# Recent Sovereign Debt Restructuring in the Caribbean

## Outcomes , Lessons and Emerging Issues


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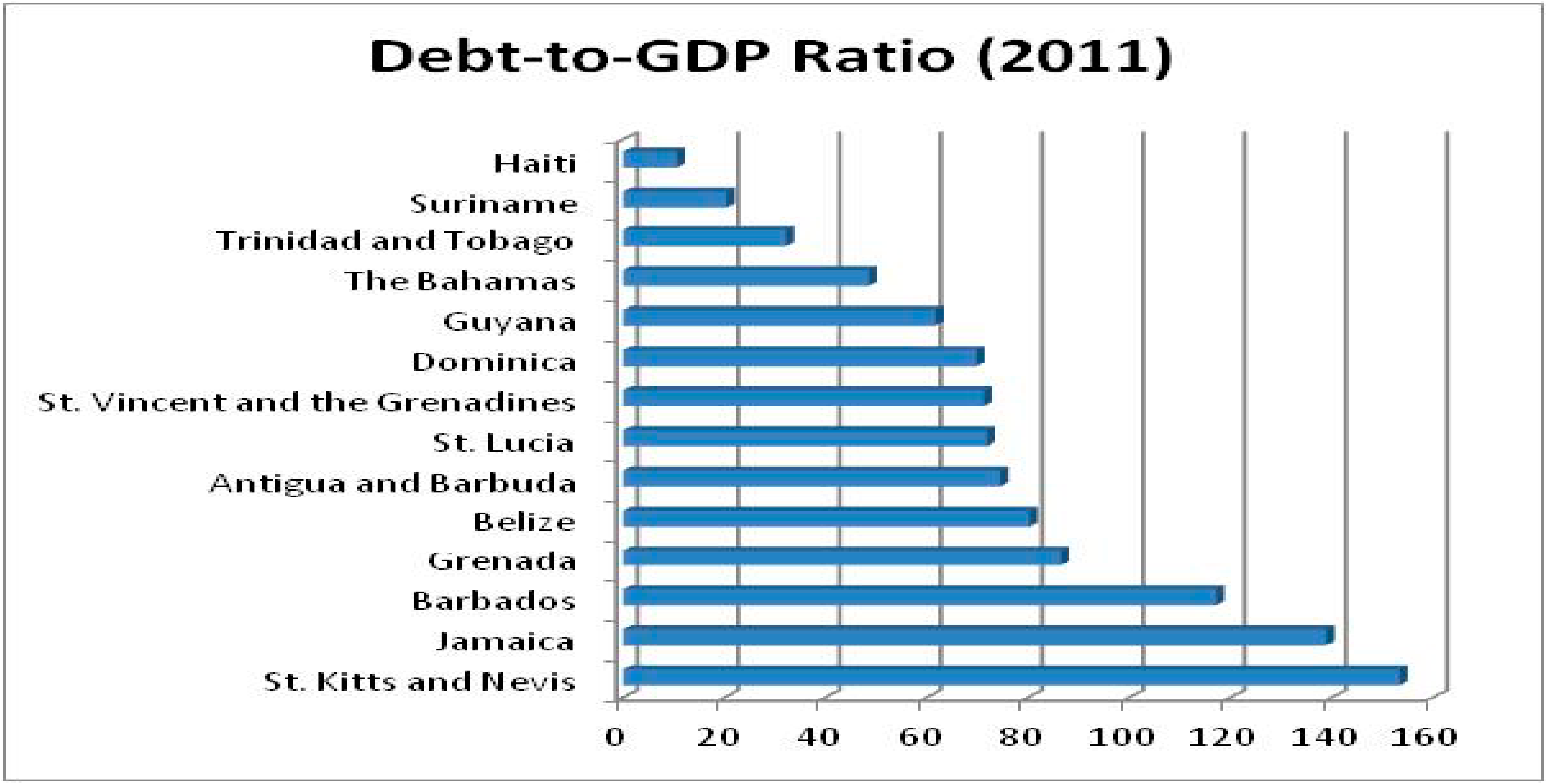
# Structure of the Presentation

- The Debt Situation in the Caribbean
- The Case for Restructuring Sovereign Debt
- Global Debt Restructuring Outcomes
- Context, Key Features and Outcomes of Recent Sovereign Debt Restructuring in the Caribbean
- Lessons of Experience
- Some Emerging Issues in Debt Restructuring
- Conclusions

