MOODY'S
INVESTORS SERVICE

SPECIAL COMMENT

Clouds Still Looming Over the Caribbean

Table of Contents:

Analyst Contacts:

NEW YORK 1.212.553.1653

Alessandra Alecci 1.212.553.7728
Vice President-Senior Analyst
Alessandra.Alecci@moodys.com

Sergio Valderrama 1.212.553.3827
Associate Analyst
Sergio.Valderrama@moodys.com

Mauro Leos 1.212.553.1947
Vice President - Senior Credit Officer
Mauro.Leos@moodys.com

Gabriel Torres 1.212.553.3769
Vice President - Senior Analyst
Gabriel.Torres@moodys.com

Bart Oosterveld 1.212.553.7914
Team Managing Director
Bart.Oosterveld@moodys.com

Naomi Richman 1.212.553.0014
Senior Vice President
Naomi.Richman@moodys.com

Main Highlights

Over the last couple of years, Caribbean ratings have been on a downward trend and the economic and fiscal short-term outlook is still quite negative. Unless there is evidence of an improvement in the governments' balance sheet some Caribbean ratings may come under downward pressure.

The main points of the special comment are the following:

I. In contrast to its neighbors in Latin America and most emerging market economies, the fall-out from the global financial crisis was much more pronounced in the Caribbean. Rating downgrades outnumbered upgrades during the crisis.

II. The region's recovery is facing headwinds. The combination of sluggish economic activity in key trading partners and limited room for counter-cyclical policies is prolonging the crisis. Some Caribbean economies will continue contracting in 2010.

III. The current macroeconomic backdrop is working against fiscal and debt consolidation. Government deficits are likely to remain high and debt ratios elevated. Faced with weaker fiscal positions as a result of last year's crisis, Caribbean countries remain vulnerable to shocks. While this situation poses potential risks to public finances, those elements are incorporated in the current ratings.

IV. The outlook for all Caribbean sovereign ratings is stable at present, but this is based on the expectation that the fiscal deterioration observed in the recent past will be partly reversed in coming yeras. If adjustments do not materialize, or if growth prospects remain weak, downward pressure on the ratings could arise

Rating Implication of the Caribbean Post-Crisis Scenario

The fallout from the global financial crisis was far more pronounced in the Caribbean[1] relative to that observed in neighboring Latin America. As Caribbean countries entered the crisis with relatively weak fiscal positions, government debt ratios have worsened significantly. Looking ahead, even as the global recovery takes hold, prospects for a vigorous economic rebound in the region are not encouraging.

Given a macroeconomic backdrop that could complicate fiscal and debt consolidation, the potential rating implication for Caribbean sovereigns include the following considerations:

i) Several of the Caribbean countries we rate benefit from relatively deep domestic financial markets, e.g., Barbados, Jamaica and Trinidad. Therefore, pressure on ratings stemming from fiscal and debt deterioration could be mitigated by adequate access to local funding; it is important to note, however, that some countries are still relying on external markets due to the need to bolster international reserves -- Barbados plans to issue debt in the international capital markets this year.

ii) The Caribbean benefits from strong institutions, often associated with a high willingness to honor contracts. In this sense, governments have been able to undertake substantial fiscal adjustments in times of crisis without a major political fall-out or social unrest. This is contrast with Latin America, where the inability to adjust has historically led to defaults and devaluations from much lower levels of indebtedness.

iii) Ratings are relative expressions of risk. Countries whose key debt metrics are out of line with peers include Bahamas, Barbados and the Cayman Islands. Moody's has observed the greatest deterioration in debt levels in these countries. Rating downgrades could result if there is additional deterioration in a government debt indicators as a result of poor growth prospects or of the inability to undertake substantive fiscal adjustments.

iv) Given a weaker fiscal position, most of the Caribbean countries are now more vulnerable to shocks, a situation that could further aggravate public finances. Still, at this stage, the outlook for all Caribbean sovereign ratings is stable, based on the expectation that some of the fiscal deterioration observed to date will begin to be reversed in the next year or two. If such adjustment does not materialize and/if growth prospects remain weak, downward pressure on the ratings could arise.

[1] We refer here to the English-speaking Caribbean and exclude the Dominican Republic (B1) and Cuba (Caa1) from the analysis. In the case of the Dominican Republic, high economic growth rates and low levels of public debt make it an outlier in the Caribbean and several of the observations in this report do not reflect its credit profile. For further details see the latest report on the Dominican Republic.

