Rabobank

Country report

TRINIDAD & TOBAGO

Summary

The hydrocarbon-dependent economy of Trinidad and Tobago was hit hard by the global economic downturn. Oil and gas prices tumbled and one of the country's largest financial conglomerates had to be bailed out by the government. Economic growth turned positive again in 2010 on the back of improving hydrocarbon prices, but remains sluggish as the recovery in the non-oil sector suffers from lost competitiveness. Given the non-energy sector's importance for local employment and domestic demand, the newly elected government will maintain stimulus measures, leading to considerable budget deficits in 2011 and 2012. As these budget deficits will be mainly financed domestically, they will not significantly increase the foreign debt load. Thanks to continuous double-digit current account surpluses, large foreign exchange reserves and a well-endowed sovereign wealth fund, Trinidad and Tobago's external position remains very strong.

Things to watch:

- Hydrocarbon price development
- Competitiveness of the non-hydrocarbon sector

Author: **Fabian Briegel**
Country Risk Research
Economic Research Department
Rabobank Nederland

Contact details: P.O.Box 17100, 3500 HG Utrecht, The Netherlands
+31-(0)30-21-64053
F.Briegel@rn.rabobank.nl

Trinidad-Tobago

National facts	
Type of government	Parliamentary Democracy
Capital	Port-of-Spain
Surface area (thousand sq km)	5
Population (millions)	1.3
Main languages	English
	Caribbean Hindustani
Main religions	Roman Catholic (26%)
	Hindu (23%)
	Anglican (8%)
Head of State (president)	George Maxwell Richards
Head of Government (prime-minister)	Kamla Persad-Bissessar
Monetary unit	T&T dollar (TTD)

Economy		2010
Economic size	*bn USD*	*% world total*
Nominal GDP	28	0.05
Nominal GDP at PPP	19	0.03
Export value of goods and services	15	0.08
IMF quotum (in mln SDR)	336	0.15
Economic structure	*2010*	*5-year av.*
Real GDP growth	1.1	4.7
Agriculture (% of GDP)	1	1
Industry (% of GDP)	59	59
Services (% of GDP)	41	41
Standards of living	*USD*	*% world av.*
Nominal GDP per head	20848	212
Nominal GDP per head at PPP	13850	119
Real GDP per head	14202	177

Social and governance indicators	rank / total
Human Development Index (rank)	59 / 169
Ease of doing business (rank)	97 / 183
Economic freedom index (rank)	52 / 179
Corruption perceptions index (rank)	72 / 180
Press freedom index (rank)	30 / 178
Gini index (income distribution)	40.3
Population below $1.25 per day (PPP)	4.20%

Foreign trade			2009
Main export partners (%)		*Main import partners (%)*	
US	39	US	31
Jamaica	9	Colombia	7
Spain	7	Venezuela	7
Mexico	6	Russia	7
Main export products (%)			*2010*
Fuels			61
Chemicals			31
Manufactures			4
Foods			1
Main import products (%)			
Capital goods			19
Consumer goods			16
Intermediate goods (excl fuels)			15
Other commodities			12
Openness of the economy			
Export value of G&S (% of GDP)			52
Import value of G&S (% of GDP)			31
Inward FDI (% of GDP)			3.0