# The Debt Situation in the Caribbean



# The Debt Situation in the Caribbean

- Domestic debt accounts for approximately 60% of total debt
- Commercial banks and other FIs are main holders of domestic debt
- In AB, BZ, DM, GD, SV, GY external debt average almost 70%
- Multilateral debt represents one-third of external debt

# The Case for Restructuring Sovereign Debt

- Liquidity or solvency problems
- High indebtedness can constrain development
  - Discourages investment
    - Economic agents anticipate fiscal tightening, which reduces projected returns
  - Debt-service needs crowd out development expenditures

# The Case for Restructuring Sovereign Debt

**Dynamics of government's debt accumulation is governed by the budget constraint**

$$D_t - D_{t-1} = (PE_t - R_t) + iD_{t-1} + O_t + F_t - F_{t-1}$$

$$\Delta d_t = \left[\frac{i_t - g_t}{1 - g_t}\right] d_{t-1} + pb_t + o_t$$

**Where:**

| | |
|---|---|
| D | = debt |
| PE | = primary expenditure; |
| I | = average effective interest rates |
| O | = other debt-creating flows |
| F | = financial assets |

| | |
|---|---|
| d | =debt/GDP |
| i | = average effective interest rate |
| pb | = primary balance/GDP |
| g | = nominal GDP growth |
| Δ | =a one-period change |

# The Case for Restructuring Sovereign Debt

$$\Delta d_t = \left[\frac{i_t - g_t}{1 + g_t}\right] d_{t-1} - pb_t + o_t$$

Immediate impact of debt restructuring

Subsequent – period impact of debt restructuring

# Global Sovereign Commercial Debt Restructuring Outcomes

- Delays in reaching agreement (Average 7.4 years)
- Creditor losses (average 38% of outstanding value)
- Debt relief – the typical country exits debt default worse off in terms of debt-to-GDP (Benjamin and Wright (2009))
- Restructuring costs – 0.5% - 3.5% of the value of the restructured debt, depending on the complexity
- Post-restructuring capital market access

# Recent Sovereign Debt Restructured in the Caribbean

– Dominica (2004)

– Grenada (2005)

– Belize (2006)

– Jamaica (2010)

– Antigua and Barbuda (2010)

– St. Kitts and Nevis (2011)

# Dominica Debt Restructuring

## CONTEXT

Weak economic performance and slow reform implementation affect IMF program (2002)

Build-up of arrears and financing gaps

Debt/GDP ratio = 95% (end-2003)

## FEATURES

- Offer launched - April 6, 2004
- 3 options for commercial creditors:
  - ➢10-year 30% discount bond
  - ➢20-year 20% discount bond
  - ➢30 year par bond
- Bilateral creditors participated
- CDB provided NPV relief

# Dominica Debt Restructuring cont'd

## OUTCOMES

70% participation of eligible debt

Last bilateral holdout settled in 2006; large commercial debt settled in July 2012

50-55% reduction in NPV terms on commercial debt

Debt/GDP fell 4.6 pps (immediately) and almost 30 pps to 67.3% (2011) (rebased GDP)

# Grenada Debt Restructuring

## CONTEXT (2004)

Public debt = 95% of GDP

Damage by Hurricane Ivan = 200% of GDP

Exports fell 24.8%

Real GDP declined 3%

## KEY FEATURES

- Launched in September 2005
- Covered ½ of total public debt
  - external debt = US$190 mn
  - domestic debt = US$86 mn
- No principal write-down; but NPV reduction = 45%
- 20-year instrument with a step-up interest rate, starting at 1% for the first 3 years

# Grenada Debt Restructuring cont'd

**OUTCOMES**

- High participation rate (91% of eligible claims)
- Entire process took approximately one year
- Credit rating improved, but still below pre-hurricane rating
- Front-loaded liquidity relief:
  - 83% reduction in debt service (2005-08)
  - 73% reduction in debt service (2009-12)
- NPV reduction around 34%
- Public debt = 103.3% of GDP (2011)

# Belize Debt Restructuring

## CONTEXT

Debt-to-GDP ratio = 92%

External debt = 90% of total debt

Debt service = 45.7% of revenue; 16.7% of exports

Effective interest rate on external debt = 11.25%

## KEY FEATURES

- Exchange offer (December 2006) on externa commercial debt exclusively
- New bond replace eligible commercial debt:
  - 22-year maturity
  - Semi-annual principal payments beginning 10 years before maturity
  - Step-up interest rate structure (4.25% to 8.5%)

