FitchRatings

16 Jan 2020 | Downgrade

Fitch Downgrades Suriname's Ratings to 'CCC'

Fitch Ratings-New York-16 January 2020:

Fitch Ratings has downgraded Suriname's Long-Term Foreign Currency Issuer Default Rating (IDR) to 'CCC' from 'B-'.

Fitch typically does not assign Outlooks or apply +/- modifiers for sovereigns with a rating of 'CCC' or below.

Key Rating Drivers

The downgrade of Suriname's rating reflects a sharp increase in government debt, reduced financing flexibility evident in the stressed terms of recent external sovereign borrowing and declining external liquidity, which increase risks to the government's capacity to service its foreign-currency (FC) liabilities. The large government deficit coupled with the widening current account deficit, in advance of May 2020 parliamentary elections, are inconsistent with the stabilized exchange rate, increasing risk of macro instability.

Public debt sustainability risks have risen. Suriname's general government (GG) debt/GDP is now estimated by Fitch to have risen to 80.9% at YE 2019 (up from 72.1% in 2018) well above the current 'B' median of 49.7%. The parliament increased the debt limit to 95% of GDP from 60% in November 2019. Three-quarters of government debt is FC-denominated, underscoring public debt sensitivity to exchange-rate adjustments. Banking system vulnerabilities (low capitalization and high financial dollarization) are a contingent liability to the sovereign.

Suriname's government deficit has remained structurally large during 2015-1H2019, averaging 8.5% of GDP on a cash basis. Fitch forecasts the deficit at 10% of GDP (cash basis) for 2019 and 2020 (in line with our view at August 2019). We expect that election-related spending will offset declining recorded net government arrears in 2H19-2020. The 3Q19 government operations results scheduled for release Dec. 20, 2019 have not been published.

A fiscal adjustment is unlikely until 2H20 or 2021 following the elections. The outcome of the elections is uncertain. Whether there is a win for the incumbent NDP or a (potential coalition) VHP or ABOP-led government, prospects for reducing the large structural deficit are uncertain (the commitment deficit exceeded 7% of GDP in 2018). Our baseline projects the 2020 deficit (cash basis) to narrow to 8.7% of GDP as election-related spending ebbs. Prospects for any IMF program are equally uncertain. The current NDP government rescinded electricity subsidy reduction measures (2016, amid public protests and macro instability) and introduction of a value-added tax (2018).

The government's financing gap is difficult to assess reflecting the weak budget credibility, statistical lags, history of arrears (although the incurrence of new reported arrears declined 2017-2018, a backlog of electricity payments was disclosed during 2H19), and uncertain timing of China's disbursements. The central bank increased monetary financing by 1.3% of GDP in October 2019 (a total of 4% of GDP during 2019). Our baseline makes a key assumption that greater project-financing in 4Q19-2020 reduces part of Suriname's fiscal and external financing gap. In late November 2019, China announced USD300 million new project-finance lines during President Bouterse's visit to China. For the government's net financing requirement of 13.4% of GDP in 2019 and 11.1% of GDP in 2020, our baseline assumes China net disbursements and one-off capital market issuances provide net foreign financing near 6% of GDP per year and the domestic market provides 7.3% of GDP in 2019 and 4.4% of GDP in 2020.

A recent sovereign external bond issue demonstrated worsening terms of access to financing and adds to the debt burden. The government issued USD125 million 2023 notes (3.4% of GDP) in December 2019 to refinance electricity arrears and acquired a hydroelectric facility (a presidential campaign pledge). However, the terms convey stressed market access conditions. The four-year bond amortizes semi-annually, was discounted to offer a 12.5% yield while containing the coupon at 9.875%, and contains mandatory redemption covenants in most instances of future government foreign issuance. The yield on Suriname's other USD550 million 2026 notes breached 16% temporarily on subordination concerns. As a result, investors agreed to the depositing of certain gold royalties, proceeds from electricity sales to a gold company, and dividends of Staatsolie, if any, into the same escrow account for servicing the 2023 and 2026 bonds, supporting pari passu treatment among the bondholders. The 2023 coupon rises to 12.875% if the gold and oil companies generating these FC streams fail to agree the depositing of these funds to a collection account.

