THE JMMB GROUP
Your best interest at heart.

INVESTOR UPDATE

OCTOBER, 2020

BAHAMAS UPDATE

PLEASE SEE IMPORTANT DISCLOSURES & COPYRIGHT INFRINGEMENT IN THE APPENDIX

SUMMARY

The spread of the coronavirus (Covid-19) across global borders is having a negative ripple effect on most economies, especially those in the Caribbean region that are heavily dependent on tourism. Regarding the macro-fiscal situation in Bahamas, we expect nominal revenue inflows to fall in 2020 and possibly in 2021. On the expenditure side, there is limited room for cuts, plus the government is facing elevated capital spending to assist with cleaning up debris from the hurricane. The combination of low revenue intake and relatively high spending will keep the deficit elevated, and debt to GDP is expected to rise above 85% in 2021. The Bahamas capacity to service the debt will be severely challenged, as the country does not possess the economic or fiscal strength to withstand dual shocks simultaneously. We still maintain that improvement in the global economy will lead to improvements in the Bahamas fiscal profile. However, this seems less than likely to happen within the next 12 months. **Given the shift in the sovereign's risk profile, we are changing our recommendation of the Bahamas global bonds to UNDERWEIGHT.**

TABLE 1: SWOT OF THE BAHAMAS

STRENGTHS	WEAKNESS
• Strong governance framework and institutions' strengths rooted in English common law. • Favourable tax regime and enabling business environment, which make the sovereign a preferred destination for offshore financial activities. Strong regulatory framework for banks, trusts, and pooled investments.	• The sovereign is highly vulnerable to external shocks due to its narrow economic base and small size. • High fiscal deficit and low economic growth pushing debt to GDP towards unsustainable levels. • Erosion of competitive advantage as an offshore financial centre due to more stringent and continued evolving regulatory environments in G-20 countries, particular the US and Europe.
OPPORTUNITIES	**THREATS**
• The political administration has signalled its willingness to deregulate the economy and reduce capital restrictions. • Improvements in global and US real GDP and job market condition over a prolonged period could usher in a cycle of higher real GDP growth and improvements in the external and fiscal accounts. This could lead to improvements in debt servicing ratios and debt to GDP.	• Acceleration in the unemployment rate due to the coronavirus could cause social unrest and increase in violent crimes. • Prolonged global economic recession due to the coronavirus may exacerbate the Bahamas fiscal problems and lead to challenges in servicing the debt. It could also push the debt dynamics on an unsustainable path. • High vulnerability to external weather related shocks, especially hurricanes and flooding.

Ratings: S&P, BB/negative; and Moody's, Ba2/negative

COVID-19: IMPACT ON GLOBAL OPERATIONS

The spread of the coronavirus (Covid-19) across global borders is having a negative ripple effect on most economies, especially those in the Caribbean region that are heavily dependent on tourism. Tourism accounts for well over a third of gross economic output in the region. Therefore, the steep decline in visitor arrivals reverberates across many sectors, especially in the Bahamas where it is estimated that tourism accounts for about half of GDP when both the direct and indirect impact of the sector are tallied. The slowdown in visitor arrivals to the region since March is due to a combination of factors. These include border closures; suspension of cruise ships making calls in the Bahamas until November; and tight labour market conditions in source countries, especially in the US.

The Bahamas is dealing with two economic challenges simultaneously. The country has not fully recovered from Hurricane Dorian in November 2019, which is estimated to have caused damages amount to US$3.4 billion or 25% of GDP. Clean-up activities and reconstruction of houses due to the hurricane are ongoing on Abaco and Grand Bahama. The decline in overall economic activities is likely to slow the pace of reconstruction and put pressure on the fiscal accounts and the debt. When the virus began to spread in the Americas in early January, there was some amount of optimism in the international community that it would fade away over the course of a year or less.

