GOVERNMENT OF THE REPUBLIC OF TRINIDAD AND TOBAGO
MINISTRY OF FINANCE

Report on the Nation's Business

The State of our Finances and Initiatives for Future Action

By

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Minister of Finance

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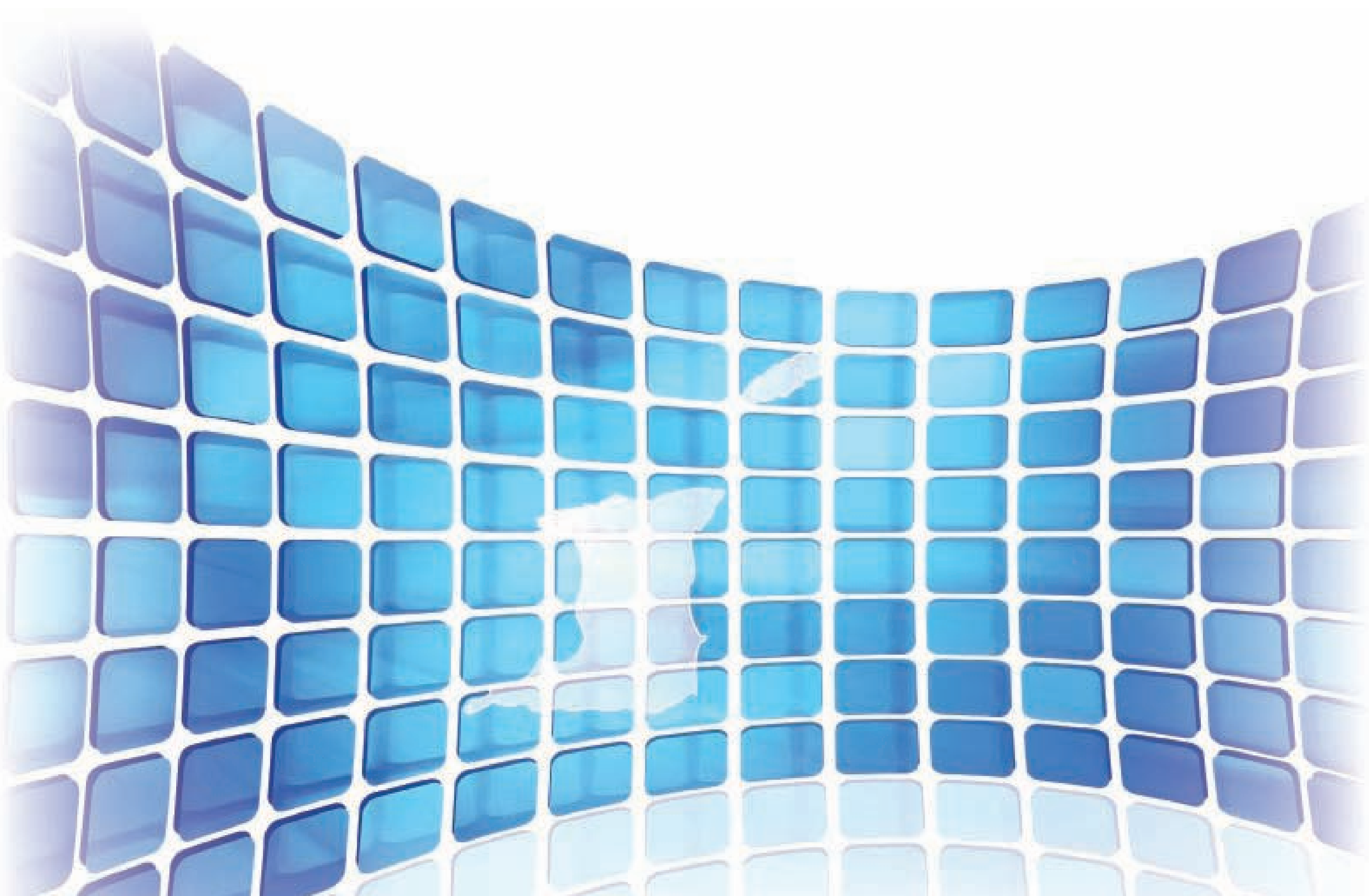

