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Research Update:

The Commonwealth of The Bahamas 'BB+/B' Ratings Affirmed; Outlook Is Stable

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Ratings

Foreign Currency: BB+/Stable/B
Local Currency: BB+/Stable/B
For further details see Ratings List.

Overview

- Bahamian political institutions strongly responded to societal priorities in the 2017 election.
- We expect the new administration's solid mandate to facilitate economic and debt stabilization, after significant deterioration.
- We are affirming our 'BB+/B' long- and short-term sovereign credit ratings on The Commonwealth of The Bahamas.
- The stable outlook balances the challenges of overcoming the country's stubborn economic bottlenecks with the government's fiscal consolidation plans.

Rating Action

On Dec. 14, 2017, S&P Global Ratings affirmed its 'BB+/B' long- and short-term sovereign credit ratings on The Commonwealth of The Bahamas. The outlook remains stable.

Outlook

The stable outlook reflects our expectation that robust political institutions will anchor fiscal consolidation and higher, albeit low, economic growth over the next one-to-two years.

We could lower our ratings on 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 rating 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 rating on The Bahamas reflects the country's high external liquidity needs and debt levels--which are rising--and a stagnant 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.

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

- The new administration plans to create a more effective and efficient public sector.
- Its reforms should free up resources for economic growth that the private sector will lead.
- Nevertheless, we believe that underlying competitiveness issues will be difficult to overcome in the near term.

We expect that the measures implemented under the new administration should arrest the deterioration in The Bahamas' fiscal deficit and debt levels. The Free National Movement (FNM), led by Prime Minister Hubert Minnis, took office in May 2017. Winning 35 of 39 seats in the lower house, the FNM was elected with a strong mandate to rein-in government spending, reform the public sector, and encourage private sector growth. Strong political capital will likely facilitate reforms early in the government's tenure. However, we think that it will take time to see the dividends of these reforms translate into sustainable public finances and higher economic growth.

The Bahamas' strong institutions allow for proactive policies to address fiscal deterioration and boost competitiveness. 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. We expect this stability to continue over the forecast horizon.

This institutional stability provides a solid foundation for government reforms. Since taking office in May, the new administration has announced a number of policies intended to strengthen public sector finances, improve the transparency and accountability of government, and ease processes for doing business. Government leaders, many of who come from the private sector, are keen to encourage growth outside of government. The new administration has established an Ease of Doing Business Committee, which is largely made up of private sector representatives. The committee will advise the government on necessary reforms, ultimately aimed at driving private sector growth.

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. Significant revisions to the country's GDP data published by the government's Department of Statistics in 2017 revealed a much larger economy than previously estimated. Based on this new data, we now believe that The Bahamas' GDP per capita will be about US$28,990 in 2017, which is nearly 27% higher than our 2017 estimate in 2016. However, the new information also reveals more volatile and significant contractions over the past several years. In our view, this largely reflects the economy's concentration in tourism. The sector, which has suffered from weather-related disruptions, delays in major tourism projects, and a general loss in competitiveness, directly represents about 20%, and indirectly close to 50%, of The Bahamas' GDP.

New room capacity and ongoing tourism projects will lead to slightly higher real GDP growth, averaging 1.4% annually, over the next three years. However, growing 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. New room capacity will come from the gradual opening of the Baha Mar resort. The over US$4 billion resort began to gradually open in mid-2017 after several years of delays, in part because of a previous developer's bankruptcy in 2015. Although new developers have opened about 1,000 rooms in 2017, with an additional 1,300 rooms scheduled by mid-2018, we believe that the resort will need time to operate at full capacity. At the same time, hotel closures in other parts of the country, following damages inflicted by a hurricane in late 2016, took nearly 1,000 rooms out of commission in Grand Bahama in 2017. We estimate that this represents about 7% of the country's total hotel rooms, before Baha Mar's opening. There is no clear timeframe for those rooms returning to service.

