

**REPORT TO CONGRESS ON
THE INTERNATIONAL MONETARY FUND'S
LOANS TO ST. KITTS AND NEVIS, JAMAICA, 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
July 2014

Introduction

This report provides an annual update assessing the likelihood that International Monetary Fund (IMF or Fund) loans, made to countries whose public debt exceeds gross domestic product and who are not eligible for assistance from the International Development Association, will be repaid in full. This report is required by section 1501 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010*.¹ Three countries: St. Kitts and Nevis (SKN), Jamaica, and Greece met the conditions of section 1501 and are covered in this report.

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 International Monetary Fund (IMF), in close coordination with the Treasury Department, conducted a careful and thorough evaluation of the proposed programs for SKN, Jamaica, and Greece when they were submitted to the IMF Executive Board.

St. Kitts and Nevis

On July 27, 2011, the IMF Executive Board approved a three-year \$84 million Stand-By Arrangement (SBA) for SKN. The seventh and eighth reviews of the IMF program were approved by the IMF Board on March 5, 2014. All fiscal program targets were met by a significant margin with the exception of the continuous ceiling on external arrears, though arrears were minor in size and quickly repaid. A waiver of applicability was granted for performance criteria for end-December 2013 because data were not yet available to assess performance and there was no evidence that they were not observed. A disbursement of \$3.43 million was approved, bringing total funding disbursed to SKN under the program so far to approximately \$74 million.

Following a 10 percent contraction in output from 2009 to 2012, the economy of SKN expanded by an estimated 1.7 percent in 2013. Growth was driven by the tourism and construction sectors, which offset declines in the manufacturing and communications sectors. The overall fiscal balance improved from a deficit of 7.8 percent of GDP in 2010 to surplus of 10.6 percent in 2013. The primary fiscal balance moved from a deficit position of 0.8 percent of GDP in 2010 to a surplus of 15.5 percent in 2013, more than double the IMF program requirement. The substantial turnaround was driven by fees collected under the Citizenship by Investment (CBI) program, as well as expenditure controls including a public sector wage freeze in place until August 2013, and a drop in capital expenditure equal to two percentage points of GDP. Revenues from the CBI were 13 percent of GDP in 2013 (historic norm is about 2.5 percent of GDP). Additional revenue generated by the VAT also contributed to the improved fiscal balance, though reforms to limit preferences for non-strategic sectors would further increase revenues. SKN's current account deficit improved from 12 percent of GDP in 2012 to 8.5

¹P.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"

percent in 2013. In addition to increased CBI and tourism receipts, import compression following years of low growth that suppressed domestic demand helps explain the sharp improvement in the current account.

However, SKN struggled to make progress in several structural reform areas. Multiple benchmarks were missed owing to capacity constraints, delays in technical assistance, and shifting priorities. SKN delayed the draft proposal for comprehensive pension reform, development of a strategy for means testing for its planned consolidated cash transfer program, and the operationalization of the 2011 Civil Service Act, though the latter was expected to be completed by end-June 2014.

Debt Status

SKN made substantial progress in reducing public debt from 164 percent of GDP in 2010 to a projected 105 percent of GDP in 2013. In addition to significant fiscal adjustment, SKN reduced public debt by rescheduling with Paris Club creditors, exchanging new debt instruments with bondholders and external creditors that imposed an average haircut equivalent to 65 percent net present value, and swapping land for debt with domestic creditors, first for secured loans and later for unsecured loans. The SKN government reduced its domestic debt from 114.4 percent of GDP in 2010 to a projected 62.4 percent at end-2013 as a result of the land-for-debt swaps and lowered its external debt from 49.5 percent of GDP to 42.5 percent.

Debt Management Strategy

The government's primary objective is to achieve a 60 percent debt-to-GDP ratio by 2020, in line with the Eastern Caribbean Currency Union (ECCU) debt target for its members. The debt restructuring already achieved has helped put SKN's debt on a downward trajectory, as reflected in the recent sharp decline in public debt to a projected 105 percent of GDP at end-2013. In addition, under the program the government is committed to continuing running primary surpluses to reduce the need for additional debt and allow for a reduction in outstanding debt. The IMF's baseline analysis projects a continued decline in debt. However, IMF staff note that the projected decline is particularly sensitive to lower-than-expected growth and higher-than-expected external financing needs, which could in turn result from a potentially worse current account position. In these scenarios, debt continues to decline as a share of GDP, but remains above the 60 percent target in 2020.

Vulnerabilities

Like other small Caribbean island economies, SKN is vulnerable to natural disasters. 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. Tourism receipts, equivalent to about 15 percent of GDP, are also dependent on economic activity in the United States, SKN's primary tourism market. To a lesser extent, uncertainties surrounding the euro area economy also present a downside risk to SKN. Savings gained from fiscal consolidation and higher-than-expected CBI receipts, in addition to debt restructuring under the IMF program, should help to provide a cushion for the government to guard against and mitigate these external vulnