MOODY'S
INVESTORS SERVICE

CREDIT OPINION
3 May 2022

Update

Government of Isle of Man – Aa3 stable

Regular update

Contacts

Evan Wohlmann +44.20.7772.5567
VP-Sr Credit Officer
evan.wohlmann@moodys.com

Nikola Apostolov +44.20.7772.1166
Associate Analyst
nikola.apostolov@moodys.com

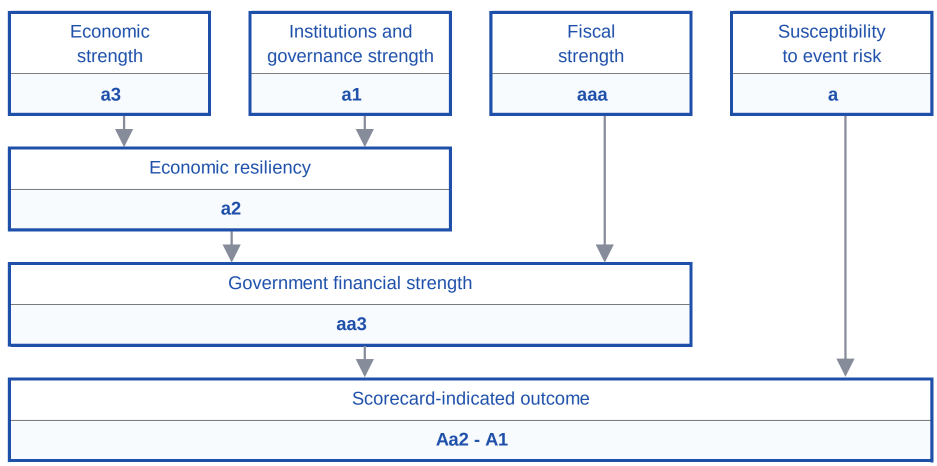
Dietmar Hornung +49.69.70730.790
Associate Managing Director
dietmar.hornung@moodys.com

Alejandro Olivo +1.212.553.3837
Managing Director
alejandro.olivo@moodys.com

Summary

The Isle of Man's (IoM, Aa3 stable) credit profile is supported by high wealth levels created by a long track record of strong economic growth, strong institutions and prudent fiscal policies. Moreover, the IoM has very low direct debt and substantial reserves. Linkages between the IoM and the United Kingdom (UK, Aa3 stable) are substantial; while these fortify the IoM's institutional strength, they also leave its credit profile exposed to the deterioration in the UK's creditworthiness and the impact of Brexit.

Exhibit 1
The Isle of Man's credit profile is determined by four factors



Source: Moody's Investors Service

Credit strengths

» A wealthy and also a relatively diversified economy for its very small size;

» Strong institutions, pragmatic policy making, and a prudent fiscal policy; and

» Low debt and substantial reserves.

Credit challenges

» High level of uncertainty regarding the ultimate impact of Brexit;

» Economic volatility that arises from a small economic base; and

» Challenges for offshore financial centres from global and regional tax coordination efforts.

Rating outlook

The IoM's credit strengths support a stable outlook on the Aa3 rating. Very high wealth levels provide a significant buffer against shocks, and the IoM has a long track record of strong GDP growth.

Another important credit strength are the Isle of Man's very strong public finances. A prudent approach to managing government finances has resulted in a high level of overall reserves through which fiscal deficits are primarily financed and very low direct government debt. Fiscal policies are forward-looking and prudent, exemplified by the large fiscal buffers that were accumulated over many years.

Factors that could lead to an upgrade

Upward pressure on the IoM's rating is unlikely over the medium-term due to the implications of Brexit and the pandemic, and the associated challenges it poses for the UK. Technological or regulatory changes to key industries in the IoM, such as insurance, e-gaming, ICT, or banking could be material for the credit profile in either a positive or negative way given concentration in these sectors.

Factors that could lead to a downgrade

Given the material linkages between the IoM and the UK, a downgrade of the UK's sovereign rating could put pressure on the IoM's rating, though if the IoM's intrinsic credit strengths remained intact it is possible that the trajectory of the IoM and UK ratings could begin to diverge somewhat. Downward pressure on the rating would also arise if we were to observe a material deterioration in the IoM's economic or fiscal position.

