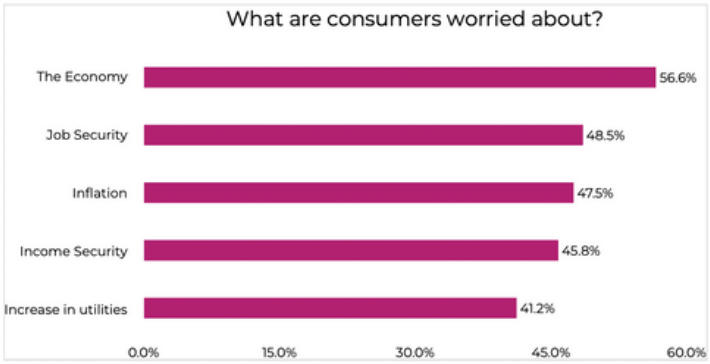



Food for Home continues to scale the ladder in which consumers are cutting costs. Adjustments made by consumers include the size of their shopping bag, changes in products, and labels.

Baby Boomers (58 years old and older) are not cutting costs in restaurants while Gen Z are not eating out. Gen Z are also limiting what they're buying at the supermarket.

## What are consumers worried about?

Over 56.6% of Puerto Ricans are worried about the economy while job security comes in second place.

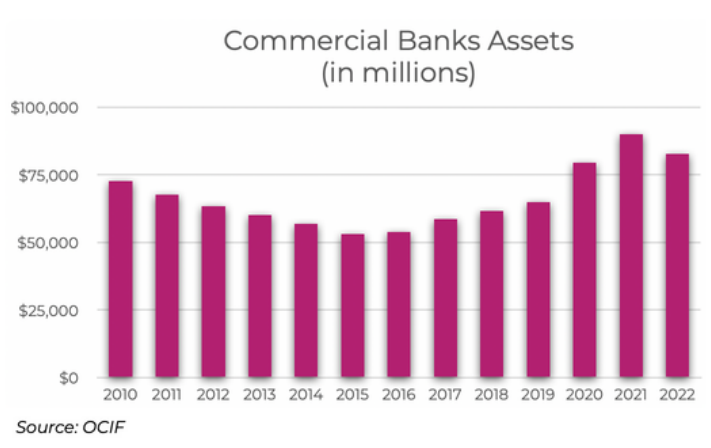


## The financial system remains stable

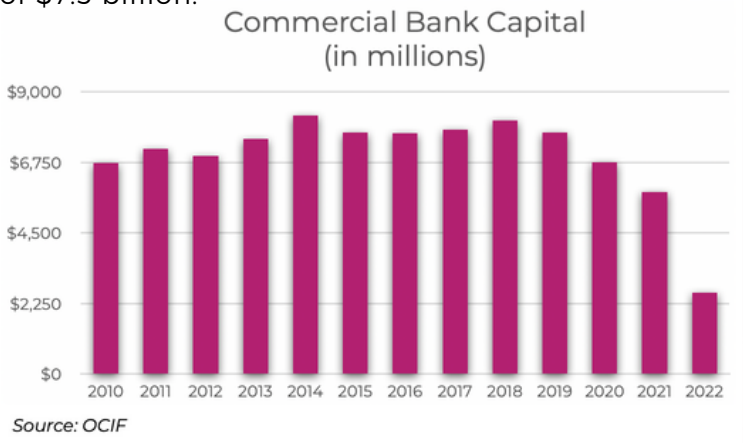
Although aided by the infusion of federal funds, commercial banks in Puerto Rico have been affected by massive economic slowdowns due to the COVID-19 response and elevated interest rates.

A measure to evaluate the banking activity is through their assets, as this considers not only their physical assets but also their vault cash, loans, investments, and securities. Assets for the recent 2022 period reached $82.7 billion, 8.1% lower than the previous year's $90 billion.

While the most recent year demonstrated a reduction in banks' assets, these remain 31.3% higher than the 2010-2020 average of $63 billion. Thus, federal funds not only provided aid for those targeted by the reliefs, but also strengthened commercial banks' overall activity.



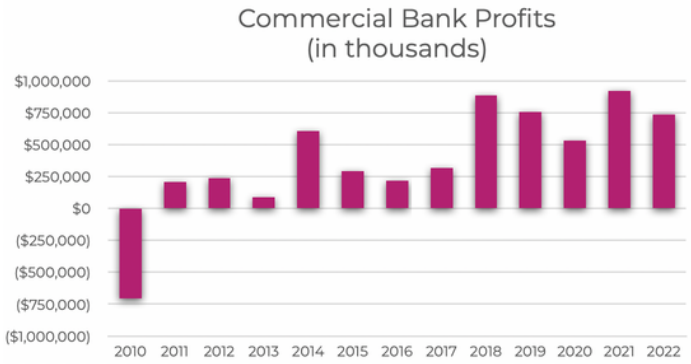

Meanwhile, bank capital allows us to examine the bank's net worth, considering the difference between a bank's assets and its liabilities. During 2022, commercial banks had $2.6 billion in capital which is 55.4% lower than in 2021 when commercial banks' capital was $5.8 billion. Unlike with their assets (which remained 31.3% higher), banks' capital took a massive hit compared to the 2010-20 average of $7.5 billion.




Since commercial banks' capital experienced a reduction, it could be reasonably expected that their profits would have decreased. In 2022, commercial banks obtained profits of $740.1 million, representing19.9% less than the profits generated in 2021 of $924.2 million.

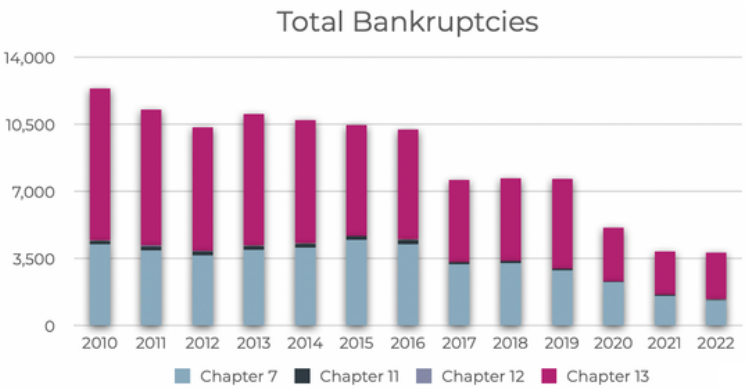
It should be noted, however, that the 2022 banks' profit levels are 136.4% higher than the average values for the 2010-20 period which stood at only $313.2 million in profits.

When these results are observed, it could be inferred that banks have benefited noticeably from federal funds given that profits used to be relatively low until after 2018, when a considerable amount of federal funds started flowing into the island's economy.




Source: OCIF

Since banks have maintained a good performance with the aid of federal transfers, the individuals and businesses that participate in this market could also be expected to be in a better state. In 2022, bankruptcies filed on the island amounted to 3,811, a slight 1.3% decrease when compared to 2021's 3,863 bankruptcies. However, as with bank profits, 2022 bankruptcies reflect a massive 59.9% decrease in comparison with the 2010-20 period, when bankruptcies filed reached 9,504 annually.




Source: US Bankruptcy Court for the District of Puerto Rico

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