

Budget 2008/ 09 – Implications on the Macro-economy
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The Vision 2020 developmental plan articulates the five pillars, which are:

1. Developing innovative people
2. Governing effectively
3. Enabling competitive business
4. Nurturing a caring society
5. Investing in sound infrastructure and environment

And this is the context in which the budget 2008/ 09 was placed. Against this backdrop, lets see where Trinidad and Tobago currently operates and what are some of the implications of the fiscal measures outlined in this yeas budget.

Vision 2020: The Challenge

	GDP (US\$bn)	GDP per capita (000' US\$)	HDI (Ranking)	Illiteracy (%)	Human Poverty Index (%)	Life Expectancy (Years)
Caribbean	51.8	5.4	78	10	10.08	69
Highest	16.5	16.7	31	49	3	77
Lowest	0.3	0.5	146	1	17.5	50
Trinidad and Tobago	21.28	14.6	59	1.6	7.3	69.2

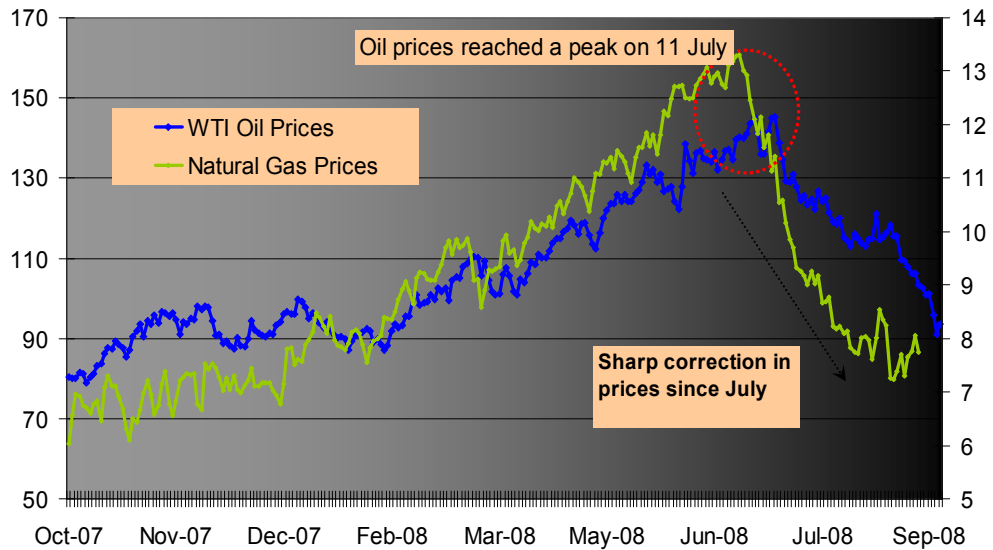
The table gives a snapshot of where Trinidad and Tobago stands, compared to its Caribbean counterparts. T&T has the second GDP per capita in the Caribbean, behind the Bahamas. The UNDP's Human Development ranking for 2007/ 08, places Trinidad and Tobago at 59th out of 177 countries. The only countries ranked higher in the Caribbean are Barbados (31), Bahamas (49), St Kitts and Nevis (54) and Antigua (57).

The Human Poverty Index for developing countries (HPI-1) focuses on the proportion of people below a threshold level in the same dimensions of human development as the human development index – which are like - living a long and healthy life, having access to education, and a decent standard of living. A high score suggests greater degree of poverty (as defined above) in the country and closer to 1; it means that poverty levels are low.

Trinidad has a score of 7.3, compared to an average of 10.1 in the Caribbean region. Barbados has the highest score among the developing countries of the world (108 countries are ranked). Belize has the highest poverty level in the Caribbean, followed by Jamaica and Guyana. In terms of rank in the Caribbean, Trinidad is the fourth better off. And this means to reach its goal of developed nation status, there is much still to be done, in terms of alleviating these pockets of poverty.

So while we have high per capita GDP and GDP growth etc, socially, we see a relatively high level of poverty (given the wealth) in the country.

