T&T RATINGS COMMENTARY: Q&A WITH MARLA DUKHARAN

JULY 25, 2019

Moody's released its Annual Credit Analysis on the Government of Trinidad and Tobago (GORTT) on June 28, 2019, followed by a FAQ on growth prospects, fiscal consolidation, and external risks on July 15, 2019. Moody's has maintained its Ba1 (speculative/junk) rating on T&T with a stable outlook. On July 9, 2019, S&P Ratings downgraded T&T's sovereign credit rating to BBB from BBB+ (one notch above speculative/junk) on economic and fiscal stress with a stable outlook. The Ministry of Finance published a release on Moody's report on July 17, 2019. This Q&A provides a review of these four publications, and responds to the questions Marla has received in the context of these developments.

MARLA DUKHARAN
CARIBBEAN ECONOMIST

Q: Have you seen any major differences between Moody's and S&P's assessments of GORTT?

In the first place, it is important to note that a sovereign credit rating like Moody's and S&P's for Trinidad and Tobago is not a reflection of the country's economic prospects per se. It is an assessment of the Government's willingness and ability to service its existing debt. So a stable outlook DOES NOT imply a stable economy. A stable outlook means the rating is most likely to remain unchanged / stable at the current level, rather than downgrade or upgrade, in the next 12-18 months.

Secondly, Moody's downgraded T&T to non-investment grade or 'junk' as it's commonly known, to Ba1 on April 25, 2017. That was two notches below S&P's rating at the time. Now S&P has downgraded T&T to BBB which is still investment grade but is only one notch above Moody's rating, or 'junk'. This is nothing to celebrate and there is nothing positive whatsoever about this latest downgrade by S&P. Moody's report is being touted as a positive, but really what they are saying, for over two years, is that the debt issued by the GORTT is NOT an investment - it's speculative in nature because of the risks associated with it, and that the risks have remained, and have not improved. Again, this is nothing to celebrate.

Ratings definitions of the T&T ratings

Moody's: Ba1 foreign currency/local currency rating. Obligations rated Ba are judged to be speculative and are subject to substantial credit risk.

S&P: BBB long-term foreign/local currency rating. An obligation rated 'BBB' exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to weaken the obligor's capacity to meet its financial commitments on the obligation.

Before I get to the differences, I would like to talk about the similarities.

Similarities between S&P and Moody's Analyses

1) Moody's and S&P both project primary fiscal deficits, meaning that GORTT has to borrow just to pay the interest on current debt, which indicates that the debt level is already unsustainable.

2)Both S&P and Moody's point to foreign exchange controls by the Central Bank as limiting non-energy sector growth.

3)Both expect the level of foreign exchange reserves will further decline, as it has for the past few years.

4)Both cite the unusually large Errors and Omissions item on the Balance of Payments as a major risk, and Moody's directly suggests that it is due to capital flight. (See TT Outlook 2019: Another Year of Errors and Omissions)

5)Both agree that lack of economic diversification / over-reliance on the energy sector increases our economic vulnerability and volatility.

6)Both indicate that the lack of data poses a major risk to surveillance, policy formulation and effectiveness.

7) Both agree that reliance on one-off sources of fiscal revenue and dividends from State Owned Enterprises is not sustainable in reducing the fiscal deficit in the long-term.

Details on the points outlined above:

1. Primary fiscal deficit:

PRIMARY BALANCE/GDP, PERCENTAGE (%)

	2018	2019f	2020f	2021f	2022f
S&P	-1.2	-0.5	-2.1	-2.9	-2.2
Moody's	-1.2	-0.3	-0.9		

2. Exchange controls and ineffective policy response:

S&P- "[Energy] sector's sharp downturn over the past several years and the limited effectiveness of policy response--particularly given a heavily managed exchange rate and a small open economy that we believe limit the role of monetary policy--pose risks to the country's ability to respond to shocks."

S&P- "A heavily managed exchange rate and a small open economy effectively limit the role of monetary policy, in our view.

The central bank has sustained a quasi-fixed exchange rate since 2016, when it allowed the currency to depreciate by about 6%. Since then, U.S. dollar shortages have constrained economic activity, weakening local businesses' ability to pay suppliers and obtain key imports."

