S&P Global
Ratings

RatingsDirect®

Summary:
Montserrat

Primary Credit Analyst:
Jennifer Love, CFA, Toronto + 1 (416) 507 3285; jennifer.love@spglobal.com

Secondary Contact:
Stephen Ogilvie, Toronto (1) 416-507-2524; stephen.ogilvie@spglobal.com

Table Of Contents

Key Rating Factors

Outlook

Rationale

Key Statistics

Ratings Score Snapshot

Related Criteria

Related Research

Summary:
Montserrat

Issuer Credit Rating	BBB-/Stable/A-3

Key Rating Factors

Flexibility and Performance Profile

- Strong ongoing support from the U.K. government boosts institutional strength.
- Continued underspending on capital projects has dampened economic growth.
- Montserrat executing its capital plan is critical to reaching sustainability.

Institutional and Economic Profile

- External grants continue to cover most of Montserrat's external financing needs, and highlight the island's external vulnerability.
- Lack of financing alternatives limits fiscal flexibility, leading the government to run balanced budget and keep the debt burden low.
- Membership in the Eastern Caribbean Currency Union (ECCU), which pegs its currency to the U.S. dollar, will continue to curb policy flexibility but also support macroeconomic stability.

Outlook

The stable outlook reflects S&P Global Ratings' expectation of continued budgetary and institutional support for Montserrat from the U.K. over the next two years, despite the complex political circumstances surrounding Brexit. We believe that the current political situation is pressuring the U.K. government to increasingly evaluate the funding it provides to the island on the island's ability to deliver value for money and promote prosperity, in our view. However, we do not think that this emphasis will represent a fundamental shift in the level, or ultimate goal of sustainability, of U.K. development support for Montserrat. This support will continue to underpin the island's creditworthiness and somewhat mitigate the risks from external vulnerabilities, particularly given the continuing low-level activity of the Soufriere Hills Volcano and the island's location in a hurricane belt.

We could lower the rating over the next two years if the U.K.'s financial support substantially wanes before the domestic economy reaches self-sufficiency. This could increase external liquidity risks arising from Montserrat's significant gross external financing needs. Under this scenario, we expect the loss of a significant portion (up to two-thirds) of government revenue would contribute to large government deficits and could lead to a multinotch downgrade. The failure to provide timely support in the wake of a natural disaster could exacerbate these risks.

Significant private-sector investment and development on the island could lead us to raise the rating in the next couple of years. These activities would increase the size and resilience of Montserrat's private economy, broadening the tax base. Sustainable private-sector growth--particularly in tourism and other export sectors--could raise the island's income and reduce the economic concentration in government services. This expansion, along with immigration to build the requisite labor force, would also increase imports. To be sustainable, export growth and foreign direct investment would finance this expansion, limiting the increase of net external borrowing from the island's large external financing needs.

Rationale

Our ratings on Montserrat continue to reflect the U.K.'s strong and ongoing institutional and budgetary support of the island. We believe this support, underpinned by Montserrat's stable parliamentary democracy, will continue to provide a strong backdrop as the territory works toward returning to self-sufficiency. However, structural economic weaknesses after the eruption of the island's active volcano in the 1990s, including the underdevelopment of the private sector, hamper economic growth.

At the same time, Montserrat's reliance on external budgetary support highlights its external vulnerability. This vulnerability, together with limited financing options, will constrain fiscal policy flexibility. Similarly, although membership in the ECCU supports monetary stability, it also impedes the use of monetary policy to respond to potential imbalances. Nevertheless, Montserrat's balanced budgets will continue to support low debt and interest payments, bolstering the territory's creditworthiness.

Institutional and Economic Profile: Continued support from the U.K. will sustain institutional stability, although structural limitations will keep economic growth low over the next two years.

