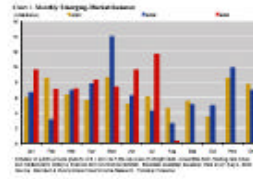




Emerging  
Markets  
Weekly



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*Underneath it all...*

### *A Closer Look at the Trinidad and Tobago Economy*

The Trinidad and Tobago economy has been growing at phenomenal rates during the past few years, commensurate with a steady decline in unemployment and improvements in the fiscal position and a healthy build-up of foreign exchange reserves. A fair share of the progress achieved thus far can be attributed to one dynamic - soaring oil prices on the international markets. The price of crude oil, as measured by West Texas Intermediate, averaged US\$42 per barrel during 2001-2005, compared to US\$20.15 per barrel in the previous five years. There is an unambiguous positive relationship between the price of crude oil and the level of economic activity in Trinidad and Tobago, which in itself masks severe vulnerabilities.

Fuelled primarily by high oil prices and government spending, real GDP growth has averaged almost 8% since 2000. However, the expansion is biased towards the energy sector, which has averaged an annual growth rate of 14%, while output in periphery sectors has averaged a meager 4.6% during the same period. The energy sector currently accounts for about 40% of GDP, and recorded a growth rate of about 11% in 2005 alone. This is expected to further rise going forward into 2006 on the back of continued tightness in the crude oil market, in addition to increased LNG production capacity. Trinidad and Tobago is the main supplier of LNG and methanol to the US market.

Meanwhile, the only driver in the non-energy sector is the construction industry, which has been benefiting from large government outlays on infrastructural developments and the erection of offices and residential buildings. Output from the agricultural sector has been on the decline, while manufacturing has remained virtually stagnant.

Government policy is geared towards economic diversification, with emphasis on traditional manufacturing and new technology-based industries, financial services, tourism and small business development. The Governor of The Central Bank of Trinidad and Tobago (CBTT) expressed concern about the direction and the new pattern of economic growth in the light of the current oil boom. He noted that there has been a shift in private sector investments from export-based manufacturing sector towards the domestic non-traded services sector. Additionally, there has been a marked increase in private investment abroad. The manufacturing

sector's share of employment and exports has shown a consistent decline since 2000, but was offset by the strong employment growth in the other sectors on the non-energy sector, specifically construction. These sectors have ramped up their foreign exchange demand requirements without a commensurate increase in market supply.

The energy sector underpins the whole economy. Revenue from the energy sector accounts for upwards of 50% of total government revenue. While the 2005/06 budget was based on a modest oil price assumption of US\$45/barrel, expenditure was based on an even more conservative US\$35/ barrel. For the first six months of the fiscal year, the government recorded a surplus as expenditure was much less than budgeted and non-energy revenue was much than anticipated. With expectations that crude oil prices should average around US\$55/ barrel, the outlook for the fiscal accounts is an overall surplus of 1-2% of GDP. The expansionary stance adopted by the government has been worsening the non-energy deficit, which has averaged 12% of the non-energy GDP in the past six years and should amount to an estimated 21% of non-oil GDP in fiscal 2005/06.

The domestic financial system remains highly liquid. The CBTT has been tightening monetary policy, successively increasing interest rates since March 2005. The Bank has also implemented additional unorthodox measures. In 2005, interest rates on special deposits were eliminated and the CBTT made it mandatory for commercial banks to place an aggregate of TT\$1 billion in an interest-bearing account for a minimum of 1 year. Further in June 2006, the Bank withdrew an additional TT\$500 million from the banking sector through this method. Although there was immediate TTS tightness after implementation of the latter measure, the other factors contributing to the liquidity, such as the large government expenditure, is outside the Central Bank's control.

Consecutive increases in interest rates in an effort to dampen demand seem ineffective. The cost of living has increased over 100% compared to six years ago. Inflation stood at 8% for the 12 months to May 2006. With recent hikes in electricity rates and the start of the rainy season, which can adversely affect agricultural prices, the outlook for inflation seems pessimistic. Excess domestic liquidity is a key contributor to the current inflationary environment, as the monetization of energy receipts to finance the government's expansionary policies boost aggregate domestic demand.

Although buoyant oil prices have significantly improved the country's balance of payments, the current 'managed' float that is in place has been under severe pressure, due to the following factors:

- Higher government spending
  - Increased import demand
  - Rise in foreign investments and portfolio outflows from the private sector, which has resulted partly because of rising interest rates in the US.
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In an effort to meet the rising foreign exchange demand, the CBTT increased sales to the market to US\$695 million in 2005. The tightness in the foreign exchange market continued well into 2006, with the CBTT intervening to the tune of US\$438 million for the period January- April 2006, compared to only US\$110 million sold during the same period in 2005. This has also aided in absorbing some of the excess liquidity.

Macroeconomic fundamentals appear strong, the Trinidad and Tobago economy is on the verge of '*overheating*'. Growth is expected to surpass 10% in 2006. The labor market is tightening significantly - the unemployment rate fell to 6.7% in the fourth quarter of 2005, the lowest in the country's history. The monetary stance is becoming increasingly rigid, and this has not thwarted inflation neither has it considerably dampened excess domestic liquidity. The culmination of these conditions has the potential to lead to a hard-landing for the economy. The key to engineering a soft landing will be fiscal restraint. Otherwise high oil prices will again turn out to be a curse to the Trinidad and Tobago economy rather than a blessing.

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## FINANCIAL & ECONOMIC INDICATORS

As at 29 June 2006

<b>Exchange Rate/US\$</b>	<b>Closing Value</b>	<b>Previous Week</b>
Yen	115.18	116.12
Euro	1.27	1.26
Jamaica	65.40	62.50
Guyana	200.70	200.70

<b>Commodity Prices</b>	<b>Closing Value</b>	<b>Previous Week</b>
Crude oil (US\$/bbl)	73.52	70.84
Natural Gas (US\$/mmbtu)	6.10	6.51
Gold (US\$/Troy Ounce)	600.00	580.65

### **Eurobond Indices (Returns, % YTD as of 29-June-06)**

Lehman Brothers Global Aggregate Index	-0.84
JP Morgan EMBI+	-5.40
CMMB Eurobond Index	-3.63

<b>Policy Interest Rates (%)</b>	<b>Closing Value</b>	<b>Previous Month</b>
United States	5.25	5.00
Euro Zone	2.75	2.75
Japan	0.02	0.02
Brazil	15.25	15.25
Trinidad	7.25	7.00
Jamaica	12.45	12.45
Barbados	4.75	4.75

<b>Market Interest Rates (%)</b>	<b>Closing Value</b>	<b>Previous Week</b>
US 90-day T-Bill	4.87	4.78
US 10-Yr Treasury	5.57	5.12
3-month UK Libor	4.76	4.75
Japan 90-day T-Bill	0.20	0.20
Brazil 90-day T-Bill	14.80	14.90
TT 90-day T-Bill	6.05	6.00
Jamaica 90-day T-Bill	12.26	12.28
Barbados 90-day T-Bill	6.19	6.05

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

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