



2009 – A year of records...

There is no doubt that 2009 proved to be one of the most difficult years for countries across the globe as the effects of the global financial crisis sent economies into a whirlwind of negative growth, plunging interest rates, low inflation, high unemployment and ballooning budget deficits. To help offset the slump being experienced by most economies as consumers skimmed on expenditure, governments adopted an expansionary fiscal stance in an effort to boost liquidity and spur demand in their domestic economies. This accommodative policy has led to record budget deficits, especially for the more developed economies such as the United States, United Kingdom and the Eurozone. This begs the question: "What are the implications for these economies in the future as debt levels rise?"

United States

After ending the year with a budget surplus of US\$48.26 billion in 2007, the highest surplus on record for the month of December since 2003, a new record was set in 2008 as the US government ramped up spending to help stimulate the economy leading to the largest budget deficit on record, in December, of US\$51.75 billion. 2008 saw deficits in almost every month of the year, the worst seen in February of US\$175.6 billion as government revenue fell 12.1% and spending increased 17.1% as Social Security and the military expenditure climbed. Once again in the month of February, a year later in 2009, the US recorded the highest monthly deficit seen since 2003 widening to US\$193.86 billion as a shrinking economy led to a reduction of income tax revenue while spending levels were unchanged. This monthly record was followed by high monthly deficits for each of the following months as the US unemployment rate reached a 26-year high of 10.2% in October 2009 cutting deeper into government tax revenue as spending continued to increase with the approval of the US\$787 billion economic stimulus plan. With a budget deficit seen every month this year, a new record is imminent and officials have estimated that the country's legal limit on debt of US\$12.1 trillion may be reached in December. For the fiscal year ended 30 September, the US Treasury reported a record deficit of US\$1.4 trillion.

United Kingdom

Like the United States, the UK also experienced a fall in tax receipts as its economy contracted and unemployment grew to a high of 7.9% in October of 2009 as spending levels increased to help boost the slumping economy. In November 2009, the British government had a £20.3 billion (approx. US\$33 billion) monthly budget deficit which was the largest since records began in 1993. This deficit was largely attributed to a 3% drop in government revenue due to a 14.2% drop in VAT payments on goods and services compared to a year ago. Meanwhile, spending in government departments increased 6.5% as welfare costs rose by 9.7% and interest paid on national debt rose 8.3%. The £66.15 billion budget deficit of 2008 is also set to be broken in 2009 as the first eight months of the fiscal year recorded a deficit of £106.4 billion compared to £49.3

billion in the same period from a year ago.

Spain

The Eurozone was not spared and countries in the region followed a similar fate to that of the US and the UK. For example Spain, in an effort to battle the worst recession seen in six decades, cut taxes while increasing spending on public projects to help boost employment, led to the largest monthly budget deficit seen in at least nine years of € 62.78 billion (approx.US\$93.44 billion). This puts Spain on the way to breaking the yearly budget deficit record seen in 2008 of €30.57 billion and places even more pressure on the Spanish government to bring the total deficit back to 3% of GDP by 2012. The first nine months of 2009 recorded a deficit of 5.96% of GDP compared to a 1.24% level for the same period from a year earlier. According to Spain's Finance Ministry, the government plans to raise VAT next year and scrap a universal tax rebate in an effort to trim the total deficit to 8.1% in 2010 from a 9.5% level in 2009 which represents one of the widest gaps in the region.

Trinidad and Tobago

Trinidad and Tobago also experienced a budget deficit for 2009 (January – August), as a retreat in oil and gas prices from the 2007 highs cut into government revenue leading to a decrease in government revenue of 58.25%. While government expenditure also fell during the same period of January – August 2009, it fell at a lower rate of 34.72% resulting in a record fiscal deficit of TT\$3.21 billion. Trinidad and Tobago's provisional data shows a deficit of TT\$8.46 billion for the period October 2008 to September 2009.

Deficit spending during times of recession is designed to help stimulate an economy as it boosts economic activity, creates jobs and spurs consumer spending. With all the stimulus packages implemented to do just that, it begs the question of how sustainable is deficit spending and what are the possible long-term implications? We saw a classic case in the United States in July through September 2009 as GDP experienced a 3.5% annualized increase over the quarter. This was mainly attributed to packages such as the 'Cash-for-Clunkers' program and first time home-buyer credit. The 'Cash-for-Clunkers' program led to a 1% growth in motor vehicle consumption, without this program, the US would have had a 2.5% growth rate. This 3.5% third quarter growth marked the first expansion in more than a year and is debatably a short-term effect of the stimulus measures and may not carry into 2010. Besides the long-term sustainability of deficit spending, sovereign debt levels can also increase as government borrows money to finance these deficits which immediately raises a red flag to investors and rating agencies.

