JMMB Investments (Trinidad and Tobago) Limited
169 Tragarete Road Port of Spain
Trinidad and Tobago

INVESTMENT AND SOVEREIGN RESEARCH *October 2017*

2017/2018 Budget Highlights: Navigating Economic Turbulence

In light of the October 2nd 2017 budget presentation for FY 2017/2018, we at JMMB Investments (Trinidad and Tobago) Limited take a look at the main comments made by Finance Minister Colm Imbert, and discuss how they relate to investors and the economy.

Fiscal 2017 Recap

Although spared by this year's hurricanes, Trinidad and Tobago faces economic headwinds due to lower revenues from the petroleum industry and increasing debt levels. To fully understand the gravity of Trinidad and Tobago's economic circumstance, consider the sizeable slowdown in revenue inflows over the past three (3) years. Once, this oil rich economy enjoyed high crude oil prices, north of USD $100.00 per barrel, but now, it grapples with oil prices that hold some resistance at USD$50.00 per barrel, with no sign of reversal. This paradigm shift resulted in a ruinous reduction in the state's petroleum revenues, which cascaded approximately 87% from $20.9 billion in 2014 to $2.8 billion in 2017. The fall-out from the steep decline has led to foreign exchange challenges and contractionary fiscal policies i.e. increased taxes and a slowdown in government expenditures.

In his budget presentation, the Finance Minister affirmed the country's shortcomings and challenges for 2017, as indicated by preliminary economic data. Total estimated revenue for 2017 was recorded at $37.84 billion, approximately $9.56 billion lower than the 2017 budgeted estimate of $47.4 billion. This 20% shortfall reflects the slowdown in proceeds from the petroleum sector, insufficient funds attained from asset sales and delays in the collection of property taxes during fiscal 2017. The preliminary data also suggests that total expenditure in 2017 is in the vicinity of $50.5 billion, some $2.9 billion below budget. This translates into a revised estimated fiscal deficit of $12.64 billion or 8.4% of GDP in fiscal 2017 versus the budgeted target of $6.0 billion.

Factor	Budgeted Estimates FY 2018	Estimated Outturn FY 2017	Budgeted Estimates FY 2017	Estimated Outturn FY 2016
Oil Price US$ (WTI)	52	48	48	35
Natural Gas Price US$ (MMBTU)	2.75	2.25	2.25	2.00
Revenue (TTD Billions)	45.74	37.84	47.4	44.9
Oil Revenue (TTD Billions)	6.41	2.80	2.58	1.7
Non-Oil Revenue (TTD Billions)	39.32	35.04	44.87	43.2
Expenditure(TTD Billions)	50.50	50.50	53.48	52.2
Fiscal Deficit (TTD Billions)	4.76	12.643	6.0	7.3

The Road Ahead: 2018 Budget Highlights

Recall that in the last budget presentation, Minister Colm Imbert alluded to the Government's fiscal plan to achieve an overall budget balance by 2020 by rebalancing our fiscal accounts and realigning expenditure with revenue against frail energy prices. In addition, the Government has communicated its Vision 2030, which comprises of the National Performance Framework (2017 – 2020) and the National Development Strategy (2016 – 2030). Vision 2030 is a long-term development plan to achieve developed country status by 2030, upon which, citizens should be provided with a more equitable share of national resources. Wide engagement and dialogue with the national community is paramount to the achievement of this strategic plan.

Revenue

Budget revenue for 2018 is based on the assumptions of an oil price of US $52.00 per barrel and a gas price of USD $2.75 per MMBTU. Identified revenue streams include:

- Sale of Assets Programme: repayments relating to the CLF/CLICO rescue plan and withdrawals from the restructured HSF, inter alia, to generate an amount of approximately $7.5 billion or 4.4 percent of GDP.
- Adjustments to the Supplemental Petroleum Tax regime; responsive to profitability instead of price.
- A 12.5% royalty rate applicable to the extraction of all gas, condensate and oil.
- Further shrinkage of the diesel subsidy and increased petroleum gross margins.
- Increased inspection fee for motor vehicles.
- A fully implemented property tax system in 2018.
- Stronger regulation governing the gaming industry and tax payments.
- Increased taxes on motor vehicle tax and customs duty on private passenger vehicles with engine sizes exceeding 1599cc and not exceeding 1999cc by 25%.
- Revenue from the New Tax Bracket for Companies and Commercial banks
- Licensing Fee implementation for Private Hospitals

Upon successful implementation of the revenue generating initiatives, the budgeted revenue for 2018 is estimated to increase by $7.9 billion to $45.74 billion, when compared to the preliminary 2017 revenue value of $37.84 billion. In past years, Government has struggled with the inefficiencies of tax collection methods. Improvements in this area, through aggressive execution and transparency, should bring the country closer to its 2018 fiscal goals.

