

Global Credit Research - 16 Dec 2015

## Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Aa3
Senior Unsecured	Aa3

## Contacts

Analyst	Phone
Gabriel Torres/New York City	1.212.553.1653
Mauro Leos/New York City	

## Key Indicators

### Cayman Islands

	2009	2010	2011	2012	2013	2014	2015F	2016F
Real GDP (% change)	-6.3	-2.7	1.2	1.2	1.4	2.1	1.7	1.7
Inflation (CPI, % change Dec/Dec)	-1.3	0.3	1.9	2.1	1.7	0.6	-0.2	1.5
Gen. Gov. Financial Balance/GDP (%)	-7.2	-2.3	-3.1	-2.0	1.7	2.4	2.8	2.4
Gen. Gov. Primary Balance/GDP	-6.4	-1.1	-1.8	-0.7	2.9	3.5	4.0	3.5
Gen. Gov. Interest Payment/Gen. Gov. Revenue	4.1	5.4	6.0	6.0	5.0	4.4	4.8	4.5
Gen. Gov. Debt/GDP (%)	20.3	24.0	24.3	22.7	21.1	19.5	18.9	17.9
Gen. Gov. Debt/Gen. Gov. Revenue (%)	108.4	114.5	112.4	103.8	88.1	80.4	79.0	75.1
Current Account Balance/GDP (%)	-16.7	-16.7	-18.2	-20.6	-22.2	-21.3	-20.4	-21.0
External Debt/CA Receipts (%) [1]	14.5	19.2	17.9	16.8	13.8	12.7	12.0	11.3
External Vulnerability Indicator [2]	25.5	25.8	149.8	27.4	26.7	33.4	32.9	30.9

[1] Current Account Receipts [2] (Short-Term External Debt + Currently Maturing Long-Term External Debt + Total Nonresident Deposits Over One Year)/ Official Foreign Exchange Reserves

## Opinion

### Credit Strengths

- Comparatively low debt burden
- Very high per-capita income
- Prudent macroeconomic management
- A well-functioning legal system; effective and adaptable financial regulatory system; longstanding political stability

### Credit Challenges

- Narrow economic base highly dependent on tourism and financial services
- Comparatively low economic growth
- Vulnerability to external shocks and to natural events, i.e., hurricanes

## Rating Rationale

The Cayman Islands' Aa3 rating balances a very high per capita GDP, very strong institutions, and a comparatively low debt burden with a small, slow growing economy highly dependent on two industries.

Cayman's economic strength reflects a very high GDP-per-capita (we use nominal per capita GDP as a comparative measure since the preferred PPP numbers are unavailable for the Cayman Islands) estimated at US\$55,751 for 2015, the 13th highest in our rating universe. Economic strength is counterbalanced by the scale of the economy, which is the fourth smallest among rated sovereigns. Cayman's high level of economic development increases its resiliency in the face of economic and natural disaster shocks, of particular importance given the country's vulnerability to hurricanes. However, tourism and financial services represent almost 70% of GDP, a sign of limited diversification.

Cayman Islands' strong institutions are a key support for the rating. Traditional governance indicators (such as those published by the World Bank) confirm this view. Indeed, the Cayman Islands' World Bank governance indicators are the highest in the region and among the highest of all sovereigns rated by Moody's, including highly developed countries. A long history of policy consensus and a sensible macroeconomic approach explains its high economic development and still low debt burden. The United Kingdom provides further institutional support through fiscal oversight and ultimate judicial review.

The Cayman Islands' fiscal and debt position is comparatively robust with fiscal surpluses, low levels of debt, high debt affordability, and easy access to finance. We expect fiscal surpluses averaging 2.6% of GDP this year and next, explaining the fall in the government debt burden. Debt to GDP is slated to fall to 18.7% of GDP in 2015, compared to a peak of 24.3% in 2011. We forecast that debt to GDP will continue to trend down, declining to around 17.8% in 2016.

