INTERNATIONAL MONETARY FUND

# Access to International Capital Markets for First Time Sovereign Issuers—Country Cases

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## INTRODUCTION

To assess the process used by countries to access international bond markets in recent years, the staff prepared a paper entitled "Access to International Capital Markets for First Time Sovereign Issuers" (SM/03/218).[1] This is an accompanying background paper that discusses the individual experience of eight countries in accessing international capital markets after 2000—a period marked by the emergence of bond financing as a source of financing to many new sovereign debtors. The countries include five first-time issuers (Bulgaria, the Dominican Republic, Egypt, Islamic Republic of Iran, and Peru). This paper also discusses the experience of three repeat issuers (Croatia, El Salvador, and Tunisia).

## I. FIRST-TIME ISSUERS

### A. Bulgaria

#### Sovereign Debut

1. In November 2001, Bulgaria issued a €250 million Eurobond due 2007. This was Bulgaria's debut Eurobond issue in international capital markets.

#### Characteristics of the Issue

2. The Eurobond will mature on March 1, 2007 and carries a coupon of 7.25 percent a year. At the time of issuance, the bond was sold at an issue price of 98.86 per €100 of face value, or 376 basis point spread over the January 2007 Bund.

3. According to market sources, the bond attracted over €1.1 billion in orders. The issue was allocated to large accounts in Germany (32 percent), fund and bank accounts in the U.K. (18 percent), and retail investors in Italy (11 percent). Bulgarian domestic investors were allocated about 10 percent of the deal. Among international investors, Swiss and Greek investors received 16 percent of the issue (evenly split), French investors bought 4 percent, and Austrian and U.S. offshore accounts took about 3 percent. Asset managers accounted for 45 percent of the allocation, with retail investors taking 20 percent, banks 30 percent and insurance companies 5 percent. In the days following the issuance, the spread narrowed to about 320 basis points.

#### Domestic Economic Conditions

4. Bulgaria is a young democracy on a path of transition to a market economy. The socialists dominated Bulgarian politics until 1997, when Bulgaria suffered a severe economic crisis. Following the crisis, a new pro-market government managed to reduce inflation and stabilize the exchange rate by putting in place a currency board arrangement. It also reformed

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[1] This paper is concerned only with access to international bond markets.

the banking system and accelerated the privatization of state-owned assets. Bulgaria continues to implement policies aimed at maintaining the viability of the currency board arrangement and joining the European Union (EU) and NATO.

5. The Bulgarian economy recovered in 1998, when real GDP growth was 3.5 percent, and has been growing ever since. At the time of the issue, market participants expected a continuation of favorable domestic economic conditions. In the event, real GDP grew by 4.8 percent in 2002, and is expected to accelerate to 5 percent in 2003. The 12-month inflation was 3.6 percent in 2002, but it is expected to reach 4 percent in 2003. Since 1998, Bulgaria has been running trade and current account deficits. In 2002, the trade deficit stabilized at about 10.5 percent of GDP, and the current account deficit was 4.4 percent of GDP. As of end-December 2002, international reserves stood at about US$4.6 billion, or 5.6 months of imports. The general government budget registered a deficit of 0.6 percent of GDP in 2002. As of end-December 2002, total public debt was about 60 percent of GDP. Public external debt represented 53.2 percent of GDP, or US$8.3 billion, of which US$2.5 billion was Brady bonds and US$2.4 billion was Euro and Global bonds.

6. Over the medium term, Bulgaria should benefit from robust growth, subdued inflation, and a gradual narrowing of the external current account deficit. Reflecting an acceleration of structural reforms and an increase in investment, Bulgaria's real GDP is expected to grow by over 5 percent in the medium term. In the context of the peg of the lev to the euro, inflation is expected to remain subdued in the medium term, with prices rising by more than in the EU only because of administrative price increases. The external current account deficit is projected to narrow gradually, as a result of an increase in private savings towards levels in other Central and East European countries. The external current account deficit would be financed by FDI.

**External Financial Market Conditions**

7. Bulgaria was one of the last EU accession candidates to issue. In this context, yields on its sovereign instruments were expected to converge to those of the rest of the EU. The debut issue was also well timed. One week prior to issuance, Standard & Poor's upgraded Bulgaria's credit rating from B+ to BB-, citing the authorities' commitment to prudent fiscal and financial policies. Both the European Central Bank and the Federal Reserve also cut interest rates just days before the bond's issuance. In addition, the market was in the process of decoupling from Argentina, and the combination of high cash balances and low interest rates, made investors quite receptive to new emerging market debt instruments, especially the rare EU convergence assets.

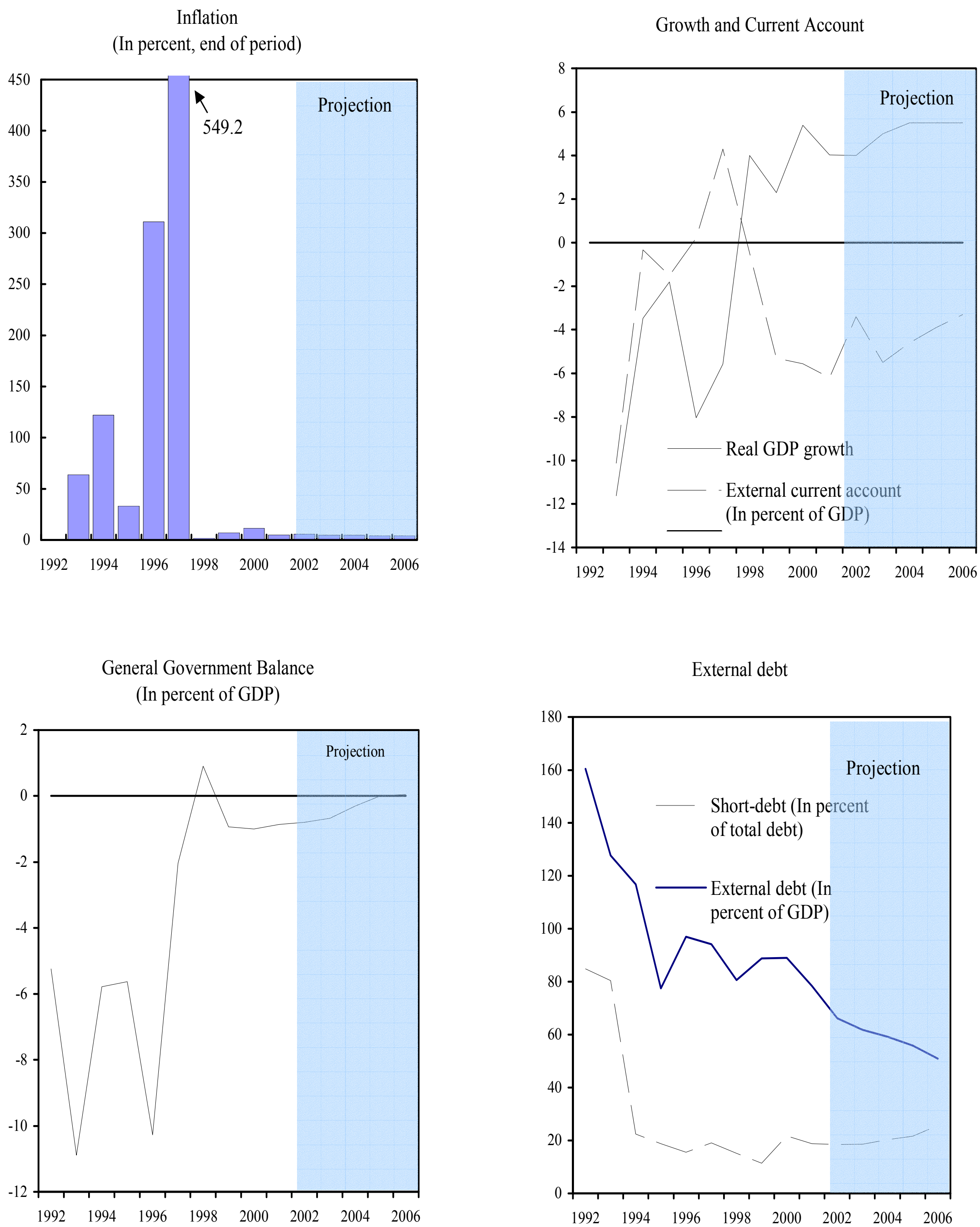
**Market Access by Non-Sovereign Issuers**

8. By end-December 2002, private sector foreign debt accounted for US$2.6 billion or 23.9 percent of gross foreign debt. Loans to companies, including intra company loans, and trade credits accounted for most of the private sector foreign debt. Outstanding private sector bonds were about US$5 million.

**Subsequent Market Access**

9. In March 2002, in the context of a Brady/Global exchange, Bulgaria issued a US$510 million bond due 2015 and a €468 million bond due 2013. It also issued and sold approximately €367 million of the new 2013 bonds. The aggregate principal amount of the new U.S. dollar and euro-denominated bonds issued was nearly US$1.3 billion dollars. The issues were part of an exchange that consisted of a swap of the Bradies for new bonds denominated in both U.S. dollars and euros, a buyback of the Bradies for cash, and an issue of the new euro-denominated bond for cash. In September 2002, the Bulgarian authorities issued an additional US$759 million of the original 2015 U.S. dollar Global Bond in exchange for Brady bonds with the face value of US$888 million.

