INVESTMENT AND SOVEREIGN RESEARCH

***SOVEREIGN*: Trinidad and Tobago**

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Executive Summary

Real economic growth is expected to improve over the next two years driven in part by higher hydrocarbon output and prices. This is likely to have a positive impact on household income, the non-petroleum sector and government revenues. No major windfall is however expected in government revenues to facilitate continuation of high subsidies and transfers by the authorities relative to earlier periods. As a consequence of the fiscal consolidation measures being undertaken, the inflationary impulse resounding from increased household spending will be tempered. Thus, while inflation is expected to rise, it is expected to be bounded at the long-term average of around 5% per annum over the medium-term.

The normalisation of monetary policy in the US will likely influence domestic rate hikes. The spread between US- and TT- dollar investments is negative and further rate hikes by the US Federal Reserve will push the margin further south, thereby increasing the risk of capital flight in Trinidad and Tobago. In an environment of continued rate hikes by the Fed, the Central Bank f Trinidad and Tobago (CBTT) is highly likely to adjust the domestic repo rate upwards to help stabilize the external accounts despite this running counter to its intention to promote higher investment activities in the non-petroleum industry.

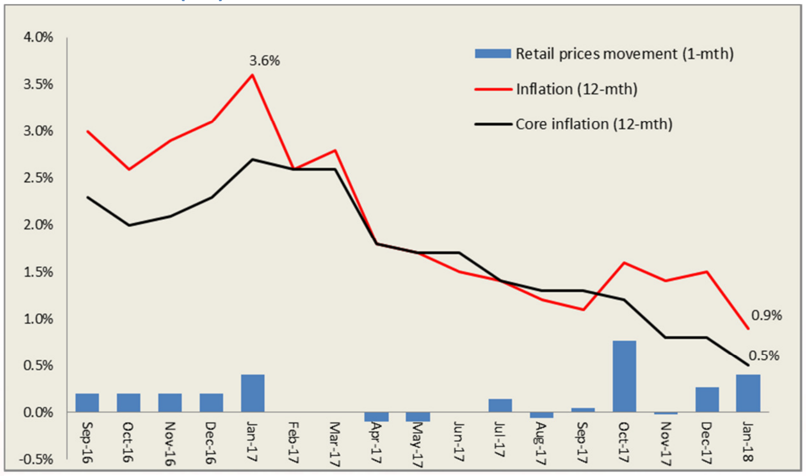
The Growth Agenda

Income flows from the petroleum sector in the recent past have largely help to fuel government and private consumption, but have slowed due to subdued hydrocarbon prices and production. As we have pointed out in previous publications, the economy operates as a dual economy. Oil revenues received by the Government of Trinidad and Tobago is distributed to the wider public through subsidies, government consumption and employment. The pass-through impact on these activities and exports help to drive output in the non-petroleum sector. With the contraction in the petroleum industry relative to the size of the economy and reduction in revenue flows to government, private consumption is expected to play a greater role in driving economic growth. The rise in private consumption to around 70% of GDP from under 55% for the 2008 to 2015 period reflects less growth in household income and more of a decline in the petroleum sector and structurally low hydrocarbon prices.

We are forecasting growth of 2% in 2018 and 2.5% in 2019 predicated in part on recovery in the petroleum sector. During the fourth quarter of 2017 British Petroleum (BP) commenced operation at the juniper field. This is expected to boost gas feedstock, which has declined due to mature fields and subdued investment in the sector, a consequence of depressed oil prices relative to mid-2014. In 2015, gross fixed investment (capital investments) as a percentage of GDP was approximately 29%, but has subsequently fallen to 10% and is likely to remain relatively low over multiple periods.

Inflation

Table 1: Inflation (CPI)



Source: CBTT and JMMBIR

The 12-month headline inflation rate in January was 0.9 % while core inflation and food inflation were 0.5% and 2.6%, respectively. Inflation is expected to remain relatively low throughout much of 2018, but is expected to increase as household income increases in tandem with expansion in real output, and the effect of expansion in the consumption tax base during the fourth quarter of 2017. Lower government spending, to curtail the fiscal deficit, is however expected to mitigate the impact on inflation from rising household income. Thus, headline inflation is expected to rise to 2.7% by year end. Looking on over the medium-term, inflation is expected to revert to the long-term average of around 5% due to higher international prices and spending in the domestic economy.

