INVESTMENT AND SOVEREIGN RESEARCH

SOVEREIGN: Trinidad and Tobago

PLEASE SEE IMPORTANT DISCLOSURES IN THE APPENDIX

Table 1: SWOT Analysis

Strengths

The sovereign is the leading oil and gas exporter in the Caribbean, with significant proven reserves and well developed physical infrastructure.
Elevated real output has led to massive welfare improvement and reduction in poverty over the years.

Large external buffers build up over the years from hydrocarbon production windfall, including foreign reserves and the Heritage Stabilization Fund.

Weakness

High dependency on the energy sector makes the sovereign highly vulnerable to external price shocks.

The two main political parties are divided along an ethnic line, with the opposition being antagonistic towards government policies. There is fear within the investment circle that a change of government could lead to a reversal of policy. Short term political risk is medium to high, exacerbated by the heightened perception of corruption among public officials.

Opportunities

Reform of the non-banking financial sector and exchange rate regime and renewed privatisation of state assets could help unlock higher growth levels.

Higher investments in tourism and agriculture offer potential upside to improve growth. This would help diversify the economy, making it less susceptible to shocks.

Threats

Depressed energy prices could make the sovereign less attractive to investment in hydrocarbon projects over the medium term, leading to lower growth, structurally high levels of unemployment and reduction in external balances.

An uptick in narco-trafficking could cause a spike in violent crimes, which could destabilise the country if left unchecked.

Credit Rating: Standard & Poor's, BBB-/Stable; and Moody's Ba2/Stable

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Summary

Trinidad and Tobago's economy is expected to grow in 2021, and the growth momentum is likely to extend over the medium term. Higher output boosted by elevated hydrocarbon prices should lead to an uptick in government revenues. With growing debt levels that caused several rating downgrades over the last five years, the government, although tempted to spend more, will have to contain spending to bring the deficit under control. Like revenues, the external balance has improved but remains tethered to price movement in the energy market and domestic energy output. Inflation remains weak, while the threat of an increase in the US policy rate could force the central bank to increase its policy rate. The overall risk to the economy is growing, reflecting mutation of the coronavirus and lower than envisaged energy prices.

Growth and Fiscal Operation

We expect Trinidad and Tobago's economy to expand by 3.8% in 2021 amid recovery from the contraction in 2020 and increases in global oil and gas prices. We forecast growth of 2.5% and 1.0% in 2022 and 2024, respectively. The outlook is rooted in moderately strong demand for oil and gas over the forecast horizon and continued expansion in the global economy. The improvement in growth has boosted government revenue, which is expected to expand to 21.3% after falling to just 20.8% in 2020. In 2017–2019, revenue to GDP averaged 26.5% over the period. We expect nominal revenue and revenue as a proportion of GDP to continue to grow over the medium term in line with expansion in the economy and output from the petroleum sector.

Despite the expansion in revenue, we expect the government to continue to adhere to fiscal prudence, although there is mounting pressure to expand spending, especially social spending. For 2021, we envisage a fiscal deficit of 5.2% compared to 11.2% in 2020. We expect the deficit will remain relatively subdued over the medium term as the government continues to rein in spending, especially subsidies and social support.

Because of improvements in revenue and lower spending, we expect the primary balance to move into surplus after being in a deficit over the last five years. We expect the primary balance surplus to grow marginally over the medium term to about 1.3%. Under this scenario, coupled with our modest growth forecast, we expect debt to GDP to stabilise at around 85% of GDP.

Budget Brief

The Government of Trinidad & Tobago (GOTT) plans to spend $52.4 billion in FY 2021/22 presented while targeting revenue of $43.3 billion. Given the lower revenue relative to expenditure, the authority expects a deficit of $9.1 billion (5.8%) of GDP, lower than the $11 billion (9% of GDP) recorded during the previous fiscal year. The budget is predicated on crude oil and gas prices of US$67.7 per barrel and US$4.1 per million BTU, respectively. Revenues from hydrocarbon is expected to contribute 29% of the overall revenue flows, while non-tax revenue makes up the remaining portion. We expect the government to draw down from the Heritage Stabilization Fund (HSF) and issue bonds on the domestic market to plug the gap.