Expenditure

Major expenditure allocations for 2018 remained with Security, Education and Health, which collectively accounted for 39% of 2018's total budgeted expenditure. Government estimated a total expenditure of $50.5 billion for fiscal 2018. Considering the 2018 budgeted revenue of $45.74 billion, Trinidad and Tobago would be facing a fiscal deficit of $4.7 billion, some $7.88 billion lower than the 2017 estimated outturn of $12.64 billion.

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Budget Summary

Investor Implication

Positive Impact | Negative Impact | No Impact | Both a Positive and Negative Impact

Key Budgetary Initiatives	Summary	Investor impact
Fuel Subsidy	**Key Changes** ■ The Government highlighted that within the current energy price structure, wholesale margins for Premium, Super, and Regular gasoline were set at 14.5 cents and since 2009, have remained constant at 9.5 cents for both Diesel and Kerosene. Finance Minister, Colm Imbert, proposed an increase all wholesale margins; for premium, super andm regular from 14.5 cents to 19.5 cents and for diesel and kerosene from 9.5 cents to 14.5 cents. This adjustment effectively increases the price of Super Gasoline by 11% from $3.58 per litre to $3.97 per litre and the price of Diesel by 48% from $2.30 per litre to $3.41 per litre. **Effective Date** ■ Immediately **Our view** ■ We believe that this measure may cause inflationary pressures that are likely to impact businesses and consumers alike. Manufacturers and wholesalers currently rely on diesel engine vehicles to distribute goods to retail vendors.	Negative Impact
Corporation Tax	**Key Changes** ■ The Government proposed to spread the tax burden amongst companies by increasing the base tax rate bracket from the previously subjected 25 percent to 30 percent. Recall that in the last budget presentation, effective January 2017, the Government introduced a new tax bracket of 30.0 percent on companies with chargeable profits in excess of $1.0 million per annum. As a result, the base tax rate bracket for companies remained at 25.0 percent. Additionally, the Government has proposed a new tax bracket of 35.0 percent on commercial banks chargeable profits. **Effective Date** ■ January 1st, 2018 **Our view** ■ The increase in corporation tax will raise the revenue inflows to the government, however, from the companies' perspective, higher taxes are expected to erode profits. As a result, investors may receive lower dividend payments as compaines grapple with lower earnings. Additionally, an increase in corporate taxes will result in an increase a company's deferred tax position.	Negative Impact

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Key Budgetary Initiatives	Summary	Investor impact
Gambling Industry	**Key Changes** ■ In an attempt to curb the extremely low level of compliance and the tax evasion within the gambling sector, the Government introduced a new gambling legislation. The following were proposed: - the existing rate of duty on all mechanical games of chance for gambling of 20 percent be increased to 40 percent. This measure will take effect from **October 20th 2017**; - the introduction of a 10 percent tax on all cash winnings by the National Lotteries Control Board. This measure will take effect from **December 1st 2017;** electronic roulette devices operating in bars throughout the country, under the Liquor Licence Act, Chap 84:10 will now attract a flat device tax of $120,000 annually; - the gaming tax which shall be payable annually under the Liquor Licence Act, Chap 84:10 will be increased from $3,000 to $6,000 in respect of each amusement game; - the taxes on gaming tables and other devices by private members' clubs would be increased. This measure will take effect from **January 1st, 2018.** **Our view** ■ This initaitive is not expected to have any direct impact on investors. However, the increase in revenue collection would assit in closing the fiscal gap and promote economic growth. It is yet to be determined if the increases in taxation for this industry will (1) be passed on to customers and (2) as a result, reduce the customer flow in the sector?	
Supplemental Petroleum Tax	**Key Changes** ■ The Minister of Finance stated that the following critical areas regarding the Supplemental Petroleum Tax (SPT) are being reviewed for implementation. - Amending the SPT from a tax charged at rates based on weighted-average annual crude oil price to a tax to be responsive to underlying profitability. - Extending the SPT to include natural gas. **Effective Date** ■ Before the end of year 2017 **Our view** ■ Currently, SPT is imposed at varying rates based on the weighted average annual crude oil price and income from the disposal of natural gas is not subject to SPT. Hence, during 2016-2017, where the weighted average crude oil price fell below US$50 per barrel, no SPT were paid. This created a revenue challenge for the Government. In response, making the SPT responsive to underlying profitability and not to price as well as extending the SPT to the country's main petroleum product, gas, is expected to raise revenue for the government in the upcoming year.	

