MOODY'S INVESTORS SERVICE

CREDIT ANALYSIS

# St. Maarten

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This Credit Analysis provides an in-depth discussion of credit rating(s) for St. Maarten and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on Moody's website.

| | Foreign Currency | Local Currency |
|---|---|---|
| Government Bond Rating | Baa1 | Baa1 |
| Country Ceiling | A2 | A1 |
| Bank Deposit Ceiling | Baa1 | A1 |

Moody's sovereign rating list

## Rating Rationale

On November 5 2012 Moody's assigned a first time government bond rating of Baa1 to St. Maarten. The rating is supported by St. Maarten's comparatively high economic development and moderate debt levels. The ratings are constrained by the untested nature of the country's institutions although we expect nation-building support and fiscal oversight from the Netherlands to continue for several more years. St. Maarten is part of the Caribbean island of Saint Martin, the other half being French territory. Prior to 2010 St. Maarten was part of the Netherlands Antilles. On October 10 2010 it became a constituent country of the Kingdom of the Netherlands.

St. Maarten's 2011 per capita GDP of $22,000 is more than double the Baa category median. As a small Caribbean island dependent on tourism and susceptible to weather-related shocks a comparatively strong per capita GDP supports the country's ability to quickly rebuild and adapt in the aftermath of a major storm. Last year debt to GDP fell to 22% from 28% in 2010, a result of debt forgiveness provided by the Dutch government as part of the breakup of the Netherlands Antilles. But we expect debt will rise this year and next, reaching almost 30% of GDP in 2013 as the new country spends to build its institutional framework. Support from the Netherlands, in the form of low interest long term financing, fiscal oversight, and assistance on security matters, will likely continue for a few more years. We consider this assistance a key ratings support.

Constraining the rating are a small undiversified economy that is barely growing and the untested nature of the new country's institutions. Having obtained greater independence only two years ago concerns remain about the strength of the institutions, particularly over time as assistance from the Netherlands diminishes.

## Factor 1: Economic Strength - Moderate

| | | Very High | High | Moderate | Low | Very Low | |
|---|---|---|---|---|---|---|---|
| **St. Maarten** | + | | | ■ | | | - |

St. Maarten's Moderate economic strength[1] balances a comparatively high economic development with a very small and undiversified economy. St. Maarten's $22,000 per capita GDP is more than twice the $10059 Baa median. But the economy's size is less than $1 billion, one of the smallest among rated sovereigns, and highly dependent on tourism.

Tourism represents about 80% of GDP, including the impact on domestic demand and construction. As a mature industry tourism is unlikely to lead to high growth although the small size of the economy means that a single large project can have a large measurable impact on GDP. After growth averaging 4.7% in the five years to 2007 the economy has settled since then, falling an average of 0.2% yearly from 2008 to 2011. For this year and next we expect a modest recovery, of less than 1% per year. St. Maarten is still in the process of developing its own economic and financial statistics in the aftermath of its 2010 independence, so future data revisions are likely. Still, the drop in economic growth since 2008, coupled with a modest recovery, mirrors similar economic developments in the rest of the Caribbean. Unlike some other Caribbean islands with similar ratings, such as Barbados or Bahamas, St. Maarten lacks an offshore financial sector. Efforts to diversify the economy will likely build on the existing tourism-related infrastructure and St. Maarten's role as a regional hub.

The external sector is characterized by large and recurrent current account deficits, common to the rest of the Caribbean, although they have dropped in recent years. The current account deficit averaged 11.5% of GDP from 2007 to 2011 but preliminary data indicates it may end up closer to a 6% deficit in 2012. There is no reliable assessment of private sector debt, so reported external debt metrics likely underestimate the real numbers.

St. Maarten is part of a currency union together with the island of Curaçao, with its currency pegged to the dollar since 1970. Earlier this year both nations discussed a possible breakup, with full dollarization a strong possibility for St. Maarten. But the two governments have since chosen to defer any decision on the currency union as St. Maarten further develops needed technical institutions. The shared Central Bank is located in Curacao and will endeavor to create a fuller office within St Maarten proper.

St. Maarten's per capita GDP is similar to that of the Bahamas (A3, negative, Moderate economic strength) but much lower than the Cayman Islands (Aa2, Stable, High economic strength) at $52,000. The median per capita GDP of rated sovereigns with a Moderate economic strength is close to $11,000 while the median of High is $23,000. St. Maarten's GDP per capita puts it closer to countries ranked as High economic strength but the small and concentrated economy limits upside potential.