Figure 1. Bulgaria: Fundamentals, 1992-2006




Source: World Economic Outlook

The Dominican Republic

**Sovereign Debut**

10. On September 20, 2001 the Dominican Republic reopened emerging markets that had closed after the terrorist attacks in the United States on September 11. Even though it considered delaying the issue until January 2002, the Dominican Republic decided to proceed because of its critical need to establish a benchmark issue. The conclusion of the road show before September 11 and the strong desire of Wall Street to return to business as usual also prompted the Dominican Republic to issue the bond.

**Characteristics of the Issue**

11. The Dominican Republic issued a Global bond of US$500 million with maturity of five years. The price was set at par, and commanded a yield of 9.5 percent, which translated into a spread of 569 basis points over a comparable U.S. Treasury debt instrument. The benchmark bond of the Dominican Republic did not perform well initially. The bond hit a low of 98.5 on the bid the day after its launch. The market attributed the weakness to a downturn in overall market sentiment, and the large size of the issue. Investors reportedly wanted to resell the bond in the secondary market only to find that local investors were not ready to absorb the paper.

**Domestic Economic Conditions**

12. Following its stabilization program in the early 1990s, the Dominican Republic continued to make efforts to strengthen its public finances, maintain prudent credit and wage policies, reduce exchange rate, price, and financial distortions, liberalize the economy, and normalize relations with external creditors. In this context, its economy performed strongly in the second half of the 1990s. Real GDP growth averaged 7 percent, and inflation was in single digits. The consolidated public sector deficit, including quasi-fiscal operations, averaged about 2 percent of GDP. The external public debt declined from 70 percent of GDP in 1990 to less than 20 percent of GDP in 2000. The current account deficit widened over time, reaching 5.1 percent of GDP in 2000, and was financed essentially by FDI. Gross international reserves declined by US$70 million to US$637 million, or one month of imports of goods and services. The Dominican Republic peso remained generally stable, although it came under some pressure on occasions resulting in moderate step devaluations. A privatization law was passed in 1997, opening the way for the sale and liquidation of several public enterprises. The banking system appeared to be healthy, with most banks complying with capital adequacy norms.

13. In 2001, the Dominican Republic suffered two external shocks—the economic slowdown in the United States and Europe, and the September 11 attacks, both broadly coinciding with the introduction of a package of fiscal measures. In this context, real GDP growth declined to 2.7 percent, and inflation was 4.4 percent by the end of the period. While the overall fiscal stance remained about unchanged (with an improvement in the central government finances offset by a worsening of the public enterprises finances), monetary

policy was eased, with lending rates falling by 800 basis points to 22 percent. Reflecting the decline in real GDP growth and the fall in international oil prices, the external current account deficit narrowed to 3.9 percent of GDP, and was more than financed by FDI, which exceeded US$1 billion for the third year in a row. Gross international reserves rose to over US$1 billion (1.8 months of imports of goods and services by end-2001), mainly because of the decision to save the proceeds from the bond issue for this purpose.

14. At the time of the debut bond issue, the Dominican Republic's medium-term prospects appeared to be positive, with the timing and pace of recovery in the tourism and free-trade sectors being crucial to the outlook. The Dominican Republic demonstrated a strong commitment to maintaining macroeconomic stability. In this context, Fund staff project annual real GDP growth of 5.5 percent over the medium term, and inflation converging to partner country inflation. A strong fiscal stance would be the centerpiece of the macroeconomic policy framework that would lead to a decline in public external debt to 15 percent of GDP in 2006. This, together with a strengthening of the banking sector, would result in a reduction in domestic interest rates and support economic growth.

**External Financial Market Conditions**

15. The Dominican Republic decided to proceed with its first sovereign issue soon after the terrorist attacks of the United States on September 11, which had resulted in the closing of international capital markets. The Dominican Republic, while leaving the door open for a reduction in the bond issue to US$300 million under these circumstances, ended up issuing the full desired amount of US$500 million. Investors were cash rich, having just cut down their positions in the Middle East. In this context, the book reached US$750 million, and was allocated mainly in the United States (71 percent), with the remainder placed in Europe (26 percent) and Latin America (3 percent). However, while a rating upgrade in August 2001 allowed the Dominican Republic to market itself as a peer of the high-quality credits in Latin America such as Mexico, in the wake of September 11 investors balked at a spread of 490 basis points targeted by the Dominican Republic, and demanded a spread of 569 basis points instead.

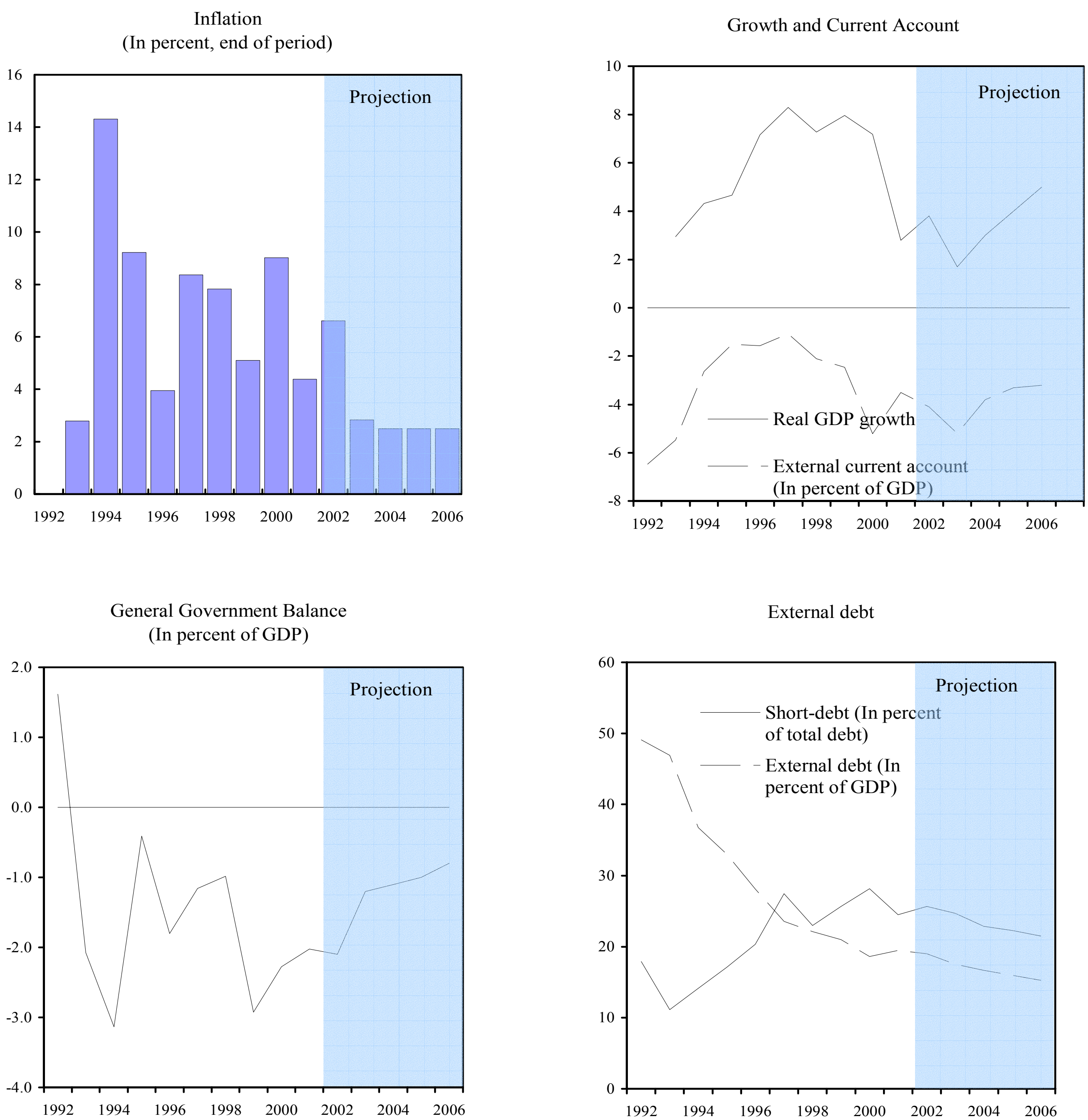
**Market Access by Non-Sovereign Issuers**

16. The issue of the benchmark bond opened the way for Dominican corporates to access international capital markets soon thereafter. Among the corporates that accessed international capital markets were Banco BDH, Banco Intercontinental (Baninter), Tricom (a telecommunications company), and Aerodom (an airport management company). The instruments used to access international capital markets included commercial papers, Eurobonds, and securitization of future flows.

**Subsequent Market Access**

17. In January 2003, the Dominican Republic again accessed international capital markets with a 10-year, US$600 million bond, with a spread of 463 basis points over a comparable U.S. Treasury debt instrument. The orders reached US$1.25 billion, with a strong participation of both American and European investors. The Dominican Republic noted that the proceeds of the bond would be used to retire short-term debt. Interestingly, soon after this bond was issued, the Dominican Republic suffered a confidence crisis as President Mejia's administration and the central bank disagreed over the course of economic policies. In April 2003, the Dominican authorities announced the failure of a large commercial, Banco Intercontinental (Baninter), which ran off-the-book accounts without the knowledge of the regulatory authorities. The cost of addressing the failure of this bank was not yet clear at the time of the announcement. Not surprisingly, these events led to a major widening of the spreads of Dominican sovereign bonds, and a sharp depreciation of the Dominican peso.

