

## Summary

Recent economic performance in Trinidad and Tobago has reflected:-

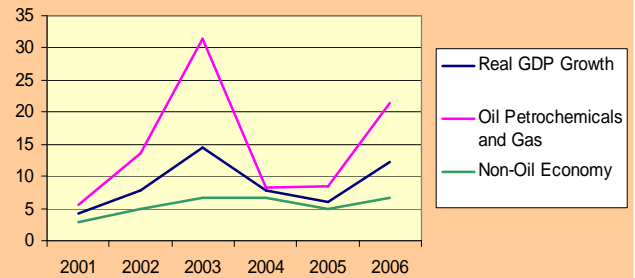
- Strong growth in real GDP reflecting higher output mainly in the energy sector and growth in Construction
- Falling unemployment in the context of a tighter labour market
- Uptick in inflation, due almost entirely to spiraling food prices
- Steady increase in foreign exchange reserves, well-behaved monetary aggregates and fairly low interest rates.
- Higher Consumer and Business Confidence

### Continued Strong But Variable Growth in Real GDP

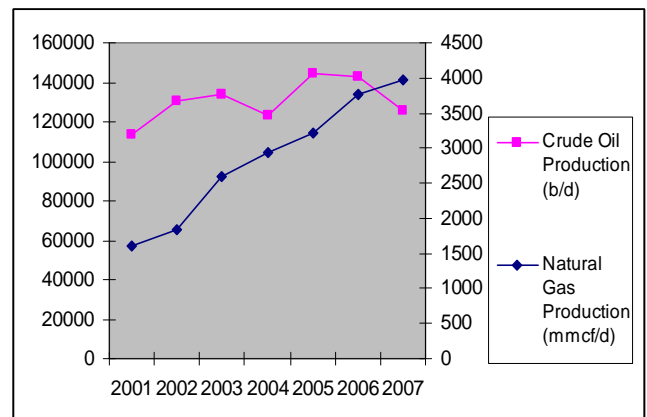
Over the last several years, real GDP growth has been strongly positive with spikes in 2003 (14.4%) and again in 2006 (12.2%). The aggregate growth data mask the fact that the energy sector (Petroleum, Natural Gas and Petrochemicals) has been growing on average three times faster than the rest of the economy. The Non-Energy economy has been growing at an average of 6% per annum in the 5 years to 2006. This too masks falling output in Agriculture and weak growth in Electricity and Water contrasting with strong growth performances in Construction, Finance Insurance and Real Estate and some areas of Manufacturing.

Available indicators for the first half of 2007 suggest that growth has slowed. Crude oil production seems to have peaked at 144,442 barrels per day (bpd) in 2005, declining to 142,809 bpd in 2006 and, for the first half of 2007, crude oil production has fallen further to an average of about 126,000 bpd.

**GDP Growth: Energy and Non-Energy Sectors**

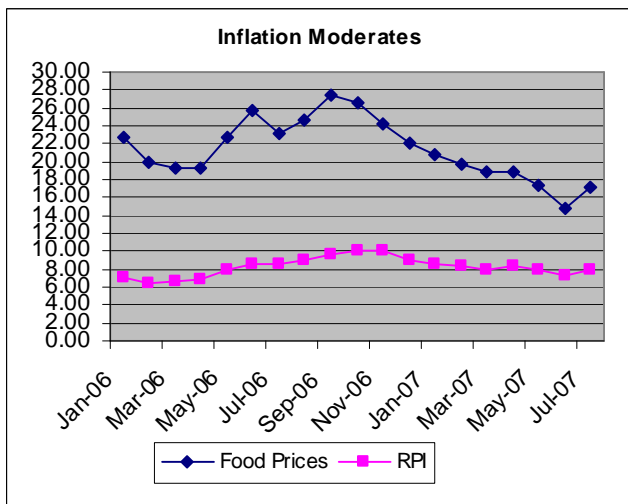


In contrast, natural gas production has continued its upward march through the first half of 2007, averaging 3989 mmscf/day compared to an average daily production of 3771 mmscf in 2006. Government commented on the latest Ryder-Scott report on T&T natural gas reserves which estimates the (proven) reserves to production ratio to have fallen to 12 years, well below previous estimates of 18-19 years. (See box below for our comments on the implications of the Ryder-Scott Report). Output of petrochemicals for the first half of 2007 are on pace with the levels of 2006, slightly higher for ammonia production and slightly lower for methanol and urea.