Decisive measures to address international scrutiny of offshore banking in The Bahamas should help stop further contraction in the financial services sector. Most estimates conclude that the sector represents about 15% of local GDP. Since taking office, the new administration has taken a multilateral approach in implementing the Organization for Economic Cooperation and Development (OECD)'s Common Reporting Standards for the Automatic Exchange of Information. Before this, The Bahamas was the last country that planned on using a bilateral approach, for which it received significant criticism. The new administration has prioritized strengthening the sector's anti-money laundering (AML)/counter terrorist financing (CTF) and tax transparency compliance, and has sought to avoid being included in any public listings of noncompliant countries. Nevertheless, 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.

Flexibility and Performance Profile: Spending cuts will halt the recent deterioration in the deficit, slowing the pace of debt increase

- Government spending spiked in the run-up to the 2017 elections and following Hurricane Matthew in late 2016.
- Spending cuts across government ministries since the new administration assumed office will reverse this trend.
- We expect the pace of growth in both external and domestic debt to slow over the next three years.

Recent public sector spending measures will bring the deficit down to more sustainable levels, in our view. Since taking office, the FNM has called for a 10% cut in recurrent spending across all government sectors. The administration has also halted most public sector hiring. It implemented these policies in response to the deficit spiking to nearly 6% of GDP in the 2016-2017 fiscal year from 2.8% a year earlier. We expect that these cuts, together with the impact of one-off posthurricane spending and revenue measures that will not reoccur in the current fiscal year, will lead to a 3.2% of GDP deficit in 2017-2018. Thereafter, spending controls, which should benefit from new fiscal responsibility legislation and strengthened revenue collection, will continue to reduce the deficit. We forecast that the deficit will average 2.2% of GDP over the next three years. Excluding the impact of the most recent Bank of the Bahamas (BOB) bailout, we expect that these deficits will lead to an average change in general government debt to GDP of 3.6% from 2017-2020.

Significant financing needs in 2017 will push The Bahamas' net general government debt to 48% of GDP in 2017, from 42% in 2016. Thereafter, we expect more moderate deficits will slow the debt burden increase. We forecast that net debt will reach 52% of GDP by 2020. At the same time, we expect general government interest payments will average 12.5% of general government revenues from 2017-2020.

Our measures of debt include the debt of Bahamas Resolve Ltd. Resolve is a special-purpose vehicle the government created in 2014 to support the BOB, which is a government-owned commercial bank and the second-largest of the system's three domestic banks servicing a niche of midmarket commercial lending. As such, the government considers it systemically important in a system where Canadian banks account for a majority of the system's overall onshore assets. Over the past several years, BOB has transferred about B$268 million in problem assets to Resolve in exchange for promissory notes from Resolve. The most recent transfer took place in late 2017. As of September 2017, B$50 million of these notes have been repaid. In addition, the government injected capital into the bank in late 2016 by buying a B$40 million rights issue. In early 2017, the government subscribed to B$10 million of BOB's perpetual contingent convertible bonds that were later converted into common shares. Despite this ongoing support to BOB, we don't believe that these problems reflect widespread under provisioning in the Bahamian banking system. Other banks have been more proactive in provisioning or have less risky, more diversified portfolios.

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With a significant increase in public sector external borrowing, The Bahamas' external debt, will, we expect, continue to rise. In late 2017, the government issued US$750 million in international capital markets. The funds from this issuance refinanced short-term loans that the government used to finance the large deficit increase. This issuance adds to the central government's US$900 million in external bonds outstanding. Following this new debt, we expect the external debt of the public and financial sectors, net of useable reserves and financial-sector external assets, to rise to nearly 58% of current account receipts (CAR) in 2017. These figures do not include the external debt and foreign direct investment in the islands' substantial tourism sector.

Beyond increasing external debt, large external liquidity needs and errors and omissions continue to contribute to a weak external profile. Errors and omission have increased significantly, accounting for nearly 70% of the current account deficit (CAD) in 2016, compared with 7% five years ago. Large errors and omissions complicate the analysis of the CAD 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 reach 331% of CARs in 2017. This reflects the still-high CAD 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 decline over the next three years, but remain above 300% of CAR through 2020.

The Bahamas' limited monetary and exchange rate flexibility constrain 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 credit ceilings and capital controls to influence money supply. 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. In addition, we expect that the banking sector will continue rolling over its external debt despite concerns raised by ongoing data leaks of offshore bank accounts in The Bahamas, along with accounts in other offshore financial centers, over the past several years. At the same time, a rising number of financial institutions--25% of survey respondents in the most recent survey conducted by the central bank in 2016--have been affected by the withdrawal of correspondent banking relationships. 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. Nevertheless, the central bank's new AML/CFT supervision regime should strengthen compliance and assist in the maintenance of the system's correspondent banks.

