INVESTMENT AND SOVEREIGN RESEARCH

SOVEREIGN: GUYANA—January 20, 2020

PLEASE SEE IMPORTANT DISCLOSURES IN THE APPENDIX

Executive Summary

Oil production in the Stabroek bloc is expected to commence in Q1:2020 with the first shipment programmed in February, but may very well come on stream in January. As we have highlighted in prior reports, the production of oil is a game changer for the local economy. We are forecasting growth in Guyana of approximately 80% in 2020 and expect that growth will remain elevated over the next decade, driven by a combination of hydrocarbon output, and an increase in government and private consumption.

Guyana's fiscal profile is set to improve over the medium term despite an expected increase in expenditure. We estimate a fiscal deficit of approximately 5% in 2019. The deficit is however expected to shift to a small surplus over the forecast horizon driven by higher revenue flows of petroleum royalties.

We remain bullish on Guyana despite the uncertainties that cloud the political environment. It is our view that oil and gas output will drive economic expansion over the next several years, which will in the process help to fuel infrastructure development and lower structural unemployment.

What we like about Guyana

Despite the short-term political troubles, Guyana has a strong democratic government with free and fair elections. The sovereign's ties with CARICOM gives it a strong voice in the international community. Guyana is poised to become a strong player in the oil and gas industry, which will provide revenues to the government to develop its poor infrastructure and improve the human resource capacity.

What we do not like about Guyana

The political class play on the ethnic division of the country to further their political ambitions, and in the process cause a deep political divide between the two main ethnic groups. After years of economic mismanagement and poor policy prescriptions, the sovereign is ranked as the second poorest in the western hemisphere. Accordingly the education and health sectors are under-developed and poverty is elevated, especially among the indigenous tribes in the hinterland.

Keys Risks

Guyana's borders are porous and the country is being increasingly used as a transhipment point to move drugs into North America and Europe. Given what we have seen in Central America, in particular Mexico, the in-fighting could lead to an increase in the homicide rate. Narco money could also find its way into public institutions, and corrupt public officers. The border dispute with Venezuela and Suriname remains a sour point. The Maduro administration may increase harassment of corporates operating in the disputed maritime territory to in part redirect the nation's attention from internal economic and social woes.

Weaknesses

Guyana's economic base is narrow and heavily dependent on primary resources – agriculture and mining. While the production of hydrocarbon is likely to usher in a virtuous economic cycle and increase wealth, in the absence of forward looking policies to diversify the economic base the sovereign could become too reliant on one sector and in the process over-expose the economy to future shocks.

Ratings: N/A

Default: N/A

Economic Outlook

As we start 2020 there are indications that the global economy may expand at a faster rate than the International Monetary Fund (IMF) is projecting. The Fund expects that the global economy will expand by 3.4% relative to the estimate of 3.0% in 2019. The increased optimism is driven by what appears to be a shift in the trade impasse between China and the US. Recently China has indicated a cut in tariffs on imports on US made goods, as a means of easing the trade tension. This is deemed to be the first step towards the possibility of both parties agreeing a trade pact.

Assuming this scenario plays out in conjunction with the Organization of Petroleum Exporting Countries (OPEC) plus Russia's reducing global oil supplies by a cumulative 1.8 million barrel per day relative to the 18 months prior, crude prices are expected at a minimum to remain at current levels throughout the year with the possibility of modest increases. In the grand scheme of things this redound bodes well for some oil exporting countries and new players to the market such as Guyana.

Break-out year for Oil Export

Oil production in the Stabroek bloc is expected to commence in Q1:2020 with the first shipment programmed in February, but may very well come on stream in January. As we have highlighted prior, the production of oil is a game changer for the local economy. We are forecasting growth for Guyana of 80% in 2020 and expect that growth will remain elevated over the next decade, driven by a combination of hydrocarbon output, and a rise in government and private consumption. On the government side, we have seen an uptick in infrastructure spending, which is expected to increase and remain sustained over multiple periods as Guyana's infrastructure is severely underdeveloped or is in a very bad state. A rise in employment and wealth will help and drive private consumption. However, the lion share of increased demand over the short- to medium-term is likely to be satisfied by importation. Guyana's backward industries and large unskilled labour force are not sufficiently equipped to meet the increased demand for basic and luxury items.