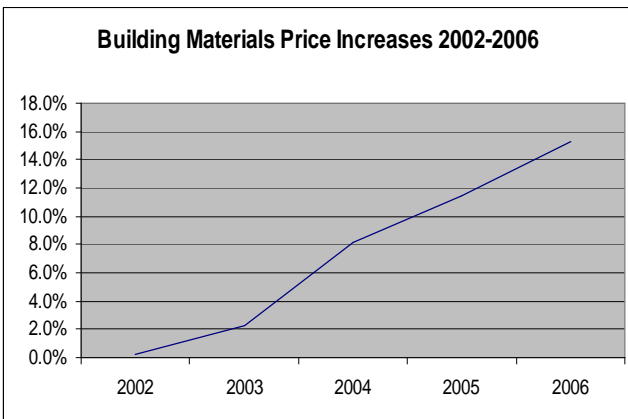


**Inflation is Moderating**

Higher food prices and a sharp increase in the Net Domestic Budget Deficit to 6% of GDP during FY 2006 caused the overall Retail Prices Index to increase to 10% by November 2006. Since then, as food price increases have declined and the NDBD has been reined in through open market operations, the year on year inflation rate has moderated sharply to 7.3% in June, with a slight uptick to 7.8% in July, paralleling an uptick in food price inflation.

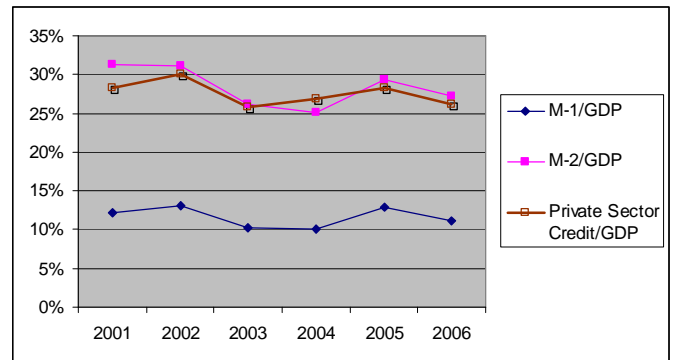


It must be noted however that there continues to be significant inflation in certain sectors, in particular the cost of building materials which is impacting construction costs.



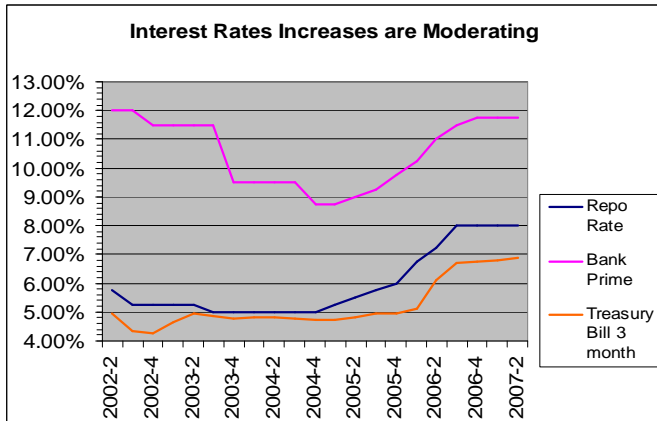
**Monetary Aggregates, Foreign Exchange Reserves and Interest Rates**

The monetary aggregates have been well-behaved throughout the period of rapid economic expansion and increase in government expenditure. The ratios of M-1, M-2 and Private Sector Credit to GDP have been consistent. As at June 2007, the year on year increases in the monetary aggregates (11% for M-2 and only 2% for M-1)) have continued to be broadly consistent with the projected growth in GDP.



The foreign exchange reserves (adjusted for the removal of the Heritage and Stabilisation Fund assets) have continued to improve steadily, reaching US\$7.5 billion at August 2007.

Interest rates have stabilized following the increases prompted by the central bank's moves to drive interest rates up by signaling its desires through increases in the Repo rate, and reinforcing this with open market sales of securities to reduce liquidity in the face of higher measured inflation. These open market sales have totaled \$2.3 billion between November 2006 and April 2007 at coupons of 7.80% and 8% for 7 and 8-year tenors. The central bank has held the Repo Rate at 8% in the light of moderating inflation. Bank Prime Loan rate remains at 11.75% while 3 month Treasury Bills hover just under 7%.



