

# Money Matters

With compliments from CMMB

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## Sweet Sweet T&T

**O**N 2 APRIL, 2003, STANDARD AND POORS International Ratings Services (S&P) upgraded Trinidad and Tobago (T&T) long-term local currency sovereign credit rating from BBB+ to A- and the long term foreign currency sovereign credit rating from BBB- to BBB.

The upgrade by S&P serves to improve T&T's image on the global arena, thus enhancing the country's investment opportunities — an important step towards the further development of the country. Let's highlight the major reasons that led to the recent upgrade by S&P.

### Reduction in Interest Burden

Currently T&T's interest burden accounts for approximately 16% of general government revenue, which is more than twice that of the BBB median. This unattractive phenomenon arose primarily in 2001, when there was heavy borrowing by state enterprises such as TIDCO, WASA, and MTS, all of which were government guaranteed. As a result, the debt/GDP ratio increased from 59% in 2000 to 66% in 2001, far surpassing the EMU ceiling of 50%. Fortunately, due to the current low interest rate environment (which we will discuss later) and the presence of embedded options in Government Issues, the present administration began to exercise its rights by redeeming high coupon debt, replacing it with lower coupon debt, resulting in a reduced future interest burden on taxpayers. To date, the Government has come to market with a TT\$500M amortized bond with structured tenors of 10 and 15 years and yields of 6% and 6.4% respectively. In addition, two new agency issues — WASA TT\$413M 6.75% 10 year note as well as a Caroni TT\$518.5M

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**Iraq, SARS, recession: Despite the nation's shortcomings, nationals of T&T should count their blessings!**



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## SWEET SWEET T&T (CONTINUED)

### PROS

- A booming energy sector supported by strong FDI flows
- A world leader in ammonia and methanol production, eventually becoming the fifth-largest producer of LNG globally
- Consensus on sound macroeconomic policy irrespective of political affiliation
- Healthy external financial position evidenced by improving liquidity and debt ratios.

### CONS

- Persistently high unemployment despite resounding performances in the energy sector (high structural unemployment)
- Continued lack of transparency into the fiscal operations stemming from a generally inefficient public service
- The high cost of running state-owned loss-making entities.

7.125% 12 year issue — were recently issued. It is anticipated that another TT\$500M will be issued in the near future with yields of 6% and 6.45% for 10 and 15 year tenors respectively.

In addition to the Government exercising its call options on these high coupon paying bonds, overall borrowing activity in the domestic capital market declined in 2002 following six consecutive years of growth. Primary market issues were down by 8.8% in 2002 compared to 2001. A total of TT\$3.606B was issued in 2002. Foreign currency denominated issues also contracted by 8.5%. Due to the slowing in borrowing activity as well as Government's prudent exercise of its call options, T&T's interest burden is expected to decline in the future.

### The Energy Sector

Another significant factor in the country's favour was a continuous growth in the energy sector in 2002. Energy-based industries provided the necessary fuel in achieving a 3% real GDP growth rate in 2002, accounting for a 10.7% increase in real value. Petrochemicals improved by 6.9%, whilst petroleum sub-groups posted an 11.7% increase. The solid performance in the energy-related industries softened the effects of slippage in the non-energy-based sectors of the economy, where real GDP growth declined by 1%. This decline arose as a result of contractions in transportation, storage and manufacturing. Further evidence of the slowing in the non-oil sector was the deterioration in the overall surplus in the balance of payments, which was US\$49M or .5% of GDP in 2002 down from US\$471M or 5.2% of GDP in 2001.

Besides the traditional oil revenue streams, T&T is patiently awaiting the receipt of its first full year of revenue from its 3 Liquefied Natural Gas Plants anticipated to kick in by fiscal year 2003/04.

Estimates suggest government revenues from Natural Gas production could be in the region of approximately TT20.0bn per annum.

These incremental revenue streams would provide the necessary platform for further enhancement in the country's economic performance, attracting new investors, increasing investment from existing investors and spurring activity in downstream industries, thus creating and expanding the involvement in the "natural gas value chain". With Atlantic LNG Train 3 in full production and Train 4 in 2004, T&T will soon be the fifth largest exporter of LNG globally, complementing the already enviable position of being a worldwide producer of ammonia and methanol. As a result, due to this broad-based energy matrix as well as the trade and financial integration with the US and other Caribbean countries, GDP growth is forecasted to be robust, with projections coming in at 4% in 2003 and 4.5% in 2004.