Figure 2. The Dominican Republic: Fundamentals, 1992-2006




Source: World Economic Outlook.

## B. Egypt

### Sovereign Debut

18. Egypt issued its debut Eurobond in June 2001. This bond issue had been rumored for a long time and had first been considered in 1996. The rationale of the deal was to establish a presence in international capital markets.

### Characteristics of the Issue

19. The bond was issued in two tranches. The first tranche amounted to US$1 billion and had a maturity of 10 years. The spread on this bond was 335 basis points over U.S. Treasuries. The second tranche amounted to US$500 million and had a maturity of five years, and commanded a spread of 275 basis points over U.S. Treasuries.

20. Despite initial talk of an issue in the US$300–500 million range, the final issue was for US$1.5 billion, with an oversubscription of 100 percent.[2] This was a very large bond issue for an emerging market sovereign and at the very top of the range considering that it was entirely new money and not linked to any debt swap: the size was even more noticeable given that it was a debut issue. It was also large when measured against Egypt's gross external financing requirement of US$5 billion in 2000–01, reserves of some US$14 billion at end-June 2001, and public external debt of US$26 billion.

21. Spread comparison is complicated by Egypt's split rating at the time—Standard & Poor's rated it investment grade at BBB-, but with a negative outlook, and Moody's at Ba1 with a stable outlook—and Egypt's unique position in the Middle East region. However, the spread was rich compared to Mexico, which also had a similar split rating at the time, while it looked tight compared to Morocco, which had the same rating by Moody's, but a lower Standard & Poor's rating. The bond did not have any credit enhancements.

22. The excellent reception by investors was mainly explained by the fact that this bond offered diversification at a time when some of the major emerging market borrowers, in particular Argentina and Turkey, were cut off from international capital markets due to internal crises, and issuance from the Middle East region was scarce. The "rarity" of the credit was also a selling point, as Egypt did not intend to continue relying on external financing to meet its financing requirements. Investors also found the spread attractive and were persuaded by the good story told by Egyptian officials, who presented the case very well. While the 5-year tranche was bought in large part by Egyptian expatriates, the 10-year tranche found favor among U.S. and European institutional investors. No bonds were placed with local investors, as this was one of the issuer's conditions. The bonds traded well in the

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[2] However, data on oversubscription should be interpreted with caution as investors tend to submit bids in excess of their real appetite when demand is expected to be high, in order to obtain something close to their desired amount in the allocation process.

secondary market with the spread tightening noticeably. The timing of the issue was carefully planned.

**Domestic Economic Conditions**

23. Domestic macroeconomic conditions were not particularly favorable at the time of the launch of the Eurobond, but the authorities' measures to stabilize the deteriorating economic situation observed in the late 1990s had strengthened the external current account balance and stabilized international reserves, albeit at the cost of lower (but still positive) growth. Some progress had also been made on structural reforms, and the signing of an association agreement with the European Union and increased exchange rate flexibility bore the promise of further improvements in the external position. Nevertheless, the fiscal deterioration of the late 1990s had not been reversed and the public debt to GDP ratio at 82 percent was high.

24. Standard & Poor's investment grade rating was accompanied by a negative outlook reflecting concerns about the level of public debt, excessive public investment spending, the level of competitiveness, and the slow pace of structural reforms. Even though some market commentaries shared these concerns, they however, maintained a relatively positive assessment of Egypt's economy based on the overall macroeconomic and political stability, as well as the strength of external debt indicators. They noted that Egypt boasted low single digit inflation and a fairly good growth performance. Furthermore, Egypt's external debt amounted only to about 28 percent of GDP, after generous debt relief from the Paris Club. Debt service indicators were also favorable: for example, official reserves were a multiple of short-term debt on a remaining maturity basis and could more than cover the gross external financing requirement of the country.

25. The Egyptian economy was still fairly closed and controlled. The trade regime was restrictive and the export base outside the oil sector narrow, although the agreement with the European Union served to mitigate this concern. In the foreign exchange market, although the adjustable currency band regime launched in early 2001 provided some exchange rate flexibility, foreign exchange shortages remained significant, only partly alleviated by official intervention. These shortages were managed through administrative measures (including the adoption of advance import requirements) and by a system of foreign exchange queues operated by banks. The liberalization of the financial system also appeared to have some way to go, as domestic interest rates remained in a very narrow range (30 basis points) for years. Nevertheless, some of these features, such as the closed nature of the financial system, were seen as a factor that made the high public debt more sustainable.

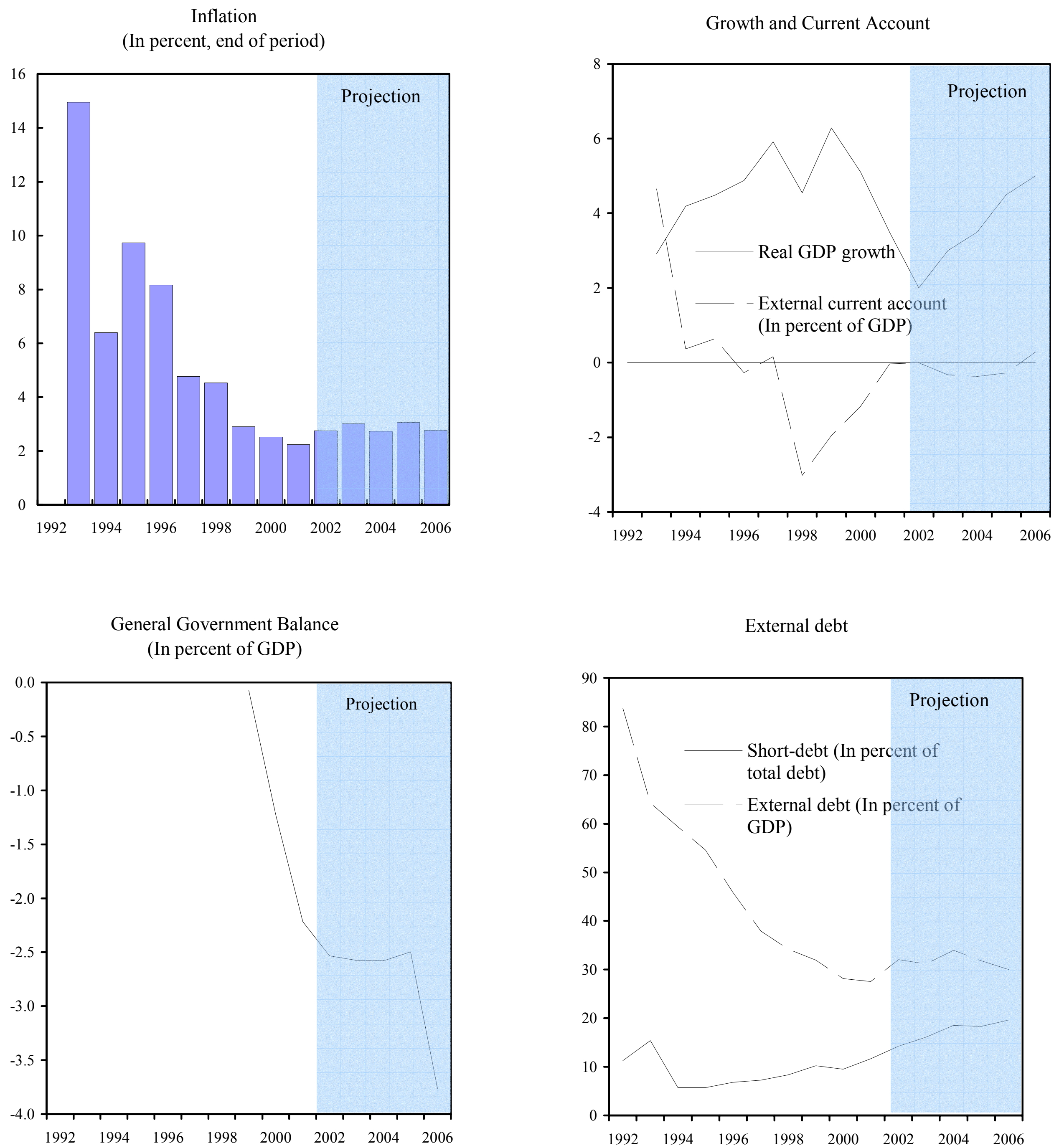
**External Financial Market Conditions**

26. At the time of Egypt's issuance in 2001, external financial market conditions were good, with declining U.S. dollar interest rates and sizable issuance in the U.S. high-yield market. Issuance by emerging markets was at about the same level as 2000, even though two large issuers, Argentina and Turkey, were cut off from international capital markets due to internal difficulties, creating significant room for new emerging market issuers.

**Subsequent Market Access**

27. There has been no bond market access by Egyptian issuers since the sovereign Eurobond issuance described above and Standard & Poor's downgraded the sovereign to BB+ in May 2002. Some issuers, mainly financial institutions, have accessed the syndicated loan market, but the investor base appears quite different from the investor base of the sovereign bonds, and seems concentrated among Middle East loan players.

Figure 3. Egypt: Fundamentals, 1992-2006




Source: World Economic Outlook.

