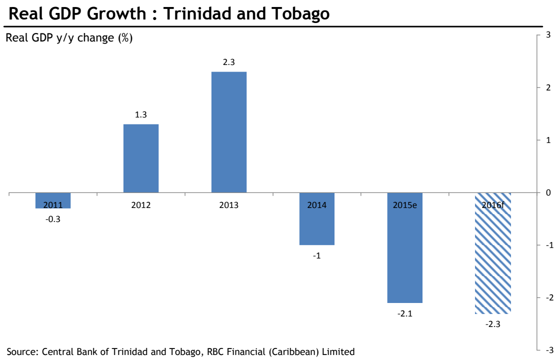
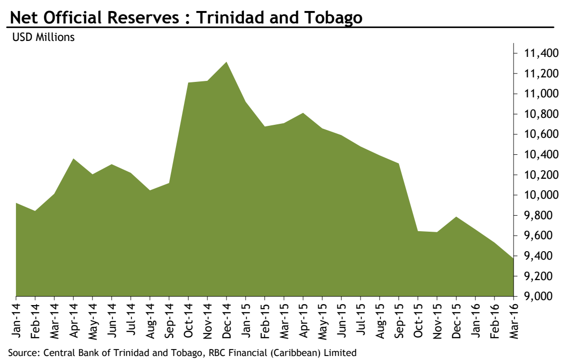
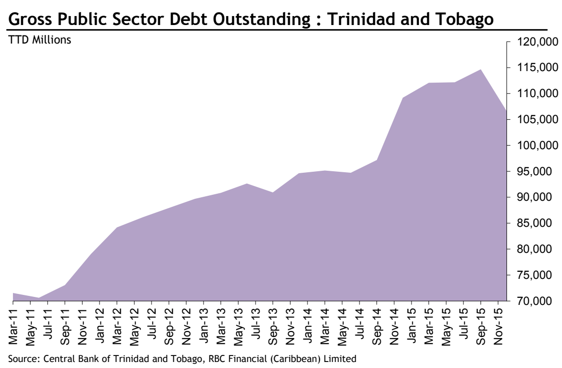
RBC CARIBBEAN | ECONOMICS

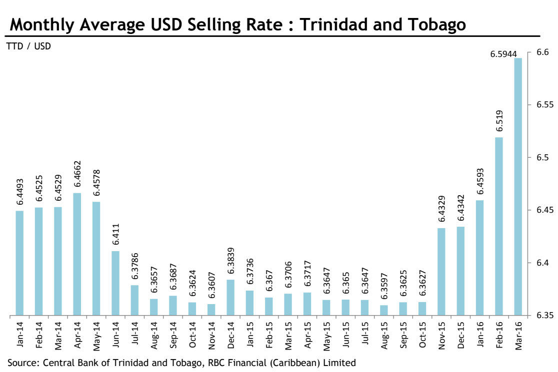
TRINIDAD & TOBAGO MID-YEAR FISCALREVIEW

FY2015/16









"We Cannot Spend More Than We Earn"

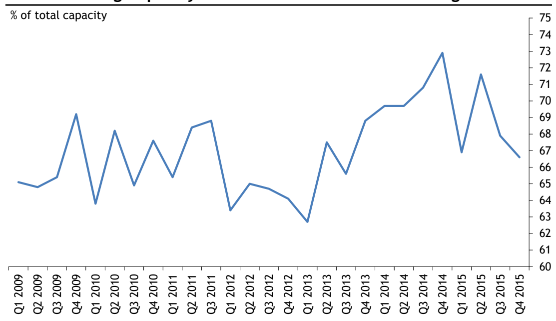
On April 8th 2016, the Minister of Finance delivered the mid-year fiscal review, ending months of speculation on several issues, while evidently igniting new anxieties and debates on others. The Minister noted that in March 2016 alone, the Government entertained annual review visits by the IMF, Moody's and Standard and Poor's—all of whose reports we now eagerly anticipate, although downgrades are likely. The Central Bank (CBTT) recently issued its March 2016 Economic Bulletin which included several important forecasts, some of which the Minister mentioned in his review. Notably, the CBTT is expecting inflation to average 6.2% and unemployment to average 4.1% this year, while the economy will contract by 2.3% in 2016, up from 2.1% in 2015.