### Current Low Interest Rate Environment

The 'on the run' 90day T-Bill rate is 4.92% up 1bps over the prior three issues, suggesting little upward movement in the short-term end of the Government of Trinidad and Tobago (GOTT) yield curve. On the longer end maturities, the GOTT being the primary issuer of long-term debt capital is currently driving interest rates to all time lows mainly by the exercise of their call options in the current environment where competition amongst underwriters is fierce. The resulting outcome on the TTD yield curve is one that is relatively flat with a slightly positive gradient over its term structure.

With this low interest rate environment, investors should be inclined to borrow and finance projects at cheaper costs of funds, thus stimulating further investment. To date, the low interest rate policy

continues to be appropriate given the low inflation rate (estimated 4.20% 2002) and the continuing excess capacity in the economy.

In early May, the Central Bank Governor echoed calls to lower the reserve requirement primarily as a means of tightening spreads between loans and deposit rates (estimated at 9.35% in Sep - Dec 2002). The net effect of such a move should translate into even cheaper borrowing costs which should hopefully provide the much needed stimulus for credit expansion.

### Rationalisation of The Public Sector

Another noteworthy yet unpopular move by the current regime is its intention to restructure the public service by rationalising the operations of loss-making institutions such as Caroni 1975 Ltd. However, any such move to rationalise the public service must be carefully planned, as the Government should adequately weigh both the economic as well as the social costs associated with such action. While the economic benefits are evident, appropriate social support services will dictate the 'true' success of such a strategy.

To summarise, T&T's future can be looked upon with some fervor, predicated by the following:

- A booming energy sector supported by strong Foreign Direct Investment flows
- A world leader in ammonia and methanol production and eventually becoming the fifth-largest producer of LNG globally
- Consensus on sound macroeconomic policy irrespective of political affiliation
- Healthy external financial position evidenced by improving liquidity and debt ratios.

However, despite the apparent 'blessings' showered on T&T a number of factors should be considered in order to balance the equation:

- Persistently high unemployment despite resounding performances in the energy sector (high structural unemployment)
- Continued lack of transparency into the fiscal operations stemming from a generally inefficient public service
- The high cost of running state-owned loss-making entities

Notwithstanding the pros and cons of the T&T economy, the challenge to any government is to ensure that the benefits to be derived from the anticipated windfall in revenues are trickled down to the 'man on the street' and not only to a privileged few. The perception of inequality is continuing to widen, supported by the dramatic rise in murders and kidnappings that have plagued the country since the start of the year. Spending on merit goods such as health and education continues to be at unacceptable levels of approximately 2.5% and 4.5% of GNP respectively given the wealth of resources the country possess.

Despite the nation's shortcomings, nationals of T&T should count their blessings given the recent global events such as the war on Iraq, a slowing US economy and not to mention the deadly SARS virus in the Far East which has crippled some economies. With prudent economic and social management, T&T's future does appear to have the potential to be SWEET contrary to many of our counterparts. ■

# Arbitrage

Making the financial market work  
FOR you (for a change)

**G**reetings fellow investors, it's the Promenade Investor here. This is the first in a series of articles designed to take some of the mystery out of investing and financial planning.

Having spent some time on the Brian Lara Promenade, reading the financial papers and talking to people in banking, stock-broking and financial services, I thought I'd share some of what I've picked up along the way. So sit back, put your feet up and have a read. I promise not to bombard you with too many technical words and phrases but if I really really have to, I will explain them as simply as I can.

I thought I'd start with Arbitrage since A is the first letter in the alphabet and this is my first article it seemed appropriate. I know it sounds like a strange fruit of some kind or a disease you'd rather not catch but simply put Arbitrage is:

**"The buying of foreign exchange, securities, or commodities in one market and the simultaneous selling in another market. By this series of actions, a profit is made because of the difference in the rates of exchange or in the prices of securities or commodities involved."**

Well that was a mouthful but all it means in essence is that you buy something in one market at one price and sell it in another at a higher price. It really doesn't matter what you trade in, it could be a commodity like oil, a foreign currency or shares in a company. Put another way, it's like buying a pound of cheese in a wholesale market for \$2.00 and selling it in your store for \$2.50. Sounds simple doesn't it? So why isn't everyone running around and making money on the price differentials between markets. Well there are a couple of things to bear in mind before deciding if Arbitrage can work for you.

**Transaction costs** There are costs involved in any purchase; these include, among others, commissions, transportation, bank charges, transfer fees and taxes. It is very important that

you consider all the possible costs involved in the transaction when computing the potential profit on the deal. Also remember that there may be costs involved in both the purchase and the sales side of the transaction.

**Timing** There may be a delay in obtaining title to the asset purchased, getting it registered in your name and transferred to the market where you are going to sell it. During this time the price of the item may change in the market you intend to sell making the transaction more or less profitable. So be very sure you find out how long transactions will generally take so that you don't have any surprises when you're calculating your gain.

**Availability** Like any market someone has to be ready to sell at the time and price that you are willing to buy for a transaction to be completed. Make a few calls to the players in the market to get information on the availability of supply in the market you'll be buying in and also the demand in the market you're going to be selling in. There's no point trying to sell potatoes if tomatoes are what everyone wants.

**Market Access** It's critical that you can transact business in both markets for Arbitrage to work. If you can't purchase the item in Market A and sell it in Market B then it simply won't work. You should therefore investigate the companies or persons authorised to trade on the markets you are going to do business in prior to making any confirmed orders.

**Currency** It is quite possible that you may be purchasing the item in one currency and selling it in another. If this is the case then you have to establish the stability of the currencies involved. If there is a change in exchange rate in any market this could spell disaster to your well thought-out plan. So it's vital that you do your homework in this regard. Also you must ensure that you can access the buying market's currency from the banks in your home country or the market you'll

be selling in. Again remember that there may be transaction costs in purchasing or selling currency.

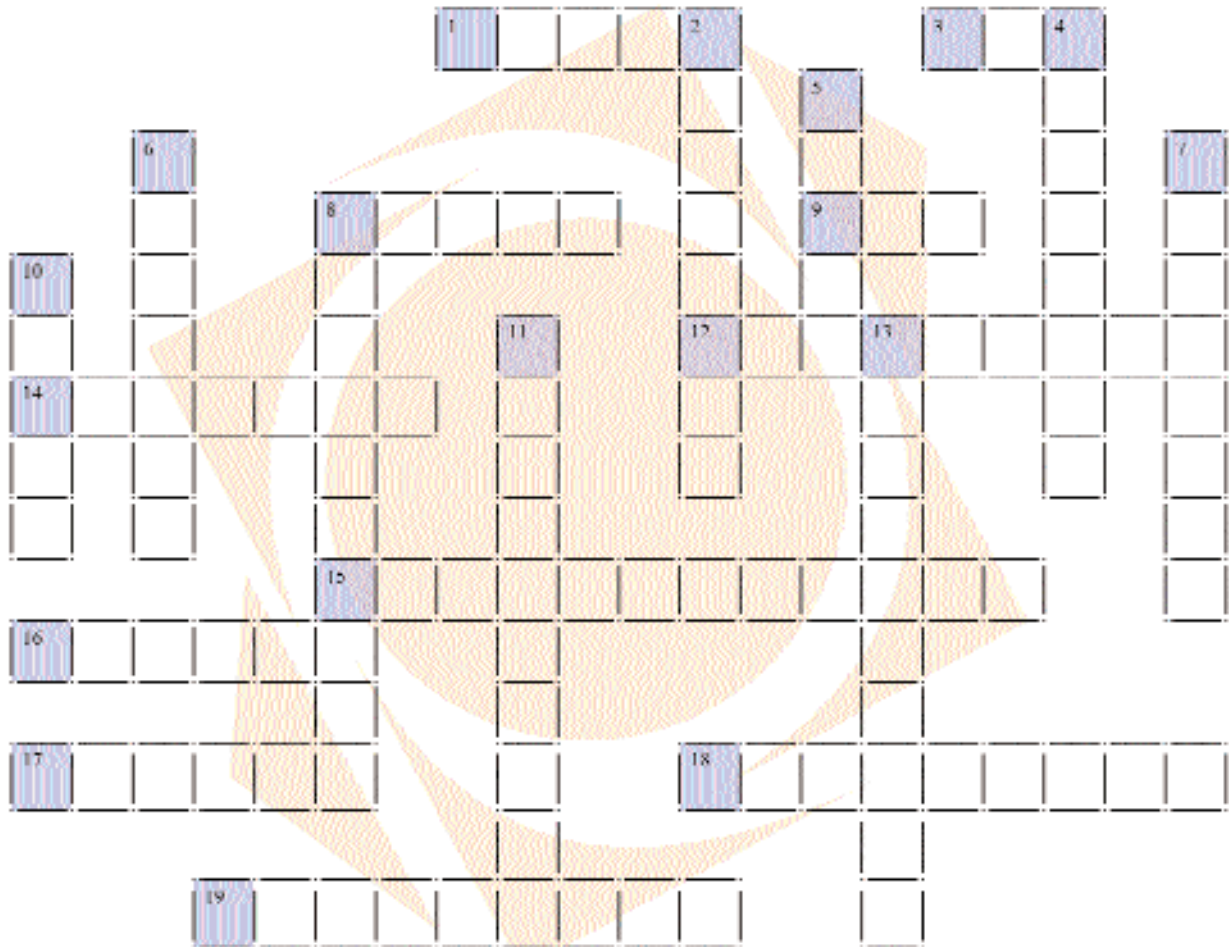
Enough theory, here's an example of how Arbitrage might work in a real world situation. Let's say shares in company A are traded on the Trinidad & Tobago Stock Exchange at TT\$12.00. The same share is traded on the Barbados Stock Exchange BDS\$3.50 and the rate of exchange is BDS\$1.00=TT\$3.00. Commissions are 2% of the consideration in both markets and bank wire transfer fees are TT\$ 15.00. You intend to buy 100 shares in Barbados and sell them in Trinidad.