Key indicators

Exhibit 2

Isle of Man	2016	2017	2018	2019	2020	2021E	2022F	2023F
Real GDP (% change)[1]	7.4	3.6	1.9	3.3	-0.7	3.9	3.0	3.2
Inflation (CPI, % change, Dec/Dec)	1.0	4.1	2.5	2.1	0.1	2.4	7.0	3.5
Gen. gov. financial balance/GDP (%)	-0.3	0.0	-0.5	0.4	-3.7	-2.3	-0.3	-0.1
Gen. gov. primary balance/GDP (%)	-0.3	0.0	-0.5	0.4	-3.7	-2.2	-0.2	0.0
Gen. gov. debt/GDP (%)	0.0	0.0	0.0	0.0	0.0	6.6	6.1	5.6
Gen. gov. debt/revenues (%)	0.0	0.0	0.0	0.0	0.0	37.2	34.4	33.4
Gen. gov. interest payment/revenues (%)	0.0	0.0	0.0	0.0	0.0	0.6	0.6	0.5
Current Account Balance/GDP (%)	--	--	--	--	--	--	--	--

[1] 2019 onwards are Moody's estimates.

Source: Moody's Investors Service

Detailed credit considerations

We consider the Isle of Man's (IoM) **economic strength** to be "a3", underpinned by high wealth levels and a long track record of strong economic growth. Per-capita income is one of the highest in our universe of rated sovereigns at around $86,000, while real GDP growth has averaged 2.9% over the last decade of available data (2010 - 2020). The coronavirus outbreak nevertheless pushed the IoM into economic contraction in 2020, for only the second time in the past three decades.

Despite the very small size of the economy — which we estimate at $7.3 billion in 2020, one of the smallest in our rating universe — we consider the economy to have a comparatively higher degree of diversification than many other economies of a similar size. This diversification, which has been supported by specific government policies, has proved able to sustain the economy during the global financial crisis.

Notwithstanding that diversity, the IoM's economy has close links to that of the UK, and we believe that the UK's departure from the European Union (EU, Aaa stable) will likely have negative repercussions for the IoM's economic prospects over the long term. The IoM shares a de facto currency union with the UK and the UK is the prime market for the island. The island had enjoyed indirect access to the EU Single Market for its goods via the UK, an arrangement that ended when the UK left the EU.

Institutions and governance strength is assessed as “a1”, given the country's robust and transparent institutional framework. As a Crown Dependency, although independent and self-governing, the Isle of Man benefits strongly from the UK's institutions and governance strength, which is also assessed at “a1”. The island has established a good regulatory framework for its important e-gaming sector and works closely with the UK's Prudential Regulation Authority, also because the largest banks on the island are UK-based financial institutions.

We consider the Isle of Man's fiscal policies to be forward-looking and prudent, exemplified by the large fiscal buffers that were accumulated over many years. Importantly for its status as a low-tax jurisdiction, it has a good track record of complying with international tax standards and is rated “compliant” by the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes, one of only a handful of small offshore financial centres to achieve this rating.

The Isle of Man's **fiscal strength** is considered to be “aaa”. The Isle of Man benefits from a high level of overall reserves, which total around 22% of estimated GDP, and very low direct debt. The Isle of Man issued its first direct bond in July 2021 amounting to £400 million or 6.6% of GDP, which remains among the lowest debt burdens in our rated universe. The government also indirectly supports the debt issued by the combined electricity and water utility, the Manx Utilities Authority (MUA). MUA is in the process of building up a reserve fund out of its own resources, so as to be able to repay its two outstanding bonds, amounting to a combined £260 million (around 4.6% of GDP), in 2030 and 2034.

The government's commitment to fiscal consolidation is also supportive of the island's fiscal strength. The prospect of significantly lower tax revenues as a result of the renegotiation with the UK government on the level of the island's share in customs duties and VAT revenues prompted the government to embark on a multi-year fiscal adjustment programme to increase efficiencies in the public sector and reduce the public-sector wage bill and pensions outlays. A challenge for fiscal consolidation is that the IoM has relatively limited policy tools, given that the island's low tax environment constitutes a competitive advantage and that the proportion of receipts from the UK (mainly VAT) is already high.

At the same time, the government continues its focus on increasing capital spending through a £485.3 million capital expenditure programme to 2026-27, which will contribute to a persistent annual structural fiscal deficit over the next five years until the capital programme is funded from government revenues. Deficits will continue to be funded from the IoM's substantial reserve funds rather than by issuing debt for that purpose.

Our “a” **susceptibility to event risk** assessment reflects the island's very low government liquidity risks and the absence of external vulnerability risk given the customs relationship with the UK and the peg with the Pound Sterling.