Expenditure—In FY2015/16, the Government originally expected to collect TTD5.5 billion in tax revenue from the energy sector—roughly TTD20 billion less than usual. Notwithstanding this, total expenditure was then budgeted at TTD63 billion, up 2% from revised estimated expenditure in of TTD61.8 billion in FY2014/15. In his mid-year review, the Minister cut budgeted expenditure for FY2015/16 by roughly TTD4 billion or 6%, to TTD 59 billion, most of which would be recurrent spending. The proposed IADB funded Mass-Transit system mentioned in the initial budget was deemed unfeasible at current energy prices, and was therefore shelved.

Revenue—The original FY2015/16 budget had projected a 10% or TTD5.5 billion y/y increase in fiscal revenue (despite energy prices collapsing) to TTD60.3 billion, including one-off capital revenue/financing items such as IPOs, divestment and extra-ordinary dividends, totaling TTD13.4 billion. However, tax revenue from the energy sector came in over TTD2 billion lower than anticipated in H1 FY2015/16, while non-oil corporation tax and VAT revenues were about TTD1 billion softer than expected, based on weak compliance, the economic slowdown, and lower then budgeted energy prices and production. As such, the Minister is now expecting current revenue at roughly TTD44 billion in FY2015/16, which is TTD2.9 billion or 6.1% less than the TTD46.9 billion originally budgeted—TTD2.4 billion less from the energy sector, TTD1.0 billion less from non-energy companies, and TTD3.0 billion less from VAT. Based on the arithmetic presented in the Minister's mid-year review, it appears that capital revenue/financing items are now expected to yield roughly TTD8.7 billion—down TTD4.72 billion or about 35% less than originally budgeted, and total fiscal revenue is now budgeted at TTD52.7 billion, which is 13% or TTD7.6 billion less than originally budgeted.

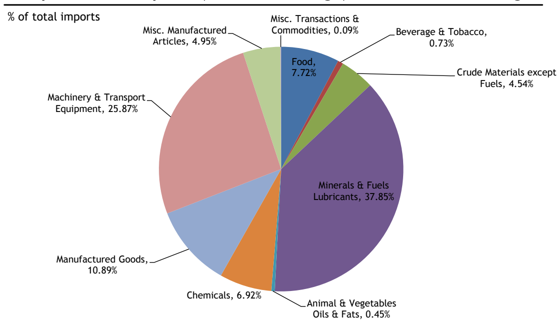
Marla Dukharan
Group Economist
RBC Caribbean
(868) 688-9845
marla.dukharan@rbc.com

Manufacturing Capacity Utilization : Trinidad and Tobago



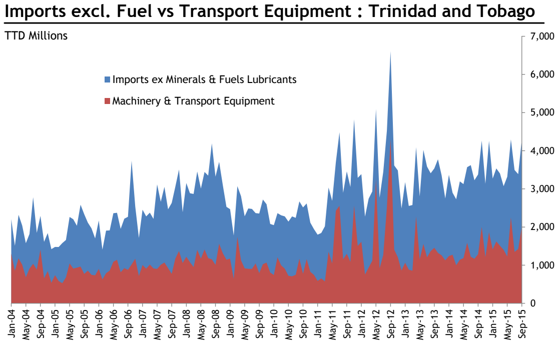
Source: Central Bank of Trinidad and Tobago, RBC Financial (Caribbean) Limited

Composition of Imports (2004-15 average) : Trinidad and Tobago



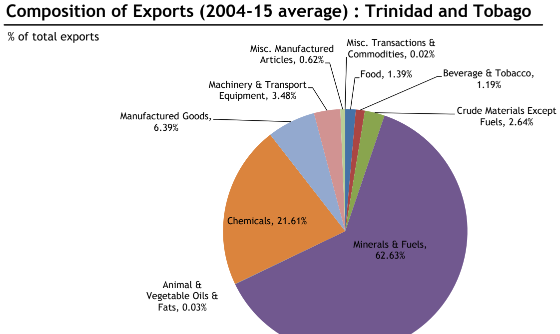
Source: Central Bank of T&T, RBC Financial (Caribbean) Limited