**Stock Market Continues to Languish ... But Consumer and Business Confidence remains high**

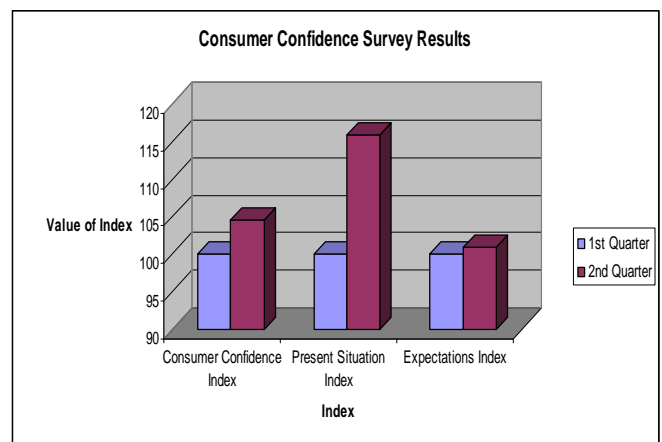
The Stock Market continues to climb slowly from the low point it reached in October 2006 when the Composite Index was at 864. At mid-September the Composite Index had improved to 921, but for 2007 there has been lower volumes and average values of transactions than in 2006. It is apparent that confidence is yet to return to the stock market following the losses since mid-2005. Activity and interest has mainly surrounded the ongoing negotiations for the acquisition of RBTT and the attempt by Ansa McAl and Neal and Massy to acquire controlling interest in Barbados Shipping and Trading (BS&T).

**Consumer Confidence Survey: Second Quarter Results**

Our Consumer Confidence Survey showed an increase in consumer confidence for the second quarter compared to the first quarter's base results. The index itself is now at 104.62. The increase in this index is attributable to an increase in both the index's component Present Situation Index and Expectations index which increased to 115.93 and 100.97 respectively for the second quarter (see Chart).

The increase in the present situation index-which is an assessment of present conditions, improved significantly, despite the fact that many consumers held a pessimistic view of the present economic conditions prevailing in the economy. This was due mainly to the favourable employment conditions that continue to boost consumer confidence namely the increase in government employment programs and the boom in the construction sector which many respondents thought were a source of job creation for many individuals.

In the second quarter, consumers were a little more optimistic about the short term outlook for the next six months. There was a slight increase in the proportion of people who believed that inflation would decline over the next six months as well as a fall in the percentage of respondents who thought that their total family income would be less in the coming months. In addition, the employment outlook remained optimistic as the proportion of people expecting fewer job opportunities over the next six months declined.



### ***Business Confidence Survey Results***

Business Owners of Trinidad and Tobago remain upbeat about the local economy. A survey conducted during the third quarter of 2007 suggest that Business Executives and Managers believe the current economic outlook is favorable and these conditions are expected to continue in the near future. The following observations are highlighted:-

- Current financial performance has improved in the various sectors of the economy compared to the first half of 2007 and business owners expect to achieve between moderate to significant improvements in financial performance in the coming six months.
- A majority of business owners wish to take a moderate to aggressive to attitude towards increased Capital Expenditure in the near future.
- Solid job hiring is foreseen with 63 % of the respondents showing a willingness to increase their labour force, while only 2.5 % of the respondents wish to decrease their labour force in the second half of 2007.
- The overall business climate is viewed as favourable by the majority of the respondents with 90 % of the respondents viewing the climate as either Satisfactory, Good or Excellent.

### ***Near Term Outlook***

- While oil production has been falling, oil prices have trended higher in the first half of 2007 and continuing into the third quarter 2007. Indeed oil price futures breached US\$80/bbl in September 2007 and some forecasters have been indicating that prices could reach US\$85/bbl. Higher prices would have offset falling production. However, we do not expect oil prices to remain at current high levels over the next two or three quarters and indeed we expect oil prices to retreat to the levels of early 2007 and perhaps even lower by mid-2008.
- Inflation should continue to moderate during the remainder of 2007 as food price inflation moderates. Demand side pressures are muted for the time being and the posture of monetary policy which involves maintaining the Repo rate and using open market operations seems to be appropriate to the current circumstances.
- Uncertainties in the global economy have increased significantly since the beginning of the year. The sub-prime mortgage problem has engendered difficulties in the credit markets in the USA and Europe and this is likely to impact consumer spending and economic growth in those countries within the next few quarters, even if the Federal Reserve moves interest rates down as expected.
- We expect the stock market in the USA and Europe to react negatively to these developments and to fall sharply from current levels (end-September 2007 – DJIA 14,000). In this scenario, all other stock markets will react negatively and bond yields will decline as investors move aggressively out of stocks and into gold and bonds. We think the probability of the recession in the USA within the next 3 quarters is now greater than 50%.