The overall event risk score is driven by our assessment of political and banking sector risks. The banking sector risks mainly reflect the large size of the banking system; total assets of the banking system have fallen in recent years but were still equivalent to more than six times the island's estimated GDP as of December 2020. It is worth noting that nearly all of those assets (with the exception of Conister Bank) are foreign-owned entities. Also, rising international pressure to enhance tax transparency could pose challenges to the island's banking system. However, the risks to the IoM's credit profile emanating from the banking sector are mitigated by the low-risk nature of the business, which is predominantly foreign-owned, and the high levels of capital.

We recently lowered our political risk score from “aa” to “a” to reflect an increased (albeit still low) risk of contagion from the Russia-Ukraine conflict. The direct exposure of the IoM to security, energy and trade risks stemming from Russia's invasion is limited, in large part due to its distant location. That said, the probability of such risks materializing or generating spillovers from other European countries have become more elevated in light of the ongoing military conflict. Nevertheless, political risks are lower for the IoM than for the majority of European sovereigns, in part due to the fact that, as a non-NATO member, the IoM is not exposed to contagion security risks through the potential activation of NATO’s collective defense clause.

ESG considerations

ISLE OF MAN's ESG Credit Impact Score is Positive CIS-1

Exhibit 3
ESG Credit Impact Score

CIS-1
Positive

NEGATIVE IMPACT
POSITIVE IMPACT

For an issuer scored CIS-1 (Positive), its ESG attributes are overall considered as having a positive impact on the rating. The overall positive influence from its ESG attributes on the rating is material.

Source: Moody's Investors Service

The Isle of Man's ESG Credit Impact Score is positive (**CIS-1**), reflecting low exposure to environmental and social risks and, like many other advanced economies, very strong governance profile and in general capacity to respond to shocks.

Exhibit 4
ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-2	**S-1**	**G-1**
Neutral-to-Low	Positive	Positive

Source: Moody's Investors Service

Environmental

Its overall E issuer profile score is neutral to low (**E-2**), reflecting low exposure to environmental risks across most categories. Natural capital is a particular point of strength for the IoM, as the entire island is a UNESCO biosphere reserve.

Social

We assess its S issuer profile score as positive (**S-1**), reflecting low exposure to social risks over most categories as well as a strong focus on quality of life for residents, which allows the island to attract labour with the skill sets that are needed to support growth sectors of the economy. This focus on quality of life also has positive spillover effects on the protection of natural capital (mentioned above).

Governance

The Isle of Man's very strong institutions and governance profile support its rating and this is captured by a a positive G issuer profile score (**G-1**). Coupled with high wealth levels and very high government financial strength, this supports a high degree of resilience

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

All of these considerations are further discussed in the "Detailed credit considerations" section above. Our approach to ESG is explained in our report on how the scores depict varied and largely credit-negative impact of ESG factors and our cross-sector methodology General Principles for Assessing Environmental, Social and Governance Risks Methodology.

Recent developments

High inflation will exert some pressure on the robust economic recovery

The Isle of Man fared relatively well during the pandemic with a relatively robust recovery. Real GDP growth in 2021 is estimated to have grown at close to 4% after a relatively shallow contraction estimated in 2020. Spikes in coronavirus cases led to the imposition of two short circuit-breaker lockdowns over January and March 2021, forcing the closure of non-essential businesses. Travel restrictions have eased significantly since the summer of 2021, leading to a gradual recovery in tourism. The TT races, an important source of tourism for the island, will resume in 2022 after a two-year break.

We expect limited long-term economic scarring from the pandemic. The government's measures to support the economy during the pandemic included a loan guarantee scheme as well as financial support schemes for businesses and people who have been temporarily or permanently laid off. The economic fallout was generally contained outside of the tourism and hospitality sectors, and these two sectors only account for around 1% of the island's gross value added (GVA). In particular, the impact of the pandemic on key sectors such as ICT, financial services and e-gaming has been much less pronounced, with the latter seeing a rise in demand for gaming licences in 2020. The Island stands to benefit from its relatively robust regulatory environment for the gaming sector at the same time as other jurisdictions, such as Malta (A2 negative), have come under scrutiny for their anti-money laundering practices. Reflecting the relatively strong economic performance, the labour market has recorded a significant recovery with unemployment falling to 0.6% in March 2022, compared to 2.2% a year earlier.