Risks

Political uncertainty dominates Guyana's risk profile over the short term. Although we maintain a positive view of the sovereign in relation to its real GDP growth over multiple periods, the contentious state of the political environment could in the short run limit growth in the non-oil sectors and stymie additional investment flows. The no-confidence motion brought against the ruling coalition forced President David Granger to call elections in March 2020. This is later than the 90 days that was anticipated following the December 2018 vote set in motion by the People Progressive Party/Civic (PPP). President Granger and his ruling coalition Partnership for Unity (APNU) sort a ruling from the Caribbean Court of Justice (CCJ) to quash the no confidence vote. The CCJ however upheld the no confidence vote.

Granger asserted prior to the CCJ's ruling that the local election commission needed ample time to complete the enumeration exercise before free and fair elections could be held. He argued that this caused him not to honour the provision in the Constitution, which clearly outlines the time period for dissolution of the government and for elections to be held subsequent to a no confidence vote. Prior to the election date being announced the PPP indicated that the APNU government was operating contrary to the Constitution. Western countries including the United States supported this view and used diplomatic channels to influence the president setting the date for the election.

The stakes are high in the upcoming election and the two main parties are fancying their chances. Whoever is the victor will favour their chances in subsequent elections, as the expected windfall from hydrocarbon production is likely to drive future social and infrastructure spending. As we have noted prior, Guyana is a fractious country and voting is usually along ethnic lines with the Afro-Guyanese traditionally voting for the APNU while Indo-Guyanese vote for the PPP.

The PPP having won 5 out of the last 6 elections since Independence and may hold a slight advantage. The Indo-Guyanese is the largest ethnic group and in recently concluded regional elections in November 2018 the party won over 60% of the regional vote. This may be an indication that there is discord within the population regarding the APNU's handle on governance.

The party which controls the government coffers is likely to use state resources to boost its base, which is likely to lead to an outcry from supporters of the opposition who may feel marginalised. Under this scenario we think that the possibility of political unrest is relatively elevated, especially given the sovereign's history of similar incidents. The stakes are very high in the upcoming elections and the political climate is charged given the circumstances under which the election was forced, i.e. a no confidence vote. While we do not anticipate pervasive violence and/or protestation over a long time horizon, the situation on the ground does not lend itself to a stable environment over the short run at least.

Traditionally both of the main political parties have been business friendly however we are betting that if the PPP win the mandate it is likely to renegotiate the terms of oil royalties with Exxon Mobil and other energy companies operating locally. As we are anticipating unemployment to remain elevated despite petrocurrency flows. Under this scenario the government may lobby the oil firms to increase the proportion of Guyanese employed to these entities.

Long-term Risk

The longstanding border dispute with Venezuela and Suriname is not going to go away any time soon. Subsequent to our last publication we have not had any reports of the Venezuelan navy harassing oil exploration vessels in Guyana's or international maritime waters / territory. President Nicolas Maduro's administration has used the border dispute to deflect the economic malaise in Venezuela and as a show of strength. His actions have caused Suriname's President Dessi Bouterse to press his country's claim over disputed territory on Guyana's eastern border with Suriname. In November while on a state visit to China, Mr. Bouterse was found guilty of ordering the extrajudicial execution of 15 political prisoners by a military court. This is likely to ease the border dispute between the two sovereign's for now, but the issue with Venezuela will persist over multiple periods. We maintain the view that the likelihood of a military conflict is low, however the uncertainty that lingers will weigh negatively on investor sentiment, especially those who desire to explore opportunities in the disputed territories.

Guyana is being used as a forward base by drug traffickers in South America to move narcotics, more so cocaine, to the USA and Europe. Demand for the commodity has slowed in the USA but demand has expanded in Europe. Given Guyana's location, it is ideally placed as the shortest route into Europe. A porous border and an under-resourced security force make it easy for traffickers to operate without detection. It is not difficult for narco-traffickers to infiltrate the government apparatus given their financial resources and the high level of corruption in Guyana. Of concern to us is the likelihood of an increase in homicides arising from turf war. The homicide rate is below the average for Latin America and the Caribbean, but things could change if steps are not taken to curtail the use of Guyana's territory as a transhipment point.

