S&P Global
Ratings

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Summary:
Montserrat

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Summary:

Montserrat

Issuer Credit Rating	BBB-/Stable/A-3

Key Rating Factors

Institutional and economic profile

Continued assistance from the U.K. will support institutional stability and help weather the global COVID-19 pandemic, although structural limitations will dampen economic growth over the next two years.

- We expect Montserrat's GDP will decline considerably in 2020 due to the impact of the global coronavirus pandemic on the island's economy.
- We expect the U.K. will continue to provide institutional and budgetary support in managing the effects of the pandemic, and work with the local authorities to return the island's economy to self-sufficiency.
- However, infrastructure gaps will hinder economic growth.

Flexibility and performance profile

Continued reliance on external support will restrict policy flexibility and require balanced budgets.

- External grants will continue to cover most of Montserrat's fiscal financing needs, but highlight the island's external vulnerability
- The lack of financing alternatives will limit fiscal flexibility and lead the government to continue to run balanced budgets, while keeping 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 will also support macroeconomic stability.

Outlook

The stable outlook reflects our view that the pandemic will have a material impact on Montserrat's economy, but that with the U.K.'s support, the island will be able to return to positive economic growth in 2021 with no increase in government debt. We believe that the U.K.'s support for Montserrat remains unchanged, as does the island's ultimate goal of sustainability. This support will continue to underpin Montserrat'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 ratings over the next two years if the U.K.'s financial support substantially wanes before the domestic economy reaches self-sufficiency. This could increase 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 deficits, and could lead to a multi-notch downgrade. The U.K.'s 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 ratings 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 labor force, would also increase imports. To be sustainable, export growth and foreign direct investment would need to finance this expansion, limiting the increase of net external borrowing from the island's large financing needs.

Rationale

Our ratings on Montserrat continue to reflect the U.K.'s srong and ongoing institutional and budgetary support of the overseas territory. We believe that the island will face unprecedented fiscal and economic pressures from the global coronavirus pandemic, but that additional and timely support from the U.K. will provide much needed economic assistance. 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 and the loss of important infrastructure 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 assistance from the U.K. will support institutional stability and help weather the global coronavirus pandemic, although structural limitations will limit economic growth over the next two years.

We expect that the COVID-19 outbreak will lead to a contraction of real GDP of about 8.7% in 2020, owing to measures taken by the government in conjunction with the global and regional impacts of the pandemic that will have negative consequences for the island's important industries such as construction, travel, hotels, and real estate. However, with the U.K.'s strong and ongoing institutional and budgetary support, and an easing in international travel restrictions, we expect the island's GDP will rebound in 2021 and 2022 by 4% and 2%, respectively.

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. The U.K., via DFID, now supplies almost two-thirds of operating revenues in grants. The volcanic eruption destroyed the capital of Plymouth and rendered 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. Notably, the U.K. Caribbean Investment Fund recently committed £14.4 million for a port development project in the territory to facilitate sea access; however, we do not expect the project to commence until late 2020, as the government must still select the building team. We, therefore, do not expect this project will significantly affect growth until the end of 2021.

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 is supported by the territory's institutional foundation and is currently led by the Movement or Change and Prosperity party. We expect economic growth will remain a priority for future governments; however, a lack of own-source resources or financing alternatives will limit progress on growth-enhancing projects. We expect U.K. politicians and constituents will continue to scrutinize development spending and its ability to maximize impact. Although we expect the government will make progress with its projects, including the port development, resurfacing of the airport, 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 remains 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 at least 50% of GDP. We believe tourism is the sector most likely to contribute to economic growth on Montserrat in the near term. However, 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 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 providing financial support largely dispels the island's liquidity pressures. Given its small private-sector economy and geography, Montserrat must import most of its food, fuel, and capital goods, resulting in a large current account deficit. We expect this deficit will average 12% of GDP over the next several years, leading to gross external financing needs that represent about 145%, on average, of current account receipts 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 benefited from EU funding. Under the 11th European Development Fund program, the EU has committed €18.4 million over four years to Montserrat for capital spending. Owing to the U.K. and EU financial 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 about 159% 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. We believe Montserrat's recurring own-source revenues and U.K. support will be sufficient to meet operating and capital expenditures; however, the Montserrat Social Security Fund's (MSSF) annual deficit and corresponding erosion of reserves is leading to a net change in general government debt of about 1.3% of GDP. The MSSF's recently updated actuarial report indicates the fund will exhaust its liquid assets by 2024, which is sooner than expected. While we do not know if the U.K. will provide additional financial support in respect of the MSSF shortfall, we do expect it will continue to provide ongoing annual 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.