**Box 1: Implications of the 2007 Natural Gas Reserves Audit (Ryder-Scott Report)**

The Government reported the results of the audit which indicated proven reserves equivalent to just 12 years at current utilization rates. The response to the audit has varied from panic that the country's gas resources would literally run out in 12 years, to official response that the situation was not a source of great concern but means merely that the Government needs to stimulate greater exploration efforts and modify the incentive regime for the E&P companies to boost proven reserves. The latter argument implies that there is no need to adjust utilization rates as part of a change in energy policy and hence no need to stop impending projects, but rather there is natural gas waiting to be found either in existing fields at perhaps greater depths or in deeper horizons (the 'ultra deep') or both.

The *Business Insight* perspective on this issue is that it is a matter of great concern and that the official and other responses on the issue have glossed over the economic and management aspects of the problem.

The economic considerations are that Trinidad and Tobago has developed its gas resources based on the competitive advantages of relatively cheap gas, political stability and a company-friendly tax and incentive regime. Changes in any one of these conditions will change its competitive advantage. The condition which is likely to change is 'cheap gas' since exploration and production of smaller pools in existing fields and/or unknown fields in the deep areas beyond the continental shelf will clearly be more expensive. The companies which are engaged in this activity are all transnational corporations with interests in oil and gas provinces all over the world. The considerations for these companies will be whether at the margin, their investment dollars are better expended in Trinidad and Tobago or elsewhere. If, as we expect, oil (and gas) prices do fall over the medium term in the wake of global economic slowdown, the economic equation justifying further exploration investment in Trinidad and Tobago may change in ways which are not favorable for Trinidad and Tobago in the calculations of the companies. The probability of this scenario is now in our view reasonably high.

The management aspect of the problem relates to the need to establish benchmarks for the exploitation of the country's finite natural resources. The benchmarks, including the reserves to production ratio, may vary with changing economic and geological considerations, and indeed one may establish different RTP ratios for different end uses of natural gas – eg power generation versus LNG export versus petrochemicals feedstock. But there must be some benchmarks against which resources and the tax and incentive regime are *managed*, or else they are not being managed at all well. Our view is that Trinidad and Tobago ought to manage its exploitation of natural gas with an (average) RTP ratio in excess of 20 years. The argument that companies will want to maximize the production of the reserves they find is cogent, but that consideration has to be balanced against the country's need to exploit its resources in a way that is optimal for the country's revenue needs today and for the needs of succeeding generations.

One can only hope that the optimism of the geologists is justified, that there is early success in increasing the category of proven reserves and that the resource allocation and investment calculations of the producing companies justify the investment expense in further significant exploration and production in Trinidad and Tobago.

**Box 2: Analysis of the FY 2008 Budget**

Presented earlier than expected, the 2008 Budget was delivered in Parliament in August 2007. The key assumptions of the budget were (1) Oil Price of US\$50/barrel and a (netback) gas price of US\$3.55/mmbtu (2) real GDP will grow by 7% in 2008 compared to projected growth of 5.5% in 2007 and (3) inflation will fall to 6% in 2008 and to 5% on a year on year basis by December 2008. There was no analysis of developments in the global economy in the Budget Statement although the risks to the Trinidad and Tobago economy are likely to arise from international developments over the next 12 to 18 months.

Our table below puts the FY 2008 budget data into the standard economic presentation format as the budget data laid in Parliament exclude certain items which need to be incorporated into the economic presentation. Capital repayments are excluded from the economic presentation and this accounts for the difference between the Budget Statement expenditure of \$42 billion and our estimate of \$40.3 billion.