The Current State of the Economy

International Context

The global economy continues to recover from 'The Great Recession', the worst economic downturn since the Great Depression of the 1930s triggered by the financial crisis beginning in the US in 2007. While the global economy has emerged somewhat from recession, recent developments with respect to the sovereign debt of some of the EU countries (Portugal, Italy, Ireland, Greece, Spain, and Hungary) has raised the possibility that the world may re-enter recessionary conditions, that is, there is a strong risk of an impending "double dip" recessionary effect. The ongoing debt crisis in Europe is threatening the stability of the global economy as the crisis has the distinct potential to spread beyond Europe to other regions of the world.

In the United States, the US Federal Reserve recently offered a somewhat grim outlook for the world's biggest economy. Given the scale and depth of the recession, the recovery is expected to be "moderate paced" with the unemployment rate in excess of 9 percent and projected to remain high for some time. Joblessness negatively affects consumer confidence and consumer spending, the latter of which accounts for approximately 60 percent of GDP of the US.

These conditions pose tremendous downside risks for the global economic recovery and the health and overall viability of the Trinidad and Tobago economy.

National and Sectoral Growth

A major policy objective of the Government has to be the urgent resumption of significant and sustainable economic growth. The major consequences of economic contraction include declining revenues, rising unemployment and the creation of dire social consequences for the citizenry. Trinidad and Tobago's economy grew by as much as 13.5 percent in 2006, but slowed markedly to 2.3 percent in 2008. In 2009, the economy is projected to contract by 3.2 percent, and is expected to grow modestly by less than 1.0 percent in 2010.

Increased output has mostly been driven by energy sector activity which has grown on average by 8 percent between 2004 and 2008. In 2008, oil prices rose to a high of US$147/barrel and natural gas to US$14/mmbtu. However, activity in the energy sector slowed in the latter half of 2008 with the onset of the financial crisis and the global economic downturn. Energy prices fell precipitously from their earlier highs due to waning demand, increased uncertainty and decreasing consumer confidence.

As activity in the energy sector slowed, so too did activity in the non-energy sector. This was due to the heavy reliance of the non-energy sector on government spending of its oil windfall. The non-energy sector naturally slowed in tandem with the energy sector. The manufacturing sector, which contributes less than 6 percent of GDP and which produces goods for export to the CARICOM market was significantly reduced in size as a result of the virtual collapse of the CARICOM market following the global economic downturn. In addition, the agricultural sector experienced zero growth in 2009.

The 2009/2010 National Budget was predicated using an oil price of US$55/barrel and $2.75/ mmbtu for natural gas. Should there be any adverse variance from these prices due to uncertain international economic conditions the economy would inevitably become vulnerable to reduced energy revenues.

Inflation

Inflation continues its upward trend since reaching an all time low of 1.3 percent in December 2009. Headline inflation rose to 7.3 percent in April 2010 from 5.1 percent in March. Intense drought, which affected domestic food crop production, has been mainly responsible for higher headline inflation.

Core inflation which filters out the impact of food prices also increased from 4.1 percent in March to 4.4 percent in April. The rise in the core inflation rate mainly reflected increases in the price of transport.

Looking forward, continuous widespread flooding, inadequate structural changes in the local agricultural sector, vulnerability/exposure to increases in international food commodity prices and liquidity challenges in the domestic financial system are potential risk factors to prices in the short to medium term. Long term sustainable agricultural policies designed to increase food production will positively impact on the agricultural sector and reduce food prices.

