Country (Ticker) (S&P / Moody's / Fitch)

Barbados (BARBAD) (B-/Caa1/--)

Barbados is a small island in the Eastern Caribbean that is highly dependent on its tourism industry. In 2019, tourism directly accounted for 17.56% of real GDP or, according to the World Travel & Tourism Council, 30.9% if its indirect contribution via linkages to several other industries is also factored in. Aside from the agriculture and government sectors, which accounted for 1.41% and 10.34% of GDP in 2019, respectively, all sectors contracted in 2020, according to the Central Bank of Barbados' latest estimates, leading to an estimated 17.6% contraction in GDP in 2020. This drove the country deeper into the recession it has been experiencing since 2018.

The country defaulted on its local and foreign currency bonds in June 2018 and restructured its global bonds in December 2019. Subsequent to the defaults, the Barbadian government established the Barbados Economic Recovery and Transformation (BERT) plan to address the unsustainable debt. Since then, it has also been working with the IMF under an Extended Fund Facility (EFF) which provides balance of payments support to the country. The IMF has continued to provide support throughout the pandemic in order to help the country regain its footing as it aims to move towards a Debt-to-GDP Ratio of 80% by Fiscal Year (FY) 2027/28 and 60% by FY 2033/34.

DEBT-TO-GDP

Source: IMF

Major Issues / Risks

<u>Strengths</u>

- Support from the IMF and other multilateral agencies
- Stable democracy, free and fair elections.
- Gross international reserves (GIR) are high at unprecedented levels, providing 40 months of import cover.

<u>Weaknesses</u>

- A precipitous decline in tourism driven by the COVID-19 pandemic has fuelled a deeper recession.
- A return to a fiscal balance surplus is expected to take at least two more years which is indicative that the country might not meet its Debt-to GDP targets.
- Heightened debt levels incurred to support the economy during the pandemic will increase interest payments, burdening an already stressed economy.
- The country has made slow progress in addressing AML/CFT deficiencies identified by the Financial Action Task Force (FATF).

<u>Opportunities</u>

- Structural reforms being pursued are expected to drive growth in the private sector and fuel tax revenues in the medium-term.

<u>Threats</u>

- Protracted recession due to a prolonged recovery in tourism if the COVID-19 pandemic persists longer than expected and the country remains solely dependent on the COVAX facility for its COVID-19 vaccines.
- Sustained low FX inflows from tourism and an insistence to peg the local currency to the USD could lead to eroding GIR.

Major Developments

Higher Debt-to-GDP than initially anticipated – As a result of tighter lockdowns in the UK and Canada and reduced traffic from the US (Barbados' three largest target markets), Barbados has had to lean on multilateral agencies for the relevant balance of payments support in order to compensate for lower exports through tourism. The IMF in particular, has augmented its EFF several times in order to support the country as tourist arrivals remain at a fraction of pre-COVID-19 levels. This has resulted in the IMF's Debt-to-GDP forecast for 2021 shifting from 133.6% to 146.0%.

Fiscal surplus deteriorated to a deficit in 2020 – In order to achieve the Debt-to-GDP targets, Barbados would have had to sustain a primary surplus of 6% of GDP. In 2019, the country recorded a primary surplus of 6.3% but, as a result of the pandemic, this number is expected to have fallen to -1.0% in 2020 and is not expected to return to the required levels for at least the next two years. The Barbadian government has committed to higher levels in the future but the country will have to engage in a significant austerity programme to get back on track, which would prove difficult given the existing hardship.

Corporate tax reform – Barbados instituted a new corporate tax regime in 2019. The regime meant lower taxes for most domestic companies since January 1, 2019 but slightly higher taxes for international companies. This, in addition to an increase in businesses in the highest income tax bracket led to a 127.68% YoY increase in corporate tax revenues in the first nine months of FY 2020/21. The regime is scheduled to take full effect on June 30, 2021 when some international businesses will see a five-fold increase in their tax rate. The higher rate is expected to be beneficial for the country as it is projected to see an increase in tax revenues, particularly in FY 2021/22. The higher tax rate is not expected to be a deterrent to Foreign Direct Investment (FDI) inflows as Barbados still has some of the lowest tax rates globally.