Moody's- "Significant data limitations and institutional constraints limit policy predictability and effectiveness. This has been a long-standing issue in Trinidad. (...) In essence, the CBTT tries to determine both the price and residual supply of foreign exchange in the market, resulting in foreign exchange shortages. This has resulted in both limited movement in the official exchange rate against the US dollar and persistent reports of foreign exchange shortages for the private sector (see Exhibit 11)."

Moody's- "Foreign exchange shortages also remain a constraint on non-energy business activity, weighing on business confidence and hampering trade and economic growth. Private companies have indicated that it can take months to get foreign exchange both to transfer dividends to their foreign headquarters and to pay for imports. Although it is difficult to quantify the exact impact on economic growth, we believe this has weighed on business confidence, particularly in certain sectors like retail and manufacturing. Moreover, foreign exchange shortages undermine investor confidence as the scarcity of hard currency likely increases the demand for foreign exchange, which leads to further capital outflows."

3. Reserves to further decline:

S&P- "We believe heavy central bank intervention in the foreign exchange market will also continue weighing on reserve levels. We estimate gross external financing needs will reach near 72% of current account receipts and useable reserves by 2022."
Moody's: "In this context, and barring a change in policy, the steady decline in reserves at the central bank are only likely to be solved with an increase in energy production or prices, or further curtailment of sales to the private sector (see Exhibit 12)."

4. Errors and Omissions in the Balance of Payments:
S&P- "Errors and omissions outflows have accounted for about 128% of the current account balance on average over the past five years." (...) "The sovereign's external data lack consistency, as demonstrated by errors and omissions at about negative 14% of CAR."

Moody's- "Even after these revisions, balance of payments data continue to exhibit large, and consistently negative, errors and omissions, suggesting continued data quality issues."

Moody's- "The decline in international reserves despite a current account surplus is explained by offsetting outflows in the financial account and persistently large errors and omissions (see Exhibit 10). By definition, errors and omissions are not easily explained, but we believe they likely reflect problems with the balance of payments data collection, likely on the financial account as well as a combination of underreported imports and capital flight. The size of errors and omissions, and uncertainty over their origin drive our concern over external vulnerabilities in the medium term. Since the fourth quarter of 2015, errors and omissions have been larger than the current account surplus in absolute terms, in all quarters except for one. Although we cannot accurately forecast errors and omissions, we currently expect them to moderate, thereby leading to a stabilization in reserves at the central bank. However, if error and omissions continue to be of this magnitude, reserves would likely fall."

5. Overdependence on the Energy Sector:
S&P- "Trinidad and Tobago's external accounts depend greatly on the energy sector, given that the sector's exports account for over 80% of the total. This concentration exposes the country to significant volatility in terms of trade, and subsequently, its external liquidity and debt position."

Moody's- "the country's prospects for economic diversification away from hydrocarbons remain limited because of deep-seated institutional shortcomings and short-term policy decisions. Among the more structural features limiting private sector activity and diversification is Trinidad & Tobago's complex and inefficient bureaucracy, which limits the ability of the private sector to drive investment and develop within the country."

6. Lack of data creates substantial risk:
S&P- "There have been repeated delays in implementing a stronger and autonomous National Statistical Institute. This reform aimed to address historical shortcomings in the country's economic data, which hamper surveillance and policy formulation."
S&P: "At the same time, institutional reforms to strengthen revenue collection and improve the provision of timely economic data have taken longer than expected, and we do not expect to see material dividends from these reforms in the near term."
Moody's: "Significant data limitations and institutional constraints limit policy predictability and effectiveness, creating uncertainty over medium-term fiscal projections."

Moody's- "The government's policy effectiveness is further limited by a lack of basic macroeconomic data, and substantial quality issues on the data that is available. This is a long-standing issue and, despite the government's efforts, it remains unresolved. In terms of data availability, demand-side gross domestic product, for instance, is a notable data input that remains absent after being discontinued in 2009."

7. Reliance on one-off revenues is not the answer to reducing the fiscal deficit long-term:
S&P- "At the same time, we believe that the government will continue to rely on one-off revenues, principally related to the recovery of assets from the CL Financial Conglomerate, which failed in 2009 and was bailed out by the government, to support its revenues. These revenue sources will contribute to a decline in the government's deficit to 2.9% of GDP in fiscal 2019, down from 4.1% a year earlier, under our forecasts. Nevertheless, we do not expect this additional revenue to fully offset the impact of contracting non-energy sector revenue and rising spending over the outlook horizon. We forecast the fiscal deficit to average 4.7% of GDP from 2019-2020 to 2021-2022, and do not expect the government to meet its previously established target of reaching a balanced budget by 2020-2021."

Moody's- "Actual fiscal outturns can deviate significantly from budgeted targets (see Exhibits 8 and 9), particularly due to uncertainty over the size and timing of asset sales as well as a reliance on dividends from SOEs. This is reflected in execution rates on current and capital revenue. Practices for both budget formulation and reporting of past fiscal outturns are subject to frequent revisions and often include unrealistic assumptions."

Differences between Moody's & S&P's Analyses

1. Fiscal Deficit outlook:
S&P- expects the fiscal deficit will increase over the next three years on increased spending and slower revenue growth.
Moody's- expects the fiscal deficit will narrow.

2. Gas production:
S&P- expects subdued gas output
Moody's- expects gas output will stabilize

Q: What is your take of Moody's assessment of Petrotrin with respect to the reopening of the refinery?

There isn't much I can say on this. I agree that closing the refinery was a necessary fiscal measure, and that insufficient information has been made available on the potential reopening of the refinery to include in base forecasts.

Moody's- "We also do no incorporate the reopening of Petrotrin's Pointe-a-Pierre refinery in our baseline, for which the government is in the process of accepting bids. The government hopes to complete the selection process by the end of 2019. The reopening of the refinery would have a positive short-term impact on growth, and potentially positive effect over the longer term if the new owner improves the refinery's operations."

Q: When should we expect to see the next Article IV Staff Report on Trinidad and Tobago from the IMF? Is it overdue?

Based on the current relationship T&T has with the IMF, annual (at least) visits by the IMF team to conduct the Article IV review and produce the accompanying Staff Report, are the norm / expectation. The last visit was around mid-2018, so another visit would be (over)due now. It is not clear whether this visit will occur later this year, but it has not occurred yet for 2019. I do hope that the Government makes the necessary arrangements to welcome an IMF staff visit this year, otherwise it could signal to the international community, existing and potential foreign investors, the Opposition, the electorate, and all other observers, that this Government is not supportive of transparent and objective assessment and reporting on the macroeconomic conditions in T&T. If the IMF team has not been 'invited', it could mean several things, none of which could be considered positive, in my view.

I consider the IMF's Article IV staff report to be one of, if not THE most important macroeconomic analyses that should be available for any country, not just T&T.

Q: How do the Ministry of Finance's release and Moody's FAQ report line up?

Let's break it down:

MoF release- After almost a decade of stagnation, the Trinidad and Tobago economy began to stabilize in late 2017 and expanded in 2018. It is expected that the recovery will broaden over the next two years.

MD commentary- Moody's points to the importance of the gas sector in the 'recovery' and election spending:

"The economy began to stabilize in late 2017 amid increased gas production, and we expect the recovery to broaden over the next two years. … "

"In 2019-20, we expect the non-energy sector to return to growth, gas output to stabilize and oil production to increase."

"Non-energy sector activity will recover primarily because of the second round effects of the government's capital spending plans ahead of the 2020 general election."

MoF release- Economic growth is projected at 1.5%-2.5% in 2019-2020, which is supportive of Trinidad's economic strength.

MD commentary- Moody's highlights lack of diversification as a risk and bureaucracy as a constraint to growth:
"Although we expect the economy to return to growth, the country's prospects for economic diversification away from hydrocarbons remain limited because of deep-seated institutional shortcomings and short-term policy decisions."

"Among the more structural features limiting private sector activity and diversification is Trinidad & Tobago's complex and inefficient bureaucracy, which limits the ability of the private sector to drive investment and develop within the country. The challenges faced by the non-energy sector are reflected in Trinidad's relatively low ranking in the World Bank's 2019 Ease of Doing Business report.."