Employment

Employment conditions were affected by the weakening of the economy.The rate of unemployment rose to an average of 5.3 percent over the first three quarters of 2009, compared with 4.9 percent for the same period of 2008. The global economic downturn, that propelled a fall in energy prices, took its toll on private sector employment and a significant level of retrenchment took place within the sector. In 2010, retrenchment notices continue although at a slower pace than 2009.

The labour force of Trinidad & Tobago is just over 600,000 persons. Of those employed, about 60,000, or close to 10 percent of the labour force, are attached to programmes like CEPEP, URP, OJT, etc. In the case of CEPEP, the programme must be view in a development context and not necessarily within the confines of a financial issue. The risk of discontinuing these programmes without providing adequate sustainable substitute employment opportunities would be to propel the unemployment rate upwards sharply towards 15 to 20 percent.

Fiscal Balance

Over the 2009 fiscal year Trinidad and Tobago recorded its first deficit in seven years. This deficit amounted to $7.4 billion or 5.3 percent of GDP as compared with a surplus of $12.1 billion or 7.8 percent of GDP in fiscal year 2008. The deficit was a direct result of declining oil prices which substantially trimmed government revenues without a concomitant decline in the level of spending by the previous administration. A further overall deficit of $7.7 billion or 5.4 percent of GDP is projected for this fiscal year. This trend towards fiscal deficits contributes significantly to the countries indebtedness and if it is not reversed urgently could result in the virtual mortgaging of several generations to come.

It should be noted that for the first time since the late 1980s, a recurrent fiscal deficit of $722 million (recurrent revenue of $37,366 million less recurrent expenditure of $36,648 million) has been projected for this fiscal year. This means that the country is now borrowing to finance recurrent expenditure, which includes components such as Wages and Salaries, Transfers and Subsidies and Interest Payments. If this situation is not curtailed, it poses tremendous downside risks for fiscal sustainability and debt management in the future. This is quite unlike borrowing to finance the Government's capital programmes which creates employment and generates economic activity.

Additionally, the fact that public sector wage negotiations are to be completed by the end of 2010 should also be factored into the fiscal equation.

It should also be noted that that the non-energy fiscal balance worsened in 2009; in 2008 fiscal year the non-energy fiscal deficit was $25,657 million compared to a deficit of $16,356 million in fiscal year 2006.

Cash Balances

Total Government Cash Balances declined steadily from $17.7 billion at the end of fiscal year 2008 to $9.7 billion at the end of fiscal year 2009 and further to $5.43 billion as at June 2010. This was primarily due to the generation of the fiscal deficits which began in 2008. In simple terms the Government's balances in the Treasury declined substantially over the last two years as the previous administration sought to maintain its high expenditure levels in the face of drastically falling revenues.

Foreign Exchange Reserves

Approximately 90 percent of Trinidad and Tobago's foreign exchange earnings come from the energy sector. Most of this accrues to the government as foreign currency. The foreign reserves currently stand at some twelve months of import cover owing to the positive balance of payments generated by the energy sector during the last five years. However, the downturn in the economy has caused a reduction in the overall balance of payments.

For the first nine months of 2009, the preliminary data for the balance of payments show an overall deficit of US$429.3 million compared with a surplus of US$2,062 million in the same period in 2008. Exports fell significantly by 50 percent compared with the previous year while imports declined by 34 percent. There were significant capital outflows accounting for a deficit of over US$2 billion during the period January to September. For 2009 as a whole, the reduction in reserves at the Central Bank reflected a balance of payments deficit of US$712 million. Gross reserves decreased from US$9,380 million in December 2008 to about US$8,652 million in December 2009 - inclusive of an allocation for US$ 435.2 million in Special Drawing Rights (SDRs) from the IMF.

Although oil prices have risen steadily to about US$75 per barrel, the price of gas (which is our main revenue earner) has been weak and has averaged around US$4/mmbtu. This price could fall even lower given the significant gas exports from Australia and Qatar and the large deposits of shale-gas in the US that are now being economically produced.