Key Statistics

Table 1

The Commonwealth of The Bahamas -- Selected Indicators											
	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017bc**	**2018bc**	**2019bc**	**2020bc**
ECONOMIC INDICATORS (%)											
Nominal GDP (bil. B$)	10.10	10.07	10.72	10.68	10.84	11.24	11.26	11.51	11.85	12.27	12.66
Nominal GDP (bil. $)	10.10	10.07	10.72	10.68	10.84	11.24	11.26	11.51	11.85	12.27	12.66
GDP per capita (000s $)	28.0	27.5	28.8	28.3	28.4	29.0	28.8	29.0	29.4	30.0	30.5
Real GDP growth	1.5	0.6	3.1	(0.6)	(1.2)	(3.1)	0.2	1.0	1.5	1.5	1.2
Real GDP per capita growth	(0.2)	(1.0)	1.5	(2.0)	(2.3)	(4.3)	(0.9)	(0.5)	(0.0)	(0.0)	(0.3)
Real investment growth	0.6	7.4	9.3	(11.6)	12.4	(20.8)	3.4	1.1	1.5	1.5	1.2
Investment/GDP	27.4	29.9	31.3	28.3	31.9	25.0	25.6	25.9	25.9	25.9	25.9
Savings/GDP	19.5	18.9	17.9	14.8	14.5	14.3	15.2	10.7	13.0	14.7	16.3
Exports/GDP	35.0	37.4	38.1	39.8	38.3	36.7	35.1	37.0	37.4	37.4	37.4
Real exports growth	1.3	6.3	7.2	8.9	(7.9)	3.6	0.4	(10.4)	2.6	1.5	1.2
Unemployment rate	14.5	15.9	14.0	16.2	15.7	14.8	11.6	10.5	10.0	10.0	10.0
EXTERNAL INDICATORS (%)											
Current account balance/GDP	(7.9)	(11.1)	(13.4)	(13.5)	(17.4)	(10.7)	(10.5)	(15.2)	(12.9)	(11.2)	(9.6)
Current account balance/CARs	(23.8)	(31.1)	(36.7)	(37.2)	(49.3)	(32.8)	(29.2)	(45.3)	(37.6)	(32.7)	(28.0)
CARs/GDP	33.2	35.6	36.6	36.2	35.3	32.6	35.9	33.6	34.4	34.3	34.4
Trade balance/GDP	(18.7)	(21.2)	(22.4)	(20.7)	(23.1)	(21.7)	(19.3)	(20.9)	(19.6)	(18.3)	(17.2)
Net FDI/GDP	8.6	6.6	4.9	3.6	2.3	0.7	0.7	0.9	1.7	2.4	2.4
Net portfolio equity inflow/GDP	(0.1)	(0.2)	(0.1)	(0.1)	(0.2)	(0.1)	(0.2)	(0.2)	(0.2)	(0.1)	(0.1)
Gross external financing needs/CARs plus usable reserves	1,814.5	1,672.3	1,734.0	1,806.5	1,414.0	800.6	484.5	331.2	322.9	313.6	301.6
Narrow net external debt/CARs	16.7	15.7	30.2	37.8	43.3	47.4	37.7	57.7	58.0	58.8	59.2
Narrow net external debt/CAPs	(13.5)	(12.0)	(22.1)	(27.5)	(29.0)	(35.7)	(29.2)	(39.7)	(42.2)	(44.3)	(46.2)
Net external liabilities/CARs	342.1	347.9	357.9	392.2	432.8	460.4	417.0	448.4	426.4	413.6	399.9
Short-term external debt by remaining maturity/CARs	1,861.2	1,643.0	1,680.8	1,644.9	1,243.5	644.5	345.3	161.1	175.0	171.2	164.2
Usable reserves/CAPs (months)	0.9	0.6	0.4	(0.1)	(0.1)	(0.3)	(0.2)	(0.6)	(0.3)	(0.3)	(0.3)
Usable reserves (mil. $)	218	189	(52)	(58)	(107)	(85)	(290)	(130)	(131)	(137)	(143)
FISCAL INDICATORS (%, General government)											
Balance/GDP	(3.8)	(4.6)	(5.1)	(4.4)	(3.5)	(2.7)	(5.9)	(3.2)	(2.6)	(2.2)	(1.7)
Change in net debt/GDP	0.6	0.9	4.7	4.2	5.8	3.2	2.7	7.0	3.2	2.8	2.3