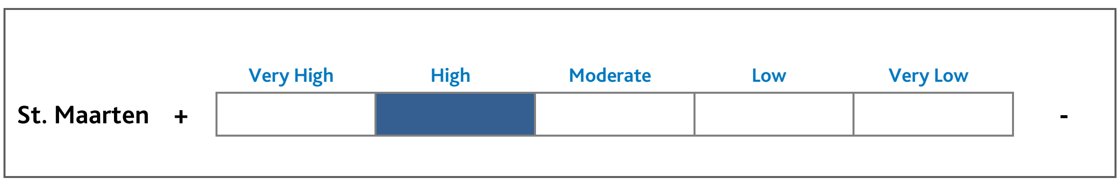
1 Moody's sovereign methodology is based on ranking all countries on four factors: Economic Strength, Institutional Strength, Government Financial Strength, and Susceptibility to Event Risk. The five-point scale for the first three factors goes from best (Very High) to worst (Very Low). The scale for the fourth, susceptibility to event risk, is also five points from best (Very Low) to worst (Very High). See Sovereign Bond Ratings (September 2008).

Beyond the numbers, and in the context of Caribbean islands, an assessment of Moderate economic strength indicates a demonstrated ability to deal with natural disasters. For example in 2004 Hurricane Ivan hit Grenada as a category 3 storm and then went on to the Cayman Islands as a category 5 hurricane. Grenada defaulted the following year while Cayman, despite losses estimated at about 200% of GDP, saw little impact on its fiscal accounts. It is this demonstrated ability to deal with shocks that supports Cayman's economic strength assessment. In the case of St. Maarten the island also suffered a series of hurricanes in the 1990s and the economy bounced back and adjusted. The waterfront was rebuilt and today 95% of electric cables are underground as a preventive measure against future storms.

The relatively high economic development is balanced by a highly concentrated economic structure, another common Caribbean theme. The key tourism market is the US with over 50% of arrivals. Canada and the Netherlands are also important. While diversifying the overall economy is not easy diversifying the customer base is more feasible. South America, in particular Brazil, is growing in importance. Targeting South America makes a lot of economic sense and something that other Caribbean islands are also exploring. The South American market is growing in purchasing power, particularly as currencies in the region appreciate. And the South American high season coincides with the Caribbean's low season, the US summer, which is another plus.

St. Maarten appeals more to mid and high end tourism market, lacking the large all-inclusive resorts common in other islands. The airport acts a stepping point to other islands, including St. Bart's and Anguilla. Besides stay over tourism over 1.6 million cruise passengers a year arrive in St. Maarten, making its port one of the top transit spots in the world. The cruise industry alone represents 35 % of GDP.

## Factor 2: Institutional Strength – High




Institutional strength seeks to measure a country's ability and willingness to pursue policies that support timely debt payment. Moody's assessment relies on a country's rankings in different independent institutional indicators, as well as our qualitative assessment of the institutional arrangements supporting debt payment.

While no single indicator captures this concept fully we rely, among others, on the World Bank's Worldwide Governance Indicators (WGI)[2]. There are no World Bank governance indicators just for St. Maarten. The closest available are governance indicators for the Netherland Antilles, which includes St. Maarten and Curaçao, although Curaçao is by far the larger of the two economies. The score of the Netherland Antilles governance indicators is 0.75, which compares with the 0.11 median for countries with a Moderate institutional strength and the 0.98 median for those with ranked as a High institutional strength.

[2] The WGI is a set of six aggregate indicators, covering topics such as government effectiveness and the rule of law, based on the views of a large number of enterprise, citizen and expert survey respondents in industrial and developing countries. The indicators are reported as a number from -2.5 to +2.5, where higher is better.

A lack of history as an independent country makes it difficult to judge how St. Maarten's institutions would react in an adverse scenario. But support from the Netherlands partially compensates for those concerns, although such support is not a permanent feature. This support includes:

» As part of the Kingdom of the Netherlands St. Maarten benefits from the Netherlands' legal system, and ultimate judicial review remains in the Netherlands. This is somewhat similar to other Caribbean nations that utilize the UK-based Privy Council as its court of final appeals. This is a feature of the institutions that has no final deadline.