	BD\$
Purchase of shares in Barbados (100 x BDS\$ 3.50)	350.00
Commissions paid on purchase	7.00
<b>Total Cost of shares in Barbados</b>	<b>357.00</b>
	TT\$
Total Cost of shares in Barbados converted to TT\$ (TT3:Bds1) (a)	1,071.00
Sale of shares in Trinidad (100 x TT\$ 12.00)	1,200.00
Commissions paid on purchase	(24.00)
Bank transfer fees for payment for share in Barbados	(15.00)
<b>Net Sales proceeds in Trinidad (b)</b>	<b>1,161.00</b>
<b>Total profit on transaction (a-b)</b>	<b>90.00</b>

Please bear in mind that this is a simplified example for illustration purpose, ignoring any changes in price between purchasing in Barbados and selling in Trinidad. It also assumes that the shares can be transferred between the markets and that there are no restrictions on ownership involved. But you get the general idea.

So, there you have it Arbitrage at a glance. I hope you find this useful in planning your next big deal. Till next time, this is the Promenade Investor, wishing you happy and profitable investing. ■

## Investors' Challenge



### ACROSS

- 1 The percentage rate of return on a stock in the form of dividends, or the rate of return paid on a bond or note. (5)
- 3 The primary regulatory agency of the securities industry. (3)
- 8 Document intended to provide shareholders the right to vote on matters to be brought up at a stockholders' meeting. (5)
- 9 A company's first sale of stock to the public. (3)
- 12 The process of completing an order to buy or sell securities. (9)
- 14 Employee of a brokerage or fund management house who studies companies and makes buy and sell recommendations on their stocks. (7)
- 15 The written statement that follows any "trade" in the securities markets. (12)

- 16 Purchase of a controlling interest (or percent of shares) of a company's stock. (6)
- 17 Certificates or book entries representing ownership in a corporation or similar entity. (6)
- 18 Profiting from differences in the price of a single security that is traded on more than one market. (9)
- 19 A classic negative change in ratings for a stock, and or other rated security. (9)

### DOWN

- 2 Distribution of a portion of a company's earnings, cash flow or capital to shareholders, in cash or additional stock. (8)
- 4 Excessive trading of a client's account in order to increase the broker's commissions. (8)
- 5 Price and volume fluctuations that can confuse interpretation of market direction. (5)

- 6 An arithmetic mean of selected stocks intended to represent the behavior of the market or some component of it. (7)
- 7 Net income for the company during the period. (8)
- 8 Formal written document to sell securities that describes the plan for a proposed business enterprise, or the facts concerning an existing one, that an investor needs to make an informed decision. (10)
- 10 A verbal (or electronic) transaction involving one party buying a security from another party. (5)
- 11 Stock that has fallen out of favor with investors; tends to have a low P/E. (10)
- 13 The fee paid to a broker to execute a trade, based on number of shares, bonds, options and/or their dollar value. (10)

# Capital discipline like Swiss Clockwork

## The New Basel Capital Accord: Implications for T&T

**B**asel 1, developed in 1988, is currently the worldwide standard for determining bank capital, both in developed and developing countries. Basel 2, referred to as the New Basel Capital Accord, is due to replace Basel 1 by December 2006.

