***SOVEREIGN*: Trinidad and Tobago**

Ratings: A-/Negative; Baa3, Negative

Default: N/A

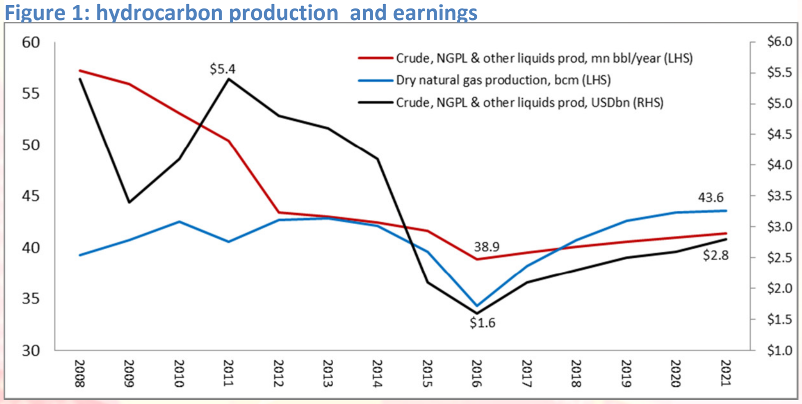
Introduction

Sharp reductions in hydrocarbon prices since 2014 and supply side challenges in the petroleum sector are having a negative impact on the domestic economy. Consequently real output contracted in 2014 and 2015 by 1.2% cumulatively and is expected to fall by 4.5% in 2016. Data from Q2:16 indicate that real output fell for the period year-on-year by 8% due to reductions in output in the Petroleum and Non-Petroleum sector of 12.6% and 5.4%, respectively. All the major subsectors experienced declines in output with the exception of Agriculture where output increased by 2%.

Although real output is expected to increase over the medium-term, the fiscal deficit will negatively impact the debt trajectory. No material change is expected in international reserves over the forecast horizon however the widening of current account, the fiscal deficit and subdued investment flows are likely to cause exchange rate pressures.

Macro-fiscal Profile

Figure 1: hydrocarbon production and earnings



The FY 2016/17 budget was revised downwards in the mid-year review due to lower than projected hydrocarbon prices, which continue to affect the fiscal accounts and the economy. In previous years, oil revenue accounted for upward of 30% of total revenue but has since fallen off to around 18%. No significant change in the trend is expected any time soon owing to several factors. Trinidad and Tobago's oil and gas fields have matured and consequently output has fallen relative to previous years; low oil prices have not facilitated the investment flows required to bring new acreage into production; and gradual increases in hydrocarbon prices is not expected to make up for subdued production (See figure 1).

A fiscal deficit of around 2.5% of GDP per annum is envisaged over the forecast horizon while the debt to GDP is expected to rise from 60% to 65%. Debt build up poses downside risks to the economy, as greater levels of resources are required to service debt to the detriment of capital expenditure.

Table 1: Selected Economic Indicators

Indicator Name	2011	2012	2013	2014	2015	2016 (e)	2017 (f)	2018 (f)	2019 (f)	2020 (f)	2021 (f)
GDP per capita, USD	19,022	19,292	19,820	19,498	17,389	16,637	17,098	15,949	14,952	14,715	15,394
Real GDP growth, % y-o-y	-0.3	1.3	2.7	-0.6	-0.6	-4.5	2.0	2.2	2.5	2.0	2.3
Population, mn	1.3	1.3	1.3	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4
Unemployment, % of labour force, eop	4.2	4.7	3.8	3.3	3.5	4.5	4.2	4.2	4.0	4.0	4.0
Inflation, % y-o-y, eop	5.3	7.2	5.6	8.5	1.5	3.3	5.6	4.8	5.4	2.3	4.7
Exchange rate: TTD/USD, eop	6.37	6.42	6.40	6.36	6.42	6.75	7.40	9.00	10.00	10.00	10.00
Total revenue, % of GDP	29.1	29.8	31.0	34.8	38.1	29.7	28.8	27.7	27.8	28.4	28.6
Budget balance, % of GDP	-0.7	-1.3	-2.9	-2.6	-1.8	-5.1	-3.7	-3.2	-2.9	-2.6	-2.3
Current account balance, % of GDP	7.0	-10.6	12.8	1.4	-0.4	-8.3	-5.4	-3.8	-1.6	0.4	-0.4
Foreign reserves ex gold, USDbn	9.8	9.2	10.0	11.3	9.8	9.3	8.4	8.6	9.0	9.5	10.0
Import cover, months	12.4	9.5	9.5	12.0	12.4	13.9	11.9	11.5	10.6	10.6	10.6
Government domestic debt, % of GDP	24.4	31.5	31.1	39.5	43.5	45.6	43.7	42.3	41.5	41.2	40.5
Total government debt, % of GDP	31.4	37.3	39.2	47.8	52.7	59.9	62.4	63.7	65.4	66.2	65.1
Total investment, % of GDP	2.7	1.3	-0.6	-	-	-	-	-	-	-	-
Central bank policy rate, % eop	3.00	2.75	2.75	3.00	4.75	4.75	5.50	5.00	5.25	5.00	5.00
Lending rate, %, eop	7.8	7.5	7.5	7.5	9.0	9.5	10.5	10.5	10.5	10.5	10.5