Table 2: Selected Macroeconomic data

Indicator Name	2014	2015	2016	2017	2018 (e)	2019 (f)	2020 (f)	2021 (f)	2022 (f)
GDP per capita, USD	19,497	17,389	15,451	15,250	15,141	12,287	12,647	14,103	15,213
Real GDP growth, % y-o-y	-0.6	-0.6	-5.1	-0.3	2.0	2.5	2.1	2.2	1.9
Inflation, eop	8.5	1.5	3.1	1.4	2.7	5.0	5.0	5.0	5.0
Central banl policy rate, Repo	3.0	4.8	4.8	4.8	5.3	5.3	5.0	5.0	5.0
Exchange rate, eop	6.37	6.42	6.75	6.76	6.92	7.20	7.20	7.20	7.20
Total revenue, % of GDP	34.8	38.1	32.2	26.9	28.9	29.4	29.5	28.6	28.9
Budget balance, % of GDP	-2.6	-1.8	-5.7	-9.0	-5.6	-4.3	-3.5	-3.0	-2.7
Balance of trade in goods, % of GDP	24.3	10.7	-5.4	0.1	4.1	5.7	7.3	7.1	7.1
Current account balance, % of GDP	15.2	4.0	-12.1	-5.8	-2.4	0.3	1.8	1.7	1.6
Foreign reserves ex gold, USDbn	11.5	9.9	9.5	8.4	8.1	8.5	9.0	9.5	10.0
Import cover, months	16.1	13.9	12.1	9.7	8.5	8.2	8.5	8.7	9.1
Government domestic debt, % of GDP	39.5	42.9	48.4	52.4	54.4	55.5	55.4	54.6	53.5
Total government debt, % of GDP	48.1	52.3	63.8	66.8	69.3	70.3	70.2	69.2	68.1
Crude, NGPL & other liquids prod, % y-o-y	-1.3	-4.6	-10.6	1.3	0.5	0.3	-0.1	-0.3	-0.4
NGPL & other liquids prod, 000b/d	116.1	110.8	99.1	100.3	100.9	101.1	101.1	100.8	100.4
Crude, NGPL & other liquids prod, US$ bn	4.1	2.0	1.5	1.9	2.4	2.7	2.8	2.8	2.8
LPG production (wellhead & refined), 000b/d	20.2	20.4	20.6	20.8	21.0	21.2	21.4	21.4	21.3

Source: CBTT and JMMBIR

Interest rate

The spread between US- and TT-dollar investments has narrowed and is in negative territory since November 2017 as reflected in the yield on the 91-day Government of Trinidad and Tobago T-bill and 91-day US Treasuries. This comes on the heel of expectations of at least three (3) rate hikes by the US Federal Reserve (Fed) in 2018 and the Central Bank's (CBTT) policy rate holding steady since 2015. Despite the risk of capital flight, the CBTT has balanced its decision to stay the policy rate to help boost investments in the non-Petroleum sector, which is being impacted by falling household income and slowdown in external demand. Low core inflation, which is running below 2%, has also helped to solidify the bank's interest rate position over the last three years. Low domestic inflation has helped to temper the growing influence of external factors on domestic interest rates.

Over the last 18 months or more we have been mooting the possibility of a domestic interest rate increase predicated on continued normalisation of monetary policy in the US. In late March the Fed adjusted the baseline interest rate by 25 basis points (bps) much to the expectation of the market. The Fed raised the 2018 and 2019 forecast for economic growth to 2.7% and 2.4% up from 2.5% and 2.1%, respectively. In the same vain the outlook on unemployment was lowered while inflation is expected at around the 2% mark over the next two years. Given the prevailing outlook on inflation and growth in the US, the expectation is that the Fed will hike rates at least three times in 2019 and twice in 2020.

Conclusion

Over the next two years real economic output is expected to expand in Trinidad and Tobago driven by increased hydrocarbon production and improvements in prices. This will have some spill over benefits for the non-petroleum sector and government coffers. The increase in revenue to the government however will not result in any significant shift in the ratio of petroleum revenues to total revenues. As such no major windfall is anticipated to support government spending on subsidies and transfers, as was the case in the period leading up to 2014. The risk to the growth outlook is fairly balanced at this time with the main downside risk being lower than projected hydrocarbon prices. Consensus forecast is pointing to moderate increases over the medium-term.

Inflation has subsided and is expected to remain low throughout much of 2018. However, as the economy picks up and household income increases, spending on goods and services is expected to rise and push inflation upward. The increase in household spending is expected to be mitigated by cuts in government spending, which will help to put a halt on the inflation momentum. As a consequence, a gradual rise in inflation is expected towards the long-term average.

At this point the probability is weighted towards an increase in repo rates. As we have noted overleaf the spread between USD- and TT-dollar investments is negative. With further rate hikes by the US Fed, it places further downward pressure on spreads and raises the risk of capital flight despite the authority's tight grip on investment flows. It is hard to envisage a scenario where the CBTT does not act if policy rates increase by at least 75 bps in the US, which is the consensus forecast in 2018.

Sources:

Central Bank of Trinidad and Tobago (CBTT)
Business Monitor International (BMI)
International Monetary Fund (IMF)

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