MOODY'S

Rating Action: Moody's downgrades The Bahamas' ratings to B1, changes outlook to stable

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New York, October 06, 2022 -- Moody's Investors Service ("Moody's") has today downgraded the Government of The Bahamas' long-term issuer and senior unsecured ratings to B1 from Ba3. The outlook has been changed to stable from negative.

The downgrade to B1 is driven by a higher degree of government liquidity risk. Despite an ongoing economic recovery, driven primarily by tourism activity, and a narrowing fiscal deficit, The Bahamas faces constrained funding options given elevated external borrowing costs. Tighter funding conditions over a prolonged period could undermine the sovereign's ability to meet external repayments, including on its international bonds.

The stable outlook reflects balanced risks at the B1 rating level. A high government debt burden and weak debt affordability metrics limit fiscal policy space to respond to future shocks, including climate shocks that will likely come with increasing frequency and intensity, and will remain significantly weaker than similarly rated peers. The Bahamas' relatively strong institutional framework, stable political system and a fiscal policy framework that is responsive to economic and climate shocks will support fiscal consolidation and a downward trend in government debt ratios. The relatively strong institutional framework along with a comparatively high level of GDP per capita support the sovereign's debt-carrying capacity.

The Bahamas' local currency ceiling was lowered to Baa3 from Baa2. The four-notch gap to the local currency rating reflects an established track record of predictable and reliable macroeconomic policymaking balanced against a reliance on tourism that represents a common risk for the government and non-government issuers in the country.

The Bahamas' foreign-currency ceiling was lowered to Ba1 from Baa3. The one-notch gap between the local and foreign-currency ceilings reflects low transfer and convertibility risk, itself anchored by a history of relatively strong economic institutions supporting exchange rate stability and limited external indebtedness, despite a history of capital controls.

RATINGS RATIONALE

RATIONALE FOR THE DOWNGRADE TO B1

CONSTRAINED FINANCING OPTIONS AMID TIGHTER GLOBAL FINANCIAL CONDITIONS WILL UNDERMINE THE SOVEREIGN'S ABILITY TO REPAY DEBT

The key driver of the downgrade is Moody's assessment that tighter financing conditions over the past year indicate more constrained financing options compared to prevailing conditions at the time of the downgrade to Ba3 in September 2021. Tighter financial conditions come amid still elevated, albeit declining, gross borrowing requirements, which Moody's estimates at around 20% of GDP when including Treasury bills.

A narrowing fiscal deficit, which Moody's expects to turn to a surplus by the fiscal year ending June 30, 2025 (fiscal 2025), will reduce gross financing requirements. The government plans to rely more heavily on domestic financing and greater utilization of multilateral funding, including guarantees and other credit enhancements to mobilize private financing. If successful, this would reduce the need to rely on international bond issuances. However, the timing and the amount raised through these transactions is uncertain.

The domestic market provides a relatively stable source of financing at affordable rates and with varying tenors. Recent Treasury bill auctions have shown strong demand from the banking sector for government securities and Moody's expects domestic investors to continue to rollover domestic amortization and finance a portion of the government's net financing needs. However, in Moody's view, the capacity of the domestic market to meet larger financing needs, including upcoming external amortizations, is limited.

Moody's expects the government to maintain sufficiently broad access to funding to finance narrowing fiscal deficits and upcoming amortizations, including $300 million of international bonds due in 2024. However, the government will face a more challenging repayment period beginning in 2027, when it will need to make principal repayments on international debt of at least $250 million per year until the end of the decade. The government continues to accumulate assets in sinking funds that will be used for future repayments, and intends to deposit the collection of any tax arrears into the sinking funds for future debt repayment. However, amortizations related to international debt and along with other external payments which include loans due to multilateral lenders and commercial bank loans will necessitate the government maintaining access to sufficiently diverse external funding options.

International reserves have grown steadily over the three years, driven by international bond issuance, increased multilateral financing, and re-insurance flows related to Hurricane Dorian. International reserves, excluding gold, stood at $3.2 billion as of 30 June 2022, or 45 weeks of import coverage. However, in the context of higher global commodity prices feeding through to higher imports, and more limited access to international capital markets, international reserves will decline unless upcoming external amortizations are offset by other sources of external financing.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook denotes balanced risks at the B1 rating level. Upside risks stem from a continued strong rebound in tourism, which supports economic activity and a durable improvement in fiscal accounts. Increased utilization of concessional financing and credit enhancements which improve the government's debt affordability metrics and refinance upcoming maturities would also represent an upside risk compared with Moody's baseline scenario. Downside risks stem from a slowdown in tourism activity in 2023 or a weaker commitment to medium-term fiscal targets.