Imports excl. Fuel vs Transport Equipment : Trinidad and Tobago



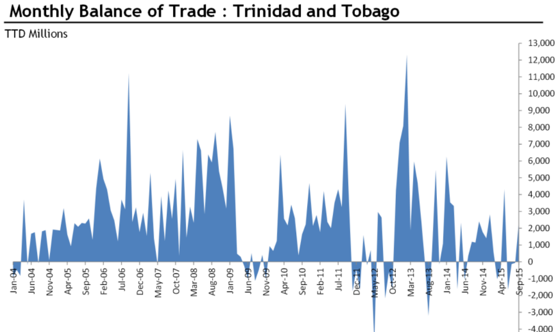
Source: Central Bank of T&T, RBC Financial (Caribbean) Limited

Composition of Exports (2004-15 average) : Trinidad and Tobago



Source: Central Bank of T&T, RBC Financial (Caribbean) Limited

Monthly Balance of Trade : Trinidad and Tobago



Source: Central Bank of T&T, RBC Financial (Caribbean) Limited

Overall Fiscal Deficit— The original FY2015/16 budgeted deficit of TTD2.8 billion or 1.5% of GDP would have been 60% lower than the FY2014/15 estimated deficit of TTD7 billion, or 4.2% of GDP. The revised deficit, after one-off capital transactions/financing items of TTD8.7 billion, is now budgeted at TTD6.7 billion or 4% of GDP—just slightly below that of the previous fiscal year. Public expenditure rose over the last five years from TTD46.7 billion in 2010 to TTD62.0 billion in FY2014/15—an increase of 33% percent, mostly devoted to wages and salaries, and transfers and subsidies. The original plan to balance the budget by 2018 has been revised. The Minister now plans that by FY2019/20, only capital spending will be financed by borrowing.

Budgeted Oil and Gas Prices— The original FY2015/16 budget used an oil price assumption of USD45/bbl and a mix of gas prices to properly reflect our markets, including Henry Hub of USD2.75/mmBtu and Indonesian LNG at USD8.00/mmBtu. Both prices and production levels for oil and gas turned out lower than anticipated in H1 FY2015/16, and the budget will now be based on oil at USD35/bbl, and natural gas at USD2.00/mmBtu. The Minister expects oil to reach USD55/bbl by 2018. According to the IMF's recently released World Economic Outlook, WTI, Brent and Dubai Fateh (which they use as T&T's oil benchmark) averaged USD50.79/bbl in 2015, and is forecast at USD34.75/bbl in 2016, USD40.99/bbl in 2017, and USD44.52 in 2018, based on futures prices. The IMF also reported natural gas (Henry Hub spot prices) averaged USD2.61/mmBtu in 2015, and is projected at USD2.07/mmBtu in 2016, USD2.52/mmBtu in 2017, and USD2.58/mmBtu in 2018. According to the Ministry of Energy's latest publication, crude oil production stood at 72,190 barrels per day, and natural gas production stood at 3,810mmscf/d in January 2016. This represents an 8.2% decline in crude oil production in January 2016, versus the average for 2015 at 78,630bopd, and a steady downward trend in production is apparent. The natural gas production level in January 2016 is just below the 2015 average of 3,835mmscf/d with fluctuations.

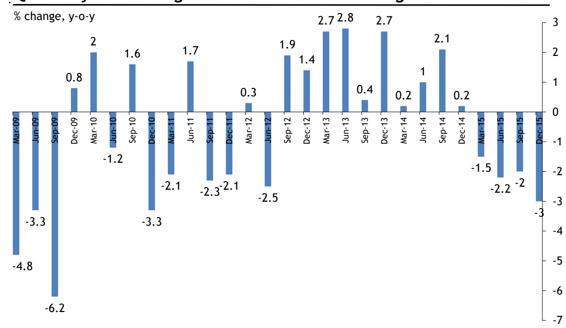
Growth— The CBTT estimates that the economy contracted by 1% in 2014, 2.1% in 2015, and is projected to contract further by 2.3% in 2016. Following their recent visit, the IMF had announced their projection for a 1% contraction this year, and online IMF data show contractions of 1.76% in 2015 and 1.1% in 2016. The IMF is expecting positive growth to return in 2017 however, at 1.78%, intensifying to 2.7% in 2018, according to their online statistics.