Credit Outlook

S&P Global's (S&P's) Outlook

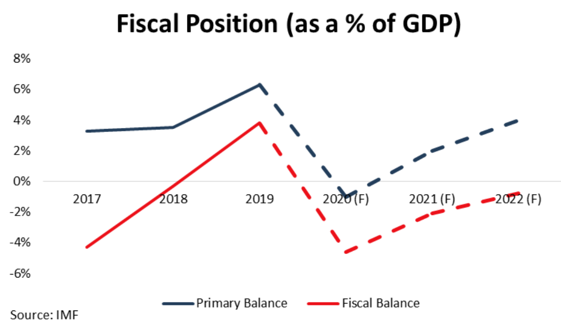
S&P upgraded Barbados' rating to B- from Selective Default (SD) on December 11, 2019. On April 16, 2020, S&P affirmed its rating and outlook (Stable), citing more sustainable debt servicing as a result of debt restructuring, and the available balance of payments support from multilateral organizations during the COVID-19 pandemic.

SIJL's Outlook

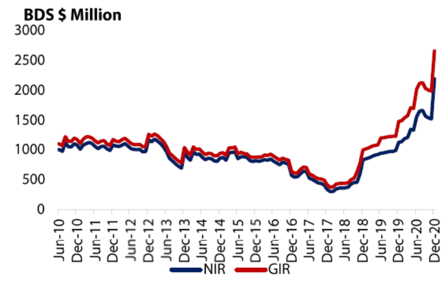
In an effort to address the economic hardships brought on by the pandemic, the Barbadian government increased its social spending but did so at the expense of the country achieving its fiscal and debt targets. The pandemic has significantly reduced tourism inflows and those of related sectors such as the distribution sector, exacerbating the recession which began in 2018. FitchSolutions forecasts a return to 2019's tourism levels in 2025 which suggests that the economic slump will likely persist for several years. However, provided that the government addresses its AML/CFT issues more stridently, the country's relatively low corporate taxation rates should make it more attractive to foreign investors which could somewhat compensate for the downturn in tourism.

Recommendation – Based on the aforementioned considerations **<u>we designate an underweight recommendation to Barbadian bonds</u>**.

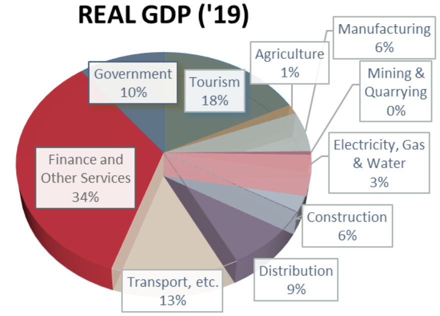
Appendix



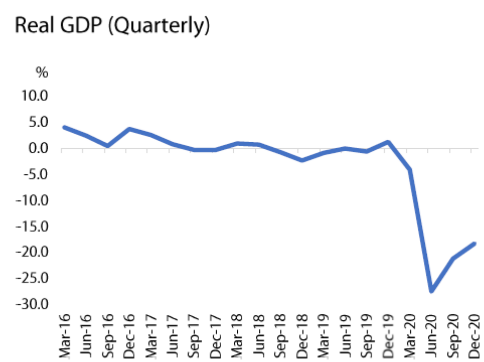
Source: IMF



Source: The Central Bank of Barbados



Source: CBB



Source: Barbados Statistical Service and the Central Bank of Barbados

Recommendation Key:

Underweight: We recommend that clients have significantly less or no exposure to the asset or asset class in question than that which is indicated by their portfolio's Strategic Asset Allocation (SAA). The variance in the amount of exposure is dependent on the client's Investor Profile.

Underweight to Marketweight: We recommend that clients have slightly less, but more than zero, exposure to the asset or asset class in question than that which is indicated by their portfolio's SAA. The variance in the amount of exposure is dependent on the client's Investor Profile.

Marketweight: We recommend that clients have the amount of exposure indicated by their portfolio's SAA.

Marketweight to Overweight: We recommend that clients have slightly more exposure to the asset or asset class in question than that which is indicated by their portfolio's SAA but less than the upper limit indicated by their portfolio's Tactical Asset Allocation (TAA). The variance in the amount of exposure is dependent on the client's Investor Profile.

Overweight: We recommend that clients have significantly more exposure to the asset or asset class in question than that which is indicated by their portfolio's SAA, up to the maximum amount indicated by their portfolio's TAA. The variance in the amount of exposure is dependent on the client's Investor Profile.