The Government of Montserrat, with the assistance of the U.K., continues to focus its policy agenda on returning the local economy to self-sufficiency over the next several years. Montserrat became heavily reliant on institutional and budgetary support from the U.K.'s Department for International Development (DFID) following the eruption of the Soufriere Hills Volcano in the 1990s. Together, DFID and the EU now supply nearly two-thirds of GDP in grants. The volcanic eruption destroyed the island's capital of Plymouth and indefinitely made the southern two-thirds of the island uninhabitable. This severely depleted Montserrat's public infrastructure and halved its population to approximately 5,000. With funding from the U.K. and the EU over the next several years, the government will work toward improving some of the infrastructure it lost, particularly to improve access to the island. Although the U.K. Caribbean Investment Fund recently committed £14.4 million for constructing a breakwater in the territory to facilitate sea access, we expect the government needs time to complete the required impact studies and select a team to build the project. We therefore do not expect this project to significantly affect growth over the next couple of years. We forecast that GDP per capita will remain stable at about US$11,600.

In addition to providing financial support, the U.K. will continue to be a strong institutional anchor on the island. As a self-governing British overseas territory, Montserrat enjoys a stable, Westminster form of parliamentary democracy and civil society. Local government, supported by the territory's institutional foundation and currently led by the People's Democratic Movement, will pursue a growth agenda that will benefit from broad popular support. However, a lack of own-source resources or financing alternatives will limit progress on growth-enhancing projects. In turn, U.K. politicians and constituents will more heavily scrutinize development spending by its ability to maximize impact.

Although we expect the government to move ahead with projects including the breakwater, geothermal energy production from the island's volcano, a new hospital, tourism infrastructure, and road development, we believe the speed at which these projects proceed over the next two years will not substantially boost the economy's below-average growth levels.

Lack of infrastructure development will also continue to hinder private-sector investment. The volcanic eruption devastated Montserrat's private sector, which has since remained underdeveloped and concentrated in small-scale tourism and volcanic sand mining. By corollary, the public sector now constitutes the majority of the economy, accounting for approximately 75% of GDP. Although the government has granted a small public-sector wage increase this year, following a 10-year wage freeze, we do not believe this increase will significantly affect growth, given its limited size and the slow pace of large-scale public-sector investment. At the same time, although we expect tourism to continue to grow, on the back of an estimated 8% growth in arrivals in 2017, the small number of hotel rooms on the island--about 200--hinders the sector's growth potential. Limited access to the island will also restrain tourism's growth until a new port facilitates safe docking and mooring.

Flexibility and Performance Profile: Continued reliance on external support will restrict policy flexibility and require balanced budgets.

Montserrat's dependence on external grants to meet its external financing needs and finance its budget will continue to constrain policy flexibility. However, the U.K.'s strong commitment to provide financial support largely dispels the island's liquidity pressures. Given its small private-sector economy and geography, Montserrat must import the majority of its food, fuel, and capital goods, resulting in a large current account deficit. We expect this deficit to average 33% of GDP over the next several years, leading to gross external financing needs that represent about 190%, on average, of current account receipts (CAR) and usable reserves. Although the U.K.'s financial support remains strong, we believe the country's large role in providing external liquidity is a long-term structural weakness for Montserrat. The island has also depended on EU funding, which, despite ongoing Brexit negotiations, we expect will continue under the 11th European Development Fund program through 2020. Under this program, the EU has committed €18.4 million over four years to Montserrat for capital spending. Given this funding support, Montserrat has very little external indebtedness. The overall economy will continue to be in a strong net external creditor position, with narrow net external assets averaging around 137% of current account payments over the next several years. This is partially because resident banks are net external creditors, largely due to the dearth of commercial lending opportunities on the island. At the same time, the territory's external account data are delayed and present inconsistencies as represented by relatively high net errors and omissions, as well as external stock and flow mismatches. Nevertheless, the inconsistencies are common among small Caribbean sovereigns and partially reflect the difficulty in obtaining accurate statistics given the lack of economies of scale, as well as geographic distribution.