We expect Montserrat's debt burden will decline over the next few years, as we believe the country will have balanced budgets. Montserrat's debt burden will likely fall gradually with the repayment of Caribbean Development Bank loans and lead to a decline in general government debt to about 3.2% of GDP in 2021; we also expect general government interest expenditures will stay low, below 0.1% of general government revenues. Including the liquid assets of the MSSF, we anticipate that the island's general government net asset position will average almost 11% 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

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Economic indicators (%)											
Nominal GDP (bil. LC)	0.16	0.16	0.17	0.17	0.16	0.17	0.18	0.17	0.18	0.18	0.19
Nominal GDP (bil. $)	0.06	0.06	0.06	0.06	0.06	0.06	0.07	0.06	0.07	0.07	0.07
GDP per capita (000s $)	12.3	12.3	12.9	13.3	12.7	13.4	14.2	13.1	13.8	14.2	14.7
Real GDP growth	1.1	1.6	1.2	1.3	(3.8)	4.0	4.5	(8.7)	4.3	2.2	1.3
Real GDP per capita growth	1.9	2.4	2.0	2.2	(3.0)	4.8	3.6	(9.5)	3.4	1.3	0.4
Investment/GDP	26.1	27.8	16.4	17.7	19.6	20.9	19.5	21.0	19.7	18.9	18.2
Savings/GDP	(22.6)	7.9	15.1	6.0	9.9	18.9	11.3	6.0	8.5	9.3	6.7
Exports/GDP	32.0	32.3	31.0	29.2	33.0	33.0	33.0	33.0	33.0	33.0	33.0

Table 1

Montserrat -- Selected Indicators (cont.)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Real exports growth	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Unemployment rate	6.5	6.5	6.5	6.5	6.5	6.5	N/A	N/A	N/A	N/A	N/A
External indicators (%)											
Current account balance/GDP	(48.8)	(19.9)	(1.3)	(11.7)	(9.7)	(2.0)	(8.2)	(14.9)	(11.2)	(9.7)	(11.5)
Current account balance/CARs	(61.6)	(22.9)	(1.3)	(14.9)	(11.0)	(2.2)	(9.0)	(16.4)	(12.7)	(11.2)	(13.7)
CARs/GDP	79.2	86.9	97.1	78.4	87.4	91.7	91.5	91.3	88.7	86.1	83.6
Trade balance/GDP	(52.6)	(56.2)	(50.9)	(45.1)	(38.7)	(39.5)	(45.1)	(45.3)	(45.3)	(45.3)	(45.3)
Net FDI/GDP	6.3	8.6	7.6	5.4	6.7	8.2	8.3	8.0	7.4	7.1	6.9
Net portfolio equity inflow/GDP	0.8	3.6	(27.4)	9.2	(3.5)	(4.0)	(1.2)	(1.2)	0.0	0.0	0.0
Gross external financing needs/CARs plus usable reserves	180.4	142.2	111.3	136.7	126.8	122.8	128.5	140.5	151.2	145.1	141.4
Narrow net external debt/CARs	(181.6)	(176.1)	(164.4)	(193.3)	(169.6)	(175.6)	(180.6)	(170.0)	(183.0)	(185.4)	(185.1)
Narrow net external debt/CAPs	(112.4)	(143.3)	(162.2)	(168.2)	(152.7)	(171.8)	(165.7)	(146.1)	(162.5)	(166.7)	(162.8)
Net external liabilities/CARs	(159.2)	(149.5)	(140.9)	(159.2)	(128.8)	(130.2)	(130.5)	(110.4)	(117.0)	(111.8)	(112.3)
Net external liabilities/CAPs	(98.5)	(121.7)	(139.1)	(138.5)	(115.9)	(127.4)	(119.8)	(94.9)	(103.8)	(100.5)	(98.8)
Short-term external debt by remaining maturity/CARs	30.8	28.8	26.0	33.8	29.3	28.4	28.0	34.3	33.2	32.8	32.5
Usable reserves/CAPs (months)	0.5	0.6	1.7	0.9	1.1	0.7	0.7	0.7	(0.4)	(0.1)	0.4
Usable reserves (mil. $)	3	9	4	6	4	4	4	(2)	(0)	2	3
Fiscal indicators (general government; %)											
Balance/GDP	(17.0)	(6.2)	18.8	(0.4)	1.2	(6.5)	0.0	0.0	0.0	0.0	0.0
Change in net debt/GDP	0.4	2.4	3.1	0.9	3.1	2.6	1.6	1.3	1.4	2.1	2.1
Primary balance/GDP	(17.0)	(6.1)	18.8	(0.4)	1.2	(6.3)	0.2	0.1	0.1	0.0	0.0
Revenue/GDP	95.8	94.4	109.5	79.3	86.0	79.0	78.8	89.0	79.3	76.7	73.3
Expenditures/GDP	112.9	100.6	90.7	79.7	84.8	85.5	78.8	89.0	79.3	76.7	73.3
Interest/revenues	0.0	0.0	0.0	0.0	0.0	0.2	0.2	0.1	0.1	0.1	0.0
Debt/GDP	1.0	2.9	4.7	4.3	5.7	5.4	4.8	3.7	3.2	2.8	2.5
Debt/revenues	1.1	3.1	4.3	5.5	6.7	6.8	6.1	4.2	4.1	3.7	3.3
Net debt/GDP	(27.7)	(25.5)	(21.4)	(19.9)	(17.9)	(14.6)	(12.0)	(11.7)	(9.6)	(7.2)	(4.8)
Liquid assets/GDP	28.7	28.4	26.1	24.3	23.6	20.0	16.9	15.4	12.8	10.0	7.3
Monetary indicators (%)											
CPI growth	0.9	(0.3)	(1.2)	(0.3)	1.3	1.3	1.2	1.7	2.0	2.0	2.0
GDP deflator growth	(7.2)	(2.5)	2.9	1.0	(1.3)	0.1	2.4	1.9	1.9	2.0	2.8
Exchange rate, year-end (LC/$)	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70
Banks' claims on resident non-gov't sector growth	(11.0)	0.4	5.4	13.5	4.1	5.4	(1.7)	0.0	0.0	0.0	0.0