That said, the surge in inflation as a result of the rise in energy prices following Russia's invasion of Ukraine (Caa2 rating under review) will weigh somewhat on economic growth. Inflation has risen significantly in recent months, reaching 6.7% year-on-year in March 2022, driven by significant increases in the prices of petrol and oil (30.3% yoy) as well as gas (19.1%). We expect inflation will remain elevated through 2022, with annual CPI forecast to reach 7% in December. Gas tariffs rose by 58% in April 2022, while a 30% rise in electricity tariffs is being phased in for customers in April and July. Energy prices and the country's broader energy security is strongly correlated with the UK given its dependence on the UK for gas and electricity imports. The negative impact on real incomes and wider consumer confidence will weigh on real GDP growth, which we forecast at 3.0% in 2022, down from our previous forecast of 3.9%.

The island's relative diversification and effective policy response are also likely to mitigate the risk of long-term economic scarring. A £100 million Economic Recovery Fund is intended to support the economy's recovery from the coronavirus shock through strengthening businesses, promoting innovation and new sectors, creating training and employment opportunities, and accelerating capital infrastructure projects. The government is planning to unveil its updated 10 year economic strategy in June 2022 to support the further development and diversification of the Island's economy.

The end of the Brexit transition period has also had a relatively limited impact to date. The Isle of Man is covered by certain parts of the UK-EU Trade and Cooperation Agreement (TCA) signed at the end of 2020, allowing for tariff-free and quota-free goods – both agricultural and manufactured – exports to the EU. The island is also in a customs union with the UK, and forms part of the Common Travel Area (CTA) between the UK, the Channel Islands and the Republic of Ireland (A2 positive), which provides for the movement of CTA nationals without immigration controls. That said, exporters now face significant non-tariff barriers in trading with the EU, creating additional costs and frictions to trade and contributing to rising inflation pressures.

The effect of the pandemic on the government finances is expected to be transitory with reserves providing a strong buffer

The government finances are continuing to improve after the pandemic drove an overall deterioration of the island's public finances, on account of higher health spending and economic support, as well as weaker tax revenue. The government's recently announced budget (Pink Book) estimates that the budget deficit (excluding transfers from reserves) in 2021 was £223.9 million (3.7% of GDP), higher than the budgeted £128.5 million (2.1% of GDP) given the need for additional financial support during the crisis. The new budget for 2022/23 forecasts a gradual decline in the deficit over the next five years, although previous plans to move to a structural surplus by 2024/25 is no longer expected to be met given higher spending on health and social care as well as the government's extensive capital programme. A plan to finance the funding gap in Health and Care from 2023-24 is expected to be outlined in the coming year.

As part of the budget, the government outlined a new five year £485.3 million capital development plan, including £174 million allocated for coming 2022/23 financial year, with a focus on improving the port infrastructure and passenger arrivals as well as measures to support climate change adaptations as part of achieving the government's net-zero carbon emissions target by 2050. The government plans for its ambitious capital expenditure programme to be fully financed from its revenues by 2026/27, which will support the gradual move towards a balanced budget. The sharp rise in energy prices poses a risk to budget performance, particularly if the government was to significantly increase support to households and businesses. The government recently broadened its financial support to households with a new £2.8 million package announced in April, extending previous measures to help families and those on low incomes.

The deficit will continue to be financed through the use of reserves, which provide an important buffer to offset the recent economic shocks. The IoM's reserves, built up due to the robust fiscal surpluses the government recorded prior to the global financial crisis, remain among the strongest across the sovereigns that we rate and support the island's fiscal strength. The market value of total externally invested funds stood at around £1.85 billion (around 22% of estimated 2021 GDP) in March 2022, with a significant proportion held in the National Insurance Fund used for the financing of the employee support programmes. The value of these funds has not been significantly affected by the coronavirus-related fiscal measures and market movements, having grown by around 6% since March 2020.

Furthermore, the Isle of Man issued its first direct government bond in July 2021, raising £400 million in sustainable bonds (equivalent to 6.6% of GDP) with a 30-year maturity and a 1.625% coupon. The proceeds will be used for the refinancing of local state-owned enterprises but also for investments in infrastructure, healthcare and climate-related projects. The debt issue would be used primarily to cover a £160 million refinancing of the Isle of Man Steam Packet Company (IOMSPC, taken into public ownership in 2018 but run at arm's length from the government) and a £178 million refinancing of existing Manx Utilities Authority internal debt to the Treasury. The Treasury is busy establishing a sinking fund to support the future repayment of its new bond issue.