In our forecast, support from the U.K. and DFID will help Montserrat run balanced fiscal accounts over the next several years. The U.K. will continue to provide yearly funding under a memorandum of understanding, which sets out reporting requirements and ring-fenced amounts for key priorities such as air and sea access subsidies, technical capacity building, and capital rehabilitation. It can also impose borrowing guidelines on the government, as per the Montserrat constitution. Given these fiscal restraints, we expect the government to run balanced budgets. Montserrat's debt increased almost EC$2 million in 2017 because the island borrowed from the Caribbean Development Bank

(CDB) to build a new power plant. We expect that Montserrat's debt burden will fall gradually with the repayment of CDB loans and lead to an average annual decline in general government debt by 0.3% of GDP from 2018-2020.

Given our expectation that DFID and EU grants will meet the government's operating and capital needs over the next two years, we do not expect the government to borrow. We believe that general government debt will fall to about 5% of GDP and general government interest expenditures will stay low, below 0.1% of general government revenues. Including the liquid assets of the Montserrat Social Security fund, we anticipate that the island's general government net asset position will average 14.6% of GDP through 2020. At the same time, we believe that the government's contingent liabilities are limited. In our view, the financial services sector maintains strong liquidity, primarily reflecting weak commercial lending conditions, while nondeposit institutions only carry out modest activities on the island.

We do not anticipate changes to Montserrat's limited monetary policy flexibility over the next several years. As members of the ECCU, which pegs its currency (the Eastern Caribbean dollar) to the U.S. dollar through a quasi-currency board arrangement, Montserrat and the Eastern Caribbean Central Bank lack the capacity to implement expansionary monetary policy. Nevertheless, we believe that membership in the ECCU, with its credible and relatively robust institutional and operational frameworks, will continue to support monetary stability on the island.

Key Statistics

Table 1

Montserrat -- Selected Indicators

	2011	2012	2013	2014	2015	2016	2017	2018f	2019f	2020f
ECONOMIC INDICATORS (%)										
Nominal GDP (bil. LC)	0.17	0.17	0.16	0.16	0.16	0.17	0.16	0.16	0.17	0.17
Nominal GDP (bil. $)	0.06	0.06	0.06	0.06	0.06	0.06	0.06	0.06	0.06	0.06
GDP per capita ($000s)	12.9	12.6	11.9	11.7	11.6	12.1	11.6	11.6	11.6	11.6
Real GDP growth	5.5	3.7	5.1	2.0	0.4	2.0	0.7	1.0	1.0	1.5
Real GDP per capita growth	4.5	2.8	4.1	1.1	(0.5)	1.1	(0.1)	0.1	0.1	0.6
Investment/GDP	21.4	22.5	26.1	27.8	17.0	17.9	19.5	21.4	21.2	20.9
Savings/GDP	5.6	0.8	(22.6)	7.3	7.3	3.8	(12.9)	(11.3)	(11.9)	(12.7)
Exports/GDP	22.7	24.2	32.0	32.3	32.1	33.2	33.0	33.0	33.0	33.0
EXTERNAL INDICATORS (%)										
Current account balance/GDP	(15.8)	(21.7)	(48.8)	(20.5)	(9.7)	(14.1)	(32.3)	(32.7)	(33.1)	(33.6)
Current account balance/CARs	(22.1)	(29.5)	(61.6)	(23.6)	(9.6)	(15.1)	(38.8)	(39.5)	(40.2)	(41.2)
CARs/GDP	71.6	73.6	79.2	86.9	100.7	93.5	83.3	82.8	82.3	81.6
Trade balance/GDP	(42.8)	(49.5)	(52.6)	(56.2)	(52.8)	(51.8)	(59.5)	(59.5)	(59.5)	(59.5)
Net FDI/GDP	3.9	4.2	6.3	8.6	8.7	13.1	13.5	13.4	13.3	13.1
Net portfolio equity inflow/GDP	0.3	0.2	0.8	4.2	(29.2)	(29.2)	0.0	0.0	0.0	0.0