The New Basel Capital Accord is built on three pillars:

- Pillar 1 — minimum capital requirement of 8%
- Pillar 2 — the Supervisory Review Process and
- Pillar 3 — Market Discipline

The three pillars are mutually reinforcing and were erected in recognition that safety and soundness of the financial system cannot be achieved solely through minimum capital requirements. The primary changes to the minimum capital requirement set out in the 1988 Accord are in the approach to measurement of credit risk; the inclusion of explicit capital requirements for operational risk; and the creation of more risk buckets to make the weighting of sovereign, bank and corporate exposures more reflective of the underlying risk. A range of risk sensitive options for addressing both credit and operational risk is elaborated, starting from the "standardised" approach and extending

to the "foundation" and "advanced" internal ratings-based (IRB) approach. These approaches simply reflect increasing levels of sophistication and comprehensiveness of the risk assessment models used. To aid in risk weight assignments, heavy emphasis will be placed on credit risk assessments done by independent credit rating agencies.

These evolutionary approaches are intended to motivate banks and financial institutions to continuously improve their risk management and measurement capabilities, and to avail themselves of the more risk-sensitive methodologies, thereby leading to a more accurate calculation of capital requirements. Of significance, the ultimate responsibility for managing risks and ensuring that capital is held at a level consistent with the institution's risk profile remains with that institution's management.

### Challenges to Implementation

1. Pillar 2 of the New Accord emphasises the supervisory process but there are several limits to this, including lack of regulatory support, lack of legal protection for staff, political interference and inadequate compensation of bank supervisory staff.



## CAPITAL DISCIPLINE — THE NEW BASEL ACCORD (CONTINUED)

2. Secondly, Governments' support of large failing banks ("too big to fail" syndrome) has led to market discipline (Pillar 3) not working properly. Further, the use of market discipline opens up room for collusion of banks in small economies, which further highlights the increasingly important role of the supervisory process.

3. Proper pricing of risk — it is often difficult to separate or isolate risks particularly in crisis times when, for example, currency risk can easily lead to increased credit risk.

4. Compliance — the challenge of inculcating a risk culture and risk way of thinking throughout the firm.

5. Regulators must ensure that the cost to the banking system is less than the benefits of any new rules and regulations being put in place. Bank supervisors should therefore turn to more risk-based supervision than simply trying to collect as much information as possible. They must be careful of over-emphasising regulation at the expense of growth and development.

### How does this affect us in T&T?

It has been estimated that not including normal disadvantages due to diseconomies of scale, Basel 2 will bring about a 200 basis points difference in cost between local indigenous banks and international banks.

Notwithstanding this, banks and financial institutions in T & T must, as a start, take elements of Basel 2 to improve their risk management practices and start eliminating the 3 Ms of risk — Misunderstanding, Miscalculation and Mismanagement.

While Basel 2 is not mandatory, large international customers are soon going to ask about your risk management practices and whether or not you follow Basel 2 guidelines. Banks and financial institutions in T & T would do well to start preparing themselves from now by collecting data, setting up databases, etc., and building a risk culture integrated throughout the institution.

Most banks in Trinidad are capitalised well beyond the required minimum of 8%, and while there might be some reallocation of capital with the adoption of



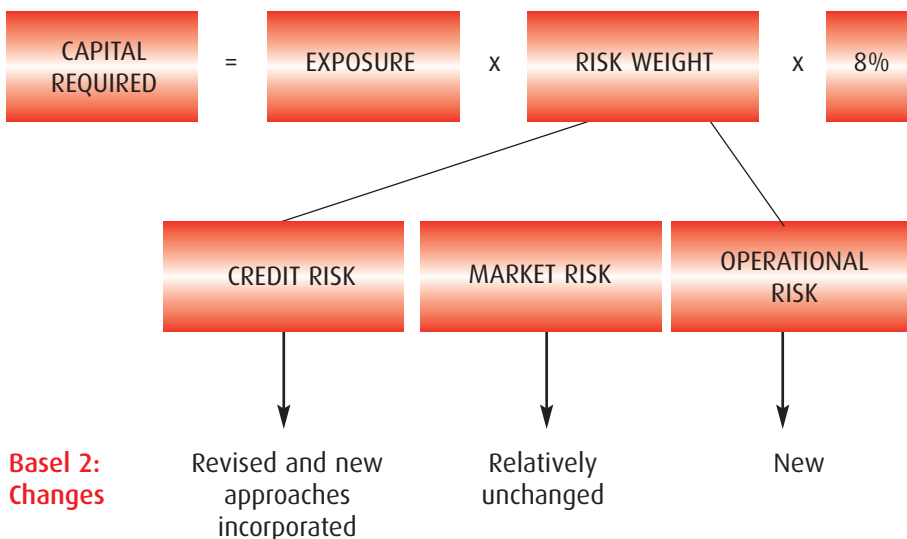
Basel 2, the biggest impact would have to be an increased focus on measurement and management of risk — credit, market and operational. As our banks and financial institutions venture into new territories in search of higher rewards, the attendant risk also increases and must now be measured.

