COUNTRY ECONOMIC REVIEW 2018

CAYMAN ISLANDS

OVERVIEW

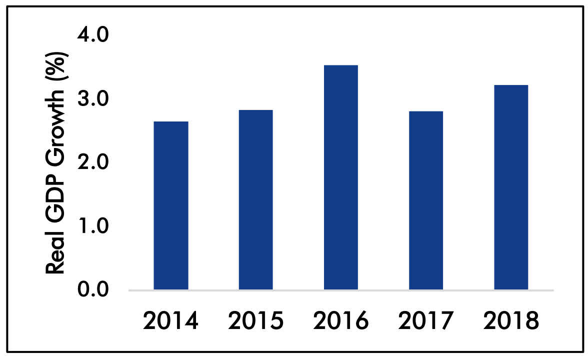
Economic growth in the Cayman Islands accelerated in 2018. Growth was hinged mainly on record tourism arrivals, and financial services, which performed well despite ongoing challenges. The construction sector contributed significantly to economic growth, with a number of hotel and public infrastructure projects under way.

Pending regulatory changes could adversely affect the operating environment of the financial services industry. The risks to the industry from a rapidly changing international regulatory environment were once again underlined by newly-adopted economic substance legislation[1]. Recently, the United Kingdom (UK) deferred the requirement to publish beneficial ownership registries for international business companies.

KEY DEVELOPMENTS IN 2018

Economic growth is estimated to have been 3.2% in 2018, a pick-up from 2.8% in the previous year. (See Chart 1). Real gross domestic product (GDP) grew by 4.0% between the first quarter of 2017, and the first quarter of 2018. Tourism was again the main contributor, with the hotels and restaurants sector performing very well. Overnight arrivals increased by 10.7% to a record high of 463,001, helped by new direct flights from Denver and Fort Lauderdale. Cruise ship arrivals were also up[2]. Professional, technical and scientific services, the financial sector, real estate activities, and the construction sector all contributed to economic growth. The financial sector remained the most important sector with a share of 25.3% of total value added, followed by professional, scientific and technical services with a share of 14.7%.

Chart 1: Real GDP Growth



Source: Economics and Statistics Office (ESO), CDB staff estimates.

Inflation increased to 4.1% in 2018, from 2.0% in the previous year. A strong rise in the cost of transport– due to increasing oil prices – was the main reason for the jump in inflation; and significant increases in the prices for housing and utilities, and in the prices of food and non-alcoholic beverages also contributed.

Unemployment declined in 2018, after a 2017 increase, and was the same rate for both women and men. The Spring Labour Force Survey in April 2018 points to a decline in the unemployment rate to 3.4% from 4.1% the previous April, (see Chart 2). The female unemployment rate fell from 4.5% to 3.4%, bringing it in line with the male rate, which declined from 3.7% to 3.4%. The rate of

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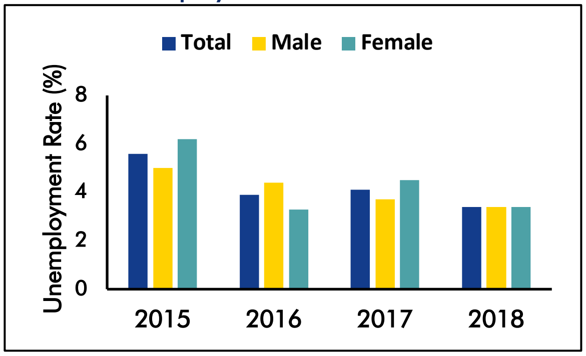
[1] The International Tax Co-operation (Economic Substance) Bill was approved on December 18, 2018, as a result of commitments made with the European Union in December 2017, requiring Cayman-registered companies to have "adequate" economic activity on the Islands.

[2] By 11.1% year-on-year to 1,921,057.

underemployment (working part-time although desiring full-time work) declined from 4.1% to 2.3%, but remains slightly higher for women (2.4%) than for men (2.1%). Youth unemployment (ages 15-24) was 9.1%.

Chart 2: Unemployment

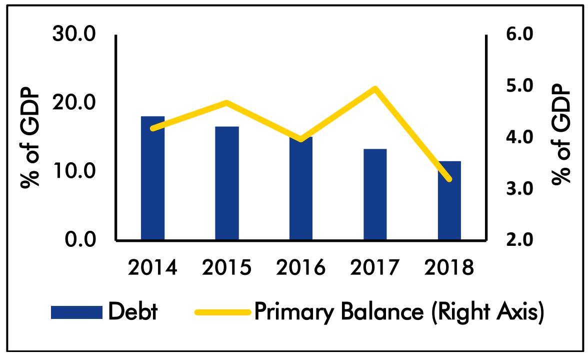


Source: CDB, ESO.