While government debt will remain significantly higher than levels that prevailed prior to Hurricane Dorian in 2019 and higher than similarly-rated peers, the debt burden will remain on a downward trend and debt affordability metrics will improve. The Bahamas' relatively strong institutional framework, stable political system and a fiscal policy framework that is more responsive to economic shocks have supported the credit profile. The relatively strong institutional framework along with a comparatively high level of GDP per capita support the sovereign's debt-carrying capacity.

After a 24% contraction in 2020, real GDP growth rebound strongly in 2021, growing 13.7%. Moody's projections a further expansion in economic growth in 2022, with real GDP growth of 7%

driven primarily by tourism activity. The Bahamas have benefited from strong pent-up demand for travel, particularly from the United States, its main source market. Despite a worsening global external environment, forward booking and other indicators for travel continue to point to unmet demand for travel. As pent-up demand for travel is satisfied, Moody's expects growth from the tourism sector to moderate.

Notwithstanding the rise in debt since 2019, Moody's expects the government's efforts at fiscal consolidation to prove effective in gradually reducing the debt burden over the next two to three years. In fiscal year 2022, stronger-than-budgeted revenue growth contributed to the government outperforming its original budget targets, with the fiscal deficit narrowing to 5.4% of GDP. Moody's projects the fiscal deficit to narrow to 4.4% of GDP in fiscal 2023, with the primary balance turning to a small surplus. Fiscal consolidation will be based on the removal of pandemic-related spending and a gradually increasing revenue base, which will benefit strong growth in VAT collection as well as some modest gains in tax collection through government tax policy.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

The Bahamas' ESG Credit Impact Score is moderately negative (CIS-3) reflecting its exposure to environmental risks, moderately negative social risks and a strong institutional framework that supports its governance.

The Bahamas' exposure to environmental risks is moderately negative (E-3 issuer profile score). The Bahamas is in the so-called Hurricane Belt and has been affected by more frequent and stronger tropical storms in recent years. Because tourism represents a large share of the economy, disruptions to the sector caused by weather events negatively affect the credit profile. In addition, The Bahamas is exposed to rising sea levels, with 72% of its land being low lying or within five meters above sea level.

Exposure to social risks is moderately negative (S-3 issuer profile score). Despite having a high per capita GDP on a purchasing power parity basis, high unemployment levels for the younger segment of the labor force can weigh on the economy.

The influence of governance on The Bahamas' credit profile is neutral-to-low (G-2 issuer profile). Aspects of governance strength, including a relatively strong institutional framework, help mitigate some of the E and S risks to which The Bahamas is exposed.

GDP per capita (PPP basis, US$): 36,151 (2021) (also known as Per Capita Income)

Real GDP growth (% change): 13.7% (2021) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 5.5% (2021)

Gen. Gov. Financial Balance/GDP: -13.3% (2021) (also known as Fiscal Balance)

Current Account Balance/GDP: -21.6% (2021) (also known as External Balance)

External debt/GDP: 44.3% (2021)

Economic resiliency: baa3

Default history: No default events (on bonds or loans) have been recorded since 1983.

On 03 October 2022, a rating committee was called to discuss the rating of the Bahamas, Government of. The main points raised during the discussion were: The issuer has become increasingly susceptible to event risks. Other views raised included: The issuer's economic fundamentals, including its economic strength, have materially increased. The issuer's fiscal or financial strength, including its debt profile, has materially decreased.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

The stable outlook reflects the view that risks are balanced at the B1 rating level. A demonstrated ability to access sufficiently diverse funding, which supports an improvement in debt affordability and reduces rollover risk, would put upward pressure on the rating. Implementation of fiscal and economic policies that support a fiscal consolidation process and place government debt on a more durable downward trajectory would, also put upward pressure on the rating.

Evidence of more elevated government liquidity risk which threatens the government's ability to meet upcoming external amortizations would likely prompt a downgrade. A slower pace of fiscal consolidation which contributes to tighter financing conditions and weaker debt affordability metrics would lead to a downgrade. Downward pressure on the rating would emerge if The Bahamas were affected by a climate-related shock and the policy response did not present a credible return to the fiscal rule's medium-term targets.

The principal methodology used in these ratings was Sovereign Ratings Methodology published in November 2019 and available at https://ratings.moodys.com/api/rmc-documents/63168. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1288235.

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