The risk to the budget is moderate to high, which reflects the possibility of slower global growth and lower energy prices in 2022. The discovery of a new strain of the coronavirus that shows resistance to vaccines (Omicron) threatens to undo

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strides made over the last 18 months to curtail the spread of the disease worldwide and to return global markets to a semblance of normalcy. If countries impose tighter travel restrictions, global aggregate demand and growth will fall—likewise, the demand and price for energy products.

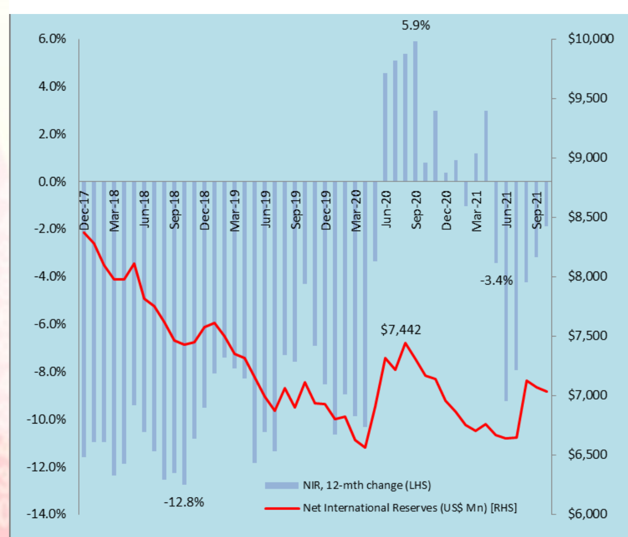
Inflation and Policy Rate

As expected, inflation remained weak throughout most of 2021, and we envisage it will end the year at around 2.4%. We forecast inflation to remain relatively flat at about 2.5% over the medium term. Although we expect improvements in the economy and employment, subdued government spending and weak monetary expansion will help to curtail aggregate demand. A stable domestic currency will help cushion the effect of external price rise. Inflation risk is tilted towards the upside and reflects higher domestic prices due to weather-related shocks and continued rise in global commodity prices.

After keeping the policy rate stable for the last 20 months, the central bank will probably increase the policy rate in the second half of 2022. We believe that the policy rate will gradually increase toward the pre-pandemic level by the end of 2023. The central bank keeps a close watch on the yields for the 3-months Treasury bills (T-bills) in the US and T&T. The difference in yield drives capital flow; high yields in the US incentivise market players to move funds away from local assets towards US-based assets. With positive interest rate differential between TT and US 3-months T-bills and Federal Reserve (Fed) holding its policy rate at 0%-0.25%, since the pandemic, the central bank has placed a greater priority on helping the domestic economy to recover by keeping rates low. Although the central bank has a low appetite to increase the policy, pressure to adjust it upwards is slowly rising.

With the global economy facing inflationary pressures, albeit mostly stemming from logistic challenges, central banks in developed countries stand ready to increase their policy rate to help stymie inflation expectations. The Fed and European Union Central Bank are already unwinding their bond-buying programmes to give themselves more ammunition to help combat inflation. The Fed may increase the policy rate in Q2:22, which would push up the 3-months T-bill yield with it. Under this scenario, the interest rate differential between short-term TT and US-dollar assets would fall, which may nudge the CBTT to increase the policy rate.