» For at least the next four years a specially set up council, the College Financieel Toezicht (CFT), will oversee St. Maarten's fiscal accounts. It can reject budgets if it considers them unrealistic, something it has done in the past. St. Maarten has some fiscal constraints, for example the inability to issue debt if it leads to interest payments higher than 5% of public sector revenues. But the CFT's review extends beyond such ratios and measures: budget approval requires sustainable fiscal accounts and realistic macroeconomic assumptions. In 2011 the budget was twice rejected for overly optimistic growth projections. In 2016 there will be a review of what the CFT has accomplished and a decision made whether to continue it or not.

» While direct government transfers from the Netherlands to St. Maarten are being phased out there are other monetary subsidies the Netherlands provides. As part of helping St. Maarten develop its judicial system there are several consultants and government employees from the Netherlands working in the island. Part of their salaries is paid by the Netherlands government and represents support with both economic and institutional value.

» Fiscal support goes beyond the CFT oversight. All the debt St. Maarten currently carries is owed to the Netherlands, which lends at highly beneficial terms. Not only does it lend to St. Maarten at very low rates and for very long maturities, but it also lends in the Netherlands guilder, the currency of the Netherlands Antilles which is fixed to the US dollar.

The government's term is for four years and the next elections are due in 2014. But we expect little policy change since there is ample policy consensus across the political spectrum, as is common in other Caribbean nations with strong institutional frameworks.

## Factor 3: Government Financial Strength - Moderate

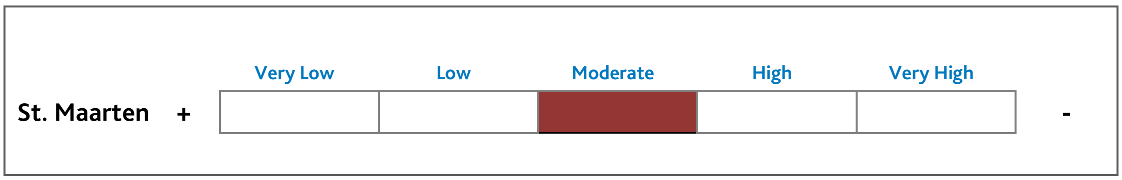
| | | Very High | High | Moderate | Low | Very Low | |
|---|---|---|---|---|---|---|---|
| **St. Maarten** | + | | | ■ | | | - |

St. Maarten's Moderate government financial strength balances comparatively low debt numbers with an expectation of rising debt metrics in the next few years as the government takes over greater responsibilities. Debt to GDP fell to 22% in 2011, compared to 30% in 2009, a result of debt forgiveness from the Netherlands as part of the independence process. This compares favorably with rating peers but we expect the debt burden to rise as the government increases infrastructure spending.

The current debt stock of St. Maarten is what has been agreed with the Netherlands. All of that debt is owed to the Netherlands and is denominated in the local currency of St. Maarten. No principal payments are due for another five years, resulting in low funding needs. And since the creditor also has veto power over any new issuance the risk of funding problems remains low, at least as long as the current framework remains in place.

Both revenues and expenditures rose since independence as the government now keeps taxes that used to be transferred to the Netherland's Antilles and is spending more to develop local institutions. By law the government must run a balanced current budget and deficits can only result from capital expenditures. The initial 2011 budget included capital expenditures of 4 to 5% of GDP which did not happen, leading to a roughly balanced fiscal outcome. For 2012 we are assuming that all of the budgeted capital expenditures will be executed and financed by debt, although the government still retains cash reserves that may reduce funding needs. Going forward the key concern on government finances is how the new government will manage competing pressures and a growing debt burden in the context of low economic growth.

### Factor 4: Susceptibility To Event Risk - Moderate




We assess St Maarten's Susceptibility to Event Risk, the risk of sudden multinotch downgrade, as Moderate relative to our rating universe. The biggest concern derives from natural disasters which St. Maarten is prone to. Hurricanes in the past led to losses of over 200% of GDP and a future hurricane could place strong pressure on the fiscal and debt numbers, a risk heightened by the expected reduction in direct support from the Netherlands.