The Caribbean suffered a significant fallout from the crisis

The economic contraction in the Caribbean region was deeper and, more importantly for sovereign risk, the crisis resulted into even higher government debt ratios. Since the onset of the crisis in mid-2007, rating actions have been dominated by downgrades in the Caribbean. These included: Jamaica, where the impact of the shock contributed to a restructuring of domestic debt; Barbados, which has experienced a steady expenditure-driven deterioration in its public finances over the past decade; and Bermuda, where concerns about the sustainability of its growth model have emerged. The only two upgrades in the region, Belize and Jamaica, were due to the completion of debt restructurings which moved both credits out of the Caa-range and into B3, the lowest rating for countries not in default.

FIGURE 1

Moody's Caribbean Ratings

COUNTRY	CURRENT RATING	LAST RATING ACTIONS	DATE OF LAST RATING ACTIONS
Bermuda	Aa2	Rating Lowered	April-09
Cayman Islands	Aa3	Rating Assigned	October-00
Bahamas	A3	Rating Assigned	January-97
Trinidad & Tobago	Baa1	Rating Raised	July-06
Barbados	Baa3	Rating Lowered	Oct-09
St. Vincent	B1	Rating Assigned	December-07
Belize	B3	Rating Raised	February-09
Jamaica	B3	Rating Raised	March-10

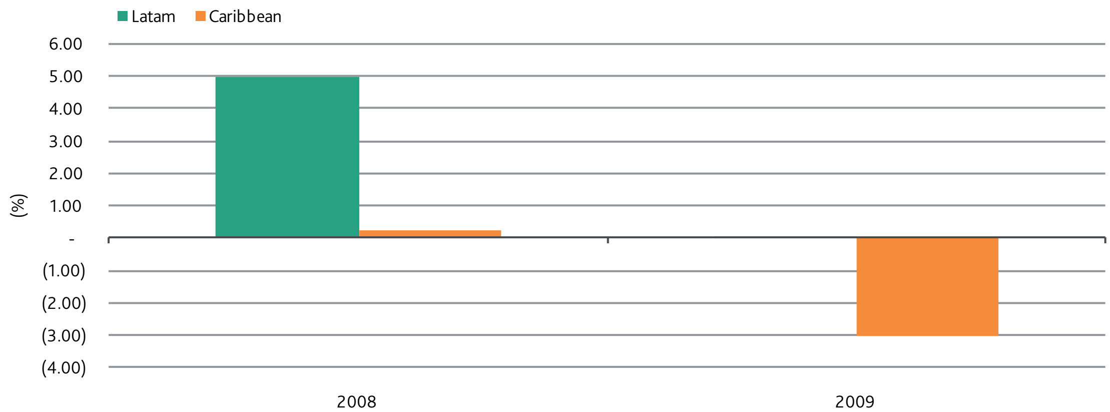
Source: Official Sources and Moody's Investor Service

Moody's approach towards sovereign ratings during the crisis focused on structural rather than cyclical factors. More specifically, Moody's focused its analysis on a country's ability to withstand a severe shock without a significant and long-lasting deterioration in credit fundamentals, downplaying the expected transitory weakening of some macroeconomic indicators. For this reason, contrary to rating actions in the Caribbean, and despite unfavorable macroeconomic developments positive rating actions were taken in Latin America during the crisis. Countries upgrades in the middle of the crisis included Chile, Uruguay Brazil and Peru, among others.

Several reasons explain the Caribbean's low shock-absorption capacity. Small island economies are not diversified and often rely on one or two key activities, with tourism usually playing a dominant role. As a result, a slowdown in arrivals and lower investment in tourism infrastructure quickly reverberates throughout the economy with significant negative impacts on the balance of payments and the fiscal accounts. Tourism-related receipts are often the main foreign-exchange generator in the external accounts and custom duties often contribute a significant portion of fiscal revenues. As Caribbean economies are extremely open, with trade to-GDP ratios often exceeding 100% and without meaningful sources of domestic demand, they are highly susceptible to global developments, particularly those in their key markets, the U.S. and Europe. Several countries are net commodity importers (with the exception of Trinidad) and susceptible to natural disasters, hurricanes in particular.