In June 2019, the International Monetary Fund projected that the global economy would rebound in 2021 with growth of 2.2%. The Fund cited as the rationale for the projection gradual fading of the virus, and higher economic output starting in Q2:21. However, with the increase in the number of persons infected with the virus in the US, South America and parts of Europe, it is possible that the pace of global expansion may be much weaker than expected. In anticipation of the possibility of low growth and sluggish job market condition in the US, the Federal Reserve signalled that it will keep the policy rate low for at least another three years. Regarding the growth outcome for the Bahamas, two outcomes are likely. On the one hand, it is possible that recovery may start in late 2021 while on the other hand the recovery may begin much later. Under either scenario, the sovereign will experience a deterioration in its macro-fiscal metrics. However, in the latter case the debt may veer towards an unsustainable path which would require radical fiscal adjustments to bring it under control.

FISCAL ACCOUNTS

The economy is facing headwinds from the after-effects of Hurricane Dorian and the Covid-19 pandemic, which have affected domestic private consumption and government revenues. We expect nominal revenue inflows to fall in 2020 and possibly in 2021. On the expenditure side, there is limited room for cuts, plus the government is facing elevated capital spending to assist with cleaning up debris from the hurricane. The combination of low revenue intake and relatively high spending will keep the deficit elevated until at least 2021. As we noted in our publication in March, we expect debt to GDP to increase due to a combination of higher than programmed deficit and contraction in real GDP. At the time we expect debt to GDP to move surge beyond 70%, up from 66.5% in 2019. However, with a presentation of the budget in May a clearer picture emerged regarding how fiscal operation is expected to evolve in 2020 through to 2021. The government is programming a fiscal deficit of 11% of GDP for the FY 2020/21. Based on our assessment of the fiscal accounts, it is possible that the deficit could decline even further. Under the scenario where the deficit is 11% and the economy contracts by 16%, we expect debt to GDP to rise above 85% in 2021. Strong economic performance in subsequent periods along with the continuation of the fiscal consolidation programme could push the ratio down to a more sustainable path further down the road.

However, in the event where the pace of economic recovery stretches over a much longer period than expected, debt to GDP will rise and so too will the cost of servicing the debt. In 2017, when the Bahamas had investment-grade credit ratings, interest to GDP was less than 10%. It has subsequently risen to 13% in 2019 and is expected to push above 25% in 2021. This is uncharted territory for the Bahamas, and we cannot say with certainty if the political administration will prioritize servicing the debt while foregoing social and capital spending. Even if the sovereign continues to service the debt in a low growth environment, debt to GDP is likely to trend along an unsustainable path which would require corrective fiscal action. This calls for increase in revenues and/or expenditure cuts. If these measures fail to yield the desired result, it is possible it may require more radical action. One such would be to restructure the debt. Although this is a distant possibility, we cannot ignore it happening given the current economic environment and the uncertainties which make medium term planning even more challenging than under normal condition.

EXTERNAL ACCOUNT AND THE CURRENCY

Sharp slowdown in visitor arrivals will continue to have a negative effect on the current account deficit (CAD) in the short run. However, over the long run, we expect structurally lower oil price and contraction in the fiscal deficit to lead to the narrowing of the CAD. We were expecting a gradual contraction in the CAD prior to the onset of the Covid-19 pandemic. This was predicated on reduction in capital imports because of the completion of construction works at the multi-billion Baha Mar hotel project. We expect foreign direct investment flows to continue into the tourism sector. However, we do not envisage any project or group of projects on a similar scale as the Baha Mar that would lead to a significant rise in capital imports to match the scale of imports when the Baha Mar was under construction. We however expect that imports of capital goods would be relatively higher in the short run when compared to expectation over a longer time horizon, as reconstruction works continue on buildings damaged on the islands of Abaco and Grand Bahama because of the hurricane in late 2019.

Tourist visits to the islands slumped to a low in Q2:20 and is likely to remain subdued for the rest of the year through to late 2021, or possibly even longer. The decline in tourism numbers follow closure of the borders by the government on March 27, to help temper the spread of Covid-19, and economic challenges facing source countries, especially the US where over 80% of arrivals originate. For the calendar year to July, total stopover arrivals amounted to 373,300, which was down by 894,500 (70.6%) when compared to the similar period in 2019.

Facing serious economic challenges and pressure from local business interests, the government re-opened the borders on July 1 but was forced to close them because of a spike in the number of persons infected with Covid-19. A few days later the administration backtracked on the announcement and re-opened the borders to international travellers, but persons visiting the Bahamas would have to quarantine for 14 days in a government facility at their own cost. They are required to take a mandatory test to check for the presence of disease at the end of isolation.