The fiscal position of the Government of the Cayman Islands' (GOCI) remained robust in 2018, although the primary surplus as a percentage of GDP declined to 3.4% from 5.0% in the previous year. The smaller primary surplus was due to a 14.4% increase in total expenditure, when compared with a 5.2% jump in total revenue. In terms of expenditure, recurrent spending increased by 9.6%. Net capital outlays more than doubled over the previous year (to 2.7% of GDP), reflecting an increase in public infrastructure projects, including the airport; the sea port; highways; a health care facility; a school; and a waste management facility. On the revenue side, taxes on international trade and on domestic goods and services – which include licensing fees for financial services – increased significantly, but non-tax revenue was less than expected. Government was fully compliant with its Framework for Fiscal Responsibility.

Public sector debt continued to fall in 2018, further lowering the ratio of debt to GDP from 13.4% to 11.7%, (see Chart 3). GOCI has not required any new financing since 2011.

Chart 3: Fiscal and Debt Performance



Source: CDB, ESO.

Domestic credit from the banking system substantially increased at the start of 2018. While credit to GOCI declined by 16.8% in the 12 months to March 2018, credit to the private sector increased by 16.7%, leading to overall credit growth of 14.1%. Credit to households displayed moderate to robust growth due to increased borrowing for domestic properties, motor vehicles, and education and technology. At the same time, credit growth to businesses outpaced new credit to households. Among the business sectors, the services sector and trade and commerce registered very strong credit growth. Credit increases were fastest in the accommodation, food, bar and entertainment services and in the wholesale and retail trade.

The credit boom in the private sector went hand in hand with an increase in domestic interest rates. The prime lending rate increased by 75 basis points in the 12 months to March 2018, to 4.7%, pushing the average weighted lending rate up by 64 basis points to 7.7%, while the weighted average deposit rate increased only marginally to 0.3%. The credit quality of the household sector improved at the start of 2018. The foreclosure rate for residential mortgages declined to 2.1% from 2.3% one year before.

The performance of the financial services sector was generally positive, although the number of banks declined by 5.8%[3]. The number of insurance companies increased by 0.8%; registrations of mutual funds increased by 4.1%; and the number of stocks listed increased by 30.9%. Company registrations increased by 28.7%, although the UK law on public registries for ownership information added to the uncertainty in the sector.

Cayman Islands has a highly dollarised economy, that is there is a high degree of usage of US dollars for domestic transactions. Unlike many other Caribbean jurisdictions, US dollars are readily available. US dollar-denominated net foreign assets stood at the equivalent of $4.3 billion as of March 2018, corresponding to close to 120% of GDP.

OUTLOOK

CDB projects that the economy will grow by 2.6% in 2019. Construction activity is expected to become the main driver in 2019, with major projects including public infrastructure as well as private projects such as hotel developments and the Cayman Enterprise City expansion. Professional business services are expected to be the second major growth driver. Tourism and financial services will also contribute to growth, but at declining rates given the economic slowdown expected in the United States of America, Cayman's biggest trading partner.

On the fiscal side, GOCI is engaging in discussions with the UK Government to provide additional flexibility in the Fiscal Framework for Responsibility. Under the current framework, the redemption of a US$312 million bullet bond in November 2019 will lead to a breach of the debt service ratio. This ratio is meant to limit payments of interest and principal for the whole public sector to 10% of Central Government revenue. The ratio, which was 8.6% in 2018, is projected to rise to 46.7% in 2019. GOCI is seeking to amend the legislation to exclude large one-time debt repayments from the calculation of the ratio. In addition, GOCI proposes to refinance 50.0% of the bond in order to avoid running down its precautionary cash balance.

[3] The year-on-year percentage growth rates in the financial services sector refer to March 2018 for the number of stocks listed, September 2018 for banks, November 2018 for company registrations, and the full year 2018 for the number of insurances and mutual funds.

DATA

The table below summarises the key economic and social indicators underpinning this Country Brief. These data are taken from a number of sources, and are the latest available at time of publication. Some are subject to revision. The 2018 data are CDB estimates.

Selected Indicators

	2013	2014	2015	2016	2017	2018[e]
Real GDP Growth (%)	1.3	2.7	2.8	3.5	2.8	3.2
Average Inflation (%)	2.2	1.2	-2.3	-0.7	2.0	4.1
Unemployment (%)[4]	6.3	4.6	4.2	4.2	4.9	3.4
Primary Balance (% of GDP)	3.6	4.2	4.7	4.0	5.0	3.4
Public Sector Debt (% of GDP)	20.2	18.1	16.6	15.2	13.4	11.6

Sources: CDB, ESO.

Notes: e – estimate.

[4] Unemployment rates refer to end of year estimates.