Table 1

Montserrat -- Selected Indicators (cont.)										
Gross external financing needs/CARs plus usable reserves	147.0	156.4	180.4	142.9	118.4	133.7	152.3	159.8	181.1	211.0
Narrow net external debt/CARs	(180.0)	(218.5)	(177.2)	(171.9)	(161.5)	(190.7)	(216.6)	(203.8)	(190.1)	(189.3)
Narrow net external debt/CAPs	(147.5)	(168.7)	(109.6)	(139.1)	(147.3)	(165.7)	(156.1)	(146.1)	(135.6)	(134.1)
Net external liabilities/CARs	96.5	61.1	(147.1)	(139.2)	(132.3)	(146.4)	(149.0)	(120.2)	(90.8)	(74.6)
Net external liabilities/CAPs	79.0	47.2	(91.0)	(112.6)	(120.7)	(127.2)	(107.3)	(86.2)	(64.8)	(52.9)
Short-term external debt by remaining maturity/CARs	31.7	34.2	30.8	28.8	25.9	28.5	30.4	31.8	31.7	31.5
Usable reserves/CAPs (months)	0.5	0.4	0.5	0.6	1.6	0.8	1.0	0.6	(0.4)	(1.5)
Usable reserves (mil. $)	2	3	3	9	4	6	4	(3)	(9)	(9)
FISCAL INDICATORS (%, general government)										
Balance/GDP	7.7	(7.0)	(17.0)	(6.2)	19.5	(0.4)	32.4	0.0	0.0	0.0
Change in net debt/GDP	(0.0)	0.2	0.0	0.2	3.0	2.4	2.4	0.9	0.9	0.8
Primary balance/GDP	7.7	(7.0)	(17.0)	(6.1)	19.5	(0.4)	32.5	0.0	0.0	0.0
Revenue/GDP	78.0	82.6	95.8	94.3	113.5	80.3	111.1	114.4	113.9	113.0
Expenditures/GDP	70.3	89.7	112.9	100.5	94.0	80.7	78.7	114.4	113.9	113.0
Interest/revenues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt/GDP	4.7	4.5	4.3	3.9	5.7	5.1	6.4	6.1	5.7	5.3
Debt/revenue	6.1	5.4	4.4	4.2	5.0	6.4	5.8	5.3	5.0	4.7
Net debt/GDP	(23.0)	(23.3)	(24.5)	(24.5)	(21.4)	(18.0)	(16.2)	(15.1)	(14.1)	(13.1)
Liquid assets/GDP	27.8	27.8	28.7	28.4	27.1	23.2	22.6	21.2	19.8	18.5
MONETARY INDICATORS (%)										
CPI growth	3.7	4.8	0.9	(0.3)	(1.1)	(0.3)	1.2	0.0	0.0	0.0
GDP deflator growth	8.8	(5.3)	(9.5)	(2.8)	(0.0)	2.7	(4.1)	0.0	(0.0)	0.0
Exchange rate, year-end (LC/$)	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70
Banks' claims on resident non-gov't sector growth	10.7	9.9	(11.0)	0.4	5.4	13.5	4.1	0.0	0.0	0.0
Banks' claims on resident non-gov't sector/GDP	39.7	44.5	41.6	42.1	44.3	47.9	51.7	51.2	50.6	49.9
Foreign currency share of residents' bank deposits	3.9	3.7	3.6	3.3	3.0	3.6	3.2	3.2	3.2	3.1
Real effective exchange rate growth	(3.7)	6.2	(3.0)	(2.1)	10.9	0.9	N/A	N/A	N/A	N/A

Note: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. f--Forecast. N/A--Not applicable. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Montserrat -- Ratings Score Snapshot	
Key rating factors	**Assessment**
Institutional assessment	2
Economic assessment	5
External assessment	4
Fiscal assessment: flexibility and performance	2
Fiscal assessment: debt burden	1
Monetary assessment	5

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- Sovereign Rating Methodology, Dec. 18, 2017
- Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Sovereign Ratings History, Sept. 5, 2018
- Global Sovereign Rating Trends Midyear 2018, July 16, 2018
- Sovereign Risk Indicators, July 5, 2018. Interactive version available at http://www.spratings.com/sri
- Sovereign Debt 2018: Global Borrowing To Remain Steady At US$7.4 Trillion, Feb. 22, 2018