Debt service on the 2023 and 2026 bonds totalling USD94 million in 2020 exceeds the 2017-2018 levels of relevant gold royalties (USD22 million average) and Staatsolie dividends (USD41 million average). According to the 2023 bond terms, the government is responsible for supplying any residual FX and debt service requirements.

Restructuring risks have risen for Suriname's creditors since our August review. Opposition members of parliament protested the transaction financing law approved along party lines in September 2019 and the increase of the government debt limit, citing public debt sustainability concerns. The pledging of the government's more robust FC revenue streams to foreign bondholders in December subordinates other FC debt. The accrual of large electricity payment arrears during a related negotiation with a foreign investor sends a negative signal for creditor rights.

Suriname's current account deficit ballooned during April-September registering an 8.3% of annual GDP (USD308 million) deficit for 1Q-3Q19, driven by increased goods and services imports. Proceeds from gold and oil exports were stable in 2019 (expected to continue through 2020). At this pace we expect the current account deficit/GDP to rise to 11.0% in 2019, sharply up from the deficits of 3.4% in 2018 and above the 8.1% we initially expected for 2019. The wider deficit and net FX sales have been financed by central bank purchases of gold from artisanal miners and commercial banks' repatriation of USD387 million foreign assets during January-October 2019 in response to a central bank directive to centralize a larger share of their required reserves on FC deposits at the monetary authority.

Suriname's unencumbered international reserves (IR) are declining. The central bank reports USD662 million in gross international reserves. By Fitch's calculation, unencumbered international reserves are far lower at USD331 million including monetary gold at November 2019, down from USD510 million in December 2018. Unencumbered IR exclude deposits of commercial banks, mainly required reserves on FC deposits held at the central bank, which Fitch does not expect would be available to defend the exchange rate. Restricted government accounts for foreign debt service totalled USD2.8 million at November 2019. Suriname's net external debt is estimated by Fitch to have jumped to 59.6% of GDP at YE 2019 (up from 42.5% in 2018) more than triple the current 'B' median (17.6%), driven by rising public external indebtedness.

Fitch forecasts Suriname has USD316 million external debt service in 2020, including USD230 million scheduled government liabilities (excluding state-oil-and-gold company, Staatsolie) plus an estimated USD86 million private-sector debt service. Domestic FC government debt to private creditors represents a further USD337 million (9.1% of GDP) at September 2019 having risen from 5.4% of GDP in 2017. The amount of domestic FC maturities in 2020 is not publicly disclosed but we estimate 55% of non-concessional domestic government debt is short-term.

Pressure on the stabilized exchange rate has increased. The parallel market premium on the SRD-USD exchange rate rose to 16% in January 2020 from 12% in August 2019. In response, the authorities have rationed FX. The central bank sold net USD236 million IR during January-October 2019 (excluding one-time measures). In view of declining reserves, the central bank has limited policy tools to maintain exchange-rate stability through the May 2020 parliamentary elections. Authorities could however draw on a China swap line of RMB1 billion (USD144 million equivalent, tested in 2015) or demand commercial banks' repatriation of the remainder (Fitch estimates

USD285 million at November 2019) of their required reserves on FC deposits.

Suriname's IDRs also reflect:

GDP per capita is above the 'B' range median. However, Suriname is a small undiversified economy, with a high dependence on commodity exports. Five-year average inflation is high (19.2%) and growth has been relatively volatile.

Suriname's governance indicators - ranking at the 44th percentile (2018) are above the current 'B' median (38th percentile, 2018). A domestic military court convicted President Bouterse in November 2019 for the execution of 15 political dissidents under the military government in 1982. The decision can be appealed. Social protests have not resulted, the president remains in office, and the result of the long-running case may not diminish his NDP party's election prospects.

Fitch affirmed the LT Local Currency IDR at 'B-'. The current one notch uplift above the LT FC IDR reflects Fitch's view of lower restructuring and default risk for Suriname's SRD-denominated debt than government's FC-denominated liabilities. This reflects the reduced weight of external finance constraints, the smaller 25% share of SRD-denominated debt and the central bank's demonstrated willingness to monetize government obligations.