Foreign exchange shortages also remain a constraint on non-energy business activity, weighing on business confidence and hampering trade and economic growth. Private companies have indicated that it can take months to get foreign exchange both to transfer dividends to their foreign headquarters and to pay for imports. Although it is difficult to quantify the exact impact on economic growth, we believe this has weighed on business confidence, particularly in certain sectors like retail and manufacturing. Moreover, foreign exchange shortages undermine investor confidence as the scarcity of hard currency likely increases the demand for foreign exchange, which leads to further capital outflows.

__Moody's highlights issues with data:__

In terms of data availability, demand-side gross domestic product, for instance, is a notable data input that remains absent after being discontinued in 2009. The current supply-side gross domestic product figures are not publicly available on a quarterly frequency and they are methodologically more akin to so-called "flash" GDP estimates than to traditional gross domestic product calculations.

MoF release- The Government has achieved current account surpluses which support low external vulnerability.

MD commentary- Moody's does not attribute this 'achievement' to government. In fact, that which is attributable to 'government' is highlighted as a major risk. Moody's point to capital flight and says the following:

Moody's- "Although Trinidad & Tobago has registered current account surpluses since 2017,which in part support our view of low external vulnerability risks, international reserves have declined for four consecutive years, and we expect this trend to continue. If international reserves continue to fall, despite a large current account surplus, external risks will gradually increase."

"By definition, errors and omissions are not easily explained, but we believe they likely reflect problems with the balance of payments data collection, likely on the financial account as well as a combination of underreported imports and capital flight."

"The size of errors and omissions, and uncertainty over their origin drive our concern over external vulnerabilities in the medium term. Since the fourth quarter of 2015, errors and omissions have been larger than the current account surplus in absolute terms, in all quarters except for one."

"Even after these revisions, balance of payments data continue to exhibit large, and consistently negative, errors and omissions, suggesting continued data quality issues."

__Moody's holds CBTT directly responsible for FX shortages:__

"In essence, the CBTT tries to determine both the price and residual supply of foreign exchange in the market, resulting in foreign exchange shortages."

"In this context, and barring a change in policy, the steady decline in reserves at the central bank are only likely to be solved with an increase in energy production or prices, or further curtailment of sales to the private sector."

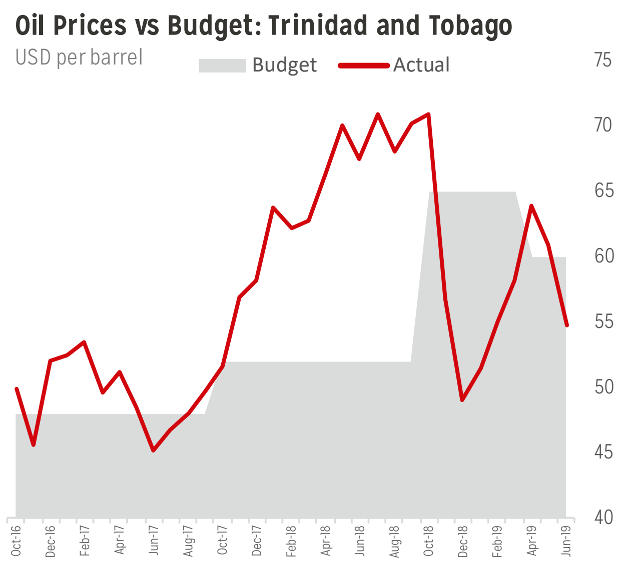
Trinidad and Tobago's fiscal position will remain broadly stable, with fiscal deficits between 2.5% and 3.5% of GDP, over the next two to three years.

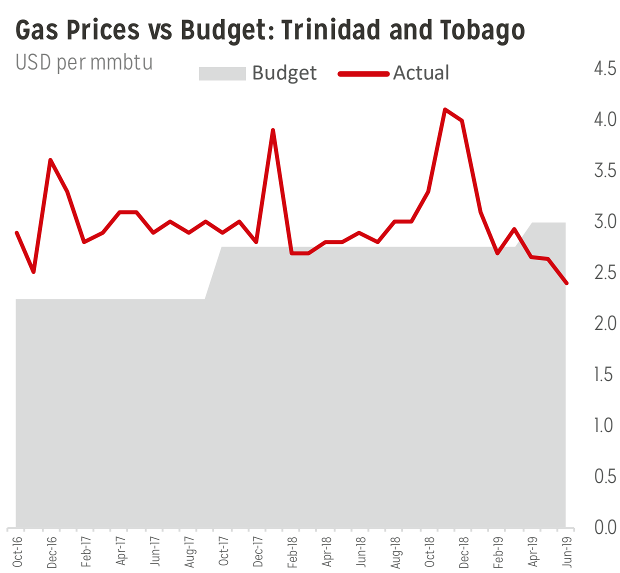
__Moody's also highlights the reliance on energy revenues for fiscal deficits to be contained:__