We do not expect any change in the currency peg as the central bank is likely to maintain tight capital control, as is usual, to help minimise imbalance in the balance of payments accounts. In a scenario where there is a chronic deterioration in the external accounts, we expect the sovereign to first seek support from the International Monetary Fund (IMF) as a backstop to what we perceived to be a temporary issue. Should however the economic malaise drag on for far longer than expected, we expect a more permanent solution. This would require adjustments in both the fiscal and external accounts, including changes to the currency peg. However, we assign a low probability to the chain of events that would lead to this being actioned by the government.

RATINGS ACTION

FIGURE 2: BAHAMAS SOVEREIGN CREDIT RATINGS CHANGE

Agency	Rating	Outlook	Date
Moody's	Ba2	negative	25-Jun-20
S&P	BB	negative	16-Apr-20
Moody's	Baa3	under review	9-Apr-20
S&P	BB+	negative	12-Mar-20
Moody's	Baa3	stable	2-Feb-19
Moody's	Baa3	negative	25-Aug-17
Moody's	Baa3	negative watch	6-Jul-17

Sources: Trading Economics and JMMBIR

In June, ratings agency Moody's downgraded the Bahamas sovereign credit ratings two notches from Baa3 to Ba3 with a negative outlook. Moody's advised that "The main driver for the downgrade is the significant negative effect the coronavirus outbreak will have on The Bahamas' economic and fiscal metrics. For the Bahamas, the shock mainly transmits through the sharp decline and potentially prolonged slump in the tourism industry, which represents a sizable proportion of gross value added in the economy as well as a source of government revenue and export earnings. Moody's regards the coronavirus outbreak to be a social risk under its ESG framework." The ratings agency noted that the fiscal deficit could contract to 16% to 20% due to the significant fallout in the tourism industry.

The Government of the Bahamas is expecting a fiscal deficit of 11% of GDP for the fiscal year 2020/21, which is the highest on record. The Moody's noted the fiscal deficit highlights significant fallout in revenue, higher capital spending to support the economic recovery and reconstruction efforts following the damage caused by Hurricane Dorian in September 2019. The ratings agency expects the debt to increase to 85% in 2021, up from 60% in 2019. Moody's expects the Bahamas to face challenges in its ability to service the debt in the future. Interest to revenue is expected to increase to 22.6% in 2020/21 compared to 13.5% in 2018/19. On the positive side, the ratings agency expects the ratio to trend down as government revenues recover with improvements in the economy.

With the sovereign's high dependency on tourism, the ratings agency advised that recovery of the global sector is exposed to shift in consumer behaviour following the outbreak of the coronavirus. The performance of the sector will largely depend on the speed and recovery of the airline industry and their ability to continue servicing destinations such as the Bahamas. The ratings agency believes that Bahamas GDP could expand by 10% in 2021 if tourism flows return to 60% -70% of the numbers observed in 2019. Moody's stated that the Bahamas economic performance is however expected to remain subdued over the medium term because of structural issues. These include weak growth, high energy cost and high energy cost.

SHORT-TERM EXPECTATION

As we noted in late March, the sharp decline in visitor arrivals, as was expected, is having a negative effect on the fiscal accounts. Government revenues have fallen precipitously, the fiscal deficit has widened, and the debt ratio is expected to increase well over 80% of GDP by the end of 2020. Back then we expected the economy will start recovering by Q2:21. This, however, was partly predicated on an effective treatment for the coronavirus and a slower rate of transmission globally. Six months later, the outlook is less optimistic as the rate of infection remains elevated in the United States (US), South America, some parts of Europe, and Asia, in particular India. While many vaccines are in trial it does not appear as if any will be on the market until late 2021. The pace of economic recovery globally and in the US is likely to be more protracted than previously envisaged. We expect job market conditions to remain tight in the US for most of 2021 into 2022. This does not redound favourably for the Bahamas as the US is the source country for 80% of visitors arriving in the Bahamas.

