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Research Update:

Turks and Caicos Islands 'BBB+/A-2' Ratings Affirmed; Outlook Revised To Stable From Positive On Slower Growth

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Overview

- We expect Turks and Caicos Islands' (TCI) large tourism sector will continue to rebound following the disruption caused by the passage of two major hurricanes in late 2017.
- Nevertheless, we expect that it will take time for the economy to fully recover.
- We are revising our outlook on TCI to stable from positive and are affirming our 'BBB+/A-2' long- and short-term sovereign credit ratings on the territory.
- The stable outlook balances our expectation that the government will continue to execute prudent fiscal policies guided by a strong institutional foundation with the economy's vulnerability to external shocks in a context of limited monetary policy flexibility.

Rating Action

On June 28, 2018, S&P Global Ratings revised its outlook on Turks and Caicos Islands (TCI) to stable from positive. At the same time, S&P Global Ratings affirmed its 'BBB+' long-term and 'A-2' short-term sovereign credit ratings on TCI. S&P Global Ratings also affirmed its 'AAA' transfer and convertibility assessment on the territory.

Outlook

The outlook revision reflects our view that the likelihood that TCI's creditworthiness could strengthen within the next two years has become more remote. Reports estimate that total damage, losses, and other costs associated with Hurricanes Irma and Maria, which both made landfall on TCI in September 2017, are around \$558 million, or about 55% of TCI's GDP. The large majority of these costs will likely be shouldered by the private sector--and tourism in particular--which has rebounded relatively quickly following the hurricanes. Nevertheless, TCI's weakened economy will be less likely to enhance the government's policy flexibility in order to offset the territory's structural vulnerabilities in the near term.

We could lower our ratings on TCI over the next two years should the

government's financing needs rise significantly, due to, for instance, the execution of large investment projects, leading to an increase in net general government debt that we expected to persist over the rating horizon. At the same time, we could raise our ratings over the same time frame should new GDP or external data reveal significantly stronger economic or external positions and materially improved data quality.

Rationale

The ratings on Turks and Caicos Islands reflect its strong institutional stability that has strengthened over the past several years as the U.K.'s role in the self-governing overseas territory has evolved. This foundation will continue to provide the backdrop for well-managed public finances that will allow the government to maintain its net asset position and accumulate savings that it can allocate to initiatives such as the National Wealth Fund. While policies like the National Wealth Fund aim to mitigate the impact of future economic shocks or natural disasters, we believe that the economy will remain subject to volatility, in part due to its concentration in the tourism industry, which is cyclical and vulnerable to external shocks. At the same time, the government's policy flexibility will continue to be limited by its inability to carry out monetary policy, due to the economy's full dollarization and the lack of a local central bank. We expect these rating weaknesses to persist over the rating horizon.

Institutional and Economic Profile: Economic growth less likely to mitigate risks of future shocks.

- The economy will continue to rebound following the passage of two major hurricanes last year.
- Nevertheless, we believe that it will take time for the economy to fully recover.
- At the same time, we expect the government's track record of prudent fiscal policy and institutional stability will continue through the rating horizon.

While we expect TCI's economy to continue to recover following the passage of back-to-back hurricanes last year, we believe it will be less likely to strengthen enough to significantly mitigate risks inherent in its structure. We now expect TCI's GDP per capita to reach around \$25,300 in 2018. Tourism is the foundation of the territory's economy. The sector directly accounts for about 38% of TCI's GDP and, indirectly, likely accounts for an even larger share. Total hurricane-related damages, losses, and other costs were estimated to have reached \$328 million for the tourism sector alone, which is nearly 60% of damages estimated for the entire territory. These damages forced nearly all of TCI's hotels and villas to close for most of third-quarter 2017, while flights were also cancelled. As a result, stay-over arrivals fell by nearly 13% in the quarter relative to the same period in 2016. This interruption contributed to an estimated 1.5% contraction in GDP and 6% contraction in real

GDP per capita in 2017. Nevertheless, nearly all hotels were up and running by the end of 2017, and we expect that a rebound in visitors, together with an increase in construction activity due to rebuilding efforts and some new tourism projects, will contribute to over 3% growth in real GDP in 2018.