The 'AAA' rated sovereign, the United States, had a debt level of US\$10.70 trillion in December 2008 which has consistently increased every month since to a record high of US\$12.11 trillion in November 2009. This marks a 13% increase in debt. Spain's high fiscal deficits led to a revision in its outlook by Standard and Poor's (S&P) to negative from stable while its 'AA+' long-term rating was approved. In Trinidad and Tobago, Gross Public Sector Debt stock is forecast to increase to TT\$41,798.1 million (31.3% of GDP) by the end of the fiscal year 2008/09. This represents a 2.1% increase from the previous fiscal year.

Most investors turn to sovereign debt as opposed to corporate debt as they are viewed as safer investments since they are fully backed by the sovereign and are therefore less likely to default on their debt than corporations. In the US, the Bid Cover index which tracks the ratio between the total number of tenders and the total amount of Treasury accepted bids on

a competitive basis increased for the 5 year, 10 year and 30 year US Treasuries by 41.92%, 8.49% and 11.88% respectively from January to November 2009. This ratio is highly correlated to demand and indicates how demand increased throughout the year for US Treasuries in 2009 despite its ballooning budget deficit and public debt. Few investors worry about the US and UK as potential default sovereigns and evidently continue to buy US Treasuries while constantly on the look out for which other countries as possibly running the risk of default. This was recently seen in the case of Dubai which accumulated US\$80 billion of debt before credit markets seized up in 2008. Without the disclosure on how it would finance more than US\$9 billion of debt due in the near future investors grew wary of this sovereign as one of the three state-owned companies, Dubai World, made the announcement that it would 'seek to freeze or delay repaying debt until at least May 30'. Meanwhile Moody's Investors Service and S&P cut the ratings on several state companies as investors saw this case of Dubai World as a "litmus test" for Dubai.

The main cause of the sub-prime crisis was the fact that borrowers were unable to make their mortgage payments. The question was then raised on whether or not "sovereign debt is the new subprime". The year 2009 has shown us how interconnected economies are as they all experience similar economic scenarios. The main difference among these economies, however, is the reaction to these scenarios which is highly influenced by investor sentiment and their stance on certain sovereigns. As 2009 comes to a close, there is not doubt that new records will be set in 2010 as economies seek to rebound from the recession as quickly as possible.

FINANCIAL & ECONOMIC INDICATORS

As at 7 January, 2010

Exchange Rate/US\$	Closing Value	Previous Week
Yen	93.37	93.02
Euro	1.43	1.43
Jamaica	89.63	89.43
Guyana	204.40	203.90

Commodity Prices	Closing Value	Previous Week
Crude oil (US\$/bbl)	82.66	79.36
Natural Gas (US\$/mmbtu)	7.51	5.83
Gold (US\$/Troy Ounce)	1,131.60	1,096.95

Eurobond Indices (As at 07-01-10)

Lehman Brothers Global Aggregate Index (Return % YTD)	0.21
JP Morgan EMBI+ (Basis points)	267
JP Morgan Central America and Caribbean Index (CACI) (YTD return %)	-2.00

Policy Interest Rates (%)	Closing Value	Previous Week
United States	0.12	0.01
Euro Zone	1.00	1.00
Japan	0.09	0.10
Brazil	8.75	8.75
Trinidad	5.25	5.25
Jamaica	12.50	12.50
Barbados	2.50	2.50

Market Interest Rates (%)	Closing Value	Previous Week
US 90-day T-Bill	0.05	0.08
US 10-Yr Treasury	3.83	3.84
3-month UK Libor	0.61	0.61
Japan 90-day T-Bill	0.28	N/A
Brazil 90-day T-Bill	8.65	N/A
TT 90-day T-Bill	1.34	1.36
Jamaica 90-day T-Bill	15.95	15.95
Barbados 90-day T-Bill	3.44	3.45

Sources: Bloomberg, J.P. Morgan, CMMB, Central Bank of Trinidad and Tobago, Bank of Jamaica, Central Bank of Barbados, www.lehman.com

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