



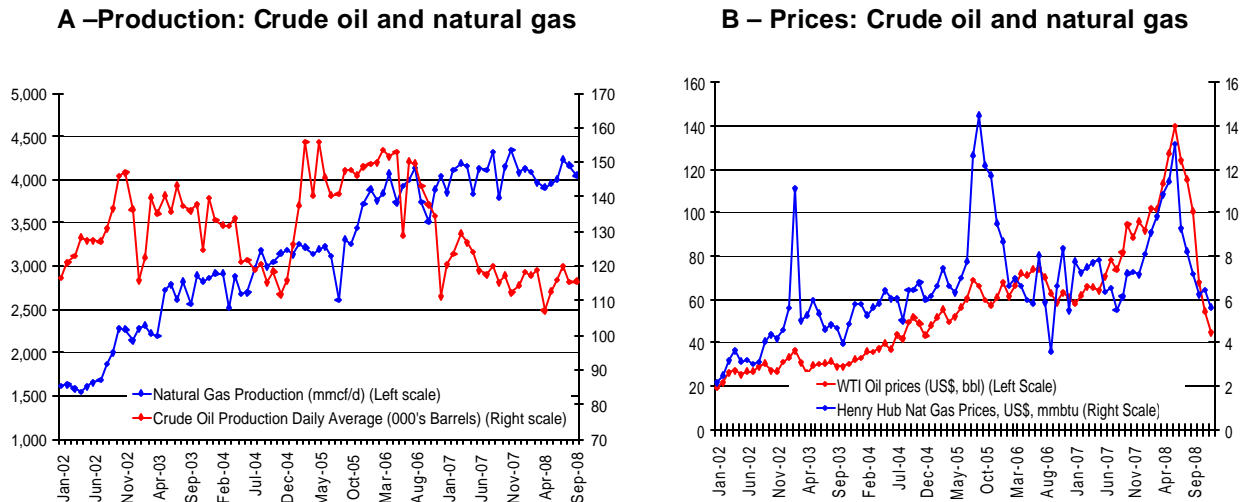
## ***A Reversal of Luck for Trinidad and Tobago in 2009?***

As we reflect on the volatility of the global economy and financial markets over the past year, we realize that no amount of analysis or model-building can guarantee accurate predictions for the New Year. Etched in the minds of investors worldwide is the collapse of well known giants on Wall Street, forever changing the landscape of the financial sector. Emerging markets' resilience has truly been put to the test during the past year and they have failed miserably, laying to rest the notion of 'decoupling'. Another lesson hopefully learnt is that confidence in markets, or lack thereof, is all it takes to undermine an entire financial system.

One thing we know with a high degree of certainty though is that 2009 will be a challenging one for the Caribbean region. History, if nothing else, has taught us that the external environment can be brutal to these little islands because of our inherent dependencies - whether it is a global economic crisis or a natural disaster, either way, the Caribbean is going to be affected.

Expectations for a dramatic slowdown in external demand and depressed commodity prices have blurred the outlook for the Caribbean economies. In the case of Trinidad and Tobago (T&T), the energy sector has been the one and only engine of growth in the past and activity in this sector is now likely to slow considerably as global demand slows and as prices come down significantly. The country's oil production has been falling due to maturing oil fields while output from the petrochemical sub-sector has been relatively stagnant. In figure 1, panel A shows the production levels of crude oil and natural gas over the period January 2002 – September 2008 and panel B shows the prices of natural gas and crude oil for the same period. Since 2002, natural gas production expanded 150%, while crude oil production declined by 0.83%. However, more recently, data from January to September 2008 showed that natural gas production fell by 1.8% and daily crude oil production contracted by 2.3%. Now that prices are coming down, energy production levels are declining/stagnant and there is lower external demand for these products, we can safely say that GDP growth is going to decline sharply.

**Figure 1: Energy Sector Production and International Prices**



Energy has played a pivotal role in the Trinidad and Tobago economy. Not only has it accounted for about 50% of the country's GDP, but it has also contributed about 60% of government revenue and in excess of 90% of total exports. The implications of declining oil and natural gas prices are dire given this excessive dependency. Of course, with oil prices back to US\$40 a barrel and natural gas prices at US\$5.80 per mmbtu, government coffers will be diminished, considering that the original budget is based on an oil price of US\$70 per barrel and a gas price of US\$4.00. This means that government may be forced to tighten fiscal policy in the next year and large expenditure plans may have to be cancelled or postponed. The government has already announced a reduction in expenditure in the current fiscal year on account of the reversal in energy prices over the past few months.