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

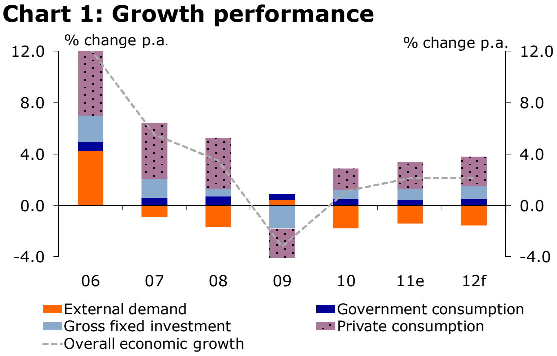
Economic structure and growth

Trinidad and Tobago is a small Caribbean twin island state off the coast of Venezuela. With a nominal GDP of USD 28bn, it is the fourth largest Caribbean economy. Thanks to its extensive oil and gas deposits, Trinidad and Tobago is one of the biggest energy suppliers in the region. Proven and probable oil and gas reserves at 2009 output levels will last for the coming 22 and 15 years, respectively. The hydrocarbon sector dominates the local economy and accounts for about 40% of GDP, with exploration and production generating 23% of GDP. Yet, it only provides 5% of total employment. While crude oil production has been declining since the 1980's, the discovery of vast reserves of natural gas a decade later has laid the groundwork for a broadening of the hydrocarbon sector from the production of crude oil to the extraction and subsequent liquefaction of natural gas. Despite efforts to diversify the economic base away from the hydrocarbon sector, other manufacturing industries' contribution to national income remains limited, which can partly be explained by their deteriorated competitiveness. Food and beverage production constitute the main non-hydrocarbon sectors. Trinidad and Tobago's exports reflect its focus on mineral resources, with fuels and chemicals accounting for 61% and 31% of total exports, respectively. Capital goods represent the most important import category, followed by consumer goods. Besides being a major regional energy supplier, Trinidad and Tobago has become an important local financial hub.
The highly concentrated banking sector of Trinidad and Tobago has weathered the international financial crisis relatively well. Even though one of the Caribbean's largest financial conglomerates, CL Financial Group, had to be bailed out by the government, contagion within the banking system

did not pose a problem. However, some non-regulated non-bank financial institutions experienced some problems because of their exposure to CL Financial Group. Overall, the performance of the non-bank financial sector is worse than that of the banking sector. While the non-performing loan ratio in the regulated banking sector stood at 3.8% in 2010, it amounted to 18% in the non-bank financial sector. Regulation and supervision of this sector by the central bank has to be implemented soon if Trinidad and Tobago wants to avoid a repetition of CL Financial-like problems in the future. In contrast to the weak non-bank financial sector, Trinidad and Tobago's regulated banking sector appears to be relatively healthy. The average capital ratio of the country's three largest banks, which account for 80% of total assets, stood at about 13% in 2010, well above the regulatory minimum capital requirement of 8%. Foreign currency deposits are estimated at about 25% of all deposits. Recently conducted stress tests confirmed the soundness of the banking system as high solvency and liquidity ratios as well as conservative lending practices should limit the banking sector's vulnerability to shocks. Going forward, this stability will likely be maintained on the back of sluggish credit growth resulting from weak economic growth, but the non-regulated non-bank financial sector remains a source of concern.

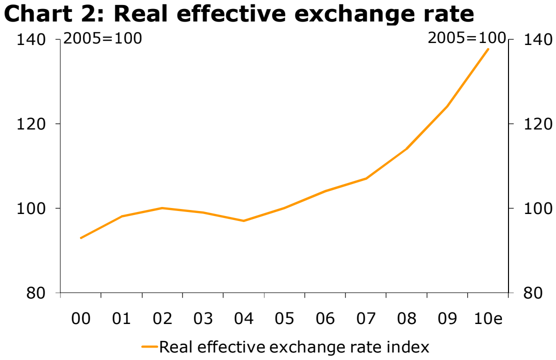
In 2009, economic growth in Trinidad and Tobago turned negative, reaching a level of -3.2%, which was primarily due to falling energy prices and declining domestic demand. As energy prices recovered in 2010, so did the Trinidadian economy, but growth remained limited, especially in the non-hydrocarbon sector. After a 1.1% expansion in 2010, we expect economic growth rates of 2.1% in both 2011 and 2012. As unemployment rates will only decline slightly in the coming years on the back of weak non-energy sector growth, domestic demand growth, the main driver of economic growth in recent years, will be tempered. Besides sluggish regional economic development, part of the explanation for the weak development of the non-energy sectors lies in its worsened competitiveness. In spite of the peg of the Trinidad & Tobago dollar to the US dollar, the country's real effective exchange rate has appreciated by about 40% in the last five years, putting the domestic non-energy sector at a considerable competitive disadvantage.

Chart 1: Growth performance



Source: EIU

Chart 2: Real effective exchange rate



Source: World Bank

Political and social situation

The political outlook for Trinidad and Tobago is stable after Ms. Kamla Persad-Bissessar's centre-left five-party People's Partnership (PP) coalition won the May 24, 2010, early parliamentary elections in a landslide victory. Since her own party, the United National Congress (UNC), enjoys a simple majority in parliament, possible tensions within the governing alliance do not pose a threat to government stability. We expect that the new administration will stick to its predecessor's business-minded policy stance, though social spending aimed at the development of the non-hydrocarbon sector will likely be increased.