Fitch's affirmation of the Country Ceiling at 'B-', opening up a one notch uplift above the LT FC IDR, reflects our view that the probability of the sovereign imposing capital or exchange controls that impede the private sector's ability to access foreign exchange and make debt service payments is less than the sovereign's probability of restructuring or default. The sovereign did not block private external debt service during the 2015-2016 balance-of-payments crisis.

Sovereign Rating Model (SRM) and Qualitative Overlay (QO)

In accordance with its rating criteria for ratings of 'CCC+' and below, Fitch's sovereign rating committee has not utilized the SRM and QO to explain the ratings, which are instead guided by the relevant ratings definitions for the 'CCC'-'D' categories.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centered averages, including one year of forecasts, to produce a score equivalent to a LT FC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within our criteria that are not fully quantifiable and/or not fully reflected in the SRM.

RATING SENSITIVITIES

The main factors that could lead to a positive rating action, individually or collectively include:

--Marked reduction of the government deficit and financing needs that reduce risks to government debt sustainability, for example due to substantial fiscal consolidation after the elections that is consistent with a stabilization of government debt/GDP.

--Improved external liquidity, for example a build-up in net foreign exchange reserves, and strengthening of the current account balance.

The main factor that could lead to a negative rating action is:

--Increased likelihood of a probable default event or restructuring of sovereign market debt, for example due to a critical weakening in the external liquidity position or capacity of the government to access financing.

Key Assumptions

--Fitch assumes global economic growth and international oil prices evolve according to our quarterly Global Economic Outlook forecasts and that international gold prices remain near current levels during 2020-2021.

--Fitch's baseline forecasts excludes the impact of Apache Corp. and Total S.A.'s find of significant, but as yet unquantified, oil reserves in Suriname waters on Suriname's balance of payments (given the discovery's early nature) as well as the first oil production (which has a roughly three to five year development timeline).

Summary of Data Adjustments

--Fitch analyses government operations on a cash basis (which includes net payments of supplier arrears) using published Ministry of Finance statistics on arrears flows because this treatment better explains the scale of the government's financing needs and change in government debt/GDP during 2015-2019, in our view, than the government commitment balance also published by the Ministry of Finance.

--Fitch values government debt at reference period-end market exchange rates; this differs from valuation according to Suriname's National Debt Law.

--The stock of government arrears to suppliers is not publicly disclosed. However, the flows of arrears incurred and payments thereof are publicly disclosed.

--Financial soundness indicators of the banking system are released periodically for the IMF Article IV reports, but not published on a regular basis.

ESG Considerations

Suriname has an ESG Relevance Score of 5 for Political Stability and Rights as World Bank Governance Indicators have the highest weight in Fitch's Sovereign Rating Model and is therefore highly relevant to the rating and a key rating driver with a high weight.

Suriname has an ESG Relevance Score of 5 for Rule of Law, Institutional and Regulatory Quality and Control of Corruption as World Bank Governance Indicators have the highest weight in the Sovereign Rating Model and are therefore highly relevant to the rating and a key rating driver with a high weight.

Suriname has an ESG Relevance Score of 4 for Human Rights and Political Freedoms as the Voice and Accountability pillar of the World Bank Governance Indicators is relevant to the rating and a rating driver.

Suriname has an ESG Relevance Score of 4 for Creditor Rights as willingness to service and repay debt is relevant to the rating and is a rating driver for Suriname, as for all sovereigns.

Suriname; Long Term Issuer Default Rating; Downgrade; CCC
----; Short Term Issuer Default Rating; Downgrade; C
----; Local Currency Long Term Issuer Default Rating; Affirmed; B-; RO:Neg
----; Local Currency Short Term Issuer Default Rating; Affirmed; B
----; Country Ceiling; Affirmed; B-
----senior unsecured; Long Term Rating; Downgrade; CCC

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Applicable Criteria

Country Ceilings Criteria (pub. 05 Jul 2019)

Sovereign Rating Criteria (pub. 26 May 2019)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.