INVESTMENT AND SOVEREIGN RESEARCH

SOVEREIGN: Cayman Islands

PLEASE SEE IMPORTANT DISCLOSURES IN THE APPEDIX

Strengths	**Weaknesses**
✓ Strong institutional strengths backed by solid governance framework and adherence to the rule of law ✓ Legal framework based on British common law and the Judicial Committee of the Privy Council acts as the final court of appeal ✓ Viable off shore financial sector grounded in low tax rate and proficient labour force ✓ Relatively stable economy with low inflation, high per capita GDP and low debt-to-GDP ✓	✓ Small island with a very narrow economic base which leaves the sovereign exposed and susceptible to external shocks ✓ Coalition government lacks a reasonable majority to push through legislation without opposition ✓ Reliance on the financial sector as the engine of growth could have an adverse effect on economic outturn in the long-run in light of the current uncertainty in relation to ongoing changes in the tax code in developed countries.
Opportunities	**Threats**
✓ Strong push by the government to build-out the infrastructure to make the destination more attractive for tourism. ✓ The Cayman Islands remain one of the more favourable tax destination in the western hemisphere, which makes the destination relatively ideal for tax planning purposes.	✓ Further tightening in financial regulation by the OECD could put downside pressure on the offshore financial sector resulting in additional job losses in the sector and economic contraction ✓ Lower than anticipated growth in the US and/or weather related shocks could negatively affect earnings from tourism

Ratings: Moody's Aa3/Stable; Fitch, N/A; and S&P, N/A

Economic Outlook

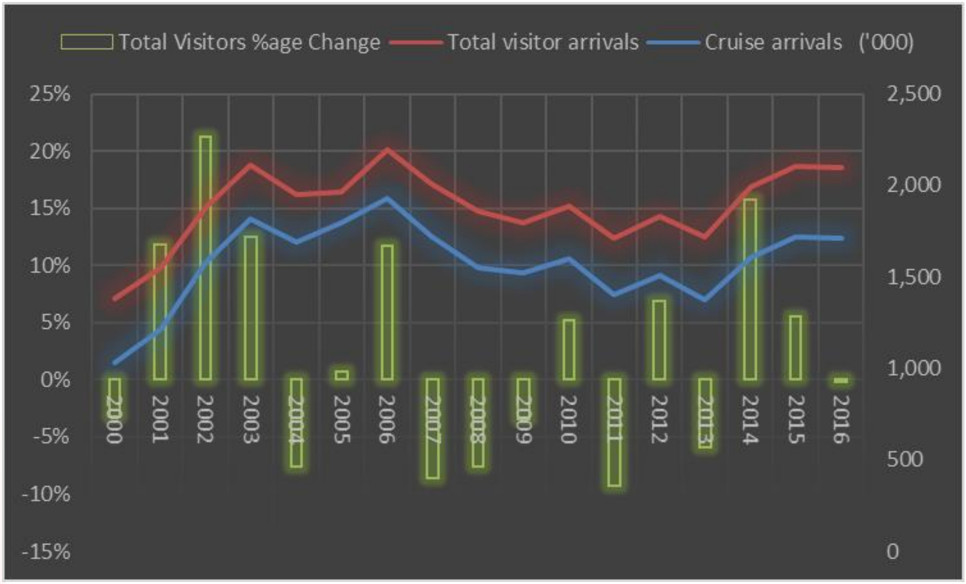
Despite the challenges facing the financial sector in the Cayman Islands, the economy is expected to expand on average by 2% per year over the medium-term driven by growth primarily in the tourism sector. Continued strong growth in the US will contribute to low levels of unemployment and help buoy improvements in household income. This will provide a conducive environment for growth in the leisure sector across the Caribbean from which the Cayman Islands stand to benefit. Tourism accounts for 30% of GDP and around 14% of overall employment. Over 5 million persons visited the Cayman Islands during the period January to September 2017, including 312,000 stopover visitors of which 82% were from the USA. Overall expenditure by visitors is estimated at $433.3 million, or 7.6% higher than the similar period in 2016.

As highlighted in previous publications, the Government has embarked on a strategic move to diversify the economy and increase the tourism product offerings so as to gradually wean the sovereign from the offshore financial sector. This is in keeping with evolution in legislation in developed countries to curtail tax leakages and bring a larger portion of the pool of their citizens' income into the tax pool.

Risk

Although the outlook on the Cayman Island is positive, the overall risk to the economy is moderate. The narrow economic base and high dependency on a few source countries for tourism leaves the sovereign highly vulnerable to external shocks, such as an economic contraction in the US or geo-political instability.

