S&P Global
Ratings

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Summary:
The Commonwealth of The Bahamas

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Summary:

The Commonwealth of The Bahamas

Issuer Credit Rating	BB+/Stable/B

Key Rating Factors

Institutional and Economic Profile	**Flexibility and Performance Profile**
Strong institutions will continue to drive public-sector reform and policies to tackle fiscal and growth constraints • The new government has passed legislation consistent with its mandate of fiscal responsibility. • We expect growth to continue at a moderate pace, following a 1.4% increase in real GDP in 2017. • New measures enacted by the government should eventually lead to improved economic growth prospects, although we believe they will take time.	Spending cuts and revenue growth should halt the recent rise in the deficit, slowing the pace of debt increase • Fiscal responsibility legislation introduced deficit and debt target ratios; we believe debt growth will slow as a result. • Large external financing needs continue to put pressure on balance of payments. • The Bahamas' limited monetary and exchange rate flexibility constrains its ability to respond to external shocks.

Outlook

The stable outlook reflects S&P Global Ratings' expectation that robust political institutions will anchor fiscal consolidation and moderate economic growth over the next one-to-two years.

We could lower our ratings on The Commonwealth of The Bahamas over this period if public finances do not improve as quickly as expected. This could result from stagnant economic growth, external shocks, or weakened political commitment. The lack of confidence that this may generate could push debt costs higher, leading to a downgrade.

Conversely, we could raise the ratings over the same timeframe if the government reduces the annual increase in general government debt beyond our expectations. This, combined with significantly higher economic growth forecasts, could lead to an upgrade.

Rationale

The sovereign credit ratings on The Bahamas reflects the country's high external liquidity needs and debt levels--which are rising--and a slow-growth economy that has lost competitiveness over the past decade. This deterioration has led to weakened public finances and higher debt levels. Nevertheless, the country's strong institutional foundation continues to provide necessary checks and balances that have prevented further erosion to creditworthiness.

We expect the government to continue to progress toward its fiscal sustainability goals, which should support economic growth. Nevertheless, it will take time to reach the government's target deficit and debt ratios, in our view. We believe that stronger tourism activity will bolster economic growth in 2018, following a return to growth in 2017, supported by the opening of Baha Mar. Longer-term growth prospects will depend on success in attracting new investment.

Institutional and Economic Profile: Strong institutions will continue to drive public-sector reform and policies to tackle fiscal and growth constraints

We believe The Bahamas benefits from its strong institutions, which allow for proactive policies that deliver sustainable and balanced economic growth. The Free National Movement (FNM) party has completed its first full year in office. The FNM was elected with a strong mandate to rein-in government spending, reform the public sector, and encourage private-sector growth. To that end, the government has enacted policies and legislation in support of its mandate including measures to strengthen public-sector finances, improve the transparency and accountability of government, and ease processes for doing business. These measures are encouraging, and support our already positive view of The Bahamas' institutional profile.

We expect political stability to continue over the forecast horizon. In our view, the country's political system is characterized by prudent and pragmatic macroeconomic policy across party lines, which provides the country with institutional stability. The leaders of The Bahamian government have alternated between the FNM and the Progressive Liberal Party over several decades, with smooth political transitions.

The economy's falling real GDP per capita growth over the past decade reflects structural challenges that will be difficult to overcome in the near term. This growth is lower than that of peers with similar levels of income. We expect that GDP per capita will be about US$31,470 in 2018, and GDP per capita growth will average 0.21% over the next three years. GDP growth in 2017 was muted at 1.4%, and partly reflected lower tourism activity in the wake of hurricane-related disruptions. The Bahamas' economy remains concentrated in the tourism sector, which is an estimated 40% of GDP. Preliminary figures for the first three quarters of 2018 show stronger tourism activity in the higher value stopover segment, which is up 7.4% year over year. We expect stronger tourism activity to support economic growth in the current year.

New measures enacted by the government should eventually lead to better economic growth prospects, although we believe it will take time for these actions to have a measurable impact. The government has indicated that it is keen to boost competitiveness and support the ease of doing business, which had received a low ranking under the World Bank's ease of doing business index. Notable actions to improve competitiveness include new legislation to facilitate business licenses and the establishment of a credit bureau. The government is also working on strategies to improve its own use of technology.