Table 1

The Commonwealth of The Bahamas -- Selected Indicators (cont.)											
	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017bc**	**2018bc**	**2019bc**	**2020bc**
Primary balance/GDP	(1.7)	(2.7)	(3.2)	(2.4)	(1.4)	(0.3)	(3.6)	(0.6)	(0.1)	0.3	0.7
Revenue/GDP	15.9	16.1	14.5	15.7	17.9	19.5	20.6	20.4	20.2	19.9	19.7
Expenditures/GDP	19.6	20.7	19.6	20.2	21.5	22.2	26.5	23.5	22.9	22.1	21.4
Interest /revenues	13.2	11.5	12.7	12.6	12.0	12.6	11.4	12.7	12.7	12.5	12.2
Debt/GDP	28.2	29.1	31.5	36.5	42.4	44.5	46.2	52.2	53.9	54.9	55.5
Debt/Revenue	178.1	180.9	217.0	232.1	236.1	228.3	224.3	256.3	266.9	275.5	281.8
Net debt/GDP	23.7	24.6	27.9	32.1	37.4	39.4	42.0	48.1	49.9	51.0	51.8
Liquid assets/GDP	4.5	4.4	3.7	4.4	4.9	5.1	4.2	4.1	4.0	3.9	3.8
MONETARY INDICATORS (%)											
CPI growth	1.8	0.5	0.7	0.5	1.2	1.9	(0.3)	1.2	1.5	2.0	2.0
GDP deflator growth	(0.4)	(0.9)	3.3	0.2	2.8	6.9	0.0	1.2	1.5	2.0	2.0
Exchange rate, year-end (B$/$)	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 nongovernment sector growth	0.2	0.9	(0.1)	(1.0)	(2.4)	(1.2)	(3.5)	(2.8)	0.0	0.8	0.8
Banks' claims on resident nongovernment sector/GDP	68.3	69.1	64.9	64.5	62.0	59.1	56.9	54.1	52.6	51.2	50.0
Real effective exchange rate growth	(1.8)	(3.4)	3.1	(1.2)	0.2	11.2	0.1	N/A	N/A	N/A	N/A

Note: 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. bc--Base case.

Ratings Score Snapshot

Table 2

The Commonwealth of The Bahamas -- Ratings Score Snapshot	
Key rating factors	**Assessment**
Institutional assessment	Strength
Economic assessment	Neutral
External assessment	Weakness
Fiscal assessment: flexibility and performance	Neutral
Fiscal assessment: debt burden	Neutral

Table 2

The Commonwealth of The Bahamas -- Ratings Score Snapshot (cont.)

Key rating factors	Assessment
Monetary assessment	Neutral

Note: 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

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Governments - Sovereigns: Sovereign Rating Methodology, Dec. 23, 2014
- 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

- Global Sovereign Rating Outlook 2018: Brighter With Risk Of Turbulence, Dec. 13, 2017
- Banking Industry Country Risk Assessment Update: December 2017, Dec. 7, 2017
- Sovereign Ratings History, Dec. 7, 2017
- Sovereign Risk Indicators, Oct. 13, 2017. Interactive version available at http://www.spratings.com/sri
- 2016 Sovereign Ratings Update: Outlook And CreditWatch Resolutions, April 18, 2017
- Default, Transition, And Recovery: 2016 Annual Sovereign Default Study And Rating Transitions, April 3, 2017
- Sovereign Debt 2017: Global Borrowing To Drop By 4% To US$6.8 Trillion, Feb. 23, 2017

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's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

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

Ratings Affirmed

Commonwealth of The Bahamas (The)	
Sovereign credit rating	BB+/Stable/B
Transfer and convertibility assessment	
Local currency	BBB-
Senior unsecured	BB+

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.capitaliq.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.