Table 1

Montserrat -- Selected Indicators (cont.)	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Banks' claims on resident non-gov't sector/GDP	41.6	42.2	42.7	47.3	51.9	52.6	48.3	51.9	48.9	46.9	45.0
Foreign currency share of claims by banks on residents	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign currency share of residents' bank deposits	3.6	3.3	3.0	3.6	3.2	4.0	5.2	5.6	5.2	5.0	4.8
Real effective exchange rate growth	(3.0)	(2.1)	10.9	0.9	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Sources: Eastern Caribbean Central Bank, International Monetary Fund, World Trade Organization, Finance Department of Montserrat, Statistics Department of Montserrat and the Department for International Development. Definitions: 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 claims on nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. 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

Montserrat -- Ratings Score Snapshot

Key rating factors	Score	Explanation
Institutional assessment	2	Strong ongoing assistance from the U.K. and stable institutions supports institutional assessment.
Economic assessment	5	Based on GDP per capita as per Selected Indicators in Table 1.
		Weighted average real GDP per capita trend growth over a 10-year period is below sovereigns in the same GDP category.
External assessment	3	Based on narrow net external debt and gross external financing needs as per Selected Indicators in Table 1.
		There is a risk of marked deterioration in the or access to external financing, due to a reliance on U.K. external funding.
		Montserrat's external data are often delayed and lack consistency, as demonstrated by relatively high errors and omissions.
Fiscal assessment: flexibility and performance	3	Based on the change in net general government debt (% of GDP) as per selected Indicators in Table 1.
		The sovereign faces shortfalls in basic services and infrastructure, after the volcanic eruption destroyed critical public infrastructure.
Fiscal assessment: debt burden	1	Based on net general government debt (% of GDP) and general government interest expenditures (% of general government revenues) as per Selected Indicators in Table 1.
Monetary assessment	5	Montserrat's exchange rate regime is a conventional peg, with a long track record.
		The Eastern Caribbean Central Bank has a track record of independence since 1981. The central bank has the ability to act as lender of last resort for the financial system.
		The sovereign is member of the Eastern Caribbean Currency Union,resulting in less individual monetary flexibility.
Indicative rating	bbb-	

Table 2

Montserrat -- Ratings Score Snapshot (cont.)

Key rating factors	Score	Explanation
Notches of supplemental adjustments and flexibility	0	
Final rating	bbb-	
Foreign currency	bbb-	
Notches of uplift	0	Default risks do not apply differently to foreign- and local-currency debt.
Local currency	bbb-	

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: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- The Escalating Coronavirus Shock Is Pushing 2020 Global Growth Toward Zero, March 30, 2020
- Stress Scenario: The Sovereigns Most Vulnerable To A COVID-19 Related Slowdown In Tourism, March 17, 2020
- S&P Global Ratings Cuts WTI And Brent Crude Oil Price Assumptions Amid Continued Near-Term Pressure, March 19, 2020
- Sovereign Ratings History, July 8, 2020
- Sovereign Ratings List, July 8, 2020
- Sovereign Ratings Score Snapshot, Aug. 5, 2020
- Banking Industry Country Risk Assessment Update: February 2020, Feb. 21, 2020
- Sovereign Debt 2020: Global Borrowing To Increase To $8.1 Trillion Amid Favorable Financing Conditions, Feb. 20, 2020
- Global Sovereign Rating Trends 2020: Sovereign Debt Buildup Continues, Jan. 29, 2020
- Sovereign Risk Indicators, July 14, 2020. Interactive version available at http://www.spratings.com/sri