Table 1: Cayman Islands visitor arrivals



Sources: CIs Economic and Statics Office and JMMIR

Ongoing changes in the tax landscape in countries affiliated with the Organisation of Economic Development on Cooperation (OECD) will continue to affect banks and other financial institutions that are registered in the Cayman Islands mainly for tax purposes. On May 1, the UK House of Commons amended the Sanctions and Anti-Money Laundering bill. The Bill requires that the 14 British Overseas Territories, including the Cayman Islands, introduce public registers listing beneficial ownership by the end of 2020. This is being done to further crackdown on illegal activities including financial crimes such as money laundering and tax evasion. The Cayman Islands has a registry, but the information is not made available to the public. Corporates operating in low tax jurisdictions do so not only because of the tax benefits but also because of the anonymity in doing so. This action by the British parliament could result in some corporates relocating from the Cayman Islands to other jurisdiction where they can operate in secrecy. To the extent that financial and insurance services account for over 40% of GDP, mass migration of these entities could have a devastating impact on the economy.

Developments in the Macroeconomy

A stable economic path is expected over the medium-term which reflects a combination of policy actions and a relatively favourable external environment. The sovereign is expected to generate a small fiscal deficit over the medium term while tax revenue to GDP is expected to fall slightly. The lower tax intake is occasioned by erosion in revenue flows from the financial services sector due to the changing tax environment in OECD countries. On the debt servicing side, the interest payment is expected to remain at around 1% of GDP while the sovereign is likely to repay the 2019 global bond from accumulated resources. Real economic growth is expected to generate increased inflows from excise and value added taxes, but will not be sufficient to offset the lower intake from the financial sector hence the reason for the reduced tax to GDP estimate over the forecast horizon.

Higher economic activity in the domestic economy is expected to generate increased job opportunities in the service sector and as a result unemployment is expected to fall, albeit marginally. Price pressures have been building due to higher import prices, particularly fuel, but the overall price level has been kept under control thanks in part to a stable currency and prudent fiscal policy. The current account is expected to fall marginally over the medium term. The falloff reflects lower outflow from the financial sector and higher tourism receipts.

Table 2: Selected Macroeconomic Data for the Cayman Islands

	2013	2014	2015	2016	2017	2018 (e)	2019 (f)	2020 (f)	2021 (f)	2022 (f)
Population	58,371	59,172	59,963	60,765	61,559	62,348	63,129	63,890	64,643	65,393
GDP per capita, USD	55,336	57,134	56,738	56,373	57,780	59,527	61,346	63,312	65,358	67,482
Real GDP, % y-o-y	1.5	2.3	3.0	3.1	1.8	1.9	2.0	2.1	2.1	2.1
Unemployment, % of labour force, ave	6.3	4.6	4.2	4.0	4.0	4.0	4.0	3.8	3.5	3.5
Consumer price inflation, % y-o-y, eop	2.2	0.6	-2.5	0.6	2.5	2.3	2.3	2.3	2.3	2.3
KYD/USD, eop	0.82	0.82	0.82	0.82	0.82	0.82	0.82	0.82	0.82	0.82
Total revenue, % of GDP	24.0	24.0	24.1	25.1	24.5	23.8	23.2	22.6	22.0	21.5
Fiscal balance, % of GDP	1.7	2.4	3.0	2.4	2.1	1.9	-0.2	-0.3	-0.4	-0.4
Current account balance, % of GDP	-22.9	-25.3	-22.5	-23.2	-22.8	-22.4	-21.5	-20.7	-19.7	-18.9
Total government debt, % of GDP	21.1	19.3	18.3	17.2	17.9	17.8	17.5	17.2	16.9	16.6

Sources: Business Monitor International and JMMBIR

Conclusion

The macro-fiscal outlook on the Cayman Islands is positive despite looming headwinds in the finical services sector. Strong growth in the United States will help to propel growth in tourism, which should help to keep unemployment at relatively low levels. It is envisaged that the government will generate a small deficit. However, the debt ratio is expected to contract by one percentage point over the medium term due to positive real economic growth, amortisation of the 2019 global bond with the use of available resources and the stability of the domestic currency.

Overall risk to the economy is relatively modest and reflects at most a combination of economic and weather related factors. Barring the manifestation of any of these risks the economy is expected to remain on a steady path, reflecting modest growth, reduction in debt levels and stability in some of the main macroeconomic variables.

Source:

Bloomberg
Business Monitor International
https://www.cia.gov/library/publications/the-world-factbook/geos/cj.html

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