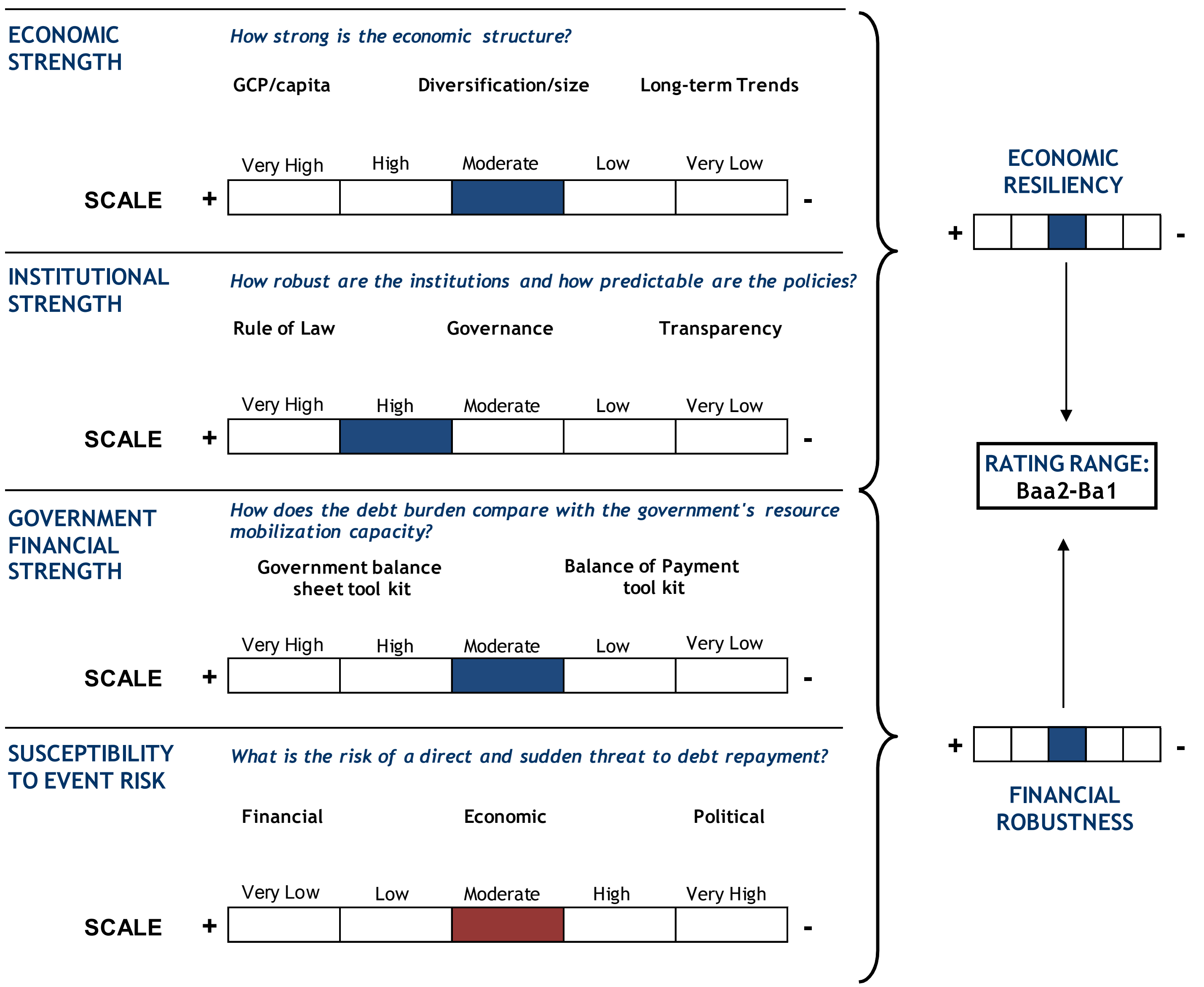
Political risk is negligible given policy consensus but institutional transition risk, key in a nation that is still developing its own institutions, is a bigger concern. Support from the Netherlands remains a key credit strength and any sudden reversal of this support absent development of equally strong domestic institutions would put downwards pressure on the rating or outlook. Direct financial risk for the government remains low given the quasi concessional nature of its current funding. Risk deriving from the banking sector is somewhat higher. IMF data for the whole currency union (St. Maarten and Curacao, where Curacao represents the bulk of the financial system) shows nonperforming loans of about 9%, with provisions covering about 75% of the NPLs.