The government has also introduced legislation aimed at improving its anti-money laundering (AML)/counter-terrorist financing (CTF) regime, as it seeks to improve international perception of its financial services sector. In 2018, The Bahamas was identified by the Financial Action Task Force as having strategic deficiencies in its AML/CFT regime.

We believe decisive measures to address international scrutiny of offshore banking in The Bahamas should help stop further contraction in the financial services sector and also lessen pressure on correspondent banking relationships. We expect that limited links between the offshore banking sector and the real economy will continue to insulate The Bahamas from the sector's evolution. The direct contribution of the sector to GDP is an estimated 3%, while the sector employs less than 1% of the country's workforce. These values have been relatively stable, despite shifts in asset jurisdiction, over the past several years.

By early 2018, the long-awaited opening of mega resort Baha Mar was essentially complete. Its opening has dramatically boosted the number of hotel rooms available on New Providence. This increase in hotel rooms is offset slightly by the closures of hotels elsewhere, notably in Grand Bahama following the 2016 hurricane season. While the government has purchased the Grand Lucayan Hotel and plans to sell it to another operator quickly, it remains partially closed. Nonetheless, we believe new room capacity in New Providence and ongoing tourism projects will lead to slightly higher real GDP growth, averaging 1.4% annually, over the next three years. However, intensifying regional competition in tourism, exposure to weather-related shocks, high energy costs, still-high nonperforming loans that clog private-sector lending, and high household indebtedness will continue to constrain growth.

Flexibility and Performance Profile: Spending cuts and revenue growth should halt the recent rise in the deficit, slowing the pace of debt increase

Measures taken in the last year should support deficit reduction targets. A combination of revenue measures and spending restraint has helped the government bring the deficit down significantly in the most recent fiscal year. Last year the government imposed a 10% reduction in recurrent spending and is also taking measures to reduce its workforce. The government has directed state-owned enterprises (SOEs) to develop plans to become self-sustaining, which, if successful, could meaningfully affect expenses, as transfers to SOEs currently account for 15% of expenses. The government has also set revenue targets, on which it fell short in fiscal 2017/2018. Nonetheless, the resulting deficit of B$415 million, while higher than the targeted B$320 million, represents a significant improvement from the B$661 million deficit in 2016/2017. Improving revenues are crucial to supporting deficit targets. In 2018, the government raised the Value Added Tax (VAT) rate to 12% although it also broadened the list of VAT-excluded items, which lessens the revenue generating potential somewhat. The government has charged its revenue enhancement unit to seek avenues to support revenue growth and the government may also consider additional tax reform. While the government's fiscal initiatives should support reduced deficits, we think that it will take time to see the dividends of these reforms translate into sustainable public finances and higher economic growth.

In 2018, the government passed its promised Fiscal Responsibility Act, which includes target deficit, debt, and spending limits as well as transparency and reporting requirements. Although these limits, if met, should arrest the deterioration in the country's fiscal deficit and debt levels, their implementation targets are 2020/2021 and 2024/2025, respectively. In 2018, we expect our measure of net debt to reach 48.9% of GDP. Thereafter, we expect more moderate deficits will slow the debt burden increase. Interest expenses should remain slightly below 15% of revenue over the next two-to-three years. If the interest burden surpassed 15% of revenue, it could put pressure on our assessment of The Bahamas' debt position.

In 2014, the government created Resolve, a special-purpose vehicle (SPV) to provide support to the Bank of the Bahamas (BOB), which is a predominantly government-owned commercial bank and the second-largest of the system's three domestic banks servicing a niche of midmarket commercial lending. The government considers BOB to be systemically important in a system where Canadian banks account for a majority of the system's overall onshore assets. In 2018, the government announced it was writing down B$80 million of its Resolve assets, based on estimates of recoverability of the SPV assets. Despite this ongoing support to BOB, we don't believe that these problems reflect widespread underprovisioning in the Bahamian banking system. Other banks have been more proactive in provisioning or have less risky, more diversified portfolios.

We expect an increase in public-sector external borrowing, and we believe this will drive an increase in The Bahamas' external debt. We expect the external debt of the public and financial sectors, net of usable reserves and financial-sector external assets, to rise to about 65% of current account receipts (CAR) in 2018. These figures include the government's $1,650 million in external bonds, but do not include the external debt and foreign direct investment in the islands' substantial tourism sector.