Figure 1: Reserve, US$ million



Sources: CBTT and JMMBIR

External Balance and the Currency

Low energy prices in the first half of 2021 and weak production output are likely to result in a low current account surplus (CAS) by the end of the period. We expect a CAS of about 1% of GDP in 2021. However, with the increase in energy prices in the second half of the period, which is likely to be sustained over the medium term, and higher output, the CAS is projected to rise and remain relatively flat at around 3.5% over the forecast horizon. Foreign reserves should increase because of positive capital flows and the CAS. We envisage reserves to move to US$9.2 billion or 36 weeks of imports in 2024 compared to US$7.0 billion or 34 weeks of imports in 2020. The rebound in reserves in 2020 bucked the trend since 2017-2019, where it declined at an annual average rate of approximately 10% due primarily to the collapse of energy prices and capital outflows. In 2013, the eve of the fall in energy prices in

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2014-2015, the current account generated a surplus of 20.4% of GDP but turned into a deficit of 3.5% in 2016. The forecasted CAS as a percentage of GDP at the end of the forecast period is only 18% of what it was in at that time.

Contrary to our previous view, we believe that currency will remain stable over the medium term owing to improved fundamentals in Trinidad & Tobago's external account. The outlook over the medium term suggests structurally higher energy prices that will redound favourable to energy output and exports and boost petro-currency flows. We also believe that capital flows will improve, reinforcing our view regarding reserves.

Table 2: Selected Macroeconomic Indicators

Indicator	2017	2018	2019	2020	2021 (e)	2022 (f)	2023 (f)	2024 (f)
Population, '000	1,384.1	1,389.8	1,395.0	1,399.5	1,403.4	1,406.6	1,409.2	1,411.2
Nominal GDP per capita, USD	16,238.3	17,130.1	17,511.9	14,696.2	16,148.7	16,724.6	17,361.2	17,139.0
Real GDP growth, % y-o-y	(3.0)	0.1	(1.3)	(7.8)	3.8	2.5	1.4	1.0
Unemployment, % of labour force, eop	4.4	3.5	4.0	5.5	5.0	4.7	4.5	4.3
inflation, eop, % chg y-o-y	1.3	1.0	0.4	0.8	2.4	2.4	2.4	2.5
Central bank policy rate, %	4.8	5.0	5.0	3.5	3.5	3.8	4.3	4.8
LCU/USD, eop	6.8	6.8	6.8	6.7	6.8	6.8	6.8	7.5
Total revenue, % of GDP	24.4	27.6	27.5	20.8	21.3	22.4	23.0	23.4
Total expenditure, % of GDP	32.6	30.3	30.8	31.9	26.5	26.0	26.1	26.0
Current expenditure, % of GDP	29.7	28.0	28.5	29.6	25.3	24.8	24.9	24.9
Fiscal balance, % of GDP	(8.2)	(2.7)	(3.2)	(11.1)	(5.2)	(5.0)	(3.0)	(2.6)
Capital expenditure, % of GDP	2.1	2.2	2.3	2.3	1.2	1.2	1.2	1.2
Primary balance, % of GDP	(5.2)	(0.2)	(0.2)	(8.6)	(3.0)	0.3	0.9	1.3
Current account balance, % of GDP	6.3	6.8	4.2	0.1	0.9	3.3	3.1	3.7
Foreign reserves ex gold, USD	8,370.0	7,575.0	6,929.0	6,954.0	7,927.0	8,324.0	8,740.0	9,177.0
Foreign reserves ex gold, % of GDP	37.2	31.9	28.4	33.7	35.0	35.4	35.7	39.9
Import cover, months	9.7	8.0	7.7	8.5	8.6	8.7	8.8	9.1
Government domestic debt, % of GDP	44.3	42.6	39.1	50.0	58.8	60.2	61.7	64.6
Total government debt, % of GDP	59.8	61.5	72.4	81.9	85.2	86.0	85.7	85.0

Sources: Fitch connect and JMMBIR

Rating Downgrade by Moody's

In mid-November, Moody's Investors Service (Moody's) downgraded Trinidad & Tobago's sovereign credit ratings to Ba2 from Ba1 and changed the outlook from negative to stable. Moody advised that a higher debt burden has weakened Trinidad & Tobago's ability to absorb economic shocks. The rating agency is projecting debt to GDP of 85% in FY 2021 and expects to remain within the region of 85% - 90% over the medium term. Moody's noted that the rise in the debt reflects support measures for the pandemic, which drove the deficit to 11.2% in FY 2020 and high rates of economic contraction in earlier periods.