"After recording small deficits between 2010-15, the government's fiscal balance deteriorated sharply, recording a deficit of 5.4% of GDP in 2016 and 9.1% of GDP in 2017. The widening of the fiscal deficit was the direct result of a sharp decline in energy revenues, which were depressed by both a sharp reduction in prices and declining output (see Exhibit 6)."

__Let's not forget that:__

Oil prices have been below budget estimate in all but 2 months this fiscal year, in spite of the downward revision of oil prices announced by the Minister in April from USD65/bbl to USD60/bbl. The Ministry revised gas prices for the budget upwards in April from USD2.75/mmbtu to USD3.00/mmbtu, leaving gas prices below budget prices for 4 months this fiscal year.





Source: Min. of Finance, Central Bank of Trinidad and Tobago, Marla Dukharan

Moody's expects Government revenues to narrow and capital spending to be under-executed, highlights reliance on energy revenues and one-off capital transactions:

"Based on the latest projections from the midyear budget review, and including payments by Shell (which will increase revenue this year), we expect the fiscal deficit to narrow to 2.7% of GDP in 2019 from 4.1% in 2018. Our forecast assumes lower government revenue intake will be met with under-execution on spending, primarily capital expenditures."

"In the long term, government finances will remain reliant on energy-related revenue as well as asset sales and other non-recurrent revenue. This represents an intrinsic vulnerability to Trinidad's fiscal strength and credit profile, and represents the key downside risk to our fiscal forecasts. According to Ministry of Finance data, non-oil, non-tax revenue and capital revenue increased to 31% of total revenue in 2018, from 19% in 2014. At the same time, energy-related revenue presents some upside risk to public finances if oil and gas production or prices increase above our moderate expectations."

It is important to note that the Minister raised the gas price target mid-year. For the last 3 months gas prices have averaged 15% below the new budget target of USD3.00, and for the last 6 months have averaged below the original USD2.75 target. The Minister budgeted for oil & gas revenues this year to be up 27% y/y (from TTD7.5 billion to TTD9.5 billion) but we know that from Oct-Dec 2018, production was down, based on the CBTT report. So getting 27% upside from Oil and Gas prices - that since April are 7% below the original estimate used to calculate the 27% y/y gain - means production would have to grow to a much greater extent.

As a result of stable and moderate deficits, Government debt is expected to stabilize at around 63% of GDP over the next two years.

This refers to Net Public Sector Debt to GDP (Moody's: "For Trinidad & Tobago, we track what the government calls 'net public sector debt', which is central government debt, net of debt issued for sterilization purposes, and the debt of state-owned enterprises (SOEs) that is explicitly guaranteed by the sovereign… Net public sector debt, as reported by the authorities, does not include the debt of other SOEs, such as Petrotrin, other than the portion that has direct government guarantees – mostly for working capital. As such, the net public sector aggregation level does not conform to standard international definitions for government sectors.")

According to CBTT data, in the first 6 months of the fiscal year, the Gross Public Sector Debt to GDP ratio has risen from 76.1% at the end of FY2018/2019 to 78.2% at the end of March 2019.

Moody's- "While Trinidad's debt burden will remain weaker than similarly-rated peers, the government maintains a sizeable financial buffer in the Heritage and Stabilize Fund (HSF), which as of September 2018 stood at $5.97 billion (or roughly 27% of GDP), underpinning our assessment of fiscal strength."

MoF release: The Government maintains a sizeable financial buffer in the Heritage and Stabilization Fund (HSF), which as of September 2018 stood at US$5.97 billion (or roughly 27% of GDP), underpinning Moody's assessment of fiscal strength (note - the Net Asset Value of the HSF in July 2019 had increased to US$6.2 billion).