Source: BMI, IMF, JMMBIR

Current Account, Exchange Rate and Interest Rate

Imports are expected to decline at a faster rate than exports over the forecast horizon, and as such it is envisaged that the current account deficit will fall from 8.3% to 0.4%. However notwithstanding positive developments in the current account, lower investment flows are likely to lead to negative capital account balances thus resulting in draw down on reserves for much of the forecast period. Only in the latter periods of the forecast horizon (2020 to 2021) do we expect reserves to show upward adjustment on account of higher net exports. The Balance of payments dynamics has implications for the currency.

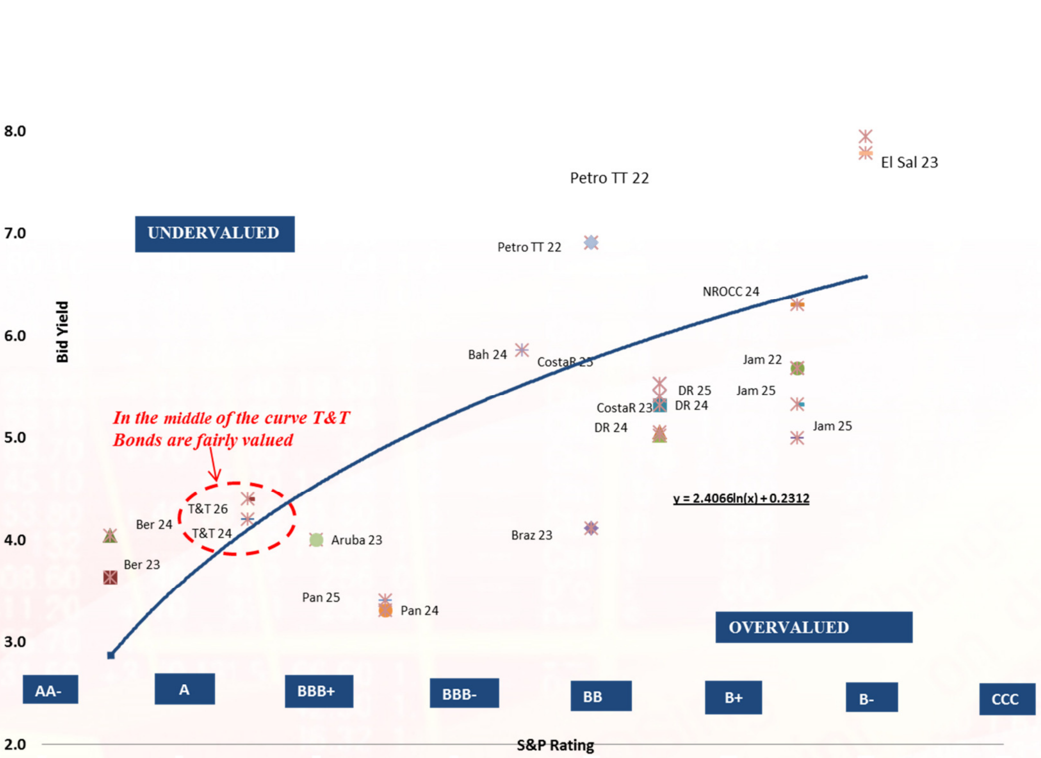
During 2016, despite the reluctance of the authorities, the domestic currency depreciated by 5.7%. Depreciatory pressure is likely to remain relatively elevated for much of the forecast period due in part to erosion in the terms of trade and subdued capital flows. As such, the domestic currency is expected to fall initially and thereafter stabilize at a relatively higher value.

The Central Bank of Trinidad and Tobago (CBTT) held the repo rate at 4.75% throughout 2016 despite pressure in the foreign exchange market. The decision was geared in part to help stimulate activities in the Non-petroleum sector. However, with continued pressure in the foreign exchange market and normalisation of US monetary policy, the CBTT will find it extremely difficult to hold rates steady under these scenarios. It is our view that the US Federal Reserve will increase lending rates by at least 50 basis points in 2017. As such the

CBTT is likely to adjust the repo rate upward accordingly to preserve the interest rate differential between TT-dollar and US-dollar assets to stymie capital outflows.