Over the next three years, we expect that growth in TCI will reflect the addition of new tourism projects, a steady stream of tourists, the gradual execution of public-sector rebuilding projects, and some challenges in the labor supply. We expect that real GDP will grow by about 2% on average from 2019-2021. Major tourism projects in the pipeline include The Ritz Carlton and Turks Cay Resort and Marina, which should introduce at least 250 new hotel rooms to the territory by 2020. Although we expect these projects will continue to drive growth in TCI, they will reinforce the economy's structural dependence on the volatile tourism sector. At the same time, the territory will remain vulnerable to weather-related events, given that studies have shown that a hurricane passes in the vicinity of the territory on average, every two years, and hits the territory every seven years. Increases in climatic catastrophic events could further raise these frequencies.

We expect that TCI's prudent institutions will continue to deliver policies that aim to mitigate the inherent risks in the economy. The government enacted the National Wealth Fund Ordinance at the end of 2017 to invest its savings in order to stabilize its economy against external shocks or natural disasters, among other uses. We expect the government to allocate an initial \$8 million to this fund in 2018. In addition, the government recently increased its coverage under The Caribbean Catastrophe Risk Insurance Facility in fiscal 2018/2019, after receiving a \$15.3 million payout in 2017/2018 related to Hurricanes Irma and Maria.

These policies have occurred under a lengthening track record of political stability, which we expect will continue in the foreseeable future. As TCI is a self-governing territory of the U.K., its public finances are set within laws and procedures established in 2009. In that year, the U.K. suspended parts of the constitution and gave a loan guarantee following deterioration of the territory's fiscal position stemming from financial mismanagement and the effects of the global financial crisis. However, the government has since significantly improved public finances and financial management. This progress supported the decision to retire the position of the CFO, who previously reported to the U.K.-appointed governor. This role was transitioned to a financial advisor in 2017. In our view, this transition was smooth, and we expect the current arrangement to continue through our rating horizon.

Flexibility and Performance Profile: Strong public finances serve as public policy anchor given lack of monetary policy.

- Debt repayment and low financing needs will maintain the government's net asset position.
- TCI's dollarization and lack of a central bank will continue to limit its monetary policy flexibility.

- The government will continue to progress toward completion of its international investment position and balance of payments data.

We expect the TCI government to maintain its strong track record of executing fiscal surpluses over the next three years. The government's surpluses have averaged 8% of GDP annually since 2012, when TCI held elections marking the end of the U.K.'s direct rule. Despite a small deficit in 2018/2019, due to recovery-related spending, we expect the government's surpluses to average about 3.5% of GDP from 2018-2021, and expect the change in net general government debt to average negative 4% of GDP. The government's 2018/2019 spending priorities include projects that will be prioritized ahead of the finalization of the official Recovery Plan. These include the rebuilding of critical government infrastructure such as schools, government offices, and shelters. Total damage and additional costs associated with the public housing, health, and education sectors caused by the 2017 hurricanes are an estimated \$47 million. We believe that it will take time for the government to fully address this damage.

The government's strong asset position will continue to provide it with ample fiscal policy flexibility, in our view. We expect net general government debt to average negative 39% of GDP from 2018-2020. Government assets include the investment assets of the National Insurance Board, the newly formed National Wealth Fund, and other accumulated liquid government assets that we expect will average 39% of GDP over the same period. At the same time, following TCI's repayment of the government guarantee loan in 2016, the government's other gross debt outstanding has been very low, and we expect it will be nearly fully repaid in the next two years. Therefore, we expect general government interest payments will average less than 0.1% of GDP through 2020.

Although the government, in consultation with the Caribbean Regional Technical Assistance Centre, has made progress in the compilation of balance of payments and international investment position data, external data gaps remain--particularly in the international investment position data--continuing to constrain full visibility on TCI's external position. We therefore continue to assess the territory's external position in accordance with our criteria for sovereigns with limited external data. We consider the U.S. as the host country and use our assessment of its initial external position as a starting point. We then apply a negative adjustment because of the uncertainty arising from external data gaps. Once the external data are more complete, we will be able to more comprehensively analyze the economy's net external indebtedness and gross external financing needs. At the same time, the territory continues to be fully dollarized, and lacks a central bank and lender of last resort, limiting its monetary policy flexibility. We do not expect this arrangement to change over the rating horizon.

