Trinidad and Tobago Outlook: Weaker TTD Ahead

- Although Trinidad and Tobago's energy sector is set to increase production during the years ahead, our projection of only a moderate recovery in global oil and gas prices will weigh on economy-wide growth, the government's fiscal accounts, and the country's balance of payments.

- The Central Bank of Trinidad and Tobago (CBTT) recently reconfirmed its commitment to a stable exchange rate through tight control over foreign exchange sales, but depreciation pressure on the Trinidadian dollar (TTD) is likely to intensify over the coming quarters and the Central Bank will have to allow the TTD to weaken further.

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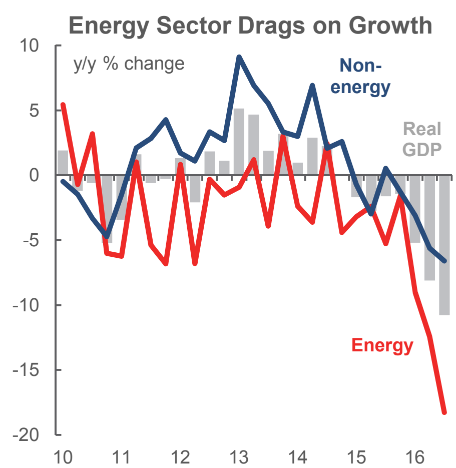
RECENT ECONOMIC DEVELOPMENTS

The Trinidadian economy is heavily dependent on the health of its domestic energy industry and global oil and gas prices: the energy sector accounts for more than 80% of Trinidadian exports and about a third of government revenue. Reductions in gas output and exports over the past three years have generated significant pressure on the country's fiscal accounts, balance of payments, and international reserves—all of which has materially increased the chances of a substantial further weakening in the Trinidadian dollar (TTD) despite the government's recent Mid-Year Budget Review promise that, "There will be no drastic or sudden depreciation of the currency."

Three consecutive years of economic contraction. The CBTT and the Central Statistical Office have revised the country's GDP data series from 2010 onward multiple times over the last year, which leaves some uncertainty over both recent data prints and any projections one would base on them. The CBTT now puts growth in 2015 at -0.6%, down from 1.0% previously. The Trinidadian economy continued shrinking during 2016, contracting 5.2% year-on-year in Q1-2016, 8.1% in Q2-2016 and a further 10.8% year on year in Q3-2016 as natural gas production fell (charts 1 and 2). This implies that Trinidadian output fell by about 5.1% during 2016, the third consecutive year in which it has contracted (see table).

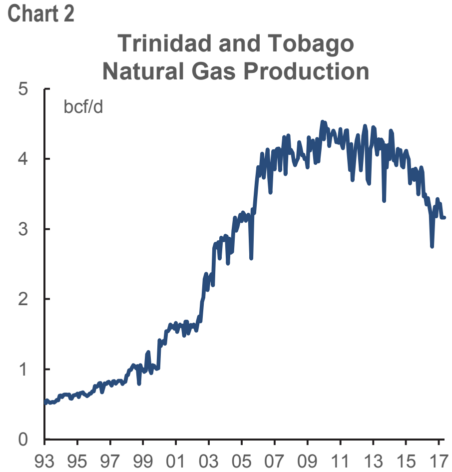
Growth may return briefly in 2017. The Trinidadian economy will continue to face challenges from relatively low export earnings, tight fiscal accounts, and relatively high unemployment during the remainder of 2017 and into 2018, but the energy sector, which accounts for about 40% of GDP, could tip growth back into positive territory in 2017. Natural gas production should rise in 2017 after a few years of decline: BP's Juniper project is set to enter production in the second half of 2017 and some additional output is set to follow later (see appendix 1). Additionally, we expect global oil and gas prices to increase gradually through 2017 and maintain their levels in 2018 (see table) as the dampening effect from continued expansion in US shale output is offset by (1) a relatively high rate of compliance with OPEC's agreed limits on production and (2) tightening inventories. Beyond 2018, the energy sector is likely to put a cap on any further acceleration in Trinidadian economy-wide growth as modest price gains keep investment growth in the sector at modest levels.

Chart 1



Sources: Scotiabank Economics, CBTT.

Chart 2



Sources: Scotiabank Economics, Central Bank of Trinidad and Tobago.

Weak fiscal picture will maintain pressure on the TTD. Increased gas production and exports could temporarily boost public revenue during 2017 and allow the authorities to quicken their execution of the government's Public Sector Investment Programme (PSIP); however, beyond the next two years, growth in public revenue is likely to slow gradually (chart 3). The Trinidadian government's efforts to increase non-energy sector investment from relatively low levels and maintain spending on current policies and programmes will widen the government's current deficit in outer years, which implies increased debt financing and continued draws on the country's USD 5.6 bn Heritage and Stabilization Fund (HSF, equivalent to about 23% of GDP). The government has made two withdrawals from the HSF—USD 375 mn in May 2016 and USD 251 mn in March 2017—which prompted criticism from credit-ratings agencies (see appendix 2) as the draws reflected the government's reluctance to adjust to the lower oil and gas prices that have affected the country for the past three years.