Moody's rating methodology and scorecard factors: Isle of Man - Aa3 stable

Factor / Sub-Factor	Metric	Indicator Year	Indicator	Initial Factor score	Final Factor score	Weights
Factor 1: Economic strength				--	a3	50%
Growth dynamics	Average real GDP growth (%)	2016-2025F	3.2	baa1		25%
	Volatility in real GDP growth (%)	2011-2020	2.5	ba1		10%
Scale of the economy	Nominal GDP ($ billion)	2020	7.3	caa3		30%
National income	GDP per capita (PPP, Intl$)	2020	--	--		35%
Adjustment to factor 1	*# notches*				0	max ±9
Factor 2: Institutions and governance strength				a1	a1	50%
Quality of institutions	Quality of legislative and executive institutions			a		20%
	Strength of civil society and the judiciary			a		20%
Policy effectiveness	Fiscal policy effectiveness			aa		30%
	Monetary and macroeconomic policy effectiveness			a		30%
Specified adjustment	Government default history and track record of arrears				0	max -3
Other adjustment to factor 2	*# notches*				0	max ±3
F1 x F2: Economic resiliency				--	a2	
Factor 3: Fiscal strength				aaa	aaa	
Debt burden	General government debt/GDP (%)	2020	0.0	aaa		25%
	General government debt/revenue (%)	2020	0.0	aaa		25%
Debt affordability	General government interest payments/revenue (%)	2020	0.0	aaa		25%
	General government interest payments/GDP (%)	2020	0.0	aaa		25%
Specified adjustments	*Total of specified adjustment (# notches)*			0	0	max ±6
	Debt trend	2016-2021F	6.6	0	0	
	Foreign currency debt/general government debt	2020	0.0	0	0	
	Other non-financial public sector debt/GDP	2020	0.0	0	0	
	Public sector assets/general government debt	2020	0.0	0	0	
Other adjustment to factor 3	*# notches*				0	max ±3
F1 x F2 x F3: Government financial strength				--	aa3	
Factor 4: Susceptibility to event risk				a	a	Min
Political risk				a		
	Domestic political risk and geopolitical risk			a		
Government liquidity risk				aaa	aaa	
	Ease of access to funding			aaa		
Specified adjustment	High refinancing risk				0	max -2
Banking sector risk				a	a	
	Risk of banking sector credit event (BSCE)	Latest available	--	aaa-a3		
	Total domestic bank assets/GDP	2020	663.2	80-180		
Adjustment to F4 BSR	*# notches*				0	max ±2
External vulnerability risk				aaa	aaa	
	External vulnerability risk			aaa		
Adjustment to F4 EVR	*# notches*				0	max ±2
Overall adjustment to F4	*# notches*				0	max -2
F1 x F2 x F3 x F4: Scorecard-indicated outcome				-	Aa2 - A1	

Note: While information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the scorecard-indicated outcome. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the scorecard-indicated outcome. For more information please see our Sovereign Ratings Methodology.

Footnotes: (1) Initial factor score: scorecard indicators combine with the automatic adjustments to produce an initial factor score for every rating factor, as detailed in Moody's Sovereign Ratings Methodology. **(2) Final factor score:** where additional analytical considerations exist, initial factor scores are augmented to produce a final factor score. Guidance on additional factors typically considered can be found in Moody's Sovereign Ratings Methodology; details on country-specific considerations are provided in Moody's research. **(3) Scorecard-indicated outcome:** Factor 1: Economic Strength, and Factor 2: Institutions and Governance Strength, combine with equal weight into a construct we designate as Economic Resiliency (ER). An aggregation function then combines ER and Factor 3: Fiscal Strength, following a non-linear pattern where Fiscal Strength has higher weight for countries with moderate ER and lower weight for countries with high or low ER. As a final step, Factor 4, a country's Susceptibility to Event Risk, is a constraint which can only lower the government financial strength as given by combining the first three factors. **(4) There are 20 ranking categories** for quantitative sub-factors: aaa, aa1, aa2, aa3, a1, a2, a3, baa1, baa2, baa3, ba1, ba2, ba3, b1, b2, b3, caa1, caa2, caa3, ca and 8 ranking categories for qualitative sub-factors: aaa, aa, a, baa, ba, b, caa, ca **(5) Indicator value:** if not explicitly stated otherwise, the indicator value corresponds to the latest data available.

Moody's related publications

» **Credit Opinion:** Government of Isle of Man - Aa3 stable: Regular update, 26 October 2021

» **Rating Methodology**: Sovereign Ratings Methodology, 25 November 2019

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.

REPORT NUMBER 1327237

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