## C. Islamic Republic of Iran

### Sovereign Debut

28. On July 10, 2002, Iran issued its first international bond since the late 1970s. The offering was designed to establish a benchmark bond to facilitate issuance by sub-sovereign credits.

### Characteristics of the Issue

29. The transaction volume reached the higher end of the €300–500 million range originally targeted, and had a five-year maturity.[3] The issue was oversubscribed by €300 million despite the censure and the regulations banning U.S. citizens from buying Iranian securities. The price was 99.23 per €100 of principal, representing a spread of 425 basis points over benchmark euro swaps. The coupon was set at 8.75 percent.

30. The bond helped fulfill Iran's objective of issuing to as widespread an investor base as possible, with 42 percent placed with European investors, 5 percent with Asian investors, and the remainder with Gulf and Middle East investors. The offer was tested at a spread of 350–400 over swaps basis points in the Middle East during the road show, but was presented at a spread of 375–425 basis points in more price-sensitive Europe because Iran specifically wanted to attract European interest. The issue was bought by some 80 different investors, including commercial banks (41 percent), asset managers and emerging market funds (32 percent), insurance companies (10 percent), and retail investors (10 percent). Market sentiment towards the bond among the 11-member syndicate was overwhelmingly positive with the transaction viewed as offering welcome diversification within the Middle East region at a tight but fair pricing level.

31. The performance of the bond has been very positive since issuance. Iran provided evidence of this success, when it increased the €500 million issue by €125 million. The reopening was prompted by strong demand for the transaction, and was launched with the same terms and conditions as the original offering. After the issue, the transaction was trading at a price of 99.75/100.25 and at a spread of 415/402 basis points over swaps, suggesting that demand was high. The bookrunners highlighted that, despite highly volatile market conditions, Iran's ability to launch and then increase its first international bond reflected investor confidence in this country's economy.

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[3] The five-year maturity was viewed as a success because the bond was offered with a maturity of three years initially.

**Domestic Economic Conditions**

32. Overall economic performance has improved significantly during the last decade, as a result of the authorities' strong commitment to reform the economy and efforts to integrate Iran in the global economy. In this context, Iran's economy was performing soundly before accessing global capital markets, with average real GDP growth of 4.3 percent in 1996–2001. Economic growth during the 1990s, however, remained well-below potential owing to structural rigidities, including trade and exchange restrictions, the dominant role of the public sector and constraints on private sector initiative, administrative allocation of resources, and a distortion of the price system. Inflation had also been declining steadily before Iran accessed international capital markets, to 11.7 percent in the 12 months to March 2002. In 2001, the government accounts registered a record surplus of 8.5 percent of GDP reflecting high international oil prices. The external current account recorded a surplus (5.5 percent of GDP), and gross international reserves were rising, reaching US$16.4 billion in March 2002, equivalent to 7.5 months of imports of goods and services. Since 1994, Iran has been a net payer of external debt.

33. In 2002, a broad reform strategy was adopted in the context of the third five-year development plan for the period 2000–04. The plan committed the government to a range of fiscal, monetary and structural reforms designed to boost economic growth, support the private sector, generate employment, and reduce Iran's reliance on the oil export industry. At the time of the launch, the outlook for 2002–03 was expected to be favorable, with strong GDP growth (projected at 5 percent), a surplus in the fiscal and external accounts, and an improvement in the capital account due to external debt buybacks and lower amortization payments. Gross official reserves were projected to increase further and at end-March 2003 reached US$21.1 billion, equivalent to eight months of imports of goods and services.

**External Financial Market Conditions**

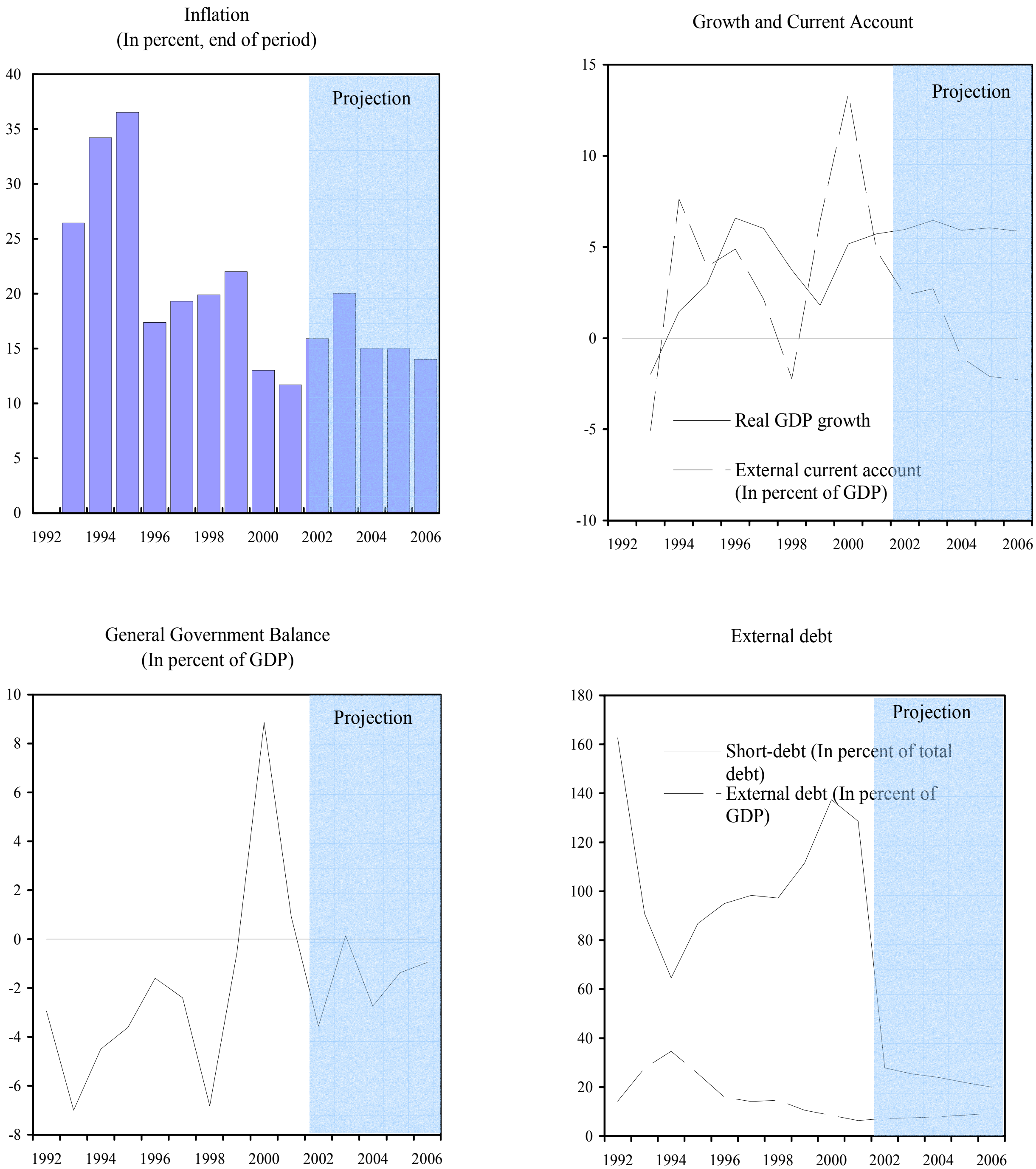
34. Iran issued in highly volatile market conditions when EM spreads were widening. The road show was complicated by Moody's withdrawal of the sovereign's B2 rating. Nevertheless, investor confidence in the strength of the credit—supported by a rating of B+ on long-term foreign currency debt and B on short-term debt assigned by Fitch—helped ensure a successful issue.

**Subsequent Market Access**

35. Iran brought to market a €375 million deal in December 2002, taking advantage of a tightening of the spread on the 2007 bond. The bond carries a coupon of 7.75 percent. It was priced to yield 7.9 percent, equivalent to a 410 basis points spread over midswaps at the time of launch, tighter than that of the debut bond despite a longer maturity (5.3 years). According to the deal managers, new investors accounted for about 15 percent of the transaction.

36. Iranian corporates have yet to access international bond markets following Iran's debut issue. Potential issuers in the capital markets include the oil company INOC, petrochemicals outfit NPC, the state-owned Iranian telecommunication company, and the national airline. However, public banks (Bank Markazi Jomhouri Islami Iran, Bank Tejarat, and Bank Mellat) and public corporates (Iran Petrochemical Commercial Company, a major exporter of Iranian chemical and petrochemical products, wholly-owned by the National Petrochemical Company of Iran) have been accessing the syndicated loan market since the 1990s.

Figure 4. Islamic Republic of Iran: Fundamentals, 1992-2006




Source: World Economic Outlook.

## D. Peru

### Sovereign Debut

37. On February 7, 2002, the Peruvian authorities successfully completed a new placement—the first by Peru since1928—of a US$500 million Global bond. In addition the authorities completed a US$923 million dollar swap of existing Brady bonds for the new Global bond. The combination of the swap and the new placement resulted in the establishment of a new liquid instrument that could be used as a benchmark for private sector borrowers in the future.

### Characteristics of the Issue

38. The Global bond matures at face value on February 21, 2012 and bears a coupon of 9.125 percent a year. The issue price per US$100 principal amount of Global bonds was US$97.73. The new bond had a maturity of 10 years, and a duration of 6.4 years, and carried a yield of 9.5 percent.

