Covid-19 and Credit Ratings – What can we expect?

By Wayne Dass, CFA
Chief Executive Officer
Caribbean Information & Credit Rating Services Limited (CariCRIS)

The novel coronavirus SARS-CoV-2 pandemic (Covid-19) has led to the unfortunate death to date of approximately 5.8 million persons worldwide over the past two years, as reported by the World Health Organization. The pandemic also dealt a heavy blow to markets and economies across the globe, leading to an estimated shrinkage in the world economy of the order of 3.3% in 2020 (IMF). Regionally, Caribbean economies contracted by roughly 13% on average in 2020. 2021 proved to be a year of overall economic recovery, with global growth recorded at 5.9% by the IMF.

Credit markets remained fairly resilient though through the period, no doubt buoyed by the extraordinary fiscal and monetary support provided by Governments and Central Banks. While there were several rating downgrades in the region, there were only two outright defaults – that of Suriname and Belize – leading to debt restructurings. In CariCRIS' portfolio of public ratings, 33% of the 60 rated entities were downgraded over the past 2 years of the pandemic (2020 & 2021). This suggests that a substantial portion of the portfolio (67%) comprised entities that were resilient enough to maintain their ratings at the same level, notwithstanding the severe negative economic and business impact of the pandemic. Interestingly, 3 entities were assigned positive outlooks over the period and 5 were actually upgraded.

The entities that were either upgraded or received positive outlooks during the pandemic were all players in the financial services industry, and some key common characteristics of these entities are:

- Significant investments had been made in prior years in Enterprise Information Systems and overall Risk Management Systems – this would have created a deep resilience in these organizations and greater synergies leading to improved operating efficiencies;
- Revenue streams were well diversified not only product-wise but also geographically, through establishment of operations in other territories, leading to increased market presence – indeed one entity opened a new branch in another territory in the middle of the pandemic;
- Displayed increased profitability that exceeded our projections despite the strained macroeconomic conditions;
- Had stronger capitalization ratios through increased profit retention;
- Was able to maintain good liquidity and a diversified funding base; and
- Had in place a robust governance structure.

The entities that were downgraded, which included a few sovereigns, would have been on a downward economic and financial trend pre-COVID-19, and the impact of the pandemic made things worse, putting them in a space where their credit metrics no longer supported their current ratings level. Included in here are entities with a high exposure to the tourism sector, which was hard hit, entities with a high exposure to mortgages (both personal and commercial), port facilities and a few manufacturing entities.

While there is still considerable uncertainty around the path of the pandemic, overall the outlook for credit ratings in the year ahead, both globally and regionally, is positive. One can reasonably expect to see more rating upgrades and less downgrades happening in 2022 and 2023 compared to 2020 and 2021, ceteris paribus. Indeed the 5 upgrades mentioned earlier all happened in the 2nd half of 2021, signaling the beginning of a general improvement in credit conditions as we ended 2021.

Some of the contributing factors behind this positive outlook are:

- Vaccines continue to be made available worldwide, albeit unequally, and increasingly the world is becoming used to living and operating with the virus;
- Economies are increasingly re-opening and restrictions are being lifted, driving a higher level of business activities – indeed good growth is projected for most Caribbean countries in 2022 and an overall global growth of the order of 4% is expected;
- The tourism industry is showing signs of a strong recovery – a credit positive for the tourism-dominated economies in the region like Barbados, the OECS and Jamaica;
- Oil and gas prices are high (the price of oil is in the USD80+ per barrel range, the highest it has been in several years) – a credit positive for the hydrocarbon-based economies like Trinidad & Tobago, Guyana and Suriname, though this may drive inflationary pressures in the oil-importing countries.

There are risks to this outlook though, which could derail growth projections and negatively impact credit conditions, including:

- Emergence of a new variant that is more severe than Omicron and resistant to the existing vaccines;
- Persistently high inflation leading to interest rate spikes which could put a damper on credit growth and competitiveness; and
- Growing social unrests and crime brought about by increased inequities resulting from the pandemic and the impact this could have on business activity and productivity.

To a large extent, CariCRIS in its ratings monitoring exercises would be examining how Caribbean Governments unwind the high levels of fiscal and monetary support extended over the past two years during the pandemic, including strategies deployed to reduce their fiscal deficits in the coming two years, thereby putting their Debt to GDP ratios back on a more sustainable path. The usual structural challenges of regional economies will re-emerge, including the need to stimulate diversified export-oriented growth, and building and maintaining adequate international reserves.

From a credit rating criteria perspective, we will be placing more emphasis on climate change impacts, management of the energy transition matrix by countries, and Environment, Social and Governance (ESG) considerations in our rating deliberations.

Wayne Dass, CFA
11 February 2022
wdass@caricris.com