Unemployment— The CBTT reported that the number of persons employed fell from 637,900 in Q3 2014, to 620,200 in Q3 2015—a 2.8% y/y decline. The unemployment rate increased from 3.3% at the end of 2014 to 3.4% in September 2015, and is expected to average 4.1% in 2016. The increase in the unemployment rate may appear subdued, based on lower labour force participation rates. From October 2015 to February 2016, retrenchment notices increased by 756 y/y according to the CBTT, mainly in the construction, finance and petroleum sectors. Additionally, there was a 6.3% y/y decline in the number of job openings for the same period.

Fuel Subsidies— The gradual phasing out of the fuel subsidy continues, as the Minister (as he had also done in October 2015) increased super gasoline and diesel prices by 15% each, to TTD3.58 and TTD2.00/litre, respectively (translating into a 32.23% cumulative increase since October 2015). At current crude oil prices, neither super nor premium gasoline are subsidized. At USD45/bbl, the unsubsidized price of super gasoline is TTD3.61/litre, and TTD3.13/litre for diesel. At current prices, diesel attracts a subsidy of roughly TTD1.00/litre. Empirical research has shown that a 5% y/y increase in diesel and super gasoline prices, ceteris paribus, triggers an overall inflationary impact of 2.6% per annum. Assuming a linear relationship between changes in fuel prices and changes in the overall price level, a 32.25% cumulative increase in fuel prices since October 2015, could lead to an almost 17% increase in the overall price level—all other factors remaining constant. In reality, the decline in government spending, higher unemployment, and overall economic contraction, should temper the inflationary impact of the difficult but necessary reduction in the fuel subsidy. Given that 'Minerals and Fuel Lubricants' is T&T's primary import, averaging 38% of total imports from January 2004 to September 2015, and 'Machinery and Transport Equipment' is the second at 26% of total for the same period, the reduction in the fuel subsidy and the increase in taxes on vehicles (with engines larger than 1,999cc), are much needed policy initiatives to stem the import and overuse of fuel, which has broad-based negative implications. In the 12 months to November 2014, there were 20,732 new motor vehicles sold, up 13.4% y/y—the highest ever according to CBTT data. Since (the 12 months to) November 2015, there have been four consecutive months of y/y decline in sales of new motor vehicles, to reach 19,743 in February 2016—the lowest level since June 2014.

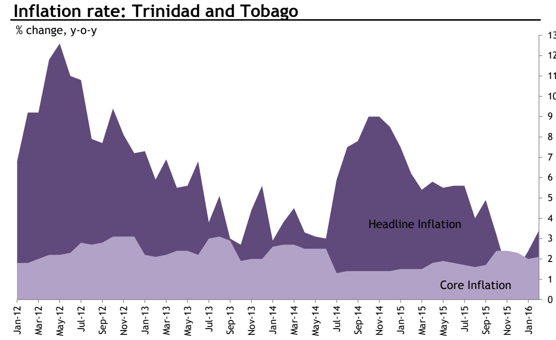
Foreign Exchange—CBTT data show that in March 2016, the TTD depreciated 3.51% y/y to a monthly average selling rate of TTD6.5944 : USD1.00. The Minister announced that the TTD will depreciate by no more than 7% from the September 2015 level of TTD6.3725, taking the exchange rate to TTD6.8186 : USD1.00, presumably by the end of the fiscal year. This forward guidance on the exchange rate should reduce the level of uncertainty, and speculative demand for USD. Reserves stood at USD9.37 billion or eleven months of imports in March 2016, down 12.5% or USD1.336 billion y/y, marking six consecutive months of y/y double-digit declines in reserves. The CBTT is projecting reserves at USD8.5 billion or 10 months of imports by end-2016, signaling a net drawdown of 13% or USD1.263 billion in reserves during 2016. The CBTT injected USD1.125 billion in H1 FY2015/16, down 8.9% y/y from the USD1.235 billion injected in H1 FY2014/15, while at the same time, conversions (purchases of USD from the public) fell by over USD257 million or 9.8% y/y, according to CBTT data. This adds some much needed context to the Minister's statement that "more and more" foreign exchange is being injected into the system. The IMF recently stated "Against a backdrop of foreign exchange shortages that have intensified since the beginning of 2015, the recent sharp falls in energy prices are further reducing the available supply...the current account of the balance of payments is estimated to have