Furthermore, there have been no significant energy finds in Trinidad & Tobago recently. Therefore in addition to falling prices, the revenues earned will drop because, potentially, lower quantities will be sold. This is made even more critical given that the present proved reserves could take us only 12 years into the future.

The Heritage and Stabilisation Fund (HSF)

As legislated, funds are to be transferred into the HSF at the end of every quarter and adjusted at the end of the fiscal year following a formula relating the actual revenue from the energy sector to the budgeted revenue during the fiscal year such that at least 60% of the excess is transferred.

In fiscal 2007/8 TT $6,588 million was transferred to the Fund. No funds were transferred in fiscal 2008/9. In May 2010 TT $650 million was transferred to the HSF. As required by law, a further TT $1.3 billion is projected to be deposited into the HSF in consideration of the prevailing energy prices during fiscal 2009/10.

Public Sector Debt

The country's Public Sector debt stock increased steadily from $50 billion or 38 percent of GDP in 2007 to $66 billion or 49 percent of GDP in 2009. At the end of April 2010 the Gross Public Sector Debt Stock amounted to $68.2 billion or 51.1 percent of GDP. The country's debt stock as a percent of GDP has now passed the 50 percent threshold which economists use as the area of danger.

Of the Total Debt Stock, Central Government Debt increased steadily from $24.7 billion in 2007 to $38.5 billion in April 2010. External Debt grew marginally from $9.3 billion in 2008 to $9.8 billion in April 2010. Approximately 70 percent of this country's external debt is in US$ dollar indicating the currency risk exposures.

Contingent Liabilities which comprise Government Guaranteed Debt and Letters of Comfort grew from $17.3 billion in 2008 to $19.7 billion as at April 2010. Contingent Debt represents the largest component of Domestic Debt (34 percent) followed by Bonds (30.1 percent) and Open Market Operations (24 percent).

Additionally it is important to note that for State Enterprises as at March 2010, Local Debt without Government Guarantee amounted to $3.4 billion while non Government Guaranteed Foreign Debt amounted to $9.0 billion. These figures are not included in the total public sector debt stock.

The debt servicing component represents a risk to future fiscal sustainability especially in a scenario where the debt profile is marked by maturing of principal bullet bond obligations in any given year or consecutive fiscal years and declining revenues in light of fluctuating commodity prices, a key variable in determining this country's revenues. In addition the accelerated Debt to GDP ratio is being monitored and is of concern to International Credit Rating Agencies such as Standard and Poors and Moody's which have rated this country's Sovereign Debt as A (adequate protection to investors) and Baa1 (below average protection; considerable variability in risk due to economic conditions) respectively. A worsening of this ratio would present a downgrade risk thereby increasing this country's cost of borrowing.

Short term adjustments in this scenario include negotiation with borrowers on existing debt to extend or defer interest and principal repayments in the short term. A longer term maturity structure for external and domestic debt can be recommended as this could provide some protection in the budget balance in the short/medium term.

Moreover in the longer term structure currency risk can be reduced by issuing more domestic debt. A determination can be made as the existing percentage of external borrowing is on concessional terms with a view to increasing the share of concessional loan financing where possible. Where interest rate or currency rate exist the portfolio can be rebalanced using derivatives such as forward or future contracts to effectively hedge against adverse movements in these variables

The Establishment of an Economic Development Board

The Minister of Finance together with the Ministers of Planning, Economic and Social Restructuring and Gender Affairs, Energy and Energy Affairs, Trade and Industry, and Labour, Small and Microenterprise Development have been updated on the state of the Trinidad and Tobago economy by both the Governor, Central Bank of Trinidad and Tobago and the Permanent Secretary, Ministry of Finance.

Essentially, the presentations highlighted the challenging economic circumstances confronting policymakers in Trinidad and Tobago and in particular, the prospect of a continuing broad based decline in economic activity and the need to define a path to fiscal sustainability in the context of diminishing fiscal space given the imperative of maintaining an appropriate level of stimulus in order to pre-empt further deterioration of economic conditions. The fiscal implications of implementing Government's immediate policy were also explored.