Table 1: selected macroeconomic indicators

	2015	2016	2017	2018	2019 (e)	2020 (f)	2021 (f)	2022 (f)	2023 (f)	2024 (f)
GDP Per Capita	4,168.5	4,531.2	4,635.6	4,984.1	5,252.0	10,249.4	10,990.1	13,501.7	17,635.8	19,404.5
Population, million	0.767	0.773	0.778	0.782	0.785	0.787	0.789	0.792	0.794	0.796
GDP Growth	3.1	3.4	2.1	4.1	4.4	85.6	4.8	20.6	26.2	3.2
Inflation, eop	-1.8	1.5	1.5	1.6	2.7	3.5	3.5	3.5	3.1	2.5
LCU/USD, eop	206.5	206.5	208.5	210.5	224.8	227.7	230.5	233.5	237.5	245.0
Revenue, % GDP	28.1	28.1	30.5	30.8	32.3	20.6	20.6	18.7	16.9	18.0
Expenditure, % of GDP	29.3	32.4	34.8	34.3	37.0	21.2	21.2	18.6	16.8	18.0
Fiscal Deficit, % of GDP	-1.2	-4.3	-4.3	-3.5	-4.8	-0.5	-0.6	0.1	0.1	0.1
Government debt, % of GDP	50.1	50.7	51.4	52.9	55.5	24.6	23.1	23.0	17.9	15.5
Total debt service, % of exports of G&S	5.22	6.24	5.17	4.82	4.22	3.23	2.42	1.67	1.26	0.93
Total debt service, % of FX reserves	13.71	16.68	14.72	14.02	13.93	12.33	10.35	8.00	6.60	5.37
Current account balance	-5.1	0.4	-6.8	-17.5	-22.7	-18.4	-15.9	-5.6	-0.7	1.7
Foreign reserves ex gold, USD	0.60	0.58	0.53	0.56	0.58	0.61	0.64	0.67	0.71	0.74
Import cover months	4.89	4.26	3.47	3.41	3.32	3.22	3.03	2.84	2.62	2.39

Source: BMI, IMF, and JMMBIR

Fiscal Operation & The Current Account

Guyana's fiscal profile is set to improve over the medium term despite an expected increase in expenditure. We estimate a fiscal deficit of approximately 5% in 2019. The deficit is however expected to shift to a small surplus over the forecast horizon driven by higher revenue flows from petroleum royalties. As a proportion of GDP, all fiscal measures – including, expenditure and fiscal balance - are likely to decline due to the sharp rise in nominal GDP. The sovereign's fiscal profile appears sound with low debt and debt service ratios. Risks to the fiscal accounts largely resound around the narrow revenue base and elevated spending. Like GDP growth, a negative shock to the oil markets could cause a rise in the fiscal deficit and debt levels. As a rise in government expenditure is pinned to oil revenues we expect that the government would scale back spending under this scenario. Therefore we are not overly concerned about the unsustainability of the fiscal accounts in the event of an adverse change in the oil markets.

It is estimated that the current account deficit (CAD) increased in 2019 to 22.7% of GDP due largely to the importation of capital goods related to the oil industry (See Table 1). We do not expect that the CAD will remain elevated. In fact we expect that it will contract over the forecast period and move to a surplus position occasioned by a combination of increased oil exports and a reduction in the importation of capital goods. Between 2017 and 2019, imports of capital equipment by Exxon Mobil and its partners were the main cause for the rise in the CAD. Given that the bulk of near-term investment required for oil production has been undertaken, related capital goods imports are expected to decline in the coming years.

Conclusion and Recommendation

We remain bullish on Guyana despite the uncertainties that cloud the political environment. It is our view that oil and gas output will drive economic expansion over the next several years, which will in the process help to fuel infrastructure development and lower structural employment. Based on our forecast we expect acceleration in other leading economic indicators, including per capita income and employment. Production of hydrocarbon is set to commence in Q1:20.

In our opinion it will take years before Guyana fully develops the internal capacity to meet in part or as a whole the additional demand for goods and services arising from higher household income. Currently, domestic consumption has a high import content, as is the case with a number of Caribbean territories, and we expect that the situation will remain relatively unchanged in coming years, Accordingly, opportunities exist for players within the Caribbean to meet consumer needs for these products. In addition to the aged and dilapidated infrastructure, there is a chronic shortage of decent housing and/or hotel accommodation for the domestic and expatriate population. We do not expect the government to focus its attention on this area in the near- to medium-term, thus leaving the door open for private players to fill the void. In the long run we do expect that the government will utilize state resources to improve the housing infrastructure. However with the skills gap that exist there is likely to be a chronic shortage of highly skilled workers in housing and infrastructure construction.

Risks to the domestic economy is above normal at this time owing to the political situation and border disputes. With the pending election, tensions are high and the outcome will largely determine how state resources will be used going forward. The border dispute with Venezuela and Suriname wont disappear any time soon, and such is likely to prevent some investors from putting resources in the disputed territories.

Source:

Business Monitor International (BMI)
Bloomberg
International Monetary Fund

APPENDIX

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