Relative Value of Global Bonds

Figure 2: Relative Value Curve for Mid-Yield Curve



Source: Oppenheimer and JMMBIR

When we compare Trinidad to other Latin American and Caribbean bonds in the middle of the yield curve, the most liquid Trinidad and Tobago global bonds – TT 2024 and TT 2026 – are fairly priced with offer yields of 4.205% and 4.402%. The face value on the bonds is US$550 million and US$1 billion respectively with duration of 5.8 and 7.6, respectively.

Despite fiscal slippages and growing debt, the sovereign continues to show strong willingness to service its debt. No material change in this stance is expected in the short- to medium term. External debt as a percentage of GDP is relatively low, under 12%, and the sovereign maintains a large external reserve of over US$9 billion, approximately 40% of GDP. In addition to this the Heritage & Stabilization Fund (HSF) is estimated at around US$5.7 billion or 24% of GDP. In principle, while the proceeds from the HSF are used for counter-cyclical spending, resources from the Fund could be used to service debt or at least interest payments in a worst case scenario.

Table 2: Summary of Ratings and Ratings Action

Rating Agency	Date	Action	Ratings and Outook
S&P	15-Apr-16	Downgrade	Baa3/Negative
Moody's	22-Apr-16	Downgrade	A-/Negative

Source: Standard and Poor's and Moody's

Trinidad and Tobago's sovereign credit ratings was downgraded in early 2016 by Standard and Poor's and Moody's amid growing concerns regarding its elevated fiscal deficit; growing debt relative to peers; guaranteed financial support to state entities, which could add to the debt, particularly PetroTrin; and lack of optimism with respect to the ability of the government to effectively undertake the necessary fiscal and economic policy reforms to arrest deterioration in government finances. In their deliberations, both rating agencies assigned a negative outlook to the sovereign predicated largely on fiscal and growth challenges.

Based on our forecast, we are not expecting any change in ratings over the next year or so, as no material deviations are expected in the main ratings drivers, particularly the fiscal dynamics and external accounts. However, we do anticipate an improved outlook (negative to stable) to reflect marked adjustments in real GDP growth. We caution however that if planned projects to increase hydrocarbon output are not realized on schedule the sentiments could change. Our growth forecast is heavily weighted on these events coming to fruition, as over the forecast horizon we envisage marginal increases in hydrocarbon prices. As such real output growth in the petroleum sector reflect higher hydrocarbon output. Relatively low but positive growth is expected in the non-petroleum sector.

Conclusion

Trinidad and Tobago is facing economic challenges culminating with the fallout in hydrocarbon prices and maturing oil fields. In addition to that, subdued economic growth in some Caribbean territories, particular Barbados could stymie export growth in non-petroleum products. Notwithstanding, there is a ray of optimism that real economic growth will increase to around 2% per annum over the medium-term while unemployment is expected to stabilize at 4%. Debt-to-GDP will increase in line with movements in the fiscal deficit and depreciation of the domestic currency.

A major structural shift is required to make the economy more shock resilient, and less dependent on Hydrocarbons. However this requires policy initiatives, some of which could result in fallout in political capital, such as rationalization of the public sector to facilitate efficiency and reduce the fiscal deficit at a faster pace. On the revenue side, a overhaul is required in tax policy and administration to improve revenue efficiency. These initiatives require consensus among stakeholders, including the political directorate, labour unions and the private sector. Given the cumbersome nature of such tri-partite discussions an agreement is not expected to be reached anytime soon, and should it be reached it would take even more time before the economy starts to see green shoots from said initiatives. Gains from these outcomes are not factored in our medium-term projections.

The sovereign is expected to continue to honour its debt obligations over the medium-term. While we envisage continued challenges with government finances, both the domestic and external environment should remain conducive to debt rollover and current revenue streams are expected to continue facilitating interest payments. Downside risks of further credit downgrades are relatively high compared to upside risks. A one-notch credit downgrade will not materially impact the sovereign's investment grade ratings. However, additional downgrades in the long-run could occur if the government does not embark on structural adjustments to reorient major economic outcomes. While these actions are painful, they are a necessary tool to put the economy on a more sustainable macro-fiscal path and therefore they should be given priority.

Source:

Business Monitor International (BMI)
Bloomberg
International Monetary Fund

IMPORTANT DISCLOSURES

ABSTRACT—As a part of our new Portfolio Strategy we are recommending strict adherence to the following Portfolio Allocation **DEFINITIONS/RECOMMENDATIONS**.

PLEASE NOTE THAT NO INDIVIDUAL ASSET IN YOUR PORTFOLIO SHOULD HAVE A WEIGHTING GREATER THAN 5% UNLESS OTHERWISE RECOMMENDED BY YOUR PORTFOLIO MANAGER OR A SPECIFIC JMMB RESEARCH REPORT. CONSEQUENTLY THE FOLLOWING **DEFINITIONS** ARE PROVIDED FOR CLARITY.

UNDERWEIGHT—REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET

SELL—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.

HOLD/MARKETWEIGHT—EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB.

OVERWEIGHT/BUY—EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

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