Quarterly Real GDP growth : Trinidad and Tobago



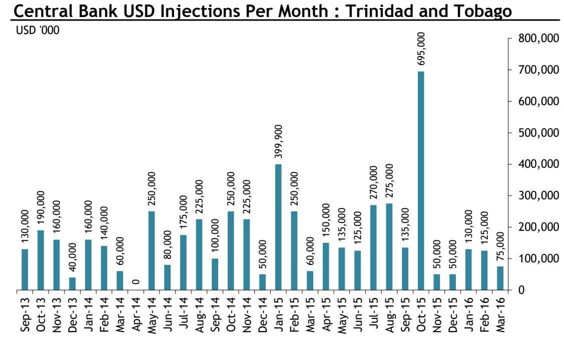
Source: Central Bank of Trinidad and Tobago Online Statistics, RBC Financial (Caribbean) Limited

Inflation rate: Trinidad and Tobago



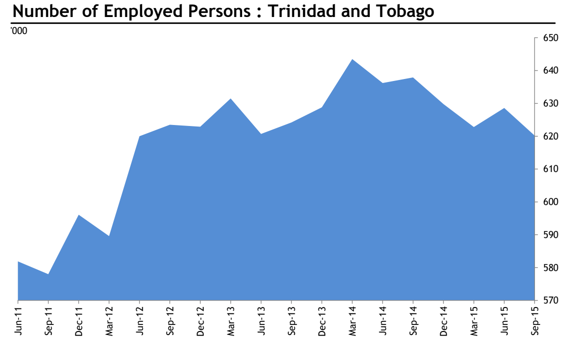
Source: Central Bank of Trinidad and Tobago Online Statistics, RBC Financial (Caribbean) Limited

Central Bank USD Injections Per Month : Trinidad and Tobago



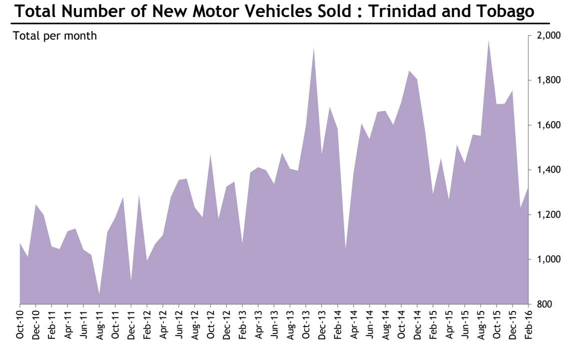
Source: Central Bank of Trinidad and Tobago, RBC Financial (Caribbean) Limited

Number of Employed Persons : Trinidad and Tobago



Source: Central Bank of Trinidad and Tobago, RBC Financial (Caribbean) Limited

Total Number of New Motor Vehicles Sold : Trinidad and Tobago

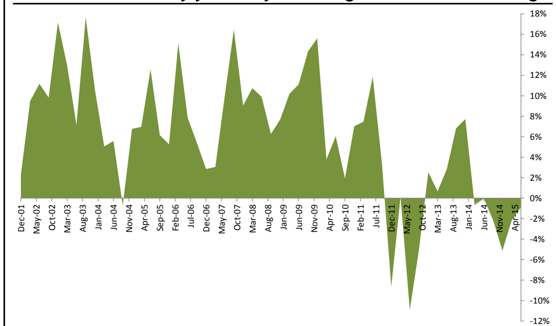


Source: Central Bank of T&T, RBC Financial (Caribbean) Limited registered a deficit of over 5% of GDP in 2015 after years of surpluses. The modest pace of depreciation should help to improve the current account. On the other hand, speculative and precautionary motives are reportedly increasing demand for foreign exchange. In the circumstances, greater flexibility in the foreign exchange market would be critical to resolving the foreign exchange shortages." The Minister noted that nominal GDP was at the same level in 2015, as it was in 2012, at TTD165 billion—adding to the apparent confusion surrounding the cause for the increased demand for USD. The Minister should note that in T&T, fiscal spending is a major driver of consumption and by extension imports, and has increased by TTD8 billion or 14.8% from TTD53.8 billion in FY2011/12 to TTD61.8 billion in FY2014/15. In addition, the Government has incurred deficits each year since FY2008/09, which is known to directly and indirectly contribute to deficits on the current account of the Balance of Payments. Put simply, balancing the fiscal budget is critical to reducing the demand for USD. Hoarding of USD was mentioned by the Minister and discussed widely in the media, but it should be noted that in January 2016, the public's USD deposits with commercial banks stood at USD3.63 billion, up a mere 0.67% y/y, representing roughly 23% (steady for about two years) of the total deposit base.