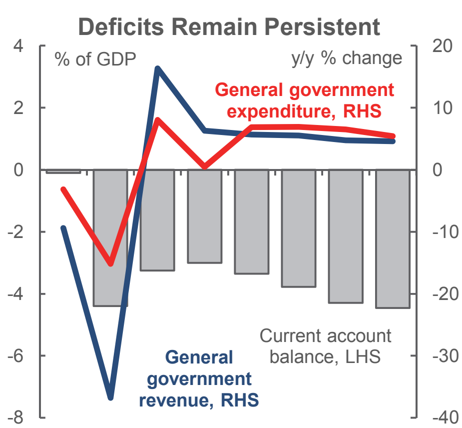
Debt concerns increasing. Total public debt (excluding short-term paper) now stands at a hair over 60% of GDP, just breaching the threshold beyond which international experience implies that sovereign debt crises become more likely. The government's need to finance ongoing deficits and service its domestic public debt may increase its tacit pressure on the CBTT to devalue the TTD in order to increase the TTD-denominated value of public energy-export revenue—which could, perversely, raise longer-term sustainability questions for Trinidad and Tobago's foreign-currency denominated external sovereign debt (currently equivalent to only about 14% of GDP).

Macroeconomic outlook: Scotiabank Economics projections

	2015	2016e	2017f	2018f
World real GDP, annual % change	3.4	3.1	3.5	3.6
US real GDP, annual % change	2.6	1.6	2.2	2.4
WTI oil, annual average $/bbl	49	43	53	56
Brent oil, annual average $/bbl	54	45	56	59
Nymex natural gas, annual average $/mmbtu	2.63	2.55	3.10	3.05
US dollar index, annual average	96.3	96.9	…	…
Trinidad and Tobago				
Real GDP, annual % change	-0.6	-5.1	…	…
Fiscal current balance (FY), % GDP	-0.1	-4.4	…	…
Current account, % GDP	-1.0	-5.5	…	…
FX reserves, months of imports	13.5	13.3	…	…

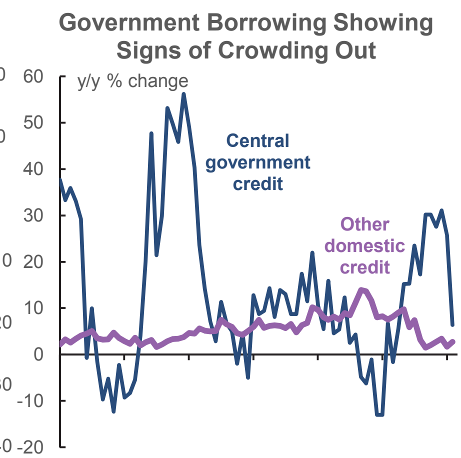
Sources: Scotiabank Economics, CBTT, IMF, Bloomberg, Haver.

Chart 3



Sources: Scotiabank Economics,, CBTT, IMF, BMI; 2015=FY 2014/15.

Chart 4



Sources: Scotiabank Economics, CBTT.

Government borrowing is crowding out the private sector. The Trinidadian government has tended to lean on the domestic financial sector to cover its ongoing fiscal shortfalls, which has put the government in direct competition for domestic credit with private Trinidadian interests (chart 4). Crowding-out by government borrowing is weighing on private-sector liquidity and credit creation, which undermines the government's efforts to diversify the economy, make growth less dependent on gas exports, and ensure a more sustainable tax base.

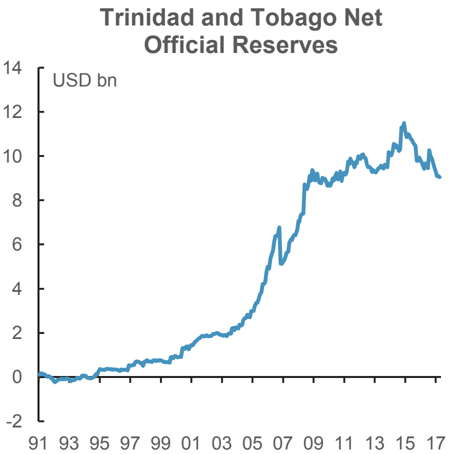
BLEAK PROSPECTS FOR THE TTD

Inflation rising amid external weight on the currency. The CBTT raised its headline repo rate from 2.75% in September 2014 to 4.75% at end-2015 through eight successive hikes intended to stem incipient domestic inflation and reduce pressure on the TTD from lower hydrocarbon prices. In the event, the CBTT proved unable to defend the TTD, which from 2010 to 2015 had been held at around USDTTD 6.30 to 6.40, in part through FX-market interventions that consumed about 10% (USD 1 bn) of the CBTT's foreign-currency reserves during 2014–15 (chart 5). During late-September 2015, the CBTT began allowing the TTD to depreciate gradually, which has brought the USDTTD exchange rate to around 6.75, a roughly 7% decline. Since the autumn of 2016 the CBTT has been forced to resume interventions in FX markets to keep the USDTTD rate stable, which has consumed another USD

1 bn (about 10%) of accumulated hard-currency stocks in an otherwise stable global environment. The weaker TTD has meant higher domestic prices for imports, which has pushed up headline inflation to 3.6% and core inflation to 2.7%.