Snap elections had been held in May 2010 after former Prime Minister Patrick Manning (People's National Movement, PNM) had asked President George Maxwell Richards to dissolve parliament almost two and a half years before regular elections had been scheduled. Since his popularity was declining strongly on the back of the ongoing recession, rising crime rates and allegations of corruption, Manning had hoped that the opposition would remain in disarray prior to the election date. Miscalculating voter discontent and the speed of unification of the opposition under the leadership of Persad-Bissessar eventually proved detrimental to Manning and his party. The landslide victory of the People's Partnership (PP) coalition marginalized the opposition and initiated a comprehensive restructuring process of the PNM.
Major policy changes due to the transfer of power from the PNM to the UNC-led PP alliance are rather unlikely. Still, in contrast to the previous government, social spending in the fields of education, healthcare and sanitation will be increased as the current government perceives these spending increases essential for the development of the non-hydrocarbon sector. Since the PP alliance won the election on an anti-corruption and anti-crime platform, increased efforts in these fields have been promised. In recent years, violent crime in Trinidad and Tobago has been on the rise as the Caribbean has become an important alternative drug trafficking route to the United States and Europe. Registered murders have increased from 391 in 2007 to 508 in 2009. Even though the implied 2009 homicide rate of 39 murders per 100,000 inhabitants remains below levels seen in Jamaica, it is well above the Caribbean average of 25. The preceding Manning administration's strengthening of border controls and the acquisition of security hardware could not stem this increase in violence since its efforts were undermined by low conviction rates as a consequence of weak law enforcement. The incumbent government has made public security its main policy objective and strives to tackle the problem with a multi-dimensional approach that not only addresses weak law enforcement, but also comprises a restructuring of the educational system and increased attention for white collar-crime.

Economic Policy

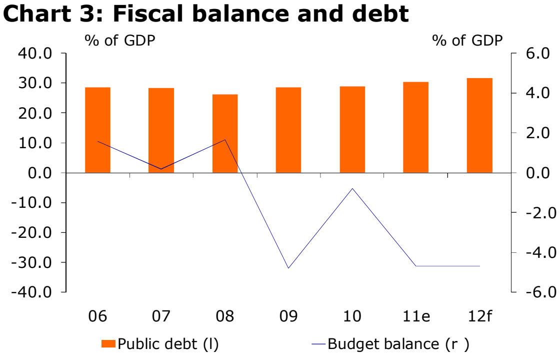
The traditionally strong fiscal stance of Trinidad and Tobago, that was primarily due to windfall gains of the hydrocarbon sector, will deteriorate in the coming years as sluggish economic growth limits tax revenues generated in the non-energy sector and necessitates additional stimulus spending. Still, given higher oil prices amidst continuous tensions in the Middle East, the strong dependence of government finances on oil price developments could mitigate this year's budget deficit.
Benefitting from rising oil and gas prices, previous governments had been able to generate continuous budget surpluses since 2003, but the global financial crisis abruptly ended this trend in 2008. On the back of falling energy prices, the government budget posted a large deficit of 4.8% of GDP in 2009, illustrating the paramount importance of price developments in the hydrocarbon sector for government finances. In 2010, due to substantial spending cuts by the new administration, the budget deficit shrunk to 0.8% of GDP. However, excluding government revenues generated in the energy sector, the 2010 budget deficit amounted to 18% of GDP. Amid fears that the economic recovery will not gain steam, additional capital spending has been announced that will increase the overall budget deficit to 4.7% of GDP in both 2011 and 2012. Continuous expenditures related to the bailout of CL Financial Group will also burden government finances. So far, 1/3 of the total bail-out costs estimated at 13% of GDP have been incurred. While an amount equalling 2.2% of GDP will be paid out to CL Financial Group's small depositors this year, the realization of the remaining costs has been postponed by issuing a 20-year zero coupon bond to CL Financial Group's large creditors.

Unless structural reforms are implemented at loss-making state-owned enterprises, they will form another drag on government finances in the coming years. The deteriorating outlook for the government finances of Trinidad and Tobago is mitigated by the existence of the Heritage and Stabilization Fund, a sovereign wealth fund intended to cushion the impact of energy price volatility on government finances. In 2010, the Heritage and Stabilization Fund had a balance of 15.7% of GDP. Despite ongoing stimulus spending in 2011 and 2012 and the resulting increase in public debt levels, the government does not intend to withdraw money from the fund. Consequently, public debt, which was on a downward trend until 2008, will increase to 30.4% of GDP in 2011 and 31.6% of GDP in 2012. Amid tensions in the Middle East and possibly higher oil and gas prices, risks to the budgetary and debt outlook are tilted to the upside, though. We expect the current administration to stick to earlier governments' practice of financing about 80% of government debt domestically, though foreign lending might be increased slightly in order to reduce the crowding out of domestic investment.