The rating agency expects a fiscal deficit of 5.8% in FY 2022 and advised that the government is projecting a primary balance surplus by 2024. Moody's noted that delivering on this commitment requires improved revenue flows and expenditure containment.

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The Heritage and Stabilization Fund (HSF) supports Trinidad & Tobago's fiscal strength, Moody's said. In 2020, the government amended the HSF legislation, allowing withdrawal up to a maximum of US$1.5 billion for budgetary support. The HSF has net assets of US$5.6 billion or 25% of GDP.

Moody's advised that the lack of diversification and exposure to carbon transition constrain Trinidad & Tobago's credit profile despite near term growth. The rating agency is forecasting growth of 5.9% in 2022 and 2% in 2023-2024. Higher energy prices and output are driving the growth outlook. Moody's noted that the over-reliance on energy output for government revenues and exports leave the sovereign highly exposed to the collapse in energy prices.

Moody's advised that the stable outlook captures the government's effort to improve the fiscal profile and diversify the economy. The rating agency said that fiscal and external buffers support the current rating, limiting government exposure to liquidity and balance of payment shocks.

Outlook

Trinidad & Tobago's economy is expected to expand in 2021, and growth should continue at least over the next two years. Improved energy prices relative to 2014-15 will drive underlying growth while helping to reinforce structural encumbrances that have undermined the development of the non-energy sector. Improvements in the economy are likely to induce job creation and minimise the risk of social tension resulting from ongoing fiscal consolidation. The risk to the growth outlook is moderate to strong, reflecting global travel restrictions because of the more virulent strain of the coronavirus, a rise in the number of local coronavirus cases, and lower energy prices. Although the impact of restrictive travel would be lower than other more tourist-dependent Caribbean countries, the sovereign would feel the secondary effect of lower global aggregate demand and its adverse impact on energy markets and prices.

At the time of writing, there were 689 new Covid-19 which exceeded the peak number of cases in late May when the government imposed stringent measures to curtail the spread of the disease. The government may likely impose further restrictions on the movement of persons, at least in the short run, to help restrict the spread of the disease. If Covid-19 cases remain elevated and no action is taken, the country could be forced into an extended lockdown sometime down the road, undermining our growth estimate.

The risk of inflation rising above our forecast is low to moderate and reflects mostly higher than expected international prices. Commodity prices could climb higher if the supply chain challenges observed throughout 2021 are unresolved in 2022. Although we expect the economy to grow, austerity measures will mute price pressure from domestic demand. The risk of the central bank increasing the policy rate is tilted towards the upside. However, with GDP below pre-pandemic level, the bank will not be too quick to pull the trigger, as it prioritises economic growth over inflation. However, if the Fed increases its policy rate, we expect the CBTT to do the same to help defuse the risk of capital migration.

We view the overall macroeconomic fundamentals for Trinidad and Tobago as stable and risk level as low to medium over the medium-term. Rising debt poses a grave risk to the sovereign's long-term economic prospects. We continue to monitor the government's action closely, as failure to control the deficit could set in motion a vicious cycle of unsustainable fiscal and debt dynamics.

Trinidad and Tobago is experiencing an upsurge in criminal activities, including murders, most of which are linked to narco-trafficking. There is no silver bullet to deal with the problem. However, fiscal challenges resulting from economic mismanagement and higher debt levels could result in higher levels of crime. The sovereign could experience an increase

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in violent crimes, like murders, if the government devotes fewer resources to social spending and law enforcement in favour of debt servicing. Therefore, the government must carefully balance its action to reduce the fiscal deficit while ensuring that critical sectors in the economy are not underserved. If the government cannot deliver on its fiscal and social prerogative, it would undermine economic growth and development.

Sources: Bloomberg, IMF and Fitch Connect

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