Retracement in Energy Prices



Oil prices peaked at US\$145.29 during this year in July and have so far averaged around US\$115 per barrel. For the year so far, the price has increased by about 20%, and is currently trading at US\$107 per barrel.

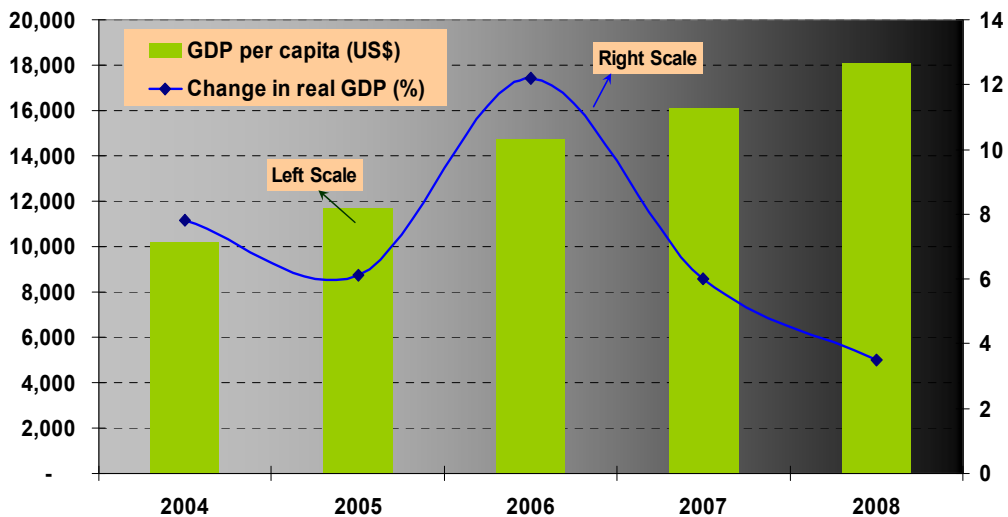
The rise in the price of oil and other petroleum products has been one of the major reasons why headline inflation across the globe, including Trinidad and Tobago, has surged.

Implications:

The budget is based on an oil price of US\$70 per barrel, and given the trend in the recent years, this seems to be practical. We see that oil prices can be very volatile in the international market. This can have severe implications on the country's revenue, especially given the dependency of our economy on this sector in terms of GDP, government revenue and exports.

Additionally, from the graph we see that oil prices and natural gas prices are very highly correlated – in fact the correlation is about 85%. So even if we have shifted our dependency from oil to gas, the same vulnerabilities exist.

Economic Growth and GDP per capita



Economic growth in Trinidad and Tobago is expected to slow to 3.5 percent in 2008, following growth of 5.5 percent in 2007.

Growth in the energy sector is estimated to have slowed significantly to 0.4%, while there was a pick up in the non-energy sector.

Exploration and production declined for crude due to the mature oil fields. Petrochemicals sub-sector performance is likely to be flat this year due to capacity limitations.

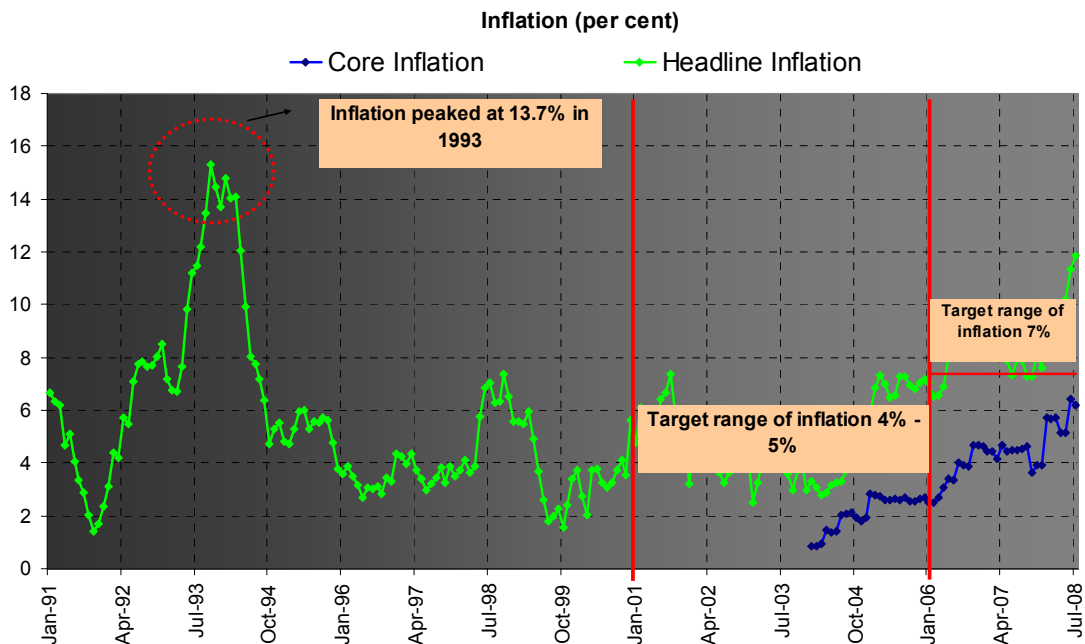
On the non-energy sector, services sector is expected to have declined by 4.9%; manufacturing declined by 4.2%. It is estimated that agriculture grew by 8.6% in 2008.