Faced with sluggish economic growth, the government attempts to spur output in the hydrocarbon and non-hydrocarbon sector, simultaneously. In the hydrocarbon sector, further investments into LNG downstream activities are promoted and agreements with neighbouring Venezuela should facilitate the exploitation of new offshore gas fields. In the non-hydrocarbon sectors, the incumbent government hopes to stimulate growth by means of increased spending into health, education and sanitation. Still, it remains to be seen whether these measures will be sufficient to overcome competitiveness problems in the non-hydrocarbon sector and reduce the country's considerable dependency on the energy sector. Given comparatively high education levels, measures aimed at a reduction of inflation, which could lead to a real exchange rate depreciation, might be more promising.

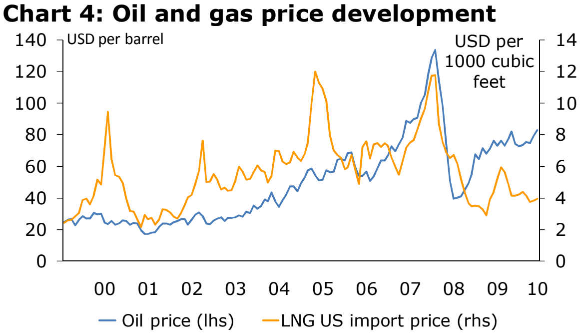
However, due to the peg of the Trinidad and Tobago dollar to the USD, the central bank's ability to address inflation is limited. In order to tackle the country's weak economic performance by means of increased credit provision, the central bank lowered the policy repo rate from 5.0% to 3.75% between April and November 2010. Even though this move was translated into lower borrowing rates at commercial banks, credit demand remained weak. Consumer and business credit fell by 2.8% and 10.1% on an annual basis, respectively, as uncertainty about economic and employment prospects prevailed. In the meantime, largely supply-induced inflationary pressures continued, driving inflation up from 7.0% in 2009 to 10.5% in 2010. As the trade-weighted average inflation rate of Trinidad and Tobago's main trading partners only amounted to 3.3%, high inflation was a main factor behind the country's strong real exchange rate appreciation in 2010.

Chart 3: Fiscal balance and debt



Source: EIU

Chart 4: Oil and gas price development

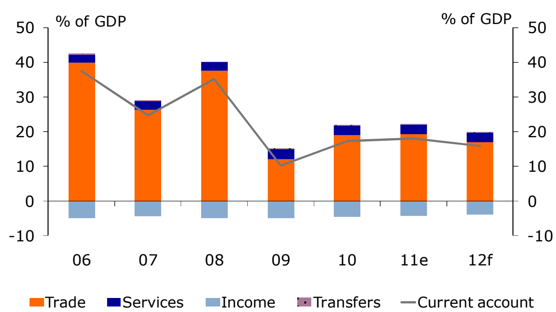


Source: EIA

Balance of Payments

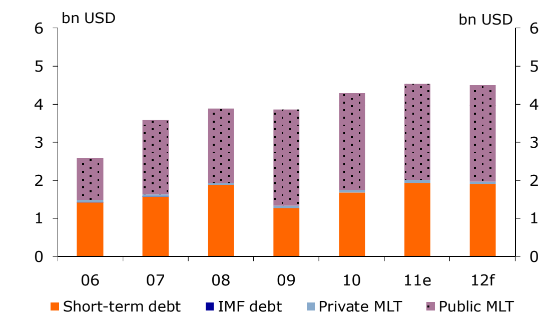
Trinidad and Tobago's balance of payments improved markedly in 2010 on the back of rising oil and gas prices, reflecting the hydrocarbon sector's paramount importance for the country's exports. After having declined to a surplus of 10.3% of GDP in 2009 from 35.2% in the previous year, the current account surplus reached a level of 17.3% of GDP in 2010. This development is predominantly driven by the country's considerable trade surplus, but increased foreign direct investments also contributed to the improvement. According to the base scenario, the 2011 current account surplus will slightly improve to 18% of GDP as hydrocarbon prices will gradually increase and domestic demand remains tempered due to stagnating high unemployment levels. Depending on developments in the Middle-East, oil and gas prices could turn out to be higher than assumed in the base scenario, though, resulting in a stronger improvement of the current account. Owing to remaining uncertainty about the economic outlook, FDI inflows are expected to decline somewhat in 2011.