In addition to the challenging fiscal situation, discussions also focused on issues that impacted the further development of the financial sector including the requirement for an early resolution of the CLICO/CL Financial matter. The Meeting also deliberated on the governance issues, particularly those relating to the state enterprise sector. The prospect for realizing significant savings from streamlining procurement practices was noted. The challenge of economic diversification and that of strengthening private sector participation in economic activity were also extensively discussed.

The Minister of Finance considers that, in light of these challenges, a new approach that will bring fresh ideas and new perspectives on how to respond to the current economic circumstances of the Trinidad and Tobago economy is necessary. In this context, therefore, the Minister of Finance proposes the establishment of an Economic Development Board (EDB) which will provide external and independent advisory inputs into the formulation of financial and economic policies to be pursued by Government. The EDB will reference and be guided by the seven pillars for sustainable development articulated in the Manifesto of the People's Partnership and in particular, Pillar 4: Connecting Trinidad and Tobago and Building the new economy, Pillar 5: A more diversified, knowledge intensive economy, and Pillar 6: Good Governance.

The Board will have the following core mandate-:

- To design a new framework for the economic development of the Trinidad and Tobago;
- To promote the alignment and strategic incorporation of existing and long term plans into the new T&T Development Framework;
- Formulate recommendations for the implementation and execution of these developmental plans;
- Advise the Government on domestic and international issues arising from changes in the economic environment.

The Minister of Finance is of the further view that the immediate work programme of the EAB should address the following priorities -:

i. Review Budget 2010 with a view to formulating recommendations for incorporating the short term policy agenda of Government;
ii. Finalize Medium Term Economic Programme including the policy initiatives to be incorporated in Budget 2011;
iii. Review Fiscal Regime for Energy Sector;
iv. Review the modalities of the Heritage and Stabilization Fund as they relate to reconciling stabilization and heritage components;

The Minister of Finance is satisfied that even as attention is being focused on revitalizing the economy, considerable effort must also be directed towards securing sustainable long term growth. This latter objective is contingent on achieving enhanced levels of national competitiveness. To this end, therefore, the Minister of Finance also proposes to strengthen the institutional arrangements to engender a more focused approach to building national competitiveness and the related dimension of innovation as envisaged in the Manifesto of the People's Partnership through the establishment of a National Competitiveness and Innovation Council (NCIC).

It is proposed that the core mandate of the NCIC be to advise the Government on how to develop a holistic competitiveness and innovation policy that will transform the economy by lowering its economic concentration ratio as well as improving its Global Competitiveness and innovation rank over the next ten years. Overall, the key objectives of the National Competitiveness and Innovation Council are as follows-:

(a) Provide critical support to Government in the execution of its policies and programmes as these relate to increasing public investment in human capital, generating industry relevant research, promoting industrial innovation, and enhancing co-ordination and simplification of the country's competitiveness, diversification and innovation support systems;
(b) Develop an Execution and Implementation Plan based on the numerous competitiveness and innovation studies completed in Trinidad and Tobago;
(c) Trigger organizational change in competitive, effective and innovative governance that will improve the Government's programme for sustainable development.

Appointment of a Select Committee to provide Financia Recommendations on CL Financial and CLICO

Background

In January 2009, CLICO Investment Bank (CIB) was unable to meet its liquidity requirements and was subsequently intervened by the Central Bank. Because of the significant inter-group exposure between CLICO and CIB, compounded by maturing short term liability products sold by CLICO (EFPA) at above market interest rates, CLICO also was unable to meet maturing policy holder claims. Firstly, as a result, Government and CL Financial entered into an MOU (January 30th) resulting in the revocation of CIB's licence and a transfer of third party liabilities to First Citizens Bank and secondly an agreement by the Government to finance the statutory deficit at CLICO.

