THE JMMB GROUP
Your best interest at heart.

INVESTOR UPDATE

November, 2017

BARBADOS UPDATE

High debt (109% of GDP), persistent fiscal deficits above 5% of GDP since 2012, net negative international reserves and a climbing interest burden have placed pressure on the fixed exchange rate-peg leading to the latest local currency rating downgrade (September 27, 2017 by S&P). The government has also continued to face difficulties turning around fiscal policy given **scheduled parliamentary elections in 2018**.

A serious consideration of the implications for the BOP (Balance of Payments) and the fixed exchange rate/currency peg must be taken into account. Given that Barbados imports a large percentage of its consumer durables there are concerns regarding lines of credit, the possible need for hard currency upfront by creditors and the ability to meet these needs given the already "negative" net international reserves.

FUNDAMENTALS REMAIN A CONCERN

At the time of our last update on Barbados in April-2017, we highlighted that the sovereign/country had experienced eleven consecutive downgrades between 2006 and 2017. Further, we expressed concerns that the fundamentals were not headed in the right direction. Our view has not changed. Since the 2008/09 global crisis, Barbados has experienced low growth in its two main economic drivers, Tourism and international financial services. While it is arguable that tourism has experienced ebbs and flows, the international financial services sector has mainly headed south.

Poor growth has meant weak revenue inflows; with a somewhat slow adjustment on the expenditure side, the fiscal deficit ballooned from a manageable 1.7% in 2011 to an average of 6.15% between 2012 and 2017. As the deficit came in consistently high, its financing was likely done via the issuance of debt. **Consequently the debt/GDP ratio ballooned from 80.6% in 2011 to an estimated 108.4% in 2017**. High debt tends to be synonymous with a high debt service ratio. Interest payments as a percentage of government revenues has climbed from 12% in 2011 to 15.3% as at 2016.

SOURCES OF FINANCING HAVE DRIED UP!

The situation is further exacerbated by limited appetite for government debt from the local market. It is also reasonable to assume that players in the international market would have also expressed similar concerns and shied away from new or additional exposure to Bajan debt. This has led to reliance on financing from the National Insurance Scheme (NIS) and the CBB (Central Bank of Barbados). NIS and central bank financing satisfied about 85% of financing requirements for 2015 and 2016. Central Bank financing has strong

THE JMMB GROUP
Your best interest at heart.

inflationary implications while financing through the NIS raises systemic or contagion risk issues. Further, Barbados has not tapped the international capital markets for the better part of a decade. The sovereign has not been able to access bilateral or multilateral lending, in part, because the government has been slow to satisfy the conditions for disbursement.

Barbados historically has had a current account deficit; however inflows on the capital and financial account (tourism, financial services) would have closed the gap and balanced the BOP. In recent times limited external inflows would have led to declining reserves (which have theoretically become negative) leading to concerns that the central bank lacks the capacity to defend the exchange rate peg. **This suggests that there is a high probability of a balance of payments (BOP) crisis.**

The S&P methodology of calculating gross central government debt places Barbados' debt/GDP ratio at 140%.

USABLE RESERVES, A MAJOR CONCERN

Barbados'usable reserves (international reserves minus monetary base) stood at US$237 million in 2011, which represented approximately 1.4 months and goods and services coverage. The rating agencies focus on usable reserves because reserve coverage of the monetary base is vital to maintaining confidence in the fixed exchange rate peg. However, since 2013 usable reserves have become negative and the forecast is for the position to continue to deteriorate in part because of the central bank's financing of the deficit. **The negative usable reserves are a major risk to maintaining confidence in the currency peg.**

Weak external inflows (tourism, financial services) are also a concern as the country's external vulnerability indicator (gross external financing needs compared to current a/c receipts and usable reserves) continues to deteriorate; moving from 123.9 in 2011 to an estimated 227 in 2017. **In simple terms the ratio is suggesting that the country's gross external financing needs are more than double the resources at its disposal/available to satisfy those needs.**

S&P OUTLOOK

S&P has maintained its negative outlook. The negative outlook means that there is the potential for a downgrade within the next 12 months. With a current rating of "CCC+", the next downgrade would put Barbados in the "CC" category, which would mean that the country is highly vulnerable to nonpayment. The 'CC' rating is used when a default has not yet occurred but S&P expects default to be a virtual certainty, regardless of the anticipated time to default.

Based on the above, we maintain our sell recommendation. We also highlight that currently Barbados' bonds have recovered with the *19's, 21's and 22's trading in the high 80's to low 90's*. This means that the bonds are at *a very reasonable exit point.*

CONCLUSION

Despite the recovery in bond prices, we remain concerned about the fundamentals. We therefore recommend that investors take this opportunity to reduce their exposure. **Consequently, we maintain our sell recommendation on Barbados.**

Disclaimer: "Unless otherwise expressly stated, copyright or similar rights in all material in this research report (including graphical images) is owned, controlled or licensed by Jamaica Money Market Brokers Limited or its affiliates (JMMB) and is protected or covered by copyright, trade mark, intellectual property law and other proprietary rights. No part of this research report or the report in its entirety may be published, used, reproduced, distributed, displayed or copied for public or private use in any form including by any mechanical, photographic or electronic process (electronically, digitally on the Internet or World Wide Web, or over any network, or local area network or otherwise) without written permission from JMMB. No part of this research report may be modified or changed or exploited or used in any way for derivative works, or offered for sale, or used to construct any kind of database or mirrored at any other location without the express written permission of JMMB. Thank you for respecting our intellectual property rights."

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.