Chart 5: Current account balance



Source: EIU

Chart 6: External debt



Source: EIU

External position

Despite the deteriorating fiscal outlook, Trinidad and Tobago's external position remains extremely strong as 80% of the budget deficits are financed domestically and current account surpluses remain in the double-digits. Foreign exchange reserves, excluding the holdings of the Heritage and Stabilization Fund, in 2011 are estimated at 31% of GDP in 2011. This level corresponds to an import cover of about a year in 2011 and 2012, respectively, and a liquidity ratio of about 220% in both years. Foreign debt as a percentage of GDP, which will remain constant at 15% of GDP in 2011 before declining to 13% in 2012, is covered twice by the foreign exchange reserves.

Trinidad-Tobago

Selection of economic indicators	2006	2007	2008	2009	2010	2011e	2012f
Key country risk indicators							
GDP (% real change pa)	12.2	5.5	3.5	-3.2	1.1	2.1	2.1
Consumer prices (average % change pa)	8.3	7.9	12.0	7.0	10.5	6.8	7.3
Current account balance (% of GDP)	37.6	24.7	35.2	10.3	17.3	18.0	15.9
Total foreign exchange reserves (mln USD)	6586	6694	9443	9178	9578	9680	9700
Economic growth							
GDP (% real change pa)	12.2	5.5	3.5	-3.2	1.1	2.1	2.1
Gross fixed investment (% real change pa)	12.0	8.9	3.5	-10.0	4.0	5.5	5.6
Private consumption (real % change pa)	7.4	6.3	5.8	-3.5	2.5	3.0	3.2
Government consumption (% real change pa)	8.6	7.4	8.1	6.5	5.5	4.3	4.9
Exports of G&S (% real change pa)	16.0	6.2	4.8	-4.1	2.0	3.8	3.5
Imports of G&S (% real change pa)	9.0	8.9	8.7	-5.2	5.6	6.5	6.4
Economic policy							
Budget balance (% of GDP)	1.6	0.2	1.7	-4.8	-0.8	-4.7	-4.7
Public debt (% of GDP)	28	28	26	29	29	30	32
M2 growth (% change pa)	21	11	17	31	10	14	15
Consumer prices (average % change pa)	8.3	7.9	12.0	7.0	10.5	6.8	7.3
Exchange rate LCU to USD (average)	6.3	6.3	6.3	6.3	6.4	6.4	6.4
Recorded unemployment (%)	6.2	5.6	4.6	5.8	6.4	6.2	6.1
Balance of payments (mln USD)							
Current account balance	7271	5364	8519	2610	4860	5510	5330
Trade balance	7700	5721	9064	3052	5318	5920	5650
Export value of goods	14217	13391	18686	10050	13534	15370	14940
Import value of goods	6517	7670	9622	6998	8216	9450	9290
Services balance	451	547	610	722	779	840	950
Income balance	-936	-964	-1202	-1219	-1297	-1300	-1320
Transfer balance	56	60	47	55	60	60	50
Net direct investment flows	513	830	2101	475	830	550	630
Net portfolio investment flows	-200	-1002	-82	-1200	-250	-250	-250
Net debt flows	-9	999	321	-55	443	240	-30
Other capital flows (negative is flight)	-5942	-6071	-8108	-2080	-5469	-5930	-5620
Change in international reserves	1633	120	2751	-250	414	120	40
External position (mln USD)							
Total foreign debt	2598	3587	3897	3862	4295	4540	4510
Short-term debt	1428	1580	1882	1269	1690	1940	1910
Total debt service due, incl. short-term debt	1800	1804	1903	2516	1614	2010	2260
Total foreign exchange reserves	6586	6694	9443	9178	9578	9680	9700
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	39.8	26.3	37.5	12.1	19.0	19.3	16.9
Current account balance (% of GDP)	37.6	24.7	35.2	10.3	17.3	18.0	15.9
Inward FDI (% of GDP)	4.6	3.8	11.6	1.9	3.0	2.1	2.2
Foreign debt (% of GDP)	13	17	16	15	15	15	13
Foreign debt (% of XGSIT)	17	24	19	34	29	27	27
International investment position (% of GDP)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt service ratio (% of XGSIT)	12	12	9	22	11	12	14
Interest service ratio incl. arrears (% of XGSIT)	1	2	1	2	1	1	1
FX-reserves import cover (months)	11.5	10.0	11.4	15.0	13.3	11.7	11.9
FX-reserves debt service cover (%)	366	371	496	365	593	480	430
Liquidity ratio	243	211	236	208	236	221	217

Source: EIU