Given all these factors, the magnitude of the economic contraction in the Caribbean was considerably deeper than in the rest of Latin America, as the graph below illustrates.

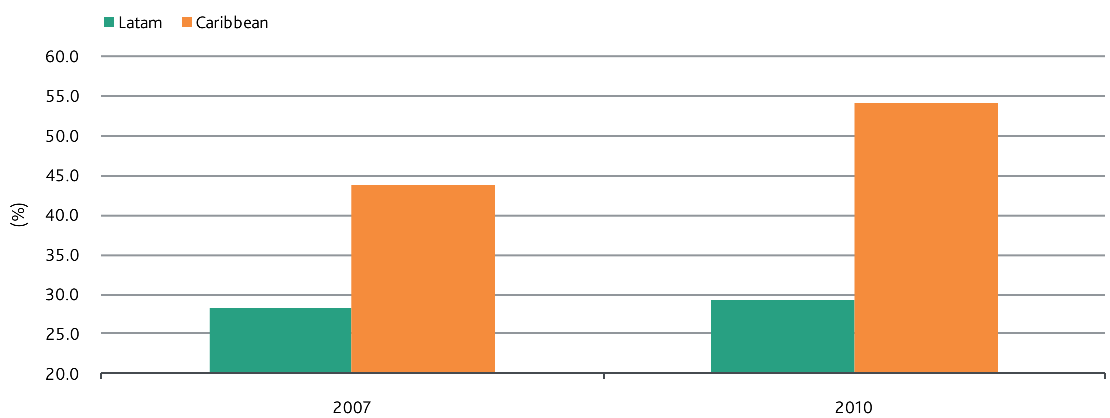
FIGURE 2
Median Real GDP Growth (%)



Source: Official Sources and Moody's Investor Service

In terms of public finances, countries in the region entered the crisis with relatively weak fiscal positions. While Latin American governments were able to lower their debt ratios during the boom years, in the Caribbean debt indicators deteriorated consistently over the past decade despite very favorable global conditions. When the crisis hit, attempts to adopt counter-cyclical policies coupled with sharp drops in government revenues exacerbated already overly-stretched government balance sheets. As a result, government debt ratios worsened considerably.

FIGURE 3
Median Gov. Debt / GDP (%)



Source: Official Sources and Moody's Investor Service

Finally, the limited ability to adjust to shock has been intensified by relatively rigid exchange rate regimes. With the exception of Jamaica, whose currency is floating, all other countries have fixed or quasi-fixed pegs to the US dollar, either formally (Bermuda, Bahamas, Barbados and Belize), via heavily-managed floats (Trinidad) or through currency boards (Cayman Islands, St. Vincent). Overall, lack of exchange rate flexibility has reduced the region's s policy options.

A Weak Economic Recovery

Even as the global recovery takes hold, prospects for a vigorous and meaningful recovery in the Caribbean are not very encouraging. Official growth projections suggest that some countries will continue posting negative GDP growth in 2010. In the rest, the recovery is estimated to be weak. This is not surprising, given that the upturn in activity in the Caribbean's key trade partners, the US and Europe is tentative. In the US, even though a recovery is clearly underway, financial deleveraging by households is likely to restrain personal consumption expenditures, a key determinant of tourism demand. In Europe, the recovery has been even more muted and is complicated by the debt crisis in several countries.

FIGURE 4

Real GDP (% change)

COUNTRY	2010F
Bermuda	1.0
Cayman Islands	-3.1
Bahamas	-0.5
Trinidad & Tobago	2.0
Barbados	0.7
St. Vincent and the Grenadines	-2.5
Belize	2.0
Jamaica	0.5

Source: Official Sources and Moody's Investor Service

Fundamental longer-term issues are also contributing to the strong headwinds facing the Caribbean. Key growth sectors in the region are facing significant structural challenges. Tourism is a mature industry in several countries and the high cost structure (particularly wages) is raising concerns about loss of market share to less expensive destinations in Central America. For several Caribbean countries (Jamaica is the exception) statistics on stay-over tourist arrivals show that the numbers had not recovered to pre-September 11 levels even before the global crisis or that they have been growing at low single digit rates in recent years.