39. The bond, which was issued at 455 basis points over U.S. Treasuries, performed well, with its spread narrowing following issuance. On a geographic and ratings peer group comparison, Ba3/BB-, Peru's bond was aggressively priced versus B1/BB- Brazil 2012s trading at a yield of 13.21 percent and spread of 825 basis points and Ba2/BB Colombia 2012s at 10.6 percent and 575 basis points. It was more comparable to Ba1/BB Panama 2012s at 9.20 percent and 425 basis points.

40. The transaction was believed to have been more than three times oversubscribed with US$1.7 billion worth of orders. Around 75 percent of the bonds were bought by accounts in the United States, with the balance of the placement split roughly between Europe and Peru.

### Domestic Economic Conditions

41. Between 1998 and 2000, the economy grew by an average of only 1 percent per year while inflation continued to decline. In 2000, the fiscal deficit reached 3.2 percent of GDP, banking sector weakened, and the current account deficit was 3 percent of GDP. However, international reserves remained at comfortable levels.

42. During the first half of 2001, real GDP declined by 1.7 percent, mainly due to a contraction in domestic demand. The newly elected administration provided a fiscal stimulus package in the second half of 2001 which included, among other measures, an increase in the corporate income tax rate from 20 percent to 27 percent, a 9 percent nominal increase in public sector wages, and the creation of an agrarian bank. In this context, real GDP remained virtually unchanged for the year 2001 as a whole.

43. At the time of issuance, Peru anticipated that domestic economic conditions would improve. In the event, during 2002 macroeconomic performance was mostly in line with the economic program under the Stand-By Arrangement. Real GDP grew 4.8 percent in the first

half of the year even though there was no employment growth, inflation was low, and international reserves increased. A formal inflation targeting framework was put in place in early 2002. Fiscal targets were met mainly through expenditure cuts, as revenue was lower than expected due to the tax amnesty program. The first stage of a comprehensive tax reform (yielding about 0.2 of GDP in 2002) was introduced in July. The external current account deficit was below program as slower-than-envisaged export growth has been more than offset by sluggish import growth. At end-2001, total external debt stood at 50.2 percent of GDP, or about US$27.2 billion, of which Brady bonds were US$3.7 billion dollars.

**External Financial Market Conditions**

44. Peru's sovereign credit ratings were unchanged in 2001 and remained below investment grade. Its long-term foreign currency risk was rated Ba3 by Moody's and BB- by Standard & Poor's. International investors had a positive outlook on the initiatives of the Toledo administration, including the proposed US$700 million privatization program and a desire to lower the budget deficit from 2.4 percent of GDP in 2001 to 1.9 percent of GDP in 2002. Coupled with the declining interest rates, the positive outlook offered a window of opportunity for new market access.

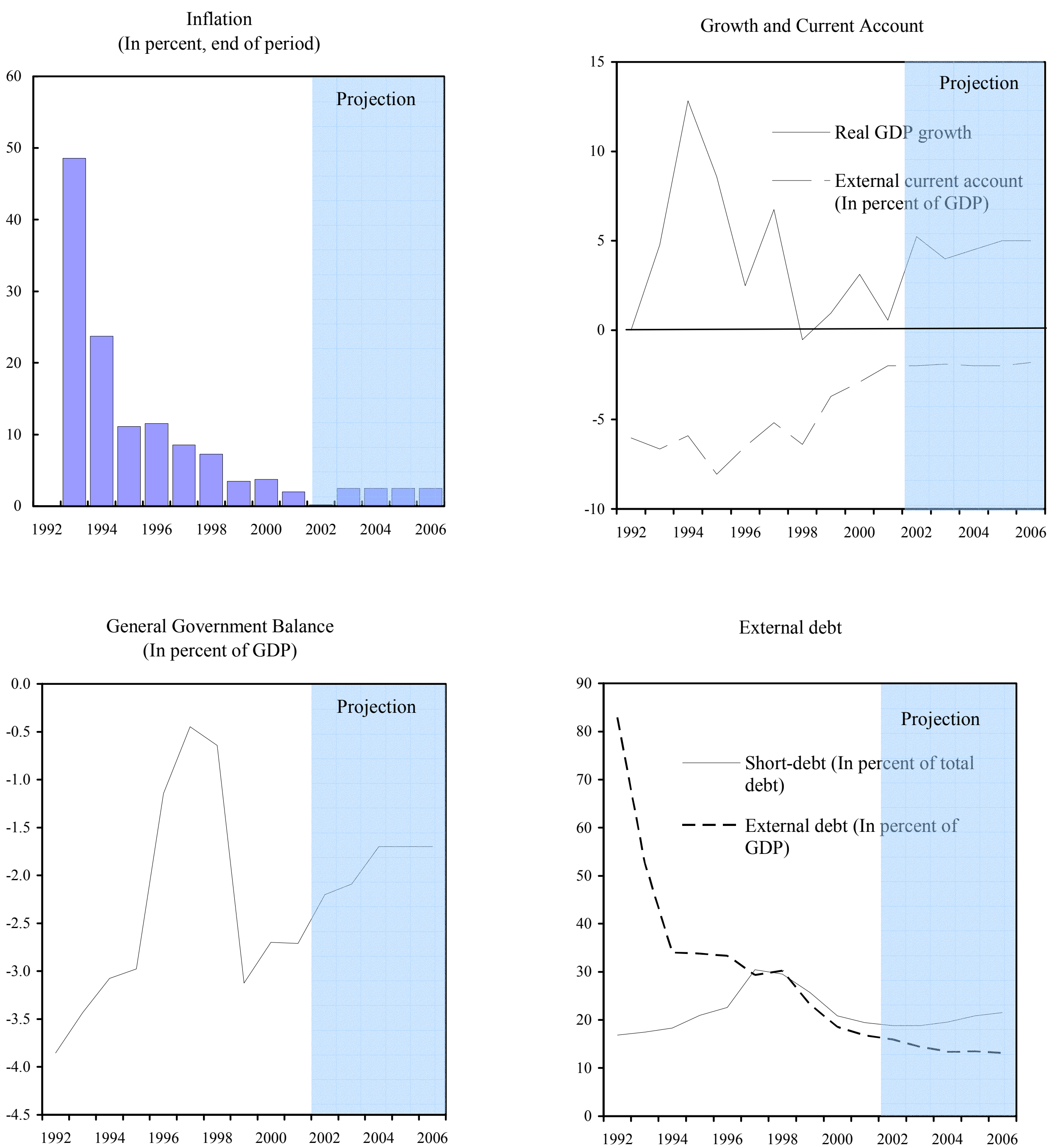
**Market Access by Non-Sovereign Issuers**

45. There were no bonds issued by private Peruvian borrowers.

**Subsequent Market Access**

46. Since its first issuance, Peru accessed international markets three times. In December 2002, Peru issued a US$500 million Global bond maturing on January 15, 2008 with a coupon of 9.125 percent. The issue price per US$100 principal amount of Global Bonds was 99.073, which translated into a spread of 612 basis points over corresponding U.S. Treasuries. In January 2003, Peru issued a US$500 million Global bond maturing on February 6, 2015 and bearing a coupon of 9.875 percent. An additional US$250 million of the same bond was issued on March 3, 2003. The original issue price was 98.455 per US$100 of the principal amount, translating into a spread of 575 basis points over a corresponding U.S. Treasury debt instrument.

Figure 5. Peru: Fundamentals, 1992-2006




Source: World Economic Outlook.

## II. Repeat Issuers

### E. Croatia

**Sovereign Debut**

48. Croatia has become an established issuer in international capital markets: the sovereign has issued every year since its debut. Croatia first issued a small (US$60 million) international bond in kunas—the local currency—in December 1996. Croatia issued its debut Eurobond in the U.S. dollar sector in February 1997, after having obtained its first credit rating from Moody's and Standard and Poor's, which assigned the sovereign an investment grade rating, Baa3 and BBB-, respectively.

49. The initial Kuna bond had a maturity of two years and a 12.5 percent coupon implying a yield of just over 13 percent. The bond was targeted at international investors, who at the time had good appetite for local currency exposure, as shown by the sizable issuance of Euro-Czech Koruna bonds and those of other Eastern European countries. The Kuna bond was bought by fixed-income funds specialized in Eastern Europe and the issue was deemed a success, given the strong demand for the currency and credit diversification. The maturity constituted an extension of the kuna yield curve and was aimed at building a benchmark for corporate issuance.

50. The first U.S. dollar bond issued by Croatia in February 1997 amounted to US$300 million, and had a 5-year bullet and a fixed coupon of 7 percent equivalent to a spread of 80 basis points over a comparable U.S. Treasury debt instrument. The bond was three to four times oversubscribed, as it offered diversification and brought a new European name to the market. This allowed the lead managers to allocate the bonds to a geographically diverse investor base. About half of the issue was sold in Europe where retail demand was an important component, some 40 percent was allocated in the United States, and the rest was placed in Asia. The proceeds of the issue were intended to be used for investment. Croatia rejected a proposal to issue a second tranche with longer maturity, as it expected to pay less in future issues. The bond traded up in the secondary market. The timing of the issue was linked more to domestic factors (with fairly positive macroeconomic and political developments) than to external factors. However, the buoyancy of the emerging market asset class allowed a new borrower to debut at such a tight spread.