The budget is based on a growth rate of 5.6%, and compared to the expected 3.5% this year, it seems that without any further exploration activity in the energy sector and pick up in activity in the non-energy sectors this may be high. Tourism and agriculture should help to sustain economic activity in the non-energy sector.

Bottom line?

The moderate pick up in the non-energy sector is a positive step, especially in the agricultural sector. It will be a gradual process, but this is a step in the right direction to eventually reduce our dependency on the energy sector.

Nagging Inflation...



We all know the issue of inflation in Trinidad right now. We feel it every time we go to the grocery store. The value of your money is being eroded more and more.

Inflation in T&T measured 11.9% in July and core inflation which strips away the volatility of food prices was also high at 6.2%. Food inflation was at almost 25%.

Inflation has been driven primarily by the following factors –

1. Firstly, with the government proceeding with its rapid pace of expenditure, we expect that net fiscal injections will continue to add liquidity to the domestic financial system.

2. High food prices on the international market will also continue to feed into headline inflation locally and adding to the inflationary pressures on food will be the impact of more flooding and inclement weather on locally produced food.

These factors will cause food inflation to hover around 20% – 25% in the short to medium term.

The budget is based on inflation of 6%, while currently it is running at double that rate. With the expansionary budget presented on Monday – we should continue to see increased net fiscal injections in the year ahead. This has been one of the major causes of the liquidity overhang and consequently – inflation. As such, inflationary pressures are expected to continue into the new fiscal year. This target as well seems out of reach, if the pace of expenditure isn't slowed and if the financial system remains liquid. Especially in the context of still high global commodity prices.

The 50 bps hike in the repo rate as well as the 400 bps increase in the reserve requirement for commercial banks for the year so far has resulted in a 100 bps increase in the prime lending rate and a mere 11 bps increase in commercial banks' ordinary savings deposit rate.

While the intent of this action by the Central Bank was to discourage consumption and curb the expansion in credit, all it had produced thus far is an 89 bps increase in the spread income accruing to commercial banks.

