

**REPORT TO CONGRESS ON  
THE INTERNATIONAL MONETARY FUND'S  
LOANS TO St. KITTS & NEVIS AND GREECE**



A Report to Congress

*consistent with*

Section 1501 of the  
Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010

United States Department of the Treasury  
June 2012

## ***Introduction***

Consistent with section 1501 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010*,<sup>1</sup> this report provides an annual update of the assessment of the likelihood that the International Monetary Fund (IMF or Fund) loans made to St. Kitts & Nevis (SKN) and to Greece will be repaid in full, including these countries' debt status, vulnerabilities, and debt management strategy.

As directed by section 1501, and consistent with its longstanding practice with respect to all loans, the Office of the United States Executive Director (USED) at the IMF, in close coordination with the Treasury Department, conducted a careful and thorough evaluation of the proposals for the SKN and Greece programs submitted to the IMF Executive Board given that these countries' debt-to-GDP ratio exceeded 100 percent and they are not eligible for assistance from the International Development Association.

## **St Kitts & Nevis**

On July 27, 2011, the IMF Executive Board approved an \$84 million Stand-By Arrangement (SBA) for SKN. The second review of the IMF program was completed by the IMF Board on May 21, 2012. All program targets for the end-December 2011 reference period were met, and the structural benchmarks were completed. A disbursement of \$4.8 million was approved bringing total funding disbursed to SKN under the program so far to \$58.1 million.

## **Program Performance**

The overall fiscal balance in 2011 was a surplus of \$15.4 million (1.8 percent of GDP), significantly above the program target of a \$12.7 million deficit. Tax revenue was broadly in line with expectations while non-tax revenue far exceeded the projection made at the time of the first review, due to strong performance of the citizenship-by-investment program, transfers from the Sugar Industry Diversification Foundation, and dividend receipts. Overall, expenditure was lower than what had been projected, with restraint in current outlays, especially on goods and services, offsetting higher capital spending.

The authorities completed the four structural benchmarks required during the period of the review, which included: (1) submitting to Cabinet a proposal to rationalize the subsidy on liquefied petroleum gas; (2) reviewing the borrowing capacity of public enterprises; (3) submitting the social safety net reform strategy to Cabinet; and, (4) updating the stress tests of the SKN banks.

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<sup>1</sup>P.L. 111-203; codified at 22 U.S.C. 286tt(b), section 68(b) of the Bretton Woods Agreements Act: "Within 30 days after the Board of Executive Directors of the Fund approves a proposal [to make a loan to a country whose public debt exceeds gross domestic product and is not eligible for assistance from the International Development Association] and annually thereafter by June 30, for the duration of any program approved under such proposals, the Secretary of the Treasury shall report in writing . . . assessing the likelihood that loans made pursuant to such proposals will be repaid in full . . . ."

### ***Debt Status***

The authorities concluded a successful debt exchange with bondholders and external commercial creditors on April 18, 2012. The exchange offer covered \$135 million of eligible claims, equivalent to about 19 percent of GDP. Creditor participation was strong, reaching 97 percent. In addition, further progress has been made with respect to the resolution of domestic loans, including on the conversion of loans secured with land. A shareholders' agreement was signed which determines the parameters of an exchange of approximately \$330 million of secured loans for land and equity in a new special purpose vehicle (SPV) that will manage land sales. Next steps involve the establishment of the SPV and the transfers of the land. In addition, the terms of unsecured domestic debt (mainly owed to commercial banks and a minority portion of domestic debt) is being negotiated to further reduce SKN's debt servicing burden.

Based on these actions and the current economic outlook, IMF staff estimates that the eventual scale of the debt restructuring will lead to a reduction in total public debt from 154 percent of GDP at end-2011 to about 100 percent of GDP at end-2012. This will set debt on a trajectory to fall within the Eastern Caribbean Currency Union (ECCU) target of 60 percent of GDP by end-2020.

SKN has relied heavily on short-term financing, with (primarily 91-day) T-bills and overdrafts representing roughly 21 percent of total public debt before the debt restructuring. Once the restructuring of remaining debt is complete, IMF staff estimate that T-bills will represent 20-25 percent of total debt. The maturity extension of the remaining unsecured loans will help lengthen the overall maturity profile.

### ***Debt Management Strategy***

The government's primary objective is to place SKN's public debt on a downward trajectory, aimed at achieving a 60 percent debt-to-GDP ratio by 2020. The debt restructuring is providing significant momentum to achieve this goal. In addition, under the program the government is committed to running primary surpluses that reduce the need for additional debt and allow for a reduction in outstanding debt.

### ***Vulnerabilities***

SKN's primary external vulnerabilities remain its exposure to the U.S. economy and natural disasters. Tourism receipts are equivalent to 15 to 25 percent of GDP, and the United States is SKN's primary tourism market. As such, a downturn and/or continued high unemployment in the United States would negatively impact SKN tourism receipts and foreign investment inflows. Like other small Caribbean island economies, SKN is also vulnerable to natural disasters. For example, the last hurricane to strike SKN, in late 2008, resulted in the extended closure of a major hotel on Nevis, adversely impacting the SKN tourism industry. Savings gained from planned fiscal consolidation and debt restructuring under the IMF program should help to provide a cushion for the government to guard against and mitigate these vulnerabilities.

SKN's primary internal vulnerability is the large exposure of its banking sector to government debt. The authorities and IMF staff are monitoring the impact of the restructuring on domestic banks closely for any signs of strain. Preliminary stress tests that the Eastern Caribbean Central Bank (ECCB) conducted were updated and confirm that the banking sector will have sufficient capital to absorb the impact of the ongoing government debt restructuring. Moreover, the Banking Sector Reserve Fund, established with financing from the IMF as part of its program, remains in place to provide a liquidity backstop to banks if required to help address vulnerabilities arising in the financial sector.

### ***Overall Assessment***

SKN remains heavily indebted and vulnerable. However, its IMF-supported program, combined with the debt restructuring, is providing the best opportunity for the country to return to a sustainable debt path and mitigate its vulnerabilities. IMF resources will continue to be safeguarded by the following:

- Demonstrated SKN government commitment to implement the policy measures that are a precondition of subsequent IMF financing under the program. Performance under the IMF program has been very strong with all targets having been met.
- Completion of a debt restructuring on external debt and bonds that reached 97 percent in creditor participation for \$135 million of eligible debt.
- Significant progress in the debt restructuring process of domestic creditors in the context of a debt-for-land swap.
- IMF financial support and policy guidance, which will help to fill SKN's financing gap, mitigate vulnerabilities by backstopping the banking sector during the debt restructuring, and ensure sound policies.
- Strong IMF program conditionality and rigorous quarterly reviews.
- The IMF's preferred creditor status, ensuring that it is repaid ahead of all other creditors.
- Agreement with the Paris Club to reschedule principal payments over the term of the IMF program.

With these factors in mind, the Treasury Department continues to assess that the IMF's loan to SKN is most likely to be repaid in full.

### **Greece**

On March 15, 2012, the IMF Executive Board approved a \$36.7 billion Extended Fund Facility (EFF) for Greece. Greece's economic reform program is a critical part of a broader European effort to promote EU and global financial stability. Europe's stability is critical for avoiding global financial contagion and safeguarding the U.S. economic recovery. Given the IMF's

wealth of experience designing credible economic adjustment programs, its engagement alongside the European Union to help restore macroeconomic and financial stability is very much in the best interests of the United States.

Greek parliamentary elections took place on Sunday, June 17, 2012. A new government was sworn in on Wednesday, June 20, led by New Democracy, together with PASOK and Democratic Left. New Democracy and PASOK parties, which have a parliamentary majority by themselves (162 of 300 seats), were signatories to a letter of support for the EU/IMF program approved in March. The European Commission and IMF are expected to engage with the new government to assess program implementation to date and to discuss policy actions that would allow continuation of the EU/IMF program.

### ***Debt Status***

Since the last report to Congress on Greece's IMF program on April 13, no further data on Greece's debt has been released. As noted in the last report, as of December 2011 (the latest date for which data are available), the Greek government's debt was \$470 billion, equivalent to 165.3 percent of 2011 GDP. Approximately \$258 billion in debt was subject to the debt exchange, and the face value of debt owed to the private sector was halved according to estimates. The debt exchange entailed a deep write down for bondholders; in net present value terms losses range from 70 to 75 percent. Debt owed to the official sector is projected to increase substantially with the approval of the EU/IMF program. The bulk of the increase (\$149 billion of the \$158 billion increase) will be owed to other EU member states, which in addition to program financing, have financed the up-front costs of the debt exchange, including by providing the EFSF notes to be used in the exchange and helping to recapitalize Greek banks which suffered losses on their holdings of Greek government debt. As noted in the last report, and based on full implementation of the program, the IMF expects that Greece's debt-to-GDP ratio would decline from 165.3 percent of GDP at end-2010 to roughly 116.5 percent of GDP by 2020.

### ***Debt Management Strategy***

The Greek government's primary objective continues to be placing its public debt on a downward trajectory, aimed at achieving a debt-to-GDP ratio of about 120 percent by 2020. To meet this objective, in addition to the private debt exchange, the government is undertaking fiscal consolidation aimed at achieving and maintaining a primary surplus that reduces the need for additional debt and allows for a reduction in outstanding debt. In addition, the Greek government has committed to undertaking significant privatizations. The authorities are aiming to regain medium- and long-term market access in the period after the program.

### ***Vulnerabilities***

The Greek authorities have committed to an ambitious package of reforms to regain growth and competitiveness that will take time to implement and bear fruit. There are significant headwinds to improving economic growth in the near term, including fiscal consolidation, the need to regain competitiveness through wage restraint and price reductions, and deleveraging in the financial

sector. Protracted economic stagnation and political risk could hinder fiscal consolidation efforts and put additional pressure on the banking sector and represents a key vulnerability.

### ***Overall Assessment***

Greece is heavily indebted and vulnerable. However, its EU/IMF-supported economic reform program, combined with the restructuring of private sector debt, provides the best opportunity for the country to return to a sustainable debt path and lower its vulnerabilities. The IMF program was carefully designed to address the significant vulnerabilities facing Greece, limit the IMF's own exposure and link it clearly to Greece's performance, and to enhance the likelihood of the IMF being repaid.

IMF resources will be safeguarded by the following:

- The government has already completed a large debt exchange that sharply reduced the face value of its privately held debt. Without this restructuring, the government's debt would have risen to unsustainable levels.
- The IMF program includes strong conditionality and rigorous quarterly reviews. Program conditionality agreed to by the government focuses on the following areas: fiscal consolidation aimed at achieving debt sustainability over the medium-term; strengthening public financial management; reforming the social transfer system and improving its effectiveness; and, enhancing the stability of the financial sector.
- The IMF's lending to Greece is set to be repaid over a much shorter time horizon (4.5-10 years) than that of the European contributions (25 years with a 10-year grace period) and the restructured privately-held Greek government bonds (30 years with a 10-year grace).
- The Eurogroup has made financing assurances to provide long-term support to Greece on adequate terms provided that Greece continues to adhere to program policies.
- The IMF's preferred creditor status, ensuring that it is repaid ahead of all other creditors.

With these factors in mind, the Treasury Department continues to assess that the IMF's loan to Greece is likely to be repaid in full.