MD commentary- The latest HSF report published on the MoF website is from September 2018. https://www.finance.gov.tt/category/reports/heritage-and-stabilization-fund/

Moody's does mention in its FAQ report:

"Significant data limitations and institutional constraints limit policy predictability and effectiveness, creating uncertainty over medium-term fiscal projections."

"The government's policy effectiveness is further limited by a lack of basic macroeconomic data, and substantial quality issues on the data that is available. This is a long-standing issue and, despite the government's efforts, it remains unresolved."

MoF release- The Government has demonstrated effective policymaking in the restructuring of Petrotrin into Trinidad Petroleum, which otherwise could have devolved into a potentially hazardous political and fiscal situation.

I would agree with Moody's on Petrotrin. But concerning policy effectiveness, Moody's states:

"Despite successful results, the restructuring of Petrotrin also highlights some of the shortcomings in the policy framework. The final decision to close the refinery came just one year prior to a large external bond maturity for Petrotrin, limiting the amount of time the newly restructured company, Trinidad Petroleum Holdings Limited, had to obtain financing ahead of the bond maturity."

"The government's policy effectiveness is further limited by a lack of basic macroeconomic data, and substantial quality issues on the data that is available."

MoF release- Trinidad Petroleum has secured financing to repay Petrotrin's upcoming bond maturity in August 2019, and the Government will not have to provide a guarantee. Heritage Petroleum, the Trinidad Petroleum subsidiary that now possesses Petrotrin's E&P assets, is expected to be profitable. This reverses the previous trend where Petrotrin was a drag on the fiscal accounts.

In 2019-2020, the non-energy sector is expected to return to growth, gas output to stabilize and oil production to increase.

MD commentary- The IMF Commodity price forecasts show oil and gas prices will remain below the current TT budget estimate levels through 2024. This means gains in production will be needed just to stay where we are.

MoF release- Natural gas production has been on the rise, growing 8.1% in 2018 from new fields coming onstream. This is the direct result of two projects - Juniper and TROC - that started producing in mid-2017. Additional output from a third project, Starfish, began in May 2018, as well as an extension of the Dolphin Phase 3 project, which began production in August 2018. Output was further boosted after the Angelin field started production in February 2019. Projects coming online in 2020 include Shell's Barracuda and EOG Resources' Toucan 4(a) contingent exploration project. As of February 2019, natural gas production was 4 billion cubic feet per day (9% year-on-year growth).

The Central Bank's quarterly production indicator shows positive growth in the first three quarters of the fiscal year, driven once again by the energy sector. The Central Bank's index of energy production grew by 4.5% year-on-year in the first three quarters, while non-energy activity contracted by 0.4%.

IMF COMMODITY PRICE FORECAST IN USD

	2019	2020	2021	2022	2023	2024
Crude Oil WTI	54.58	55.49	54.32	53.51	53.27	53.31
Nat Gas, Henry Hub	2.75	2.70	2.63	2.65	2.71	2.81
Oil change y/y	-16%	2%	-2%	-1%	0%	0%
Gas change y/y	-13%	-2%	-3%	1%	2%	3%

Source: IMF

MD commentary- If they are referring here to the Economic Activity Index, energy and non-energy sectors declined y/y in the 3rd and 4th quarters of 2018, according to the CBTT March 2019 report:

QUARTERLY INDEX OF ECONOMIC ACTIVITY TRINIDAD AND TOBAGO, CHANGE % Y/Y

	4Q18	3Q18	2Q18	1Q18	4Q17
Total	-2.1	-1.6	3.3	3.1	-1.6
Energy	-2.5	-3.8	8.9	9.2	2.7
Petrochem.	-3.7	-10.8	0.3	13.7	8.9
Other Petrol.	-2.2	-2.2	11	8.2	1.3
Non-Energy	-1.8	-0.4	0.4	-0.2	-3.8
Construction	-4.7	-6.4	3.4	-4.2	-6.9
Manufacturing	-0.6	-0.4	-1.2	-6.5	-3
Distribution	-2.5	1.6	0	2.1	-5.8
Agriculture	-3.8	1.4	0.2	-0.6	-8.6

Source: Central Bank of Trinidad and Tobago, Summary Economic Indicators March 2019