Moreover, security problems may negatively affect tourism, investment and overall confidence. Security remains an ongoing problem which has deteriorated in the last couple of years. Recent developments in Jamaica are an example[2]. The government's attempt to capture a drug kingpin has resulted in significant violence that could deter tourists. In Trinidad, escalating violence was one of the factors leading to a general election upset in May. In Belize, a deterioration in public security resulted in a cabinet re-shuffle. In St. Vincent, rising crime is a key theme in the upcoming general elections in December. Tackling this issue may be difficult given that violence is mostly linked to lucrative drug-trafficking. Caribbean countries are far from experiencing the problems that Colombia did in the 1990's and that Mexico may be facing now, but they may heading in that direction.

Another important industry, off-shore financial services, is facing significant setbacks in light of severe scrutiny on the part of fiscally-challenged developed countries (such as the US and the UK) seeking to boost their own revenues. A multi-year, sustained drop in demand for off-shore financial services

[2] For further details see issuer comment : Jamaican Conflict Could Not Happen at a Worse Time.

could have a devastating impact on economies such as the Cayman Islands and Bermuda (where the exposure is the greatest) and Barbados, among others. Finally, the surge in commodity prices could aggravate growth prospects via a negative wealth effect – with the exception of Trinidad, the region is a net oil importer.

Large Current Account Deficits, but Comfortable Reserves

Large current account deficits reflect structural problems within the region. With the exception of Trinidad and Tobago and Bermuda, countries regularly post current account deficits well above 5% of GDP. Given the lack of economic diversification most of the countries import a large share of their consumption goods. High reliance on imported goods, including food items and oil products, exposes the region to fluctuations in commodity prices. The financing of such large current account deficits will require large amounts of FDI if further external debt accumulation is to be avoided.

High levels of foreign reserves partly offset structural balance-of-payments problems. Most countries continue to report high levels of international liquidity, reflected in low external vulnerability ratios -- all the Caribbean countries (with one exception) have external vulnerability indicators below 100%[3]. However, some of the governments have resorted to issuing international bonds in order to rebuild the foreign reserves.

FIGURE 5

Caribbean Countries External Position (2009 ratios)

COUNTRY	EVI	FOREIGN EXCHANGE RESERVES/GDP
Cayman Islands	16.9	4.0
Bahamas	69.0	11.3
Trinidad & Tobago	3.9	41.0
Barbados	84.5	18.9
St. Vincent and the Grenadines	112.6	15.6
Belize	52.6	12.9
Jamaica	72.8	14.0

Source: Official Sources and Moody's Investor Service

Limited Prospects for Fiscal and Debt consolidation

The macroeconomic backdrop is working against fiscal and debt consolidation, at least this year. In addition to pressure on government revenues stemming from low economic growth, several governments are opting to only gradually adjust expenditures in order to sustain the recovery. Fiscal deficits are expected to remain large, some even double their 2007 level. In countries such as Barbados, Cayman Islands, Jamaica and Trinidad, fiscal deficits are officially projected to exceed 5.0% in 2010, with the primary balances remaining in deficit in almost all the countries.

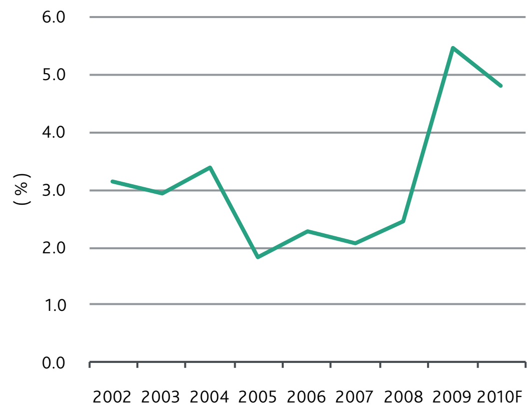
[3] The external vulnerability indicator (EVI) is the ratio of short term external debt, currently maturing long term external debt and non-resident deposits over official foreign exchange reserves. It is an indicator of whether a country immediately available foreign exchange resources are sufficient to allow it to make all external debt payments, even in the event of a complete refusal of creditors to roll over debt due within a given year.