## Rating History

### St. Maarten

| | Foreign Currency Ceilings | | | | Government Bonds | | Outlook | Date |
|---|---|---|---|---|---|---|---|---|
| St.. Maarten | Bonds & Notes | | Bank Deposit | | Foreign Currency | Local Currency | | |
| Rating Assigned | A2 | -- | Baa1 | -- | Baa1 | Baa1 | Stable | November-12 |

## Sovereign Rating Mechanics[3]




3 [Link to our Sovereign Bond Rating Methodology]

## Annual Statistics

### St. Maarten

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|---|---|
| **Economic Structure and Performance** | | | | | | | | |
| Nominal GDP (US$, Bil.) | 0.70 | 0.75 | 0.80 | 0.79 | 0.82 | 0.84 | 0.87 | 0.90 |
| Population (Mil.) | 0.04 | 0.04 | 0.04 | 0.04 | 0.04 | 0.04 | 0.04 | 0.04 |
| GDP per capita (US$) | 18,687 | 19,238 | 19,881 | 19,392 | 21,876 | 22,179 | 22,848 | 23,653 |
| GDP per capita (PPP basis, US$) | - | - | - | - | - | - | - | - |
| Nominal GDP (% change, local currency) | 7.10 | 6.50 | 6.21 | -0.25 | 3.20 | 2.93 | 3.01 | 3.53 |
| Real GDP (% change) | 5.20 | 4.50 | 1.60 | -0.90 | 0.00 | -1.50 | 0.50 | 1.00 |
| Inflation (CPI, % change Dec/Dec) | 2.30 | 2.30 | 4.60 | 0.70 | 3.20 | 4.50 | 2.50 | 2.50 |
| Gross Investment/GDP | - | - | - | - | - | - | - | - |
| Gross Domestic Saving/GDP | - | - | - | - | - | - | - | - |
| Nominal Exports of G & S (% change, US$ basis) | - | - | -0.41 | -6.72 | 4.43 | 10.35 | 3.18 | 4.00 |
| Nominal Imports of G & S (% change, US$ basis) | - | - | 6.94 | -9.99 | -2.81 | 4.16 | 3.27 | 4.00 |
| Openness of the Economy [1] | - | 261 | 254 | 233 | 228 | 237 | 238 | 240 |
| Government Effectiveness [2] | 0.73 | 0.72 | 0.75 | 0.75 | 0.75 | 0.75 | | |
| **Government Finance** | | | | | | | | |
| Gen. Gov. Revenue/GDP | - | 18.1 | 17.9 | 17.3 | 17.5 | 22.7 | 27.8 | 28.2 |
| Gen. Gov. Expenditure/GDP | - | 21.5 | 23.0 | 23.9 | 22.9 | 22.5 | 32.1 | 32.6 |
| Gen. Gov. Financial Balance/GDP | - | -3.4 | -5.1 | -6.5 | -5.3 | 0.2 | -4.2 | (4.4) |
| Gen. Gov. Primary Balance/GDP | - | -1.4 | -3.1 | -4.5 | -3.3 | 1.1 | -3.3 | (3.7) |
| Gen. Gov. Debt (US$ Bil.) | - | 0.2 | 0.2 | 0.3 | 0.2 | 0.2 | 0.2 | 0.3 |
| Gen. Gov. Debt/GDP | - | 30.7 | 29.0 | 31.8 | 28.3 | 22.2 | 25.7 | 29.2 |
| Gen. Gov. Debt/Gen. Gov. Revenue | - | 170 | 162 | 184 | 161 | 97 | 92 | 103.5 |
| Gen. Gov. Int. Pymt/Gen. Gov. Revenue | - | 11.1 | 11.2 | 11.5 | 11.4 | 3.9 | 3.4 | 2.4 |
| Gen. Gov. FC & FC-indexed Debt/GG Debt | - | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.0 |