If the government decides to continue with large expenditure projects in a scenario of relatively low commodity prices, then they may be faced with the challenge of raising financing. The troubles in the international financial market may mean overall financing conditions for the Caribbean region will be even tighter than before, even for countries like Trinidad and Tobago, which is rated investment grade. If they do access the market, it will come at a very high cost as investors will demand an incredibly high risk premium on Caribbean debt, assuming that there will be any interest at all.

Another potential threat will be in the tourism sector. Weaker global economies and rising joblessness in many advanced countries will result in a dramatic slowdown in, if not tourist arrivals, definitely in tourism expenditure. Unemployment may also rise as many businesses cut back on staff to maintain profit margins in the face of a very challenging market. Also, if construction projects are scaled back, then employment in this sector may be cut back. Additionally, as government revenue from the energy sector declines, government-supported programs may also be curtailed, but this is a worse-case scenario.

Inflation in Trinidad and Tobago has been sticky upwards since around 2005, owing mainly to the surge in commodity prices as well as the elevated pace of credit expansion by both the public and private sectors. A lot of the inflationary pressures also came from the previously weak US dollar to which the TT dollar is 'pegged'. Going into 2009 however, we should witness a gradual reversal of these trends and inflation is likely to fall. With a situation of slowing growth and slight moderation in inflation, the Central Bank is not expected to raise interest rates further. Naturally, a reduction in

international commodity prices does not necessarily translate into lower domestic prices, as it depends on the extent to which businesses pass on the savings to the general public.

Trinidad and Tobago is by no means insulated from the downturn in the global economy. The effects have the potential to weaken what was once a very strong, well shielded economy. While it is very difficult to project what will happen by the end of the year, it is safe to assume that economic growth for 2009 will be very low - we are forecasting economic growth in the region of around 1.5% - 2% for 2009. Inflation should moderate to around 7% - 9% by the end of 2009. Real estate prices are also expected to decline gradually in the coming year. While the country's debt profile remains very favourable, the fiscal accounts should eventually end up in a small deficit and the surplus on the external current account should start to shrink as well. The country's net official reserves currently stand at US\$9.2 billion and the Heritage and Stabilization Fund (HSF) has about TT\$15 billion, which can be quickly eroded if not carefully monitored. A coordinated effort between the public and private sectors must be made in order to ensure that Trinidad and Tobago does not spiral into a dramatic economic downturn.

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## FINANCIAL & ECONOMIC INDICATORS

As at 31 December, 2008

<u>Exchange Rate/US\$</u>	<u>Closing Value</u>	<u>Previous Week</u>
Yen	90.64	90.46
Euro	1.40	1.40
Jamaica	79.90	80.14
Guyana	205.20	204.40

<u>Commodity Prices</u>	<u>Closing Value</u>	<u>Previous Week</u>
Crude oil (US\$/bbl)	44.60	35.35
Natural Gas (US\$/mmbtu)	5.63	5.44
Gold (US\$/Troy Ounce)	882.05	848.00

### Eurobond Indices (As at 31-December-08)

Lehman Brothers Global Aggregate Index (Return % YTD)	4.79
JP Morgan EMBI+ (Basis points)	690
JP Morgan Central America and Caribbean Index (CACI) (YTD return %)	-17.90

<u>Policy Interest Rates (%)</u>	<u>Closing Value</u>	<u>Previous Week</u>
United States	0-0.25	0-0.25
Euro Zone	2.50	2.50
Japan	0.11	0.13
Brazil	13.75	13.75
Trinidad	8.75	8.75
Jamaica	13.50	13.50
Barbados	4.00	4.00

<u>Market Interest Rates (%)</u>	<u>Closing Value</u>	<u>Previous Week</u>
US 90-day T-Bill	0.08	0.03
US 10-Yr Treasury	2.21	2.18
3-month UK Libor	2.77	2.87
Japan 90-day T-Bill	N/A	0.38
Brazil 90-day T-Bill	N/A	13.15
TT 90-day T-Bill	7.07	7.07
Jamaica 90-day T-Bill	22.01	22.01
Barbados 90-day T-Bill	4.81	4.68

Sources: Bloomberg, CMMB, Central Bank of Trinidad and Tobago, Bank of Jamaica, Central Bank of Barbados, [www.lehman.com](http://www.lehman.com)

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