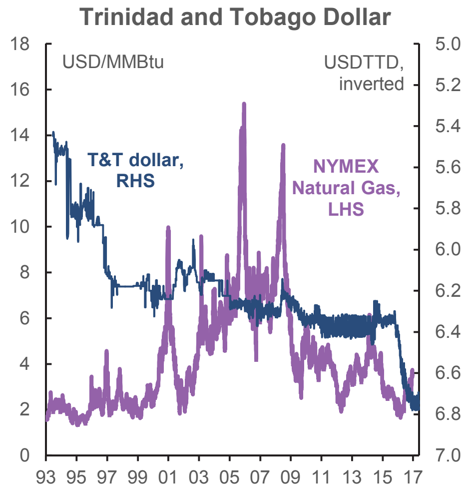
The TTD remains over-valued and is set to fall. Against standard indicators of fundamental value, such as real effective exchange-rate measures or purchasing-power parity, the TTD remains somewhere between 20 and 50% over-valued. Declining foreign-currency reserves and domestic FX controls imply that the TTD has further to fall. While the CBTT has ample reserve cover at around 13 months of imports, if the recent pace of drawdowns were sustained to keep the USDTTD around 6.75 then reserves would fall near to the critical threshold of three months of import cover within three to four years. Recent experience implies that mildly higher global gas prices and the prospect of exports to Asia via the newly-expanded Panama Canal will provide little respite for the balance of payments and the TTD (charts 6 and 7). The CBTT will need to allow the TTD to fall to prevent a precipitous decline in its foreign-currency reserves or a hike in the repo rate that would stifle the non-energy sector.

Chart 5



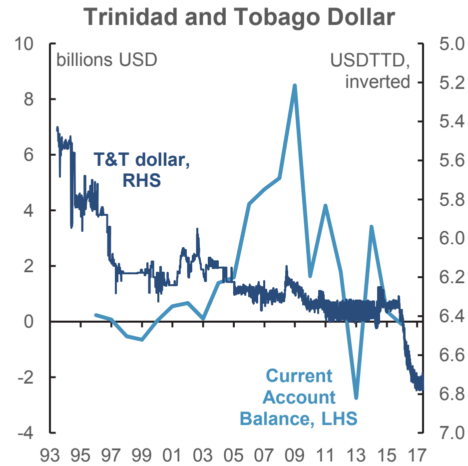
Sources: Scotiabank Economics, Central Bank of Trinidad and Tobago.

Chart 6



Sources: Scotiabank Economics, Bloomberg.

Chart 7



Sources: Scotiabank Economics, Central Bank of Trinidad and Tobago.

APPENDIX 1. RECENT BUSINESS EVENTS

Venezuela Export Agreement. Trinidad and Tobago and Venezuela signed a new gas export agreement in March 2017. The agreement deals with the construction, operation, and maintenance of a gas pipeline that goes from the Dragón field on the north coast of the Venezuelan state of Sucre to the Hibiscus field in Trinidad. The Dragón field has about 12 to 13 tn cubic feet of reserves; its initial production is expected to start at between 200 and 300 mmscf from four wells.

Petrotrin Plant. Petrotrin intends to move ahead with the construction of its planned ultra-low sulphur diesel (ULSD) plant by the first quarter of 2020. The USLD plant forms part of Petrotrin's clean-fuels upgrade programme to enable its products to meet international quality standards.

BP's Angelin Project. The National Gas Company (NGC) has completed negotiations with BP on a new supply agreement that would support the approval of the Angelin project, the next large natural gas field that BP hopes to monetize. The company intends to put Angelin into production by 2019, just as the Juniper project's production is expected to begin declining. The Angelin project would support potential investments of roughly USD 5 to USD 6 bn from 2017 to 2022.

APPENDIX 2. RATINGS DOWNGRADES

Trinidad and Tobago was downgraded by both S&P Global Ratings (S&P) and Moody's Investors Service (Moody's) during April 2017. S&P lowered its long-term sovereign credit ratings on the Republic of Trinidad and Tobago to BBB+ from A-, leaving the country one notch inside investment grade with a stable outlook. At the same time, S&P affirmed its A-2 short-term sovereign credit ratings and lowered the transfer and convertibility assessment for the country to A from AA-. Similarly, Moody's downgraded Trinidad and Tobago's issuer and senior unsecured debt ratings to Ba1 from Baa3 and assigned a stable outlook.

The sovereign downgrade by S&P prompted the agency to revise the credit ratings for four of Trinidad and Tobago's major companies: the National Gas Company of Trinidad & Tobago (NGC) to BBB from BBB+; Trinidad Generation Unlimited (TGU) to BBB- from BBB; Republic Bank Limited (RBL) to BBB from BBB+; and First Citizens Bank to BBB from BBB+.