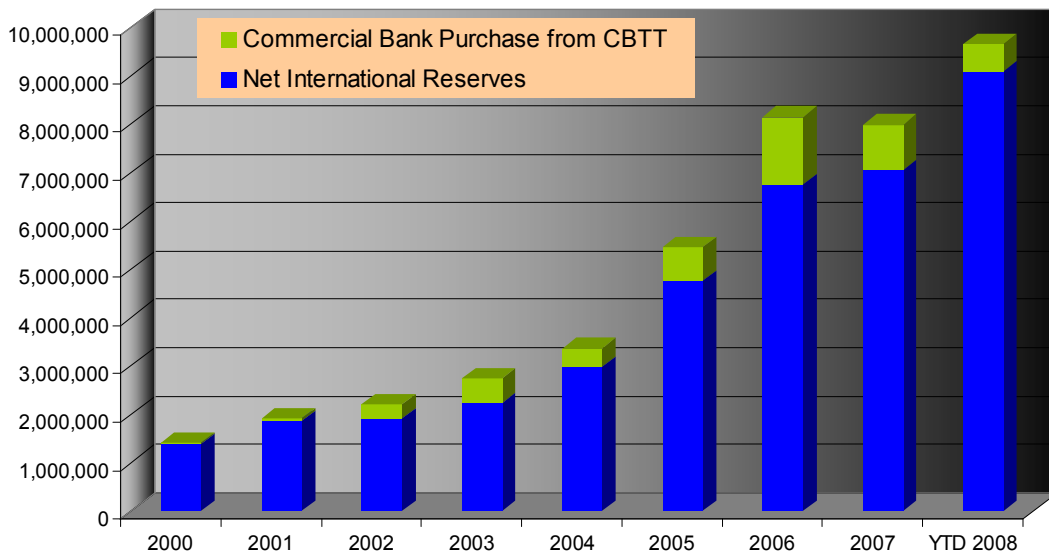
Going forward:

With inflationary pressures expected to rise and as the demand for credit continues its robust path, we should see interest rates on a continued upward trajectory. The CBTT is expected to continue to aggressively tighten liquidity through increased OMO operations and the use of the repo rate. We may also see another temporary hike in the reserve requirement for commercial banks.

Monetary policy appears ineffective in a situation such as the one prevailing now, as the impact of expansionary fiscal policy is completely nullifying the impact of tighter monetary policies, exacerbated by an unfavourable external environment.

Propping up the TT Dollar

Net International Reserves (US\$)



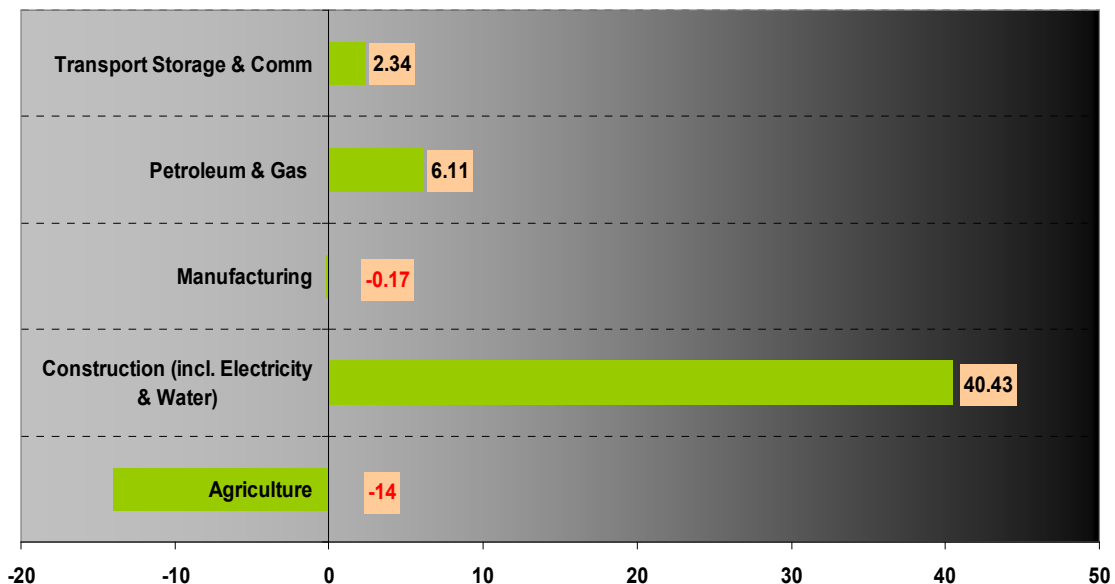
External accounts are healthy, with a steady build up of international reserves, which is currently at around US\$9.1 billion year to date 2008.

However, due to the continued liquidity overhang, the CBTT has been intervening in the foreign exchange market – selling to the commercial banks USD. For the year so far, the CBTT intervened to the tune of about US\$565, 675.

So if the CBTT didn't intervene, we would have seen a bigger increase in the country's net international reserves and import cover, adding to the protection we have against what can be a harsh external environment.

Where are the jobs?

Net Changes in Sectoral Employment: 2000-2007
(In thousands of persons)



The graph shows where the jobs are...

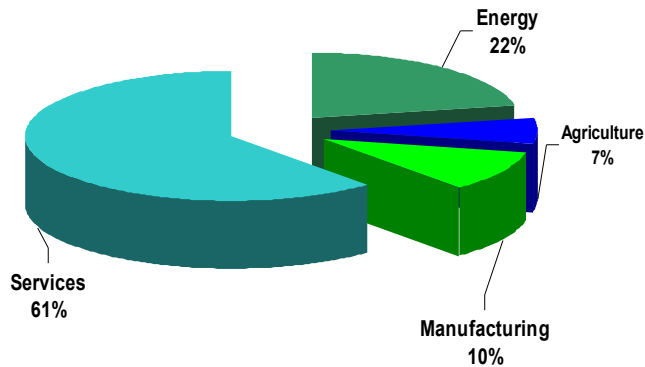
It shows the net changes in employment for the major sectors of the economy – and takes the average of 2000-2007.

We notice a 41% increase in employment in construction from 2000 to 2007 and marginal increases in transport and petroleum and gas. But declines in agriculture and manufacturing were recorded, and these are essentially, the two major tradable sectors of the economy, and are able to generate sustainable growth for any economy.

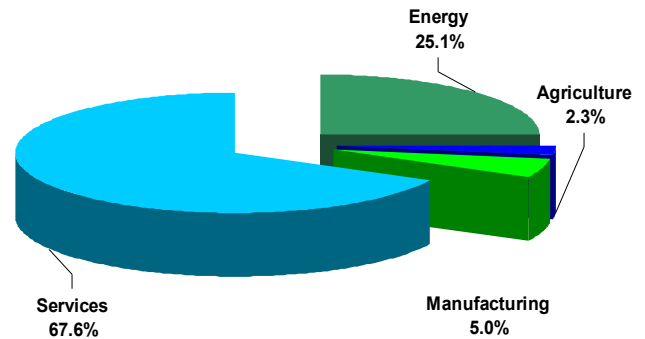
The Unemployment rate increased to 5.3% in the second quarter of the financial year from reaching a historic low of 4.5% in the first quarter.

Diversification or Dutch Disease?