Corporate Governance is still most important — you can have all the numbers on your dashboard, if you don't have execution of remedial measures driven by the Board and Management, your institution can still fail. Hand in hand with this is the need for the education of Board Members on the meaning of the risk measures and risk limits and the practical significance of deviations from these risk limits.

Finally, there is the need now more than ever to attract persons in our financial institutions who:

- have a risk way of thinking
- are willing to challenge and probe
- are system thinkers and
- are quantitative and have a good understanding of the metrics of risk.

The road ahead no doubt will be very challenging for our regulators, particularly with the increased responsibilities brought on by Basel 2. Our banks and financial institutions would be well advised, however, to be proactive in their risk management development. A sound financial institution with a comprehensive and integrated risk management system is way too critical now to be left in the hands of the regulators. ■



**F**or years, women have stayed on the sidelines of the financial industry simply because of lack of knowledge or fear of investing. However, women are now becoming more financially successful and independent and as such, there is a greater need for them to manage their own wealth.

### Why target women specifically?

Statistics have shown that women live longer than men by an average 7 years and so they need to save more for retirement.

Women's working life is also interrupted by family life, as on average, women have to take off about 11 years more from work than men. Most importantly, women earn 25 percent less than most men for the same work. All these statistics just prove that women need to be more conscious about the growth of their money.

The most recent statistics from North America also showed that women tend to be better investors than men. Women's portfolios have gained 1.4 percent more than men's portfolios. Women tend to do more research in their investments and therefore, they make more sound financial decisions rather than just going with a tip or 'following a hunch'.

Some key points for women who are investing:

### Start Now.

Time is money. It is never too early or too late to start investing. Take advantage of any extra funds you may have now and make finances your priority. Also, look at any employer benefits such as pensions, insurance coverage and even educational subsidies.

## WHY WOMEN SHOULD INVEST MORE

# Women make great investors



## WOMEN MAKE GREAT INVESTORS (CONTINUED)

### Plan a Budget.

There are some expenses that are mandatory such as, utility bills, mortgage or rental payments and food. And then there are other expenses that you can place a limit on like shopping, entertainment and other luxury items. However, when placing limits on these luxury items, do not go so far as to deprive yourself of something that you enjoy. This will only reduce your motivation for saving and investing.

**Do not be afraid of making mistakes in some investments. Learn from those mistakes and look for ways to improve your investments.**

### Set Realistic Goals.

As part of portfolio management, investors have to set goals for their funds. Women may be planning for retirement, children's education or their own personal education. These goals are important in order to determine a time horizon for investing, how liquid these investments should be and the amount of risks that should be taken. At the same time, have expectations that are realistic and attainable.

### Seek Financial Advice.

Most people lack the financial expertise needed to make wise investments. Therefore, women should not be afraid to ask questions. Read the newspapers and articles on financial matters in order to increase your knowledge. Seek advice

from a professional advisor, a close friend or relative or anyone else who you can feel comfortable talking with. Some women can even undertake their own research via the internet or libraries.

### Do Not Be Afraid of Risk

Most women have typically been very conservative in their investments. It is important to understand that there is a difference between saving and investing. Saving is simply putting money away for a rainy day. Investing involves the use of more aggressive investment vehicles for growth of money that one already has saved. In order to receive a higher return, a higher level of risk has to be taken. Women can become more aggressive by investing in mutual funds, money market funds or even stocks and bonds. Of course, it is always best to seek professional financial advice before taking on risk. Do not be afraid of making mistakes in some investments. Learn from those mistakes



and look for ways to improve your investments.

### Seek a Financial Identity

While women should work with their partners and family to make financial decisions, it is important for a woman to create her own financial identity. This could start by simply ensuring that there are accounts in her name or joint accounts with her partner. Financial independence is important because as statistics have shown, women do outlive men, and over 75 percent of women are widowed by the age 56. Therefore, women should learn to take care of themselves and have the necessary funds in place in which to do so. ■

### Solution for Investors' Challenge:

