S&P Global
Ratings

Standard & Poor's Credit Research

Research Update:

Barbados Long-Term Sovereign Credit Ratings Lowered To 'B-' From 'B' On High Fiscal Deficits; Outlook Is Negative

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Overview

- Barbados' fiscal adjustment again fell short of stemming another increase in debt to GDP, which is already very high and a key credit constraint.
- Central bank financing of the government's deficit continues, exacerbating Barbados' financial and external weaknesses.
- As a result, we are lowering our long-term foreign and local currency sovereign credit ratings on Barbados to 'B-' from 'B'.
- The outlook on the long-term rating is negative, reflecting a greater than one-in-three chance of a downgrade, should the government be unable to lower its fiscal deficits, or if growth fails to strengthen, putting additional pressure on the country's weakening external position.

Rating Action

On Sept. 23, 2016, S&P Global Ratings lowered its long-term foreign and local currency sovereign ratings on Barbados to 'B-' from 'B'. The outlook is negative.

The short-term ratings were affirmed at 'B.' We also downgraded our transfer and convertibility assessment for Barbados to 'B-' from 'B'.

Rationale

The government's financial profile has eroded over the last several years because of persistently high fiscal deficits, reflecting both budget slippage and unbudgeted spending. The central bank continues to directly finance the government, which we consider at odds with its goal to defend Barbados' long-standing currency peg with the U.S. dollar. The government deficits, coupled with current account deficits (CADs) not fully financed by foreign direct investment (FDI), have increased the country's external vulnerabilities. We do expect economic growth to pick up during the next two to three years, but lackluster private-sector confidence, continued delays in several tourism projects, and potential spillover from Brexit should keep growth moderate. We expect per capita GDP growth to be around 1% in the next two years, comparatively low for a country at its level of income. The country's per capita income, projected to be almost US$16,000 in 2016, is higher than that of most of its rating peers. That said, Barbados' economy and the sovereign credit rating benefit from a low level of perceived corruption and a generally stronger political system and institutions than most of the sovereign's peers in the 'B' rating category.

The government did not lower its fiscal deficit as much as we had expected last year, and we expect slow progress in lowering the deficit over the next several years. The fiscal slippage reflects poor implementation of various adjustment measures, which only became effective during the second half of the last fiscal year, as well as failure to meet targets for state-owned enterprises (SOEs). The general government deficit was 6.1% of GDP in fiscal-year 2015 (from April 2015 to March 2016), slightly above the 5.8% of the prior year; the general government deficit includes the National Insurance Scheme (NIS) surplus of 1.2% of GDP. Stricter control over expenditure at SOEs, some one-off revenues from the sale of the Barbados National Terminal Company, and the full impact of the fiscal measures announced in 2015 and 2016, should reduce the fiscal deficit (and change in government debt) toward 5% of GDP during 2016-2018. The management of SOE finances poses a risk to the success of the fiscal consolidation of the government, in our view.

On Aug. 15, 2016, the government announced additional fiscal measures and a midterm financial and economic review. This process updates the pro forma budget proposal laid out in March, with updated economic assumptions, and incorporates further planned fiscal tightening. Moreover, the government introduced a social responsibility levy (2% on imports except those for tourism, construction, and agriculture) to fund health expenditure and increased the bank asset tax to 0.35% (from 0.2%). Finally, the government plans to reduce transfers to SOEs during the next four years below BB$1 billion, where they have stood for the last five fiscal years, through improving its control on its SOE's expenditures and refinancing arrears.

In our opinion, these measures will help reduce the annual increase in government debt to an average of 5% of GDP during 2016-2018 from the 6.5% observed in 2013-2015. However, we expect Barbados' net general government debt to continue to rise toward just below 100% of GDP over the next three years from 93% in 2015. We consider the level of debt a key credit constraint, particularly given Barbados' narrow, open economy (which depends highly on tourism) and fixed exchange rate regime. In addition, the general government interest to revenue burden is over 15% (this figure excludes interest payments to NIS). Moreover, the government continues to run arrears, which the International Monetary Fund estimates at 5.9% of GDP last fiscal year, up from the 4.3% the year before. We assess Barbados' contingent liabilities as limited; this considers our view of the strength of the banking system with assets of the deposit-taking financial institutions at 170% of GDP.

Consistently high CADs from 2011 to 2015, which averaged 10% of GDP, the absence of significant FDI flows--coupled with the sovereign's decision not to tap global capital markets--underpin a steady downward trend in international reserves, which were $544 million at year-end 2015. Our expectation for continued low commodity prices over the next two to three years and some pickup in tourism arrivals, especially from the U.S., should keep the average CAD at a lower 7% of GDP during 2016-2018. Within the last 12 months, three major hotels have announced new investments on the island--the Hyatt, the Sam Lord's Castle project by Wyndham (which the China Exim Bank will finance as well), and the expansion of the all-inclusive Sandals hotel. This should boost FDI flows and finance around 80% of the projected CAD. Coupled with disbursements from multilateral organizations, this should ease the downward trend of the international reserves.