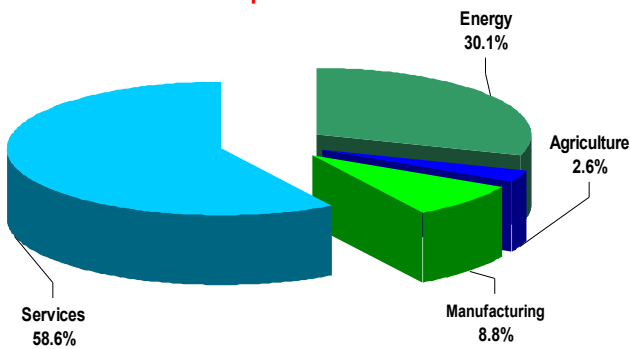
GDP Composition - 1970



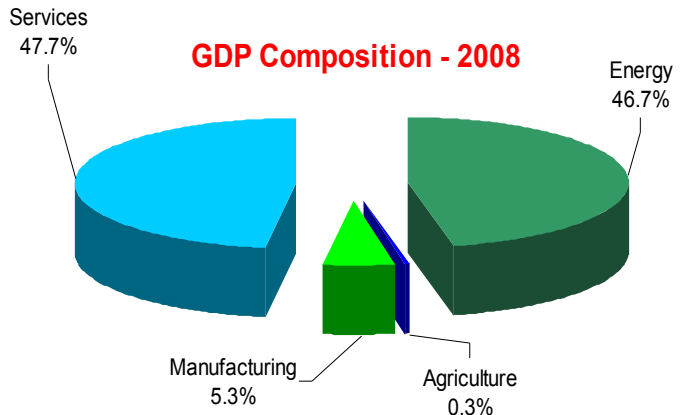
GDP Composition- 1982



GDP Composition - 1990



GDP Composition - 2008



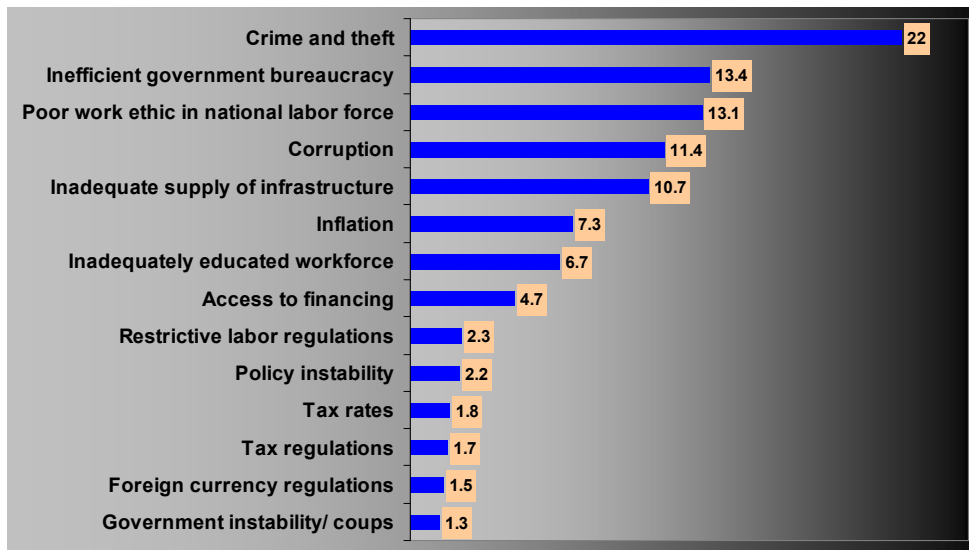
Dutch disease is a concept we have been hearing about for quite some time now. This graph shows the shift in the composition of GDP over the years.

Back in the 1970's and 1980's, the services sector accounted for the largest portion of GDP. We see during the recession in the 80's, the manufacturing sector's share of GDP fell to 5% from 10% during 1970. Then, with the recovery period starting around 1990, its share increased once again.

This time around in 2008 – GDP composition has shifted from dependency of the services sector to that of energy, which now accounts for 47% of GDP. Agriculture and manufacturing together account for just 5.6% of total GDP.

If energy prices remain buoyant, this bodes well for T&T, but in a scenario of declining prices, which is possible, the T&T economy can find itself in some hot water.

Global Competitiveness – The problematic areas

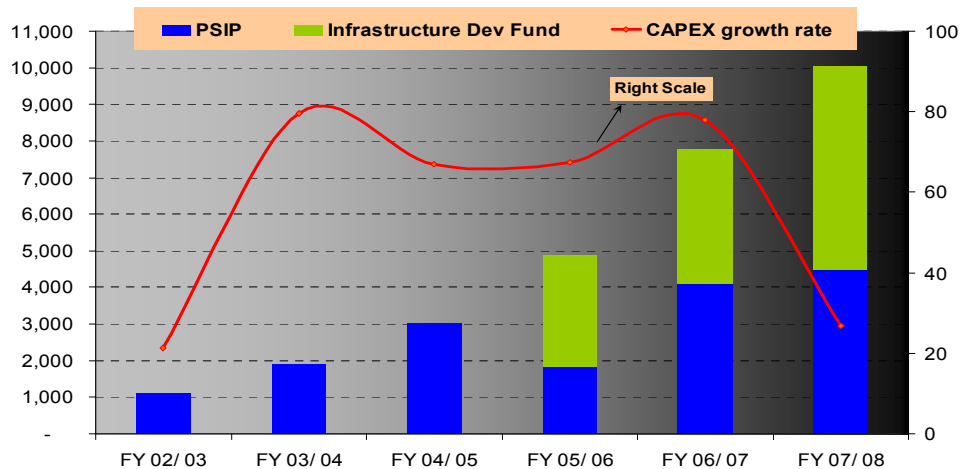


Trinidad and Tobago's competitiveness has consistently been deteriorating within the past few years. From the period 2004 to 2008, T&T has moved down 25 spots from 59 to currently 84 out of 121 countries, according to the World Economic Forum – the Global competitiveness report. This compares to Barbados who is ranked at 50 and Jamaica ranked at 78.