Cayman also benefits from a very low susceptibility to event risk. Politically there is very little risk of a destabilizing event, given strong institutions and UK fiscal oversight. Long-term economic risks related to loss of competitiveness in the Cayman Islands' two key industries, tourism and financial services, could affect government finances and put pressure on the country's external accounts. But the likelihood of a major shock is low. Hurricanes are a recurrent threat given the Cayman Islands' geographic location. The country's relative wealth provides a strong buffer against weather-related shocks as evidenced by Hurricane Ivan in 2004, which inflicted damage equivalent to 200% of GDP, and the subsequent quick recovery.

In addition to vulnerability to hurricanes, factors that limit upward movement in the rating include limited fiscal flexibility given a narrow revenue base that excludes direct income taxation, and dependence on exogenous sources of growth.

## Rating Outlook

Cayman's stable outlook indicates that no rating changes are likely at this time. The outlook balances the very high levels of economic development and low debt metrics with the vulnerabilities resulting from a small and narrow economic base.

### What Could Change the Rating - Up

A positive outlook could be considered in the event of a significant reduction of overall projected debt levels and a policy framework that makes it unlikely that debt will increase significantly again. Alternatively greater growth that pushed per capita GDP even higher relative to peers could lead to a positive rating action.

### What Could Change the Rating - Down

A negative outlook could result if the debt burden begins to rise, either due to policy reasons, a slower economic recovery or both. While Moody's does not have a specific numerical target that would trigger a change in outlook, given that long term growth prospects for Cayman are modest and the economy has little diversification, we see the current levels of debt, measured as percentage of GDP and percentage of revenues, as relatively high for the country.

## Recent Developments

The Cayman government's Strategic Policy Statement (SPS), published on November 25, outlines the administration's policy priorities, fiscal plans and strategic goals for the next four years, starting in July 2016 and

ending in December 2019. Fiscal policy continues to be the cornerstone of the government agenda, guided by the principles set out in the Medium Term Fiscal Strategy (MTFS) that the administration established upon taking office in August 2013. In the current 2015/16 fiscal year, the administration is on target to achieve full compliance with the principles outlined in the Framework for Fiscal Responsibility (FFR). It will be the first time that the government is fully compliant since the FFR came into force in 2012.

According to the SPS, economic growth in 2015 is expected at 1.7%, weaker than the 2.1% growth in 2014. The downward adjustment is driven by lower global growth prospects and a softening of tourism inflows. Average annual growth in the forecast period 2016-19 is estimated at 2%, higher than the average growth of -0.5% for the past 7 years following the financial crisis. The forecasts rely on projections of increasing private and public sector investment, primarily in construction projects, as well as solid growth forecasts for the US and other advanced economies that serve as source markets for Cayman's two key industries; financial services and tourism.

The gradual improvement in macroeconomic conditions over the forecast period is contingent upon the implementation of private and public sector projects. Important private sector developments include hotel and condominium projects along the Seven Mile Beach and Beach Bay, and public sector or quasi-government developments include the upgrade of the Owen Roberts International Airport, the new cruise berthing terminal, the revitalization of George Town and the extension of the east-west arterial road. However, private investment is expected to be the main driver of growth as government spending is constrained by the FFR.

For 2015, inflation is projected at -0.2% due to a decrease in prices for housing and utilities, transport, hotels and restaurants and other consumer goods and services. However, given the expected uptick in economic growth and employment, prices are expected to rise slightly in 2016.

Cayman's fiscal metrics have been improving steadily in recent years as the government continues to make progress on its consolidation efforts. In 2014, the fiscal surplus reached an estimated 2.4% of GDP, and debt-to-GDP decreased to 19.5%, from 21.1% in 2013. For 2015, we expect a robust fiscal surplus of 2.8% of GDP. The improved fiscal position is mainly a result of increased revenues from taxes on property, domestic taxes on goods and services, and taxes on international trade and transactions. Next year, due to an uptick in expenditure, we expect a smaller fiscal surplus of 2.4% of GDP.

The operating surpluses have been used to fund capital investments, repay debt and build cash reserves. Core government debt is expected to be reduced by 60% from mid-2016 to end-2019. The extent of the debt reduction in nominal terms is very rare among sovereign peers and is considered a credit positive. However, Cayman remains exposed to weather related shocks, which, in an adverse event, could have an impact on government finances. Yet, with improved fiscal balance and increasing cash reserves, the government is well-positioned to face climate related challenges.