However, usable international reserves, which we consider for assessing external liquidity, are even lower; we subtract the monetary base from international reserves because reserve coverage of the monetary base is critical to maintaining confidence in the exchange-rate regime. Barbados' usable reserves have been negative since 2013, and the position continues to deteriorate, in part because of the central bank's deficit financing, which has expanded the monetary base. We expect Barbados' gross external financing needs to be above 200% of current account receipts (CAR) plus usable reserves. We expect narrow net external debt to average around 40% of CAR during 2016-2018. Our external assessment also considers that net external liabilities of a projected 170% of CAR during 2016-2018 are substantially higher than narrow net external debt. Finally, we note that Barbados' International Investment Position has inconsistencies and is not timely.

At almost $16,000 GDP per capita, Barbados is still one of the richest countries in the Caribbean. However, growth has been below that of peers with a similar level of economic development, and the economy is very dependent on tourism. These factors weigh on the strength of the economy. There have been anecdotal signs of some pickup in growth--as tourism has improved--and we expect real GDP to post small but consistent gains during 2016-2018. Largely as a result of a robust tourism sector, the economy posted 0.8% growth in 2015, above the 0.3% average of the previous five years. Tourism arrivals were up by 14% in 2015, led by the U.S. market; higher arrivals, however, have not translated to higher tourist per capita spend. This is likely because of low commodity prices and increased use of Internet platforms for room accommodation.

Since its independence, Barbados has kept strong ties with the U.K.; it is still early to assess the full impact of Brexit on the island. The U.K. accounts for 36% of tourist arrivals, and Britons are the main nonresident buyers in the local housing market. The impact of the Brexit, if any, could be mitigated by reactivation of the construction sector following the announcement of major hotel projects and growth in U.S. tourism. We expect GDP growth of 1.5% during 2015-2018.

Outlook

The negative outlook reflects the potential for a downgrade if the government fails to make additional progress in lowering its high fiscal deficit, if growth resulting from key investment projects fails to materialize, or if external pressures worsen because of persistent and large CADs. This scenario would likely lead to a further deterioration in the availability of financing for large fiscal deficits during the next 12-18 months.

We could revise the outlook to stable within the next 12-18 months if the government succeeds in stemming further slippage in its fiscal accounts--be it from implementation of fiscal measures or a stronger-than-expected rebound in growth--improves its access to financing, especially from private creditors locally and globally, and stabilizes the country's external vulnerabilities.

Key Statistics

Table 1

Barbados--Selected Indicators

	2010	2011	2012	2013	2014	2015	2016f	2017f	2018f	2019f
ECONOMIC INDICATORS (%)										
Nominal GDP (bil. LC)	8.89	8.72	8.66	8.74	8.71	8.68	8.87	9.20	9.60	10.03
Nominal GDP (bil. $)	4.45	4.36	4.33	4.37	4.35	4.34	4.43	4.60	4.80	5.02
GDP per capita (000s $)	16.1	15.7	15.6	15.7	15.6	15.5	15.8	16.3	17.0	17.7
Real GDP growth	0.3	0.8	0.3	(0.0)	0.2	0.8	1.0	1.5	1.8	2.0
Real GDP per capita growth	(0.1)	0.8	(0.1)	(0.0)	(0.2)	0.4	0.7	1.2	1.5	1.7
Real investment growth	(12.7)	7.4	(7.1)	(5.5)	(0.5)	(1.9)	2.1	3.7	4.3	4.5
Investment/GDP	13.8	15.1	14.1	13.2	13.2	12.8	12.8	12.8	12.8	12.8
Savings/GDP	8.1	2.4	4.6	2.6	2.7	4.9	5.9	5.8	5.4	5.4
Exports/GDP	46.2	39.0	39.3	36.4	36.8	36.8	36.8	36.8	36.8	36.8
Real exports growth	11.9	(15.0)	1.1	(7.4)	1.3	0.8	1.0	1.5	1.8	2.0
Unemployment rate	10.3	11.2	11.5	11.6	12.3	11.3	11.5	11.0	10.5	10.5
EXTERNAL INDICATORS (%)										
Current account balance/GDP	(5.7)	(12.7)	(9.6)	(10.6)	(10.5)	(7.9)	(6.9)	(7.0)	(7.4)	(7.4)
Current account balance/CARs	(10.5)	(23.4)	(18.7)	(20.4)	(20.5)	(15.2)	(13.2)	(13.6)	(14.6)	(15.0)
Trade balance/GDP	(24.2)	(28.6)	(26.2)	(29.2)	(27.1)	(24.3)	(23.5)	(22.8)	(22.6)	(22.3)
Net FDI/GDP	4.3	12.5	11.8	3.6	8.9	5.6	5.6	5.9	6.0	6.0
Net portfolio equity inflow/GDP	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.5	1.4	1.5
Gross external financing needs/CARs plus usable reserves	128.4	123.7	124.5	162.7	163.9	176.7	200.8	215.8	217.0	220.4
Narrow net external debt/CARs	7.6	7.3	19.6	33.6	36.8	32.8	37.4	38.6	40.3	42.4
Net external liabilities/CARs	64.1	75.1	157.3	146.2	144.1	148.6	164.4	177.0	190.8	202.5
Short-term external debt by remaining maturity/CARs	34.5	18.8	19.1	50.8	42.8	51.1	50.0	48.8	47.8	47.0
Reserves/CAPs (months)	1.4	1.4	1.1	0.5	(0.0)	(0.6)	(2.0)	(2.6)	(2.6)	(2.8)
FISCAL INDICATORS (%, General government)										
Balance/GDP	(5.6)	(1.7)	(6.5)	(8.4)	(5.8)	(6.1)	(5.3)	(5.1)	(4.8)	(4.9)
Change in debt/GDP	6.4	6.2	5.2	8.9	5.3	5.5	5.3	5.1	4.8	4.9
Primary balance/GDP	(1.4)	2.9	(1.6)	(3.2)	(0.2)	(0.4)	0.5	0.9	1.2	1.1
Revenue/GDP	34.2	37.6	37.2	35.9	38.5	39.8	40.1	40.3	40.3	40.4

