# Moody's Maintains Stable Outlook on the Cayman Islands

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Moody's is carefully monitoring developments in the Cayman Islands and their possible implications for the government's Aa3 ratings. The outlook on the ratings remains stable.

"For the first time in the territory's history, the government made an explicit request to the UK Foreign and Commonwealth Office (FCO) in order to increase its debt levels," said Alessandra Alecci, Vice President-Senior Analyst in Moody's Sovereign Risk Group. "The request was necessary because some of the principles in the territory's Public Management and Finance Law were violated last year, also an unprecedented development given traditional adherence to the fiscal responsibility law."

Alecci said the main reasons for the violations were falling revenues due to a drop in tourism and other services' income and higher expenditures associated with a one-off ambitious capital expenditure program. Among the principles violated was maintaining an operating surplus in the government budget.

The UK, however, turned down the government's request for increased borrowings until the Cayman authorities can present a medium-term strategy that ensures government revenues are sustainable in the longer term. Their concern partly relates to the unusual tax structure in the territory, where there are no income or property taxes. Instead, government revenues come mainly from import duties and license fees on off-shore entities.

The government is now looking into a number of expenditure and revenue measures to address the FCO's concerns. In addition, the government is contemplating changes to the financing of its capital program, which might include private finance initiatives that would both limit the need for additional public debt and boost liquidity. The government plans to present its revised plans to the FCO over the next couple of weeks. A budget for the current fiscal year should be presented within a few weeks.

These latest developments are not a complete surprise. In a report published in June this year, Moody's discussed the deterioration in public finances and the sharp increase in the Cayman Islands' debt levels, which reached close to 20% of GDP during the 2009 fiscal year, double the size just a few years prior. While this level of debt is still highly affordable, it is higher than the average such debt ratios in Cayman Islands'Aa peers.

"Given the islands' long history of fiscal prudence, Moody's views the significant widening of the central government deficit during 2004/2005 (when the costs associated with Hurricane Ivan were incurred) and subsequently as being more the result of extraordinary circumstances than a fundamental policy shift away from fiscal conservatism," said Alecci. "However, we will be monitoring the situation to confirm that these are only temporary deviations."

As such, Moody's said that the Aa3 rating and stable outlook incorporate the expectation of a significant improvement in fiscal outturns once the capital program is completed.

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