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A New Government to Tackle Old Challenges

Trinidad and Tobago is the latest country to join the revolution of change taking place in the global political arena. Less than two years ago, the United States elected the Democratic Party's Barack Obama on the basis of the policies and actions of the previous Republican Party as well as the American electorate's desire for change. Right here in the region, Jamaica elected the Jamaican Labor Party headed by Bruce Golding, defeating the People's National Party in 2007 after 18 years of unbroken rule. And only on 6 May 2010, general elections in the UK resulted in a 'hung' parliament as the Conservatives won the most seats, but not enough to secure an overall Commons majority. The first coalition in the UK since the Second World War was subsequently formed and for the first time the Conservatives and Liberal Democrats have had a power-sharing deal. On 24 May 2010, the Opposition Coalition forces in Trinidad and Tobago (The People's Partnership) won the General Elections, removing the People's National Movement (PNM) from its 13 year reign. Following the historic election, Kamla Persad-Bissessar, the leader of the United National Congress (UNC), became the country's first female prime minister, having been officially sworn into office on 26 May 2010. The coalition was able to snatch 29 seats out of a total of 41, giving it the two-thirds constitutional majority in parliament.

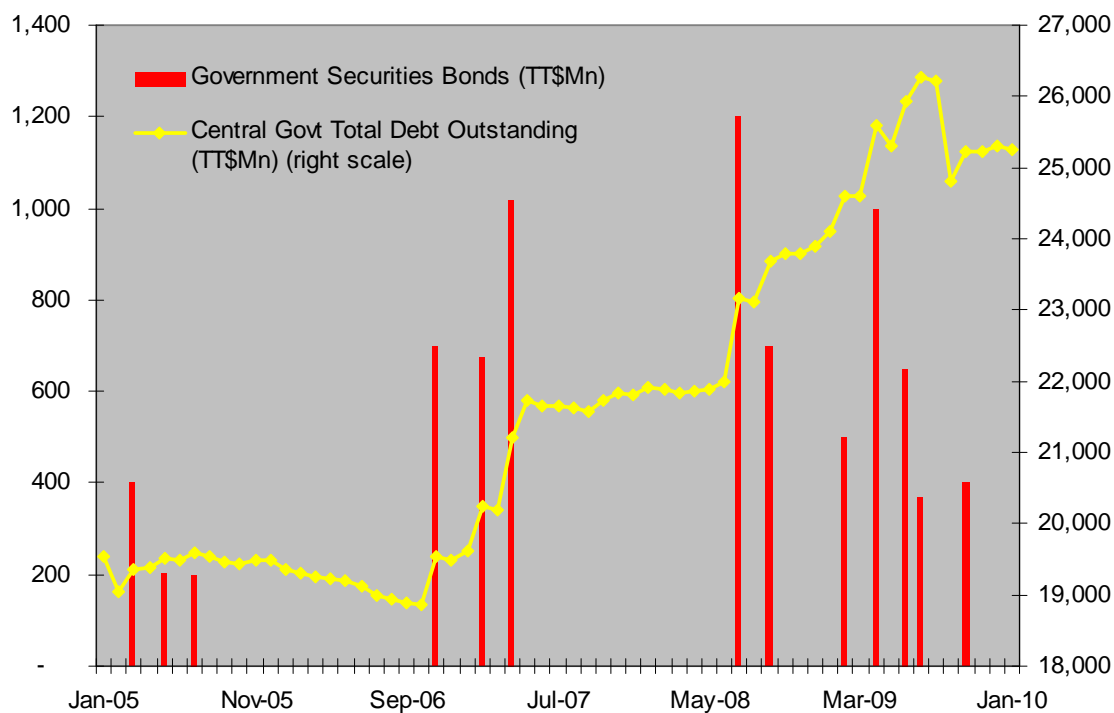
The new government will be entering office during a challenging economic period in Trinidad and Tobago. The global economy is now slowly pulling itself out of an economic rut and even though activity is increasing, there still exists tremendous downside risk to the global economic recovery. The major 'fly in the ointment' is the European sovereign debt issues which are ongoing, and has the potential to delay the global recovery. This can place additional pressures on the Trinidad and Tobago (T&T) economy, which is already in a fragile state. In 2009, the domestic economy recorded its first economic contraction in about 16 years as the global downturn slashed demand and prices for commodities, specifically natural gas and crude oil. Domestic demand has also weakened notably as consumer confidence remained dampened during the year. There are some green shoots however. After four consecutive quarters of economic contractions, the T&T economy recorded a small positive gain during the fourth quarter of 2009, with real GDP increasing 0.8% on a year-on-year basis. The recovery in the fourth quarter was largely driven by the improved performance of the energy sector, specifically petrochemicals and natural gas.