51. In subsequent issues, Croatia issued mainly in euros to attract European investors, this country's natural investor base. Croatia built a yield curve in euros that extends to 10 years. A recent 7-year euro issue commanded a yield of 4.62 percent, equivalent to a spread of 95 basis points over swaps. The bond was reportedly sold mostly to European institutional investors, including EU government bond funds. The sovereign also issued five times in yen to take advantage of low interest rates.

52. Croatia's accession prospects to the European Union provide a powerful anchor for its economic outlook and have resulted in market participants viewing the country as a converging credit. This, together with a relatively low correlation with major emerging market countries, has kept the demand for this credit high.

**Domestic Economic Conditions**

53. Croatia's sovereign debut in international bond markets marked the achievements of a successful macroeconomic stabilization that led to: (i) a reduction in inflation to industrial country levels, reflected also in a fairly strong currency; (ii) a solid economic growth rate; (iii) and a manageable fiscal position. The sovereign's investment grade rating was supported by these factors, as well as by a low external debt level (after Croatia reached agreement with the creditors of the Former Socialist Republic of Yugoslavia) accompanied by a strong reserve position, the diversity of its production base, and its location. Croatia was also about to embark on a new extended Fund arrangement aimed at consolidating the gains of its macroeconomic stabilization, focusing on maintaining a sustainable fiscal and external position, while the country was reconstructing after the war and taking steps to become a fully market-based economy.

54. A more stable political backdrop was also an important ingredient in providing comfort to investors who participated in the initial bond issues, even though politics was still viewed as one of the major risks together with underperformance on the extensive structural reform agenda (especially regarding privatization of state enterprises and the banking system). In addition, budgetary pressures arising from capital and social spending was considered a potential risk that could spill over into the external current account (which was already registering substantial deficits).

55. In subsequent years, Croatia sustained a solid growth performance, with real GDP growth averaging over 3 percent in 1997–2002. Inflation remained contained and converged to that of the EU area. Although progress has been made, the Achilles' heel of the macroeconomic situation remains the fiscal position, which has led to a 19 percentage point increase in the public-debt-to-GDP ratio since 1998 to 51 percent of GDP in 2002. The external current account deficit is also of concern—it widened to 6.9 percent of GDP in 2002, after a significant narrowing between 1997–2001. However, since 1999 the external current account deficit has been more than covered by FDI, which together with other medium- and long-term inflows, has resulted in sizable international reserve accumulation. Progress on structural reforms remains uneven, with delays especially in the areas of privatization and labor market. Nevertheless, the anchor provided by Croatia's EU accession status, and successive Fund programs, have allowed the country to maintain its investment

grade credit rating, while preserving investor confidence and continued access to international capital markets.[4]

56. The Fund approved a new 14-month Stand-By Arrangement in January 2003. As the country's international reserve situation is strong, the authorities planned to treat the arrangement as precautionary. The program's main objective was to stabilize the public debt ratio and advance the structural reform agenda to ensure Croatia's smooth convergence to the EU.

**External Financial Market Conditions**

57. Global liquidity conditions were very favorable at the time of issuing the first two Croatian bonds, and international interest rates were very low. Both 1996 and 1997 were years in which flows to emerging markets reached an all time high. As spreads of traditional EM countries had become compressed, "exotic" issuers benefited from the search for yield and even local markets received sizable inflows of foreign capital.

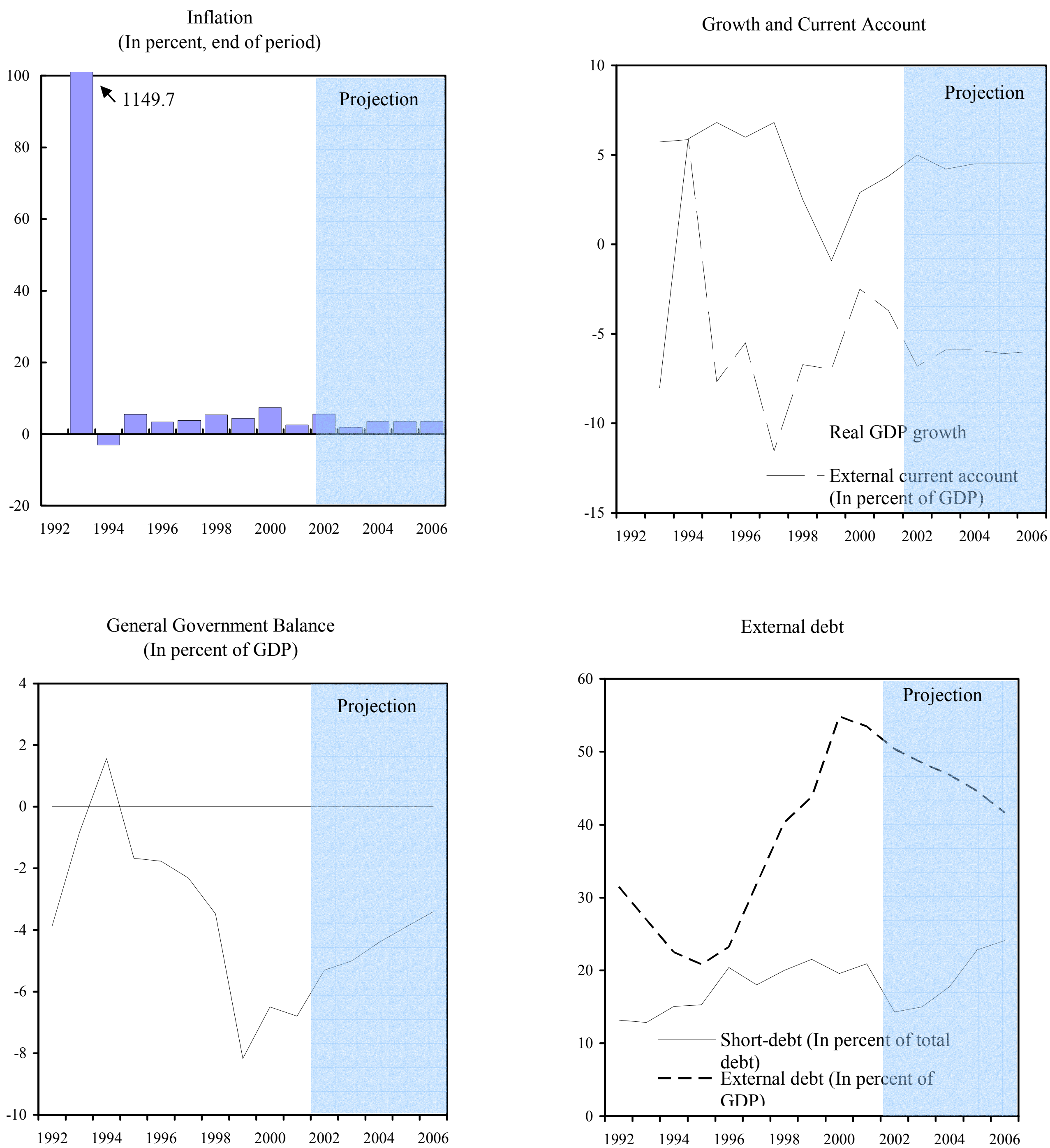
58. Subsequent issuance by the sovereign generally took place in favorable external market conditions. Croatia also benefited from its diversification value, as shown by the fact that the sovereign issued three times in 2001, while major EM issuers were cut off from international capital markets.

**Non-Sovereign Market Access**

59. A few other Croatian issuers have also appeared in the bond market, such as the Croatian Bank of Reconstruction and Development, Agrokor, a private food and drink company, and more recently Bina-Istra, the motorway concession company. The majority of Croatian issuers, however, continue to be focused on the syndicated loan market.

[4] Only Fitch downgraded it to speculative rating in 1999, but upgraded it to investment grade in 2001.

Figure 6. Croatia: Fundamentals, 1992-2006




Source: World Economic Outlook.

## F. El Salvador

### Sovereign Issues

60. El Salvador has accessed the international capital markets on many occasions in recent years. In August 1999, El Salvador issued a Global bond of US$150 million maturing in August 2006. In January 2000, this country accessed international capital markets again with an external note of US$50 million maturing in January 2007. In July 2001, El Salvador placed a Global bond of US$353.5 million maturing in July 2011.

61. In April 2002, El Salvador issued a 30-year U.S. dollar-denominated Global bond of US$500 million. The issue was increased from a targeted US$300 million because of high demand (the order book reached US$2.5 billion). The bond was priced at 98.6, which translated into a spread of 265 basis points over a comparable U.S. Treasury debt instrument. In July 2002, El Salvador braved highly volatile market conditions and tapped its existing 8.5 percent 2011 bonds for US$300 million. The issue, increased from an initial US$150 million as it attracted orders of US$1.2 billion, commanded a spread of 300 basis points over a comparable U.S. Treasury debt instrument, or 114 basis points less than the spread on the original issue in July 2001. In October 2002, spotting a window of opportunity to complete its funding needs through June 2003, El Salvador again accessed international capital markets, issuing a 20-year bond of US$452 million subject to a 10-year put option, with a spread of 361 basis points. This issue brought total issuance to US$1.25 billion in 2002.