FIGURE 6
Gov. Fiscal Balance/GDP

COUNTRY	2007	2010F
Bermuda	-1.9	-1.2
Cayman Islands	-5.2	-7.4
Bahamas	-1.3	-4.7
Trinidad & Tobago	1.8	-5.4
Barbados	-1.6	-6.7
St. Vincent and the Grenadines	-3.6	-4.3
Belize	-0.7	-2.1
Jamaica	-4.1	-6.5

Source: Official Sources and Moody's Investor Service

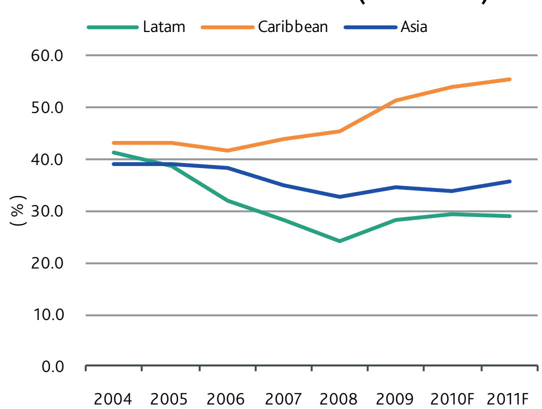
FIGURE 7
Median Fiscal Deficit (% of GDP)



Source: Official Sources and Moody's Investor Service

Combined with low growth prospects, the region's fiscal position will contribute to an increase in average debt-to-GDP ratio of more than 10 percentage points of GDP from 2007 to 2010, compared to a 0% increase in Latin America and 4% drop in Asia. Indeed, as the graph below illustrates, debt levels in the Caribbean have taken a different path than in other regions since 2004. Total public debt levels (which also include guarantees) are even higher than the general government debt that appears in the graph.

FIGURE 8
Median Gen. Gov. Debt Ratios (% of GDP)



Source: Official Sources and Moody's Investor Service

FIGURE 9
Total Public Debt (% GDP, 2010)

COUNTRY	2010F
Bermuda	15.6
Cayman Islands	33.5
Bahamas	64.2
Trinidad & Tobago	44.8
Barbados	114.2
St. Vincent and the Grenadines	72.6
Belize	81.1
Jamaica	127.1

Source: Official Sources and Moody's Investor Service

FIGURE 10

Ratings Snapshot as of July 1, 2010 [1]

		RATINGS		RATING FACTORS			
	COUNTRY	FC/LC	OUTLOOK	ECONOMIC STRENGTH	INSTITUTIONAL STRENGTH	GOVERNMENT FINANCE	EVENT RISK
Investment Grade	Bermuda	Aa2/Aa2	Stable	medium	very high	very high	low
	Cayman Islands	Aa3/	Stable	high	high	very high	low
	Bahamas	A3/A3	Stable	medium	high	medium	low
	Trinidad & Tobago	Baa1/Baa1	Stable	medium	high	high	low
	Barbados	Baa3/Baa2	Stable	medium	high	medium	medium
Speculative Grade	St. Vincent and the Grenadines	B1/B1	Stable	low	high	low	very high
	Dominican Republic	B1/B1	Stable	low	low	low	high
	Belize	B3/B3	Stable	low	low	very low	very high
	Jamaica	B3/B3	Stable	low	medium	very low	high

Moody's sovereign methodology is based on ranking all countries on four factors: the economic, institutional, and government financial strength, as well as the vulnerability to sudden multi-notch rating downgrades. The five-point scale for the first three factors goes from best (very high) to worst (very low). The scale for the fourth, susceptibility to event risk, is also five points from best (very low) to worst (very high).

[1] The investment grade/speculative grade divide is based on a country's foreign currency rating

Moody's Related Research

Moody's Website Links:

» Sovereign Risk Group webpage

» Sovereign Rating List

Special Comments:

» 2010 IDB Meeting: Happy Days Are Here Again In Latin America?, March 2010 (124015)

» Latin America's 2010 Government Financing Needs, March 2010 (123405)

» Latin American sovereign ratings remain resilient, but concerns remain, January 2010 (120521)

» Latin America's Newfound Resilience: Upwards Rating Pressure Amidst Global Crisis, July 2009 (118697)

» IADB Meetings: Crisis Grows, But Remains Under Control April 2009 (115845)

Statistical Handbook:

» Moody's Country Credit Statistical Handbook, May 2010 (125105)

Rating Methodologies:

» Sovereign Methodology Update - Narrowing the Gap – a Clarification of Moody's Approach to Local Vs. Foreign Currency Government Bond Ratings, February 2010 (118820)

» Sovereign Bond Ratings, September 2008 (109490)

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Authors
Alessandra Alecci
Sergio Valderrama

Senior Production Associate
Wendy Kroeker

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