The graph shows the most problematic factors for doing business in Trinidad, according to the World Economic Forum's survey for 2007.

By far, crime and theft is the most worrisome factor in investors' minds according to the survey, followed by inefficient government bureaucracy. So these are some of the areas in which we need to improve to strengthen our investment climate.

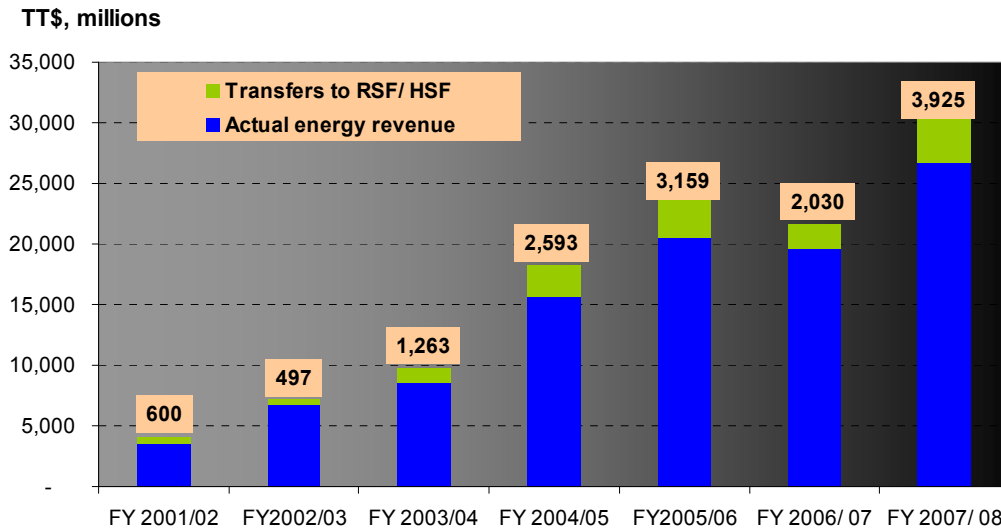
Capital Expenditure



Capital expenditure has ballooned in the past few years. The graph shows the consistent upward trend in capex. The average growth rate for capital expenditure during the 6-year period to fiscal year 2008 was at 57%!

In the last fiscal year however, we did see a slowdown in the growth rate on capex to around 27%, from a high of 78% last year. The country's non-energy fiscal deficit has also been on the rise. This basically tells us what the fiscal deficit would be in the absence of energy revenue, and as a percentage of non-energy GDP, this ratio was at 33%. The 5 year average is at 26% of non-energy GDP, which is unacceptably high and measures must be put in place to prevent this ratio from rising even further.

HSF: How Much is Enough?



The graph shows transfers that the government has made to the HSF, relative to energy revenue. The HSF currently has a balance of around TT\$15 billion, representing about 10% of GDP. This compares to cumulative energy revenue of TT\$101 billion. It suggests that about 15% of the revenue derived from the energy sector has been saved via the HSF.

If we take the average of the transfers to the HSF as a percentage of actual revenue annually, this rate is about 14%. If we compare this with the transfers to the infrastructural development fund as a percentage of energy revenue, we see that the transfers to the Infrastructure development fund is higher averaging around 18% for the past 3 years.

A point to note here is that the HSF is governed by legislation which outlines conditions under which withdrawals can be made from this fund. The Infrastructural development fund is not governed by legislation, so that funds can be withdrawn at any point. The purpose of this IDF is primarily to fund the mega projects that are soon to come – the highway, the rapid rail and ferry projects. It is likely that more such projects will be added to this list along the way.

Some Warning Signs

High levels of capital expenditure on infrastructural services

Advent of Dutch Disease - Loss of Competitiveness in Non-Energy Sector (manufacturing, agriculture)

Greater dependency on energy and energy-financed expenditures to meet social programs