Key Statistics

Table 1

Turks and Caicos Islands -- Selected Indicators											
(Mil. \$)	2011	2012	2013	2014	2015	2016	2017	2018f	2019f	2020f	2021f
ECONOMIC INDICATORS (%)											
Nominal GDP (bil. LC)	0.73	0.72	0.74	0.82	0.89	0.95	0.96	1.02	1.06	1.11	1.15
Nominal GDP (bil. \$)	0.73	0.72	0.74	0.82	0.89	0.95	0.96	1.02	1.06	1.11	1.15
GDP per capita (000s \$)	21.8	22.2	22.0	23.4	24.4	25.1	24.2	25.3	26.0	26.7	27.4
Real GDP growth	4.6	(2.5)	1.4	6.7	5.9	4.4	(1.5)	3.2	2.0	2.0	2.0
Real GDP per capita growth	7.7	1.4	(3.1)	2.2	1.5	1.0	(6.1)	1.8	0.6	0.6	0.6
Real investment growth	(25.8)	3.0	16.1	5.6	5.9	4.4	(1.5)	3.2	2.0	2.0	2.0
Investment/GDP	14.5	15.3	17.5	17.3	17.3	17.4	17.2	17.1	17.1	17.1	17.1
Exports/GDP	77.8	78.8	76.7	75.5	75.5	75.6	75.1	74.5	74.5	74.5	74.5
Real exports growth	(0.2)	(1.3)	(1.3)	5.2	5.9	4.4	(1.5)	3.2	2.0	2.0	2.0
Unemployment rate		17.2	15.0	12.0	11.0	7.0	6.0	7.0	7.0	7.0	7.0
EXTERNAL INDICATORS (%)											
Trade balance/GDP	(41.6)	(45.9)	(45.8)	(48.3)	(45.1)	(40.3)	(44.5)	(49.6)	(49.6)	(46.6)	(46.6)
FISCAL INDICATORS (% , General government)											
Balance/GDP	(3.3)	9.4	6.5	10.1	8.1	6.6	6.9	1.7	3.7	4.2	4.3
Change in net debt/GDP	1.8	(8.4)	(5.4)	(6.1)	(9.7)	(6.5)	(10.8)	(1.9)	(4.0)	(4.8)	(5.5)
Primary balance/GDP	(3.0)	10.5	7.5	10.3	8.3	6.7	7.0	1.7	3.8	4.2	4.3
Revenue/GDP	27.3	38.2	33.5	35.1	33.5	33.2	33.9	31.6	30.4	29.4	29.0
Expenditures/GDP	30.6	28.8	26.9	25.0	25.4	26.6	26.9	29.9	26.7	25.2	24.7
Interest /revenues	1.1	2.8	3.0	0.5	0.4	0.4	0.3	0.2	0.1	0.0	0.0
Debt/GDP	29.4	30.0	28.0	23.3	5.0	3.4	2.1	0.9	0.3	0.1	0.0
Debt/Revenue	108.0	78.6	83.7	66.3	14.8	10.3	6.1	2.9	1.0	0.2	0.0
Net debt/GDP	7.5	(0.8)	(6.1)	(11.6)	(20.3)	(25.6)	(36.0)	(35.8)	(38.4)	(41.7)	(45.5)
Liquid assets/GDP	21.9	30.8	34.1	34.9	25.3	29.0	38.1	36.7	38.7	41.8	45.5
MONETARY INDICATORS (%)											
CPI growth	5.2	3.1	2.5	2.3	2.3	2.0	2.1	2.1	2.1	2.1	2.1
GDP deflator growth	1.4	0.8	2.1	4.2	2.4	1.9	2.8	2.9	2.1	2.1	2.1
Exchange rate, year-end (LC/\$)	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

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. 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

Turks and Caicos Islands -- Ratings Score Snapshot	
Key rating factors	Assessment
Institutional assessment	2
Economic assessment	4
External assessment	4
Fiscal assessment: flexibility and performance	1
Fiscal assessment: debt burden	1
Monetary assessment	6

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 Dec 18, 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

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

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria and Research').

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Turks and Caicos Islands Sovereign Credit Rating	BBB+/Stable/A-2	BBB+/Positive/A-2

Ratings Affirmed

Turks and Caicos Islands Transfer & Convertibility Assessment Local Currency	AAA
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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