Another key challenge which the new administration may be faced with is the potential for the unemployment rate to rise. Notwithstanding preliminary estimates indicating some improvements in the labor market, with the jobless rate estimated to have fallen to 5.2% in the final quarter of 2009, compared to 5.8% in the preceding quarter, there is the possibility that this rate can rise. This is largely because some of the key economic sectors remain weak, for example, agriculture, manufacturing and construction, and if this weakness persists for much longer, businesses may resort to cutting jobs to shore up bottom line. Another major concern is the rising cost of living. Food price levels have increased markedly over the past two years or so, which is a major concern for people who live on a fixed income. Inflation continued to edge higher

during the month of March, rising to 5.1%, compared to 4.8% in February 2010. The main reason for the uptick in headline inflation was the increase in the price of food. Food inflation rose 6.9% in March. The recent extremely dry weather conditions had negatively affected domestic food prices, evidenced by a 61% jump in prices of fruits alone. Alongside rising inflation, there is protracted weakness in credit conditions in T&T. In the 12 months to February 2010, private sector credit declined by 3.6%. Consumer credit contracted 3.1%, while business credit fell for the fourth straight month by a larger 5.4%. This is becoming a more worrying issue, and if inflation continues to inch up and economic activity remains subdued, there may be the possibility of stagflation.

A major topic of contention during the heated election campaign was the state of the government coffers. Over the fiscal year which ended in September 2009, the overall fiscal balance entered the 'red' zone, recording its first deficit in seven years. Largely on account of plunging international energy prices, the fiscal accounts registered a deficit equivalent to 5.3% of GDP, compared to a significant surplus of 7.8% of GDP in the previous fiscal year. Also undermining government coffers was the erosion of the non-energy tax base, due to a slowdown in domestic activity. During the financial year, the government even had to revise its initial budgeted numbers, lowering revenue estimates and cutting planned expenditure, with capital spending bearing the brunt of the cutback. To finance the growing deficit on the fiscal account, the government increased its level of borrowing over the past year or so. During the last fiscal year, the government issued bonds totaling TT\$2.52 billion, compared to the previous year, in which government bond securities amounted to TT\$1.9 billion. Figure 1 shows the accumulation of central government total debt outstanding since 2005. Since 2006, there has been a sharp rise. The country's public debt to GDP is still however at moderate levels, just over 30%. A major issue which will have to also be dealt with is the CL Financial bailout, which can further erode the fiscal accounts.

FIGURE 1 – TRINIDAD AND TOBAGO: CENTRAL GOVERNMENT DEBT OUTSTANDING



Source: Central Bank of Trinidad and Tobago (www.central-bank.org.tt)

On the balance of payments account, data for the first nine months of 2009 showed a significant decline in energy sector exports, largely on account of the fall in international commodity prices. The value of energy exports was US\$6.3 billion, around half the value in the same period a year earlier. Non-energy exports also fell to US\$932 million, a 47.8% contraction compared to the corresponding period a year ago. Manufacturing exports, specifically to the CARICOM region declined by just under 50%. Notwithstanding the decline in export earnings, the current account still managed to record a surplus, but this was insufficient to offset the considerable deficit on the capital account. Private sector outflows reached US\$2.2 billion, while net inflows of foreign direct investments declined by 77% to US\$410 million. The balance of payment subsequently registered an overall deficit of US\$429.3 million.