Inflation—Headline inflation stood at 3.5% in February 2016, with core inflation at 2.1%. As mentioned earlier, the IMF has projected inflation to average 6.2% this year, while the CBTT's projection is at 8.7%. The increase in inflation is expected based on the pass-through effect on retail prices, of the TTD depreciation, the introduction of VAT on previously exempt/zero-rated items, and higher fuel prices. This upward pressure on prices would be tempered by the effect of lower consumption, based on the overall economic slowdown, slower credit growth, and lower fiscal spending.

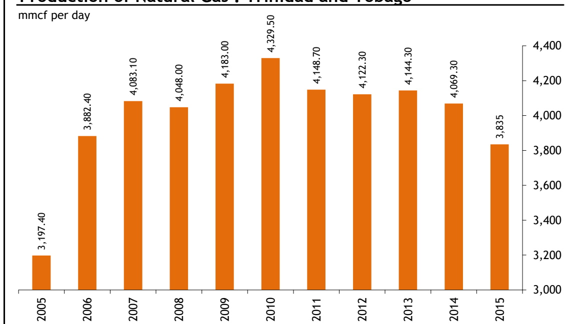
Debt—Gross public sector debt had been expanding in the double digits y/y from TTD97.2 billion in September 2014 to TTD114.7 billion in September 2015—an increase of TTD17.5 billion or 18% in one year. This brought the level of gross public sector debt from 56% to 68.4% of GDP over the same period. In Q4 2015, debt repayment and amortization saw the level of gross public sector debt post its first y/y decline in several years at 2.4% y/y, bringing the level to TTD106.6 billion—the lowest level since September 2014, according to CBTT online data.

National Productivity year-on-year Change : Trinidad and Tobago



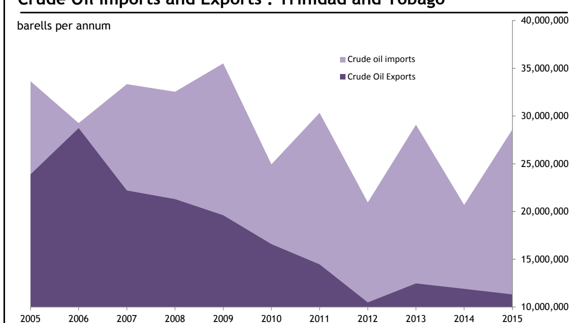
Source: Central Bank of T&T, RBC Financial (Caribbean) Limited

Production of Natural Gas : Trinidad and Tobago



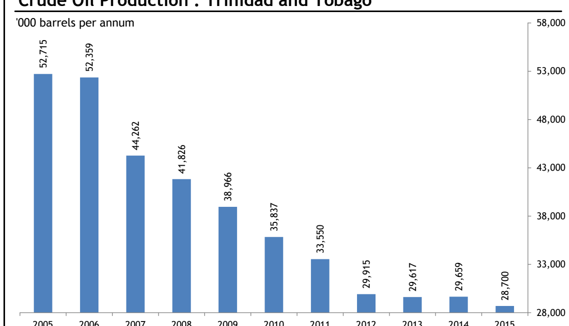
Source: Central Bank of Trinidad and Tobago, RBC Financial (Caribbean) Limited

Crude Oil Imports and Exports : Trinidad and Tobago



Source: Central Bank of T&T, Ministry of Energy T&T, RBC Financial (Caribbean) Limited

Crude Oil Production : Trinidad and Tobago



Source: Central Bank of T&T, Ministry of Energy T&T, RBC Financial (Caribbean) Limited

TTD Millions	Actual FY2012/13	Actual FY2013/14	Estimated FY2014/15	Budgeted FY2015/16	Revised FY2015/16	% change
Total revenue and grants	52,782	58,397	54,804	60,287	52,300	-13%
Total Expenditure	58,827	62,839	61,817	63,048	59,000	-6%
OVERALL BALANCE	-6,045	-4,442	-7,014	-2,761	-6,700	143%
% of GDP	-3.4	2.60%	4.20%	1.50%	4%	167%