In June 2009, CL Financial and the Government agreed that because of the significant shortfall in statutory assets and Government's willingness to lend CLICO the sums necessary to bridge the gap, CL Financial would appoint a new Board which the majority held by Government to exercise proper governance so that the assets owned by and managed by CL Financial would provide a source of repayment for GOTTs loan capital in CLICO, which is now approximately TT$5 billion.

Current Position – CLICO

Consultants contracted by the Central Bank have concluded that policy holders can be repaid, principal only, no interest, over a five year period provided there is a further injection of capital. In addition, to this is the challenge of major debt restructuring that has economy-wide inputs that must be addressed.

CL Financial

On a group consolidated basis CL Financial may be technically bankrupt. However when CLICO and CIB are stripped from the consolidation, as they are under Section 44D of the Central Bank Act, the remaining assets e.g. Angostura and Lascelles de Mercado exhibit economic viability and appear attractive to global companies.

The key challenge is to:

(i) ensure that non key strategic assets have the right management and financial plan to repay bank debt;

(ii) Non- core strategic assets are quickly disposed;

(iii) CL Financial repays CLICO its outstanding inter-group debt which will assist CLICO in discharging its liabilities.

Team members to the Select Committee

The Team Members to the Select Committee to provide Financial Recommendations on CLICO and CL Financial are as follows:

Steve Bideshi	- Chairman
Wendell Mottley	- Member
Colin Soo Ping Chow	- Member

Terms of Reference

The team will recommend:

(a) A preferred solution, from a Menu of options, for the repayment of CLICO's Traditional and non-traditional (EFPA) insurance liability products.

(b) A financial re-organization plan for CL Financial that demonstrates financial stability and ensures full satisfaction of commercial bank and inter-company debt.

(c) A clear path and timetable on how the Government of Trinidad and Tobago will exit its loan capital position and restore public confidence.

Caribbean Airlines Ltd (CAL) and Air Jamaica

The Minister of Finance is in receipt of information regarding recent initiatives taken by the previous administration relating to new arrangements between CAL and Air Jamaica. The Minister of Finance is of the view that there is an urgent need to clarify the precise nature and scope of these new arrangements particularly having regard to the possible significant level of fiscal resources involved, the relative lack of disclosure regarding the details of the new arrangements and the need to ensure that the resources of the country are utilized for the maximum benefit of its citizens.

To this end, the Minister of Finance proposes the establishment of a Working Committee to assess the status and implications of the CAL/Air Jamaica arrangements. The Working Committee will undertake the following-:

(i) Conduct a comprehensive assessment of the operations of CAL with a view to identifying opportunities for improving the efficiency and profitability of the airline;
(ii) Undertake a comprehensive cost/benefit evaluation of the proposed/new arrangements involving CAL and Air Jamaica from both a financial and economic perspective;
(iii) Make recommendations regarding the preferred future strategic direction for CAL to secure maximum benefits for the citizens of Trinidad and Tobago in the short, medium and long term.

The Minister of Finance further, proposes that the Working Committee to assess the operations of CAL, examine the status and the implications of the CAL/Air Jamaica arrangements and to make recommendations regarding the preferred future direction for CAL should comprise persons with the competence to evaluate the commercial dimensions of the new arrangements, determine the wider economic impact that would emanate from the proposed arrangements and establish the technical considerations that would inform a determination of the preferred arrangements going forward. In this regard, the Minister of Finance proposes the following membership for the Committee-:

Mr. Conrad Aleong	-	Former CEO, BWIA
Mr. Selby Wilson	-	Management Consultant
Mr. Krishna Boodhai	-	CEO, ICATT

Other Issues

The Minister of Finance also indicated his intention to hold discussions on critical issues pertaining to the National Insurance Board. In addition, the Minister will meet with the Business Community, Civil Society and the Labour sector to initiate a Partnership Compact on issues of National Economic Management.

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