# Belize Debt Restructuring Cont'd

## OUTCOMES

- 97% participation of eligible debt
- Process completed in six months
- Significant liquidity relief
  - debt service = 24.6% of revenue and 10% of exports
- 21% reduction in NPV terms
- Debt-to-GDP not significantly affected

# Jamaica Debt Restructuring

**CONTEXT**

- Debt/GDP ratio = 140% (2009/10)
- Interest payments = 62% of revenue and grants
- Average effective interest rate on domestic debt (17.9%) and external debt (7.4%)
- Capital expenditure had borne the brunt of fiscal consolidation

**KEY FEATURES**

- Debt exchange launched Jan. 2010
- Limited to domestic debt
- No principal haircuts
- Interest rate reduction and extended maturities
- Instruments reduced (345 to 24)

# Jamaica Debt Restructuring Cont'd

## Outcomes

- All debt holders participated
- Process took 1 month
- 20% reduction in NPV terms
- Interest payments fell 20 pps to 40% of revenue (2010/11)
- Reduced average effective interest rate on debt, and lower domestic interest rate structure
- Debt-to-GDP ratio below 100% by 2015/16

# Antigua & Barbuda Debt Restructuring

**CONTEXT**

- Public debt = 111% of GDP (2009)
- Average nominal interest rate = 7.9%
- Arrears = 50% of debt stock
- Real GDP  decline = 10.3%
- Primary balance =-7.7%

**KEY FEATURES**

- Process started 2010
- No principal haircuts
- Debt consolidation/rate reduction/asset swap/extended maturities
- Upfront payments/assets swaps to local suppliers
- Negotiated settlements with local banks
- Maturities lengthened from 5 to 20 years; interest rates reduced from 13% to 8%

# Antigua & Barbuda Debt Restructuring Cont'd

## Outcomes

- Process started in 2009 and is ongoing
- Debt/GDP fell to 94% (2011)
- Debt/GDP expected to fall to 90% (end-2012)
- Arrears = 13% of total debt
- Debt dynamics have improved

# St. Kitts & Nevis Debt Restructuring

**CONTEXT**

Debt/GDP = 155% (2011)
- 35 pp increase (2008-10)

Domestic debt = 70% of total debt

Interest payments averaged 19.5% of total revenue (2007-11)

Primary balances

- 2.8% (post 2005)

**KEY FEATURES**

- Launched February 2012
- External commercial debt exchange:
  - 50% discount bond with 20-year maturity & step-down interest rate starting at 6%, then falling to 3%; or
  - Par bond with 45-year maturity; 15 years grace; & interest rate = 1.5%
- Domestic debt to be exchanged for land, a stake in a SPV etc
- Paris Club relief; discussions with non-Paris Club

# St. Kitts & Nevis Debt Restructuring

## OUTCOMES

- Process started in June 2011 and is ongoing
- Anticipated reduction in debt/GDP – 90 – 100%
- Discount bond = 61% NPV reduction
- par bond = 73% NPV reduction
- Relief from Paris Club and Non-Paris Club

## Debt restructuring in the Caribbean - Regional Outcomes

- Time span is relatively short on average
- Principal haircuts are infrequent
- NPV reductions range from 20% to 70%
- Restructuring has generally not gone far enough

# Lessons of Experience

- Debt difficult to manage beyond 90% of GDP
- Debt restructuring should be part of a comprehensive reform program supported by key stakeholders

$$\Delta d_t = \left[\frac{i_t - g_t}{1 + g_t}\right] d_{t-1} - pb_t + o_t$$

- Restructuring should take cognizance of medium term resource capacity plus make allowance for a reasonable shock
- Debt profile limits restructuring options

# Lessons of Experience Cont'd

- Step-up interest rate instruments that assume significantly better medium-term prospects can be risky

$$\Delta d_t = \left[ \frac{i_t - g_t}{1 + g_t} \right] d_{t-1} - pb_t + o_t$$

- Consultation with creditors is key to high participation rates, but can be at expense of relief
- Domestic debt is easier to settle than external debt
- Non-Paris Club credits are more difficult to settle

# Emerging Issues in Debt Restructuring

- Financial sector vulnerabilities
- Reputational risk and access
- Creditor coordination
- De facto sovereign ownership of debt
- The use of guarantees and state contingent debt
- Litigation and vulture funds

# Conclusions

Debt restructuring is a last resort. Minimum conditions for restructuring

- Fiscal consolidation will not lead to debt sustainability
- Vulnerabilities are significant

Debt restructuring requires sound analysis & conservative outlook

Debt restructuring should be part of a comprehensive debt sustainability program