There is really little of macro-economic (as distinct from political) significance in the budget package. The budgeted expenditures and revenues are reasonable and consistent with macro-economic stability in that the ratios of expenditure and revenue to GDP are contained within acceptable bounds. The structure of expenditure continues to be weighted toward Capital Expenditure rather than Recurrent Expenditure which is sensible in the context of an economy subject to sudden revenue fluctuations and given that it is easier to reduce capital expenditure than recurrent expenditure. The ratio of Capital Expenditure to GDP has risen from 2.1% in FY 2004 to 6% in FY 2007 and a projected 5% in FY 2008. Wages and salaries have grown slower than recurrent revenue over the last five years and have actually declined as a proportion of total expenditure. However, recent increases granted to teachers which amount to 20 per cent over the triennium

is somewhat higher than other recent wage settlements in the public sector.

The recurrent surplus is healthy at 7% in FY 2007 and 5% (projected) in FY 2008. The grand overall surplus (which includes transfers to the Heritage and Stabilisation Fund) amounted to 3.5% of GDP in FY 2007 compared to 4.1% of GDP in FY 2006.

The public debt is under control at 28% of GDP in 2007 compared to 58% in 2002. Domestic debt has increased only on account of the requirement of open market operations for issuance of government securities.

GOVERNMENT FISCAL OPERATIONS	Oct '03/ Sep '04	Oct '04/ Sep '05	Oct '05/ Sep '06r	Oct '06/ Sep '07p	FY 2008
<b>Total Revenue and Grants</b>	<b>20,885.4</b>	<b>29,647.8</b>	<b>38,910.9</b>	<b>40,499.9</b>	<b>40,359.0</b>
Recurrent Revenue	20,878.2	29,638.7	38,906.9	40,449.9	40,338.1
Tax Revenue	18,429.3	26,568.4	35,084.0	36,578.2	36,465.8
Non-Tax Revenue	2,448.9	3,070.3	3,822.9	3,871.7	3,872.3
Unemployment Fund					1,053.6
Green Fund					278.8
Capital Receipts	6.0	4.6	2.6	28.8	5.9
Grants	1.2	2.7	1.2	21.2	15.0
<b>Total Expenditure and Net Lending</b>	<b>20673.9</b>	<b>27,234.0</b>	<b>37,084.8</b>	<b>39,231.2</b>	<b>40,269.9</b>
Recurrent Expenditure	18,933.6	24,328.4	28,769.3	31,060.5	31,942.0
Wages and Salaries	4,814.8	5,309.2	5,113.2	6,442.0	6,946.7
Goods and Services	2,519.8	3,170.1	3,608.2	4,603.7	5,530.3
Interest Payment	2,396.3	2,541.5	2,458.2	2,582.4	2,440.0
Transfers and Subsidies	9,202.7	13,307.6	17,589.7	17,432.4	17,025.0
Capital Expenditure and Net Lending	1,740.3	2,905.6	4,865.3	8,170.7	8,327.9
<i>of which:-</i>					
Development Programme (PSIP)	1,892.6	3,031.9	1,844.4	3,926.1	3,900.0
Infrastructure Development Fund	0.0	0.0	3,023.0	3,843.7	4,000.0
Road Improvement Programme	46.8	44.1	0.0	0.0	0.0
Dollar for Dollar	51.0	2.8	0.0	0.0	0.0
GATE	0.0	102.2	250.0	425.0	450.0
Net Lending	-269.8	-277.5	-271.1	-43.9	-22.1
<b>Current Account Balance</b>	<b>1,944.6</b>	<b>5,310.3</b>	<b>10,137.6</b>	<b>9,389.4</b>	<b>8,396.1</b>
<b>Overall Surplus/(Deficit)</b>	<b>211.5</b>	<b>2,413.8</b>	<b>1,826.1</b>	<b>1,268.7</b>	<b>89.1</b>
Overall Surplus incl HSF	1,072.8	5,006.9	4,986.1	4,567.7	89.1
GDP	82,838.6	95,399.4	120,556.0	132,114.8	163,760.0
Grand Surplus/GDP	1.3%	5.2%	4.1%	3.5%	
<b>Financing Requirements</b>	<b>(211.5)</b>	<b>(2,413.8)</b>	<b>(1,826.1)</b>	<b>(1,268.7)</b>	<b>(89.1)</b>
External Financing (net)		-1,273.3	-410.8	24.1	407.0
Domestic Financing (net)		-1,140.5	-1,415.3	-1,292.8	- 496.1
Source: Ministry of Finance and Review of the Economy 2007					