The government is expecting to maintain full compliance with the FFR during the SPS forecast period, with one exception in 2019. The government is scheduled to repay a US\$312 million bullet bond that matures in November 2019. By repaying this bond, the government will be technically "non-compliant" with the 2019 debt service ratio. However, cash balances have increased significantly and the government is aiming to repay the bullet payment with its own resources.

## Rating Factors

Cayman Islands, Government of  
Rating Factors Grid

Org ID: 600010327

Rating Factors	Sub-Factor Weighting	Indicator	Factor Score
<b>Factor 1: Economic Strength</b>			<b>H-</b>
<b>Growth Dynamics</b>	<b>50%</b>		
Average Real GDP Growth (2010-19F)		1.3	
Volatility in Real GDP Growth (Standard Deviation, 2005-14)		3.7	
WEF Global Competitiveness Index (2015)		--	
<b>Scale of the Economy</b>	<b>25%</b>		
Nominal GDP (US\$ billion, 2014)		3.3	

<b>National Income</b>	<b>25%</b>		
GDP per Capita (PPP, US\$, 2014)		--	
<b>Factor 2: Institutional Strength</b>			<b>VH</b>
<b>Institutional Framework and Effectiveness</b>	<b>75%</b>		
Worldwide Government Effectiveness Index (2014)		1.2	
Worldwide Rule of Law Index (2014)		0.6	
Worldwide Control of Corruption Index (2014)		1.0	
<b>Policy Credibility and Effectiveness</b>	<b>25%</b>		
Inflation Level (% , 2010-19F)		1.1	
Inflation Volatility (Standard Deviation, 2005-14)		2.4	
<b>Economic Resiliency (F1xF2)</b>			<b>H+</b>
<b>Factor 3: Fiscal Strength</b>			<b>H+</b>
<b>Debt Burden</b>	<b>50%</b>		
General Government Debt/GDP (2014)		19.5	
General Government Debt/Revenues (2014)		80.4	
<b>Debt Affordability</b>	<b>50%</b>		
General Government Interest Payments/Revenue (2014)		4.4	
General Government Interest Payments/GDP (2014)		1.1	
<b>Government Financial Strength (F1xF2xF3)</b>			<b>H+</b>
<b>Factor 4: Susceptibility to Event Risk</b>	<b>Max. Function</b>		<b>VL+</b>
<b>Political Risk</b>			
Worldwide Voice & Accountability Index (2014)		0.4	
<b>Government Liquidity Risk</b>			
Gross Borrowing Requirements/GDP		-1.6	
Non-Resident Share of General Government Debt (%)		100.0	
Market-Implied Ratings		Baa3	
<b>Banking Sector Risk</b>			
Average Baseline Credit Assessment (BCA)		--	
Total Domestic Bank Assets/GDP		222.1	
Banking System Loan-to-Deposit Ratio		45.5	
<b>External Vulnerability Risk</b>			
(Current Account Balance + FDI Inflows)/GDP		--	
External Vulnerability Indicator (EVI)		30.9	
Net International Investment Position/GDP		--	
<b>Government Bond Rating Range (F1xF2xF3xF4)</b>			<b>Aa3 - A2</b>
<b>Assigned Foreign Currency Government Bond Rating</b>		<b>Aa3</b>	
<p>Note: While the information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the rating range. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the indicative rating range.</p> <p>For more information please see our Sovereign Bond Rating Methodology</p>			

Footnotes:(1) Rating Range: Factors 1, Economic Strength, and Factor 2, Institutional Strength, combine with equal weight into a construct we designate as Economic Resiliency or ER. An aggregation function then combines ER and Factor 3, Fiscal Strength (FS), following a non-linear pattern where FS has higher weight for countries with moderate ER and lower weight for countries with high or low ER. As a final step, Factor 4, a country's Susceptibility to Event Risk, is a constraint which can only lower the preliminary Government Financial Strength rating range as given by combining the first three factors.(2) 15 Ranking Categories: VH+, VH, VH-, H+, H, H-, M+, M, M-, L+, L, L-, VL+, VL, VL-(3) Indicator Value: If not explicitly stated otherwise, the indicator value

corresponds to the latest data available.

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