In another blow to tourism in the Bahamas, members of the Cruise Line International Association (CLIA) voluntarily agreed to suspend sailing from the US through to October 31. The group includes Carnival Cruise Line, Disney Cruise Line, Cunard Line, Holland America Line, Norwegian Cruise Line, and Royal Caribbean International, most of which make regular calls to the Bahamas. This follows a 'No sail' order issued by the Centre for Disease Control in March 2020 that is to end on September 30th. The order suspends passenger operations on cruise ships with the capacity to carry at least 250 passengers in waters subject to U.S. jurisdiction. It is possible that the cruise line may extend their voluntary suspension into Q1:21 or later to help prevent the spread of the coronavirus. Passengers and crew members of at least three ships that set sail in Europe and Asia since August have been quarantined because of an outbreak of the coronavirus, or passengers testing positive for the diseases.

Given the Bahamas' high dependency on tourism and the headwinds that are facing the industry, the economic contraction is likely to extend well into 2021. The outlook into 2020 is not very sanguine, as even with a shift in economic outlook for the US it may take some time before leisure activities return to normal, as households build up their savings.

RECOMMENDATION

Emerging Market fixed income assets have experienced an improvement in prices relative to March when prices fell because of the panic caused by the spread of the coronavirus pandemic. The shift in investor sentiments reflects expected gradual improvement in global economic recovery and by extension improvements in the macro-fiscal metrics of the sovereigns in the group. The change in prices is however not equal across all sovereigns, as Bahamas global bonds have experienced further contraction in prices. The reduction reflects deterioration in the macro-fiscal metrics, which is expected to linger over the medium term due to pre-existing structural issues that will take time to correct. Of concern to us is the significant increase in the debt service cost, which has risen above 20% of revenue and could remain at these levels over the next two years as real GDP and revenue growth are weighted towards the downside. In the event of a weather-related shock, the Bahamas capacity to service the debt will be severely challenged, as the country does not possess the economic or the fiscal strength to withstand a dual shock simultaneously. We still maintain that improvement in the global economy will lead to improvements in the Bahamas fiscal profile. However, this seems less than likely to happen within the next 12 months. Given the shift in the sovereign's risk profile, we are changing our recommendation of the Bahamas global bonds to UNDERWEIGHT.

Source: Fitch-Connect, Bloomberg, S&P Global/RatingsDirect®, Moodys.com.

APPENDIX

IMPORTANT DISCLOSURES

ABSTRACT— As a part of our new Portfolio Strategy we are recommending strict adherence to the following Portfolio Allocation DEFINITIONS/ RECOMMENDATIONS.

PLEASE NOTE THAT NO INDIVIDUAL ASSET IN YOUR PORTFOLIO SHOULD HAVE A WEIGHTING GREATER THAN 5% UNLESS OTHERWISE RECOMMENDED BY YOUR PORTFOLIO MANAGER OR A SPECIFIC JMMB RESEARCH REPORT. CONSEQUENTLY THE FOLLOWING **DEFINITIONS** ARE PROVIDED FOR CLARITY.

UNDERWEIGHT -
REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET
SELL -
REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.
HOLD/MARKET WEIGHT -
EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB.

OVERWEIGHT/BUY -
EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

The investments referred to in this report may not be suitable for you. You should consult your licensed investment advisor. Nothing in this report constitutes investment, legal, accounting or tax advice or a representation that any investment or strategy is suitable to your individual circumstances or otherwise constitutes a personal recommendation to you.

DISCLOSURE UNDER THE SECURITIES ACT

This disclosure is being provided pursuant to section 39 of the Securities Act. This research report is prepared by Jamaica Money Market Brokers Limited (JMMB) and the information and views expressed are those of JMMB. JMMB is a subsidiary of the JMMB Group Limited (JMMBGL). Associated persons of JMMB include JMMBGL and its subsidiaries and affiliated companies, including JMMB Fund Managers Limited, a licensed securities dealer and manager of collective investment schemes.

As at the date of this report, JMMB and its affiliates, directors, officers, employees and other associated persons may from time to time buy or sell, or act as principal or agent in, the securities mentioned in this research report. JMMB or its affiliates, directors, officers and employees have no interest in, or interest in the acquisition or disposal of the securities, other than expressed above. No part of their compensation is or will be related to the recommendations or opinions in this report.