## St. Maarten

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|---|---|
| **External Payments and Debt** | | | | | | | | |
| Nominal Exchange Rate (local currency per US$, Dec) | 1.8 | 1.8 | 1.8 | 1.8 | 1.8 | 1.8 | 1.8 | 1.8 |
| Real Eff. Exchange Rate (% change) | - | - | -0.3 | 1.7 | 1.6 | 0.0 | 0.0 | - |
| Current Account Balance (US$ Bil.) | - | -0.1 | -0.2 | -0.1 | -0.1 | 0.0 | -0.1 | (0.1) |
| Current Account Balance/GDP | - | -12.1 | -22.0 | -16.3 | -6.8 | -0.3 | -6.4 | (7.5) |
| External Debt (US$ Bil.) | - | 0.2 | 0.2 | 0.3 | 0.2 | 0.2 | 0.2 | 0.3 |
| Public Sector External Debt/Total External Debt | - | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Short-term External Debt/Total External Debt | - | - | - | - | - | - | - | - |
| External Debt/GDP | - | 30.70 | 29.00 | 31.80 | 28.30 | 22.16 | 25.73 | 29.2 |
| External Debt/CA Receipts [3] | - | 21.69 | 21.77 | 25.57 | 22.56 | 16.57 | 19.51 | 22.4 |
| Interest Paid on External Debt (US$ Bil.) | 12.7 | 18.2 | 13.5 | 16.3 | 15.8 | 0.0 | 0.0 | - |
| Amortization Paid on External Debt (US$ Bil.) | 87.5 | 181.7 | 166.2 | 140.7 | 169.4 | 0.0 | 0.0 | - |
| Net Foreign Direct Investment/GDP | - | 9.06 | 8.85 | 4.91 | 3.58 | -5.89 | 3.00 | 4.0 |
| Net International Investment Position/GDP | - | - | - | - | - | - | - | - |
| Official Foreign Exchange Reserves (US$ Bil.) | - | 0.22 | 0.27 | 0.29 | 0.30 | 0.33 | 0.34 | 0.4 |
| Net Foreign Assets of Domestic Banks (US$ Bil.) | 0.06 | 0.06 | 0.01 | 0.00 | -0.01 | | | |
| **Monetary, Vulnerability and Liquidity Indicators** | | | | | | | | |
| M2 (% change Dec/Dec) | - | - | - | - | - | -- | -- | -- |
| Monetary Policy Rate (% per annum, Dec 31) | 5.50 | 5.00 | 1.00 | 1.00 | 1.00 | -- | -- | -- |
| Domestic Credit (% change Dec/Dec) [6] | 19.90 | 8.81 | 7.87 | 11.13 | 0.94 | -- | -- | -- |
| Domestic Credit/GDP [6] | 95.45 | 97.52 | 99.04 | 110.34 | 107.92 | -- | -- | -- |
| M2/Official Forex Reserves (X) | - | - | - | - | - | -- | -- | -- |
| Total External Debt/Official Forex Reserves | - | 105.80 | 85.56 | 85.96 | 76.45 | 57.16 | 65.75 | 75.02 |
| Debt Service Ratio [4] | - | 18.86 | 16.96 | 15.91 | 18.03 | -- | -- | -- |
| External Vulnerability Indicator [5] | - | - | 76.48 | 52.19 | 57.72 | -- | -- | -- |
| Liquidity Ratio [6] | - | - | - | - | - | -- | -- | -- |
| Total Liab. due BIS Banks/Total Assets Held in BIS Banks | 76.57 | 92.87 | 107.58 | 148.71 | 152.65 | -- | -- | -- |
| "Dollarization" Ratio [7] | 38.41 | 39.29 | 33.42 | 29.89 | 23.70 | -- | -- | -- |
| "Dollarization" Vulnerability Indicator [8] | 0.00 | 66.48 | 44.47 | 38.28 | 33.78 | -- | -- | -- |

Notes:

[1] Sum of Exports and Imports of Goods and Services/GDP

[2] Composite index with values from -2.50 to 2.50: higher values suggest greater maturity and responsiveness of government institutions

[3] Current Account Receipts

[4] (Interest + Current-Year Repayment of Principal)/Current Account Receipts

[5] (Short-Term External Debt + Currently Maturing Long-Term External Debt + Total Nonresident Deposits Over One Year)/Official Foreign Exchange Reserves

[6] Liabilities to BIS Banks Falling Due Within One Year/Total Assets Held in BIS Banks

[7] Total Foreign Currency Deposits in the Domestic Banking System/Total Deposits in the Domestic Banking System

[8] Total Foreign Currency Deposits in the Domestic Banking System/(Official Foreign Exchange Reserves + Foreign Assets of Domestic Banks)

Sources referenced in this report:

» Central Bank of Curaçao and St. Maarten

» Ministry of Planning and Finance

» International Monetary Fund – International Finance Statistics

» World Bank

## Moody's Related Research

Credit Opinion:

» St.. Maarten, Government of

Rating Action:

» Moody's assigns first time Baa1 rating to St. Maarten, Outlook Stable, Nov 2012

Statistical Handbook:

» Moody's Country Credit Statistical Handbook, May 2012 (141528)

Rating Methodologies:

» Sovereign Methodology Update - Narrowing the Gap – a Clarification of Moody's Approach to Local vs. Foreign Currency Government Bond Ratings, February 2010 (118820)

» Sovereign Bond Ratings, September 2008 (109490)

Moody's Website Links:

» Sovereign Risk Group webpage

» Sovereign Rating List

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

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