Table 1

Barbados--Selected Indicators (cont.)										
Expenditures/GDP	39.9	39.3	43.7	44.3	44.3	46.0	45.5	45.3	45.1	45.2
Interest /revenues	12.4	12.0	13.1	14.4	14.7	14.4	14.7	14.8	14.8	14.8
Debt/GDP	73.0	80.6	86.3	94.4	100.1	105.9	109.0	110.2	110.4	110.4
Debt/Revenue	213.2	214.1	231.7	262.7	260.0	265.7	271.6	273.6	273.7	273.5
Net debt/GDP	55.9	62.1	68.8	77.8	84.8	93.2	96.6	98.2	98.9	99.4
Liquid assets/GDP	17.0	18.5	17.5	16.6	15.3	12.7	12.5	12.0	11.5	11.0
MONETARY INDICATORS (%)										
CPI growth	5.8	9.4	4.5	1.8	1.9	(1.1)	1.1	2.2	2.5	2.5
GDP deflator growth	(3.6)	(2.7)	(0.9)	0.9	(0.6)	(1.1)	1.1	2.2	2.5	2.5
Exchange rate, year-end (LC/$)	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Banks' claims on resident non-gov't sector growth	(23.5)	1.5	6.3	(2.6)	(0.4)	(0.8)	2.1	3.7	4.3	4.5
Banks' claims on resident non-gov't sector/GDP	64.1	66.3	71.0	68.5	68.5	68.2	68.2	68.2	68.2	68.2
Foreign currency share of residents' bank deposits	15.2	7.1	4.1	3.8	4.8	6.4	6.4	6.3	6.3	6.3
Real effective exchange rate growth	1.6	3.9	1.6	(0.6)	(1.2)	N/A	N/A	N/A	N/A	N/A

Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. f--Forecast. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Barbados--Ratings Score Snapshot	
Key rating factors	
Institutional assessment	Neutral
Economic assessment	Weakness
External assessment	Weakness
Fiscal assessment: flexibility and performance	Weakness
Fiscal assessment: debt burden	Weakness
Monetary assessment	Weakness

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). Section V.B of S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 23, 2014 , summarizes how the various factors are combined to derive the sovereign foreign currency rating, while section V.C details how the scores are derived. The ratings score snapshot summarizes whether we consider that the individual rating factors listed in our methodology constitute a strength or a weakness to the sovereign credit profile, or whether we consider them to be neutral. The concepts of "strength," "neutral," or "weakness" are absolute, rather than in relation to sovereigns in a given rating category. Therefore, highly rated sovereigns will typically display more strengths, and lower rated sovereigns more weaknesses. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in assessment of the aforementioned factors does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the assessments.

Related Criteria And Research

Related Criteria

- Sovereign Rating Methodology, Dec. 23, 2014
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee agreed that "external assessment" had deteriorated. All other key rating factors were unchanged.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Downgraded; Ratings Affirmed

	To	From
Barbados		
Sovereign Credit Rating	B-/Negative/B	B/Negative/B
Transfer & Convertibility Assessment	B-	B
Senior Unsecured		

Long Term	B-	B
Short Term	B	B

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.