Beyond rising external debt, large external liquidity needs and errors and omissions continue to contribute to a weak external profile. Errors and omission increased significantly from 2014-2016, before falling in 2017. Errors and omissions were only about 10% of CAR in 2017, based on data reported in December 2018; however, they had been 24%, in data reported as recently as August 2018. These high levels and swings complicate the analysis of the current account deficit financing and the country's overall external balance sheet. We estimate these errors and omissions likely represent underreported foreign direct investment or tourism flows. Based on the gross external liabilities of the country's large banking sector, we expect the gross external financial needs of the public and financial sectors to be 307% of CAR in 2018. This reflects the still-high current account deficit and the financial sector's high rollover needs. However, we consider the sector's external assets highly liquid, which somewhat diminishes liquidity risk. We expect external liquidity needs to remain stable over the next three years, averaging 306.4% of CAR through 2021.

The Bahamas' limited monetary and exchange rate flexibility constrains its ability to respond to external shocks. The Bahamian dollar is fixed at par with the U.S. dollar. We expect that the central bank will continue to primarily rely on a combination of interest rates, moral suasion, and macroprudential tools to influence domestic credit growth. The central bank has recently eased access to foreign currency and external financing for entities with foreign currency inflows as a way to stimulate business activity. However, this activity's limited nature and restriction to sectors that generate foreign currency should limit the impact on the country's external accounts. Loss of correspondent banking relationships remains a risk for The Bahamas, as it does for many of the Caribbean sovereigns we rate. While we do not believe that this trend will threaten the banking sector's ability to roll over its debt, we do think that it could further stress the financial system. We believe this highlights the importance of the central bank's new AML/CFT supervision regime, which should strengthen compliance and assist in the maintenance of the system's correspondent banks.

Key Statistics

Table 1

Bahamas -- Selected Indicators

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
ECONOMIC INDICATORS (%)											

Table 1

Bahamas -- Selected Indicators (cont.)											
	2011	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
Nominal GDP (bil. LC)	10.07	10.72	10.63	10.96	11.79	11.84	12.16	12.59	13.01	13.43	13.86
Nominal GDP (bil. $)	10.07	10.72	10.63	10.96	11.79	11.84	12.16	12.59	13.01	13.43	13.86
GDP per capita (000s $)	27.5	28.8	28.2	28.7	30.5	30.3	30.8	31.5	32.1	32.7	33.4
Real GDP growth	0.6	3.1	(0.4)	(0.1)	1.0	(1.7)	1.4	1.8	1.3	1.2	1.2
Real GDP per capita growth	(1.0)	1.6	(1.8)	(1.4)	(0.2)	(2.8)	0.4	0.6	0.1	(0.0)	(0.0)
Real investment growth	7.4	9.3	(10.8)	13.4	(19.4)	1.1	11.8	(4.1)	1.3	1.2	1.2
Investment/GDP	29.9	31.3	28.7	32.2	24.7	24.7	27.0	27.1	27.1	27.0	27.0
Savings/GDP	18.9	17.0	14.4	12.1	11.0	14.1	10.7	13.5	15.1	16.7	18.2
Exports/GDP	37.4	38.1	39.9	37.9	35.0	35.8	33.7	37.4	37.4	37.4	37.4
Real exports growth	6.3	7.2	8.9	(7.9)	3.5	(1.6)	(5.9)	4.0	1.3	1.2	1.2
Unemployment rate	15.9	14.0	16.2	15.7	14.8	11.6	10.1	10.0	10.0	10.0	10.0
EXTERNAL INDICATORS (%)											
Current account balance/GDP	(11.1)	(14.3)	(14.3)	(20.0)	(13.7)	(10.6)	(16.3)	(13.6)	(11.9)	(10.4)	(8.8)
Current account balance/CARs	(31.1)	(39.1)	(39.2)	(57.3)	(43.9)	(31.1)	(53.8)	(43.9)	(38.5)	(33.4)	(28.5)
CARs/GDP	35.6	36.6	36.4	34.9	31.1	34.0	30.3	31.0	31.0	31.0	31.0
Trade balance/GDP	(21.2)	(22.4)	(20.8)	(22.9)	(20.6)	(18.2)	(20.9)	(19.3)	(18.1)	(17.0)	(16.1)
Net FDI/GDP	6.6	4.7	3.6	1.5	0.6	0.6	4.9	2.0	1.9	1.9	1.8
Net portfolio equity inflow/GDP	(0.2)	(0.3)	(0.3)	(0.2)	(0.1)	(0.2)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
Gross external financing needs/CARs plus usable reserves	1,672.1	1,736.3	1,808.6	1,422.1	812.0	487.8	350.9	306.5	315.4	306.8	296.6
Narrow net external debt/CARs	15.7	30.2	37.8	43.3	47.1	37.6	50.7	65.3	67.9	69.0	69.7
Narrow net external debt/CAPs	12.0	21.7	27.1	27.5	32.8	28.7	33.0	45.4	49.0	51.7	54.2
Net external liabilities/CARs	347.9	357.9	392.2	432.8	460.2	418.2	488.5	482.6	475.7	467.3	459.4
Net external liabilities/CAPs	265.4	257.4	281.7	275.2	319.9	318.9	317.6	335.4	343.4	350.4	357.5
Short-term external debt by remaining maturity/CARs	1,643.0	1,680.8	1,644.9	1,243.5	644.5	346.4	169.5	168.3	164.9	158.1	153.3
Usable reserves/CAPs (months)	0.6	0.4	(0.1)	(0.1)	(0.2)	(0.2)	(0.6)	0.2	(0.3)	(0.5)	(0.5)
Usable reserves (mil. $)	189	(52)	(58)	(107)	(85)	(290)	72	(153)	(209)	(215)	(221)
FISCAL INDICATORS (%, General government)											
Balance/GDP	(4.6)	(5.1)	(4.5)	(3.5)	(2.6)	(5.8)	(3.5)	(3.2)	(3.0)	(2.5)	(2.4)
Change in net debt/GDP	0.9	4.7	4.2	5.7	2.7	3.1	7.9	3.5	3.3	3.2	2.6
Primary balance/GDP	(2.7)	(3.2)	(2.5)	(1.4)	(0.3)	(3.5)	(0.9)	(0.4)	(0.4)	0.1	0.1
Revenue/GDP	16.1	14.5	15.8	17.8	18.6	19.6	19.0	18.9	18.9	18.8	18.8
Expenditures/GDP	20.7	19.6	20.3	21.2	21.2	25.4	22.5	22.1	21.9	21.3	21.2
Interest /revenues	11.5	12.7	12.6	12.0	12.6	11.5	13.6	14.6	14.1	13.7	13.3
Debt/GDP	29.1	31.5	36.7	41.9	42.0	44.3	51.2	53.0	54.6	56.0	56.9