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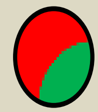
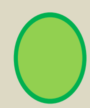
Key Budgetary Initiatives	Summary	Investor impact
Access to Foreign Exchange	**Key Incentive** ■ The exchange rate is now expected to move more in step with demand and supply and the availability of foreign exchange. In addition, the Minster has proposed the establishment of an Export Promotion Facility which would provide manufacturers with access to foreign exchange required for the purchase of raw materials and other inputs. The Export Import Bank of Trinidad & Tobago Limited (EximBank) will now act as a dealer in foreign exchange. **Effective Date** ■ January 2018 **Our view** ■ Comments centered around the exchange rate seem to signal the Minister's intention to move closer to a free floating foreign exchange rate, allowing the foreign exchange rate to fluctuate based on market conditions. In the event our speculations are correct, a free floating exchange rate would aid in softening the exchange limitations and encourage direct foreign investment. However, this incentive is not without its challenges. A depreciated currency and inflationary pressures usually go hand in hand due to higher input costs for export products and/or higher import bills. Both of which, will widen the trade deficit. Manufacturers, now being able to access foreign currency is a positive incentative to stir operational growth for companies.	
Sale of Asset: CLF/Clico Repayment Plan	**Key Incentive** ■ The net debt of CLF to the Government is now $15.6 billion**.** As part of the Government's repayment plan, major strategic assets of the CLF Group will be divested either by public offerings on the Stock Exchange or through placement in a new National Mutual Fund. Through these means, the assets will be available for purchase by the general public and institutional investors, such as pension funds, the NIB and the UTC, in the form of units which will pay dividends. The Finance Minister has advised that the creation of the new National Mutual Fund has already begun, with the transfer by Clico to the Corporation Sole of 29.9% of the shares of Angostura and 16% of the shares of Home Construction, which together, are worth $1.4 billion. This transfer will go towards reduction of the debt owed by CLF/Clico to the Government. **Our view** ■ The liquidation options addressed reduces investors' concern that the assets of CL Financial and Clico will be sold to wealthy private concerns, which may not be in the best interests of the national population. Investors would have a opportunity during the upcoming year to partake in this divestment opportunity, promoting trading activity and providing investors with a means of investment in the current low interest rate environment.	

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One can argue that initiatives with underlying negative impacts to investors in the short term, can promote growth and stability in the economy, which would be beneficial to investors in the long term.

Our View

Depressed energy prices, rising debt burden and inefficient tax collection measures have all created the bleak reality for the economy of Trinidad and Tobago. We believe that the budget presentation fell short of economic divestment initiatives that can truly stimulate economic growth. Instead, continual dependence on the energy sector continues to make our revenue inflows susceptible to external shocks.

The persistent unmet demand for foreign exchange versus supply has placed further pressure on manufacturers, wholesalers, retailers and investors. The Minister's language around foreign exchange suggests that the TT dollar may depreciate against the US dollar, creating an investment opportunity for investors through USD investments.

The Minister advised that the preparation for the creation of the new National Mutual Fund has already begun, with the following transfers by CLICO; 29.9% Angostura shares and 16% Home Construction shares, which is geared towards reducing the debt owed to the Government. As a result, we anticipate some level of liquidity mopping-up. This, coupled with the estimated increase in Government borrowing, leads us to expect an upward movement in local interest rates in the medium term.

The country's net official reserves[1] wavered to $8.5 billion, the equivalent of 9.8 months as at September 2017, in line with 2008 lows. As at September 30th 2017, net public sector debt outstanding totaled $93.7 billion or 62.6% of GDP compared with $87.5 billion, the equivalent of 58.8% of GDP at the end of September 2016. This ratio is expected to worsen as public sector debt is anticipated to continuously climb while GDP retreats.

If the necessary internal restructuring methods are not implemented, the economy of Trinidad and Tobago faces further negative credit rating movements, restricting its ability for external financing, and stunted growth in the future.

[1] Net official reserves refer to the foreign currency resources (including both official reserve assets and other foreign currency assets) at the disposal of the authorities that readily can be mobilized to meet demands for foreign exchange. **Source:** IMF's international reserves and foreign currency liquidity report.