According to the central bank, net foreign reserves position at the end of December 2009 stood at US\$11.245 billion, a decline of 6% relative to the end of 2008. A strong and healthy accumulation of foreign exchange reserves is vital for the sustenance of foreign exchange stability given the current exchange rate regime in Trinidad and Tobago. The de facto peg to the US dollar suggests that sufficient levels of reserves are necessary to back the currency in the case of any disequilibrium in the foreign exchange market. The Central Bank of Trinidad and Tobago estimates that the trade-weighted real effective exchange rate depreciated by 5.4% in the 11 months to November 2009. The reasons for this were 'the narrowing of inflation differential in T&T relative to its trading partners, combined with movements in nominal exchange rates'. In the previous year, when inflation peaked at 15%, the T&T dollar in real effective terms appreciated strongly by around 17%, which eroded the competitiveness of the T&T economy. The government must ensure that expenditure plans do not fuel inflation to the extent that it puts pressure on the TT dollar 'peg', which of course has implications for the competitiveness of the tradable sectors of the economy, including the vital manufacturing and the agriculture sectors.

The T&T economy is susceptible as it is exposed to various factors (both internal and external) which can undermine its potential. One of the most fundamental concerns which will have to be addressed by the new government is the state of the fiscal accounts. If the budget deficit is allowed to widen much further, the country's fiscal flexibility will be significantly reduced. Even though debt levels are still at favorable levels, gradual increases can creep up over time and eventually spiral out of control if not carefully monitored. Therefore there is need to put in place a fiscal plan which sees a gradual reduction in the fiscal deficit over the medium term. Another medium- to long- term goal should be that of diversifying the T&T economy, and re-energizing the non-energy sector. Currently more than 80% of the country's export earnings originate from the energy sector, which exposes T&T's external accounts to the volatility of the global commodity market. Additionally, the energy sector, while providing the major engine of growth for the T&T economy, employs less than 5% of the total labor force in the country. By developing and facilitating expansion in other productive sectors of the economy, more sustainable job creation can be achieved.

There is still much to be done to propel Trinidad and Tobago to its full potential and to create a more sustainable growth and development path, both economically and socially. As one chapter in the country's continuing story ends, a new one begins. The same old challenges exist, but the new government armed with new strategies will hopefully seek to achieve more than the same old results.

FINANCIAL & ECONOMIC INDICATORS

As at 27 May 2010

| <u>Exchange Rate/US\$</u> | <u>Closing Value</u> | <u>Previous Week</u> |
|---------------------------|----------------------|----------------------|
| Yen | 91.04 | 93.22 |
| Euro | 1.24 | 1.34 |
| Jamaica | 88.96 | 89.32 |

| <u>Commodity Prices</u> | <u>Closing Value</u> | <u>Previous Week</u> |
|--------------------------|----------------------|----------------------|
| Crude oil (US\$/bbl) | 74.55 | 83.45 |
| Natural Gas (US\$/mmbtu) | 4.22 | 3.93 |
| Gold (US\$/Troy Ounce) | 1,212.65 | 1,140.75 |

Eurobond Indices (As at 27-05-10)

| | |
|---|------|
| JP Morgan EMBI+ (Basis points) | 317 |
| JP Morgan Central America and Caribbean Index (CACI) (YTD return %) | 0.55 |

| <u>Policy Interest Rates (%)</u> | <u>Closing Value</u> | <u>Previous Week</u> |
|----------------------------------|----------------------|----------------------|
| United States | 0.25 | 0.25 |
| Euro Zone | 1.00 | 1.00 |
| Japan | 0.10 | 0.10 |
| Brazil | 9.40 | 9.40 |
| Trinidad | 5.00 | 5.00 |
| Jamaica | 10.50 | 10.50 |
| Barbados | 2.50 | 2.50 |

| <u>Market Interest Rates (%)</u> | <u>Closing Value</u> | <u>Previous Week</u> |
|----------------------------------|----------------------|----------------------|
| US 90-day T-Bill | 0.16 | 0.16 |
| US 10-Yr Treasury | 3.36 | 3.21 |
| 3-month UK Libor | 0.71 | 0.70 |
| Japan 90-day T-Bill | 0.28 | 0.28 |
| Brazil 90-day T-Bill | 10.20 | 10.08 |
| TT 90-day T-Bill | 1.16 | 1.16 |
| Jamaica 90-day T-Bill | 9.77 | 9.87 |
| Barbados 90-day T-Bill | 3.24 | 3.24 |

Sources: Bloomberg, J.P. Morgan, CMMB Research Center, Central Bank of Trinidad and Tobago, Bank of Jamaica, Central Bank of Barbados

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