Table 1

Bahamas -- Selected Indicators (cont.)	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Debt/Revenue	180.9	217.0	232.1	236.1	226.3	225.8	269.3	280.4	289.3	297.5	302.7
Net debt/GDP	24.6	27.9	32.3	37.1	37.1	40.1	47.0	48.9	50.6	52.2	53.2
Liquid assets/GDP	4.4	3.7	4.4	4.9	4.9	4.2	4.2	4.1	3.9	3.8	3.7
MONETARY INDICATORS (%)											
CPI growth	3.2	2.0	0.7	1.5	1.9	(0.3)	1.5	1.8	2.0	2.0	2.0
GDP deflator growth	(0.9)	3.3	(0.5)	3.3	6.5	2.1	1.3	1.7	2.0	2.0	2.0
Exchange rate, year-end (LC/$)	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Banks' claims on resident non-gov't sector growth	0.9	(0.1)	(1.2)	(2.4)	(1.2)	(3.5)	(3.5)	0.0	0.8	0.8	0.8
Banks' claims on resident non-gov't sector/GDP	69.3	65.1	64.8	61.4	56.3	54.1	50.8	49.1	47.9	46.8	45.7
Foreign currency share of claims by banks on residents	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Real effective exchange rate growth	(3.4)	3.1	(0.8)	0.3	11.3	(0.3)	(1.3)	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. 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. N/A--Not applicable.

Ratings Score Snapshot

Table 2

Bahamas	
Key rating factors	**Assessment**
Institutional assessment	2
Economic assessment	4
External assessment	6
Fiscal assessment: flexibility and performance	3
Fiscal assessment: debt burden	4
Monetary assessment	4

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). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score 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 scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- Criteria - Governments - Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Sovereign Risk Indicators, Dec. 13, 2018
- Banking Industry Country Risk Assessment Update: November 2018, Nov. 23, 2018
- Sovereign Ratings History, March 6, 2018
- Sovereign Debt 2018: Global Borrowing To Remain Steady At US$7.4 Trillion, Feb. 22, 2018
- Global Sovereign Rating Trends 2018, Jan. 10, 2018