62. In January 2003, El Salvador reopened its 20-year bond for US$349 million. The reopening, which attracted offers of US$1.25 billion, was placed at a spread of 355 basis points over a comparable U.S. Treasury debt instrument. International investors generally expressed satisfaction with El Salvador's deals because they traded up as a result of the strong local demand for the paper and the fact that the sovereign was insulated from Brazil's difficulties resulting from its elections cycle.

### Domestic Economic Conditions

63. Since the end of civil war in 1992, economic policies in El Salvador have sought to promote sustained economic growth by reducing inflation, expanding the role of the private sector, and integrating the economy with the rest of the world. Real GDP growth averaged 6.5 percent a year in 1993–95, but tapered off to about 3 percent a year in 1996–99. Real GDP growth slowed to 2.2 percent in 2000, and inflation, which had been on a downward trend, rose from a negative 1 percent in 1999 to 4.2 percent in 2000 due to higher energy prices and the elimination of some VAT exemptions. In 1993–99, the overall public sector deficit averaged about 1.5 percent of GDP, rising to 2.9 percent of GDP in 2000. The external current account deficit, which had narrowed over the period 1993–98 because of the strong growth of nontraditional exports and high workers' remittances, widened to over 3 percent of GDP in 2000. As net capital inflows declined that year due to a slowdown in privatization proceeds, net international reserves fell somewhat to US$1.9 billion by end

2000. Structural reforms since the mid 1990s focused on financial liberalization, privatization, and comprehensive trade reform.

64. In January 2001, following the approval of the Monetary Integration Law, the U.S. dollar (in parallel with the colon) became the legal tender of El Salvador. The transition to the new monetary regime was smooth. Among the benefits sought by the introduction of a new monetary regime were (i) a reduction in the interest rate from the elimination of the exchange rate risk; (ii) an increase in foreign direct investment in the financial system through the protection against devaluation and improvement in creditworthiness and stability; and (iii) an increase in local savings rate due to the decline in the devaluation risk.

65. In 2001, two earthquakes adversely affected the economy, causing an estimated damage of US$2.2 billion (16 percent of GDP). Nevertheless, real GDP grew by 1.8 percent, while inflation declined to 1.4 percent (from 4.3 percent in 2000). Reflecting in part the spending on reconstruction, the overall public sector deficit rose to 4.5 percent of GDP. At end-2001, the public debt stood at 34.1 percent of GDP. The external current account deficit narrowed to 1.3 percent of GDP in 2001, reflecting the inflows of insurance reimbursements for the damages caused by the earthquakes. Despite the economic slowdown in the United States (where the Salvadorian community is large), workers' remittances remained strong.

66. At a time when many Latin American countries were undergoing severe economic difficulties, economic activity in El Salvador continued to expand in 2002. Real GDP rose by 2.1 percent, led by the construction and manufacturing sectors, and inflation was 2.8 percent. The overall public deficit rose to 4.9 percent of GDP as a result of continuing expenditure on reconstruction. Reflecting the decision to use the U.S. dollar as the legal tender of El Salvador, interest rates declined further and the maturity of loans continued to increase.

67. El Salvador's medium-term prospects appeared to be good as it accessed international capital markets in early 2003. Market participants projected a pickup in real GDP growth in 2003, and inflation to remain under control. The overall public sector deficit was expected to decline as the reconstruction costs fell, and the current account deficit was projected to widen as insurance reimbursements returned to normal levels. Workers' remittances were expected to finance most of the external current account deficit. Market participants also believed that El Salvador was pursuing a medium-term strategy aimed at boosting economic growth, while maintaining low inflation and a sustainable external position. A strong fiscal effort was to be the lynchpin of this strategy. A prudent minimum wage policy was expected to maintain external competitiveness.

**External Financial Market Conditions**

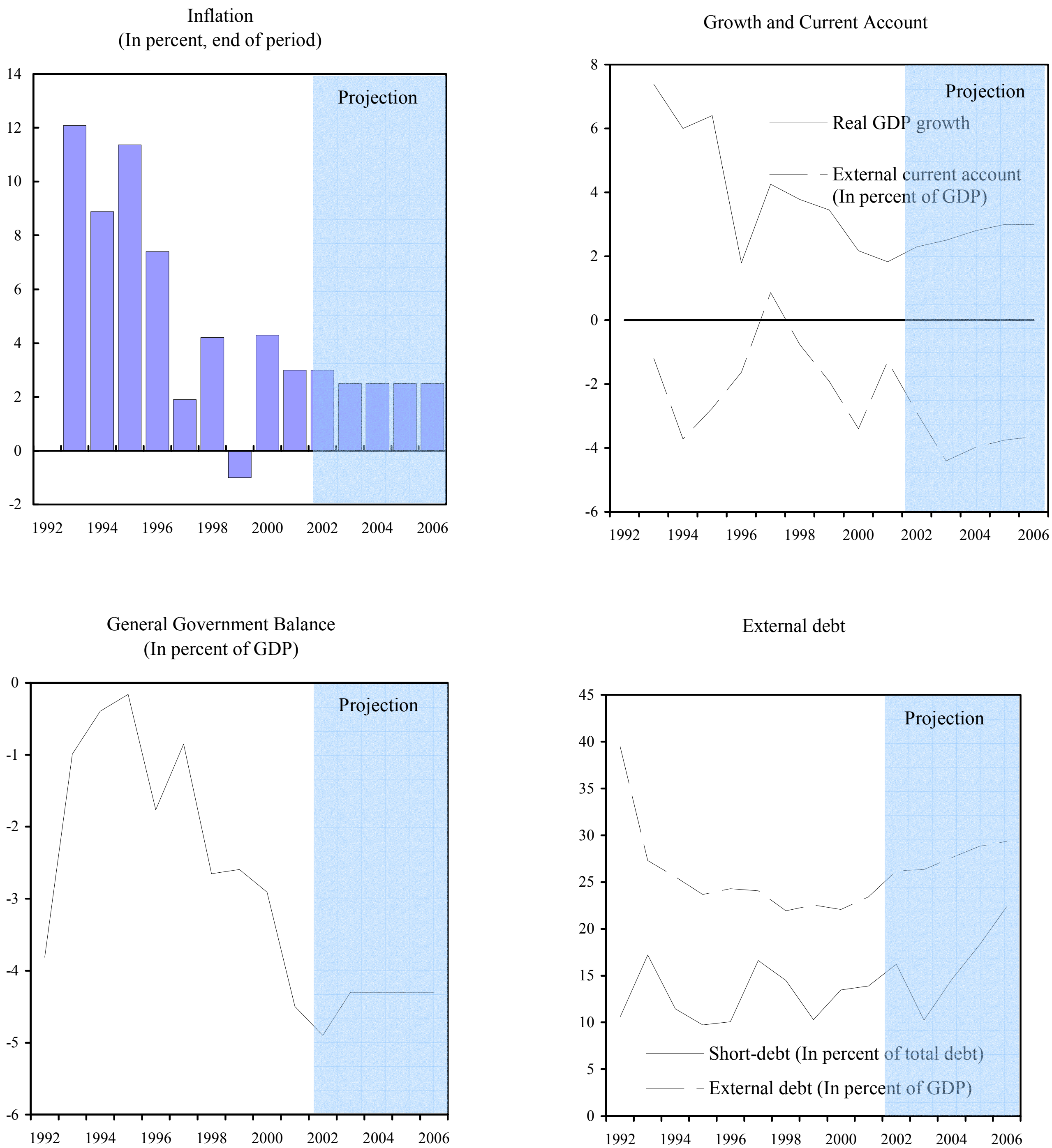
68. El Salvador has generally accessed international capital markets against mixed external financial market conditions. El Salvador issued its first three bonds in international capital markets when U.S. interest rates were either stable or declining. However, conditions in emerging markets were not supportive as emerging market spreads over comparable U.S. Treasury debt instruments were generally high. El Salvador's bond issue in April 2002

benefited from both stable U.S. interest rates and low emerging market spreads. This bond was placed in a period when emerging bond issuance reached near-record levels (after the longest dry spell in new emerging market issuance following the September 11 events). Investor demand at the time of issuance was driven by both crossover and dedicated investors, the latter drawing on a large cash position. El Salvador also benefited from Moodys' rating of Baa3 that reflected a moderate external debt burden, a good track record of structural reforms, and a continued commitment to macroeconomic stability. El Salvador's subsequent issues took place against a background of declining U.S. interest rates. Nonetheless, conditions in emerging markets were less than ideal as a result of concerns about the political situation in Brazil. El Salvador's successful placement during this period appears to indicate that investors placed more importance on this country's domestic economic performance.

**Market Access by Non-Sovereign Issuers**

69. El Salvador has become one the most sought after Latin American sovereign issuers, particularly reflecting its macroeconomic stability. This has been critical in helping Salvadorian financial institutions access international capital markets. Among the most important issuers in these markets have been Banco Agrícola, Banco Salvadoreño, and Banco Cuzcatlan.

Figure 7. El Salvador: Fundamentals, 1992-2006




Source: World Economic Outlook

## G. Tunisia

**Sovereign Bond Issues**

70. Tunisia first accessed international bond markets by tapping the Japanese market in 1994, when it issued a 20-year Samurai bond carrying a coupon of 5.85 percent. The bond was sold at 100.45 per 100 percent of face value. In an effort to benefit from the low coupons in the yen market, Tunisia subsequently issued in the Japanese market 10 bonds with maturities ranging from 2 years to 30 years. However, Tunisia also took steps to diversify its investor base by issuing bonds both in the United States and Europe. The country first issued two plain vanilla bonds with 10-year and 30-year maturities in the United States in 1997, for US$400 million, with a spread of 159 and 206 basis points, respectively. In 1999, Tunisia targeted the European market with a private placement of senior notes of €225 million with a spread of 280 basis points.

71. With a view to establishing a benchmark issue in international capital markets, in 2002 the authorities placed a 10-year U.S. dollar Global bond for US$650 million, thereby allowing Tunisia to become part of the EMBI Global. The high demand for this bond allowed Tunisia to increase the intended size of the issue by US$150 million. The issue was priced at 98.7 per US$100 of principal amount. The bond commanded a yield of 7.5 percent, which represented a spread at launch of 235 basis points over the 4.88 percent U.S. Treasuries, and had a duration of 6.6 years. The bond achieved widespread distribution as a result of its index-eligible size. While U.S. based investors absorbed 52 percent of the total issue, European investors took 48 percent of the issue. Across investor types, the split was the following: money managers (33 percent), insurance funds (22 percent), pension funds (21 percent), and banks (15 percent), with the rest allocated between hedge funds and retail investors.

72. In February 2003, Tunisia made a number of private placements, including one in yen. At the same time, Tunisia launched a €300 million bond in Europe with a maturity of 10 years. The bond was reopened later for an additional €30 million. The spread at launch was 230 basis points over mid-swaps, and the coupon was 6.25 percent. The bond was Tunisia's first issue in the euro market since 1999, and was placed mainly with European dedicated EM funds and crossover investors, this country's natural investor base.

**Domestic Economic Conditions**

73. Tunisia's economy has performed well for many years. Real GDP growth averaged 4.5 percent in 1994–2002. This reflected a sharp rise in investment and robust growth of exports, facilitated by a well-focused strategy in the tourism sector. The economy enjoyed a steadily rising investment rate since 1992 to around 27 percent of GDP. In this connection, FDI has played a critical role, increasing by an average of 10 percent during 1992–2001. Inflation has averaged 3.5 percent in 1994–2002. The government has shown a strong commitment to fiscal prudence, with the overall fiscal deficit averaging a manageable 3.2 percent of GDP. After widening in 2000–01, the current account deficit fell to 3.5 percent

of GDP in 2002 due to the sharp slowdown of the economy. Since 1994, external debt has remained unchanged at about 60 percent of GDP, of which the public external debt accounting for almost 75 percent. Some two-thirds of public external debt were owed to official creditors.

74. Tunisia's medium-term strategy (stated in the five-year policy plans) continues to be viewed positively by markets. A significant increase in real GDP growth is expected in 2003 (to around 5½ percent) and beyond based on a rebound in agricultural output, an economic recovery in Europe, and a pickup in the tourism sector. The authorities are targeting an average real GDP growth rate of about 6 percent in the medium term, requiring higher investment ratios and structural reforms. A prudent fiscal strategy is expected to continue to underpin macroeconomic stability. New borrowing is expected to stay fairly constant over the medium-term, resulting in a small projected decline of public external debt.

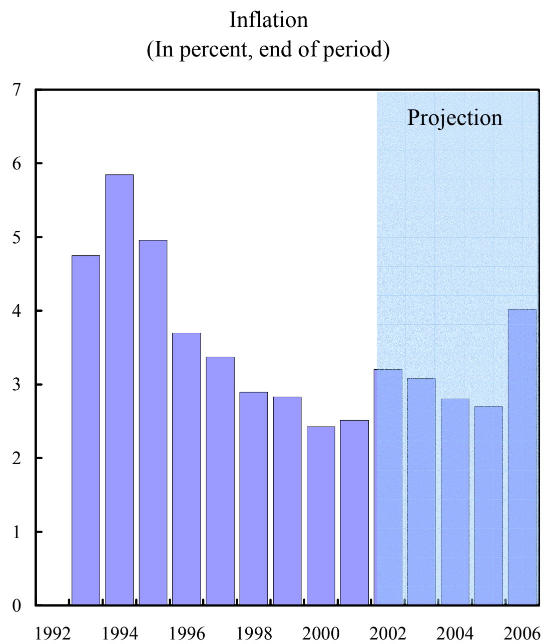
**External Financial Market Conditions**

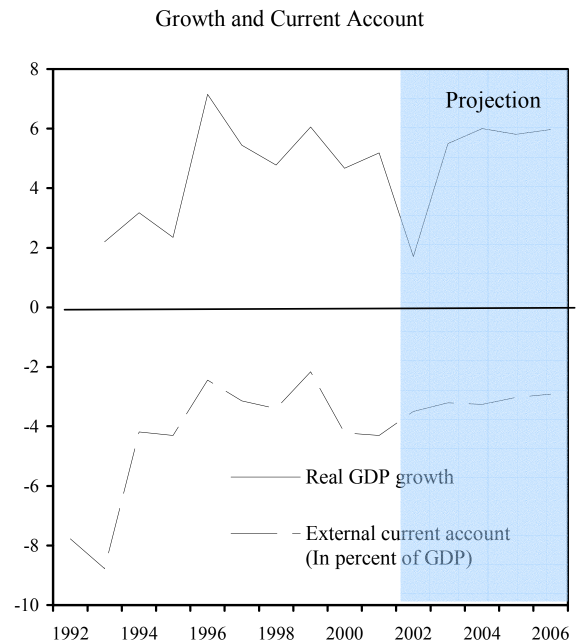
75. Tunisia is viewed as an active and sophisticated borrower with a diversified portfolio. Tunisia has benefited not only from its original investment credit rating (BBB-/Baa3) in 1997, but also from an outlook upgrade by Standard & Poor's (to BBB) in March 2000 and a credit rating upgrade by Moody's (to Baa2) in March 2003. Positive external market conditions and investor confidence in the Tunisian economy's prospects have allowed a tightening in spreads in 2003 (to 197 basis points in mid-April). Tunisia accessed the U.S. market in July 2002 at a time when risk appetite and liquidity were high. In February 2003, the country issued a 10-year Eurobond against the backdrop of an EM rally. Given abundant international liquidity, the authorities decided to launch the transaction to complete Tunisia's external borrowing at the beginning of the year.

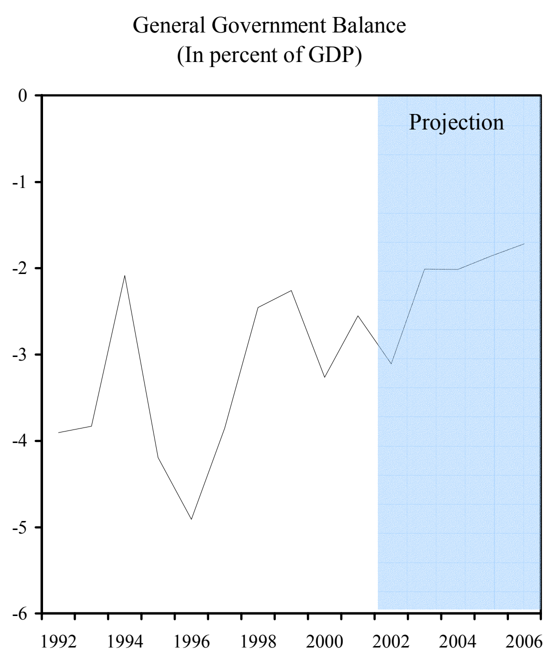
**Market Access by Non-Sovereign Issuers**

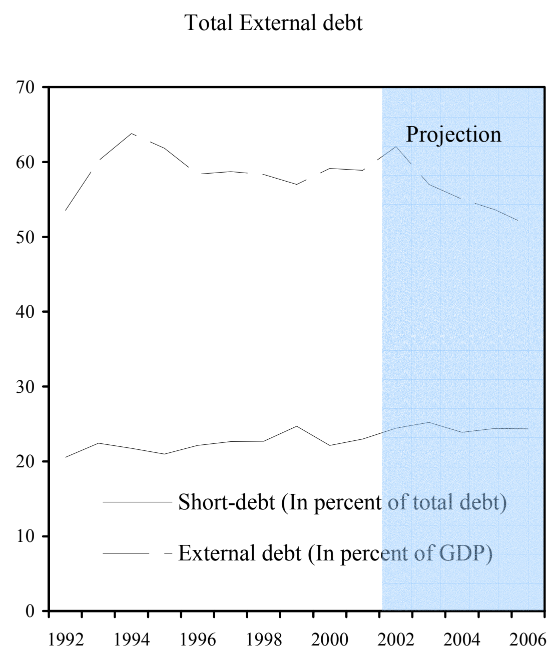
76. Tunisian corporates have not accessed international bond markets. However, public corporates have accessed the syndicated loan market regularly since 1980. Nouvelair, Societe Tunisienne d'Electricite et du Gaz, Societe d'Electricite, l'Enterprise Tunissiene d'Activites Petroliers, and Tunissair have secured loans in recent years. Union Internationale de Banques obtained its debut loan of US$50 million in July 2002 with a spread of 75 basis points over Libor.

Figure 8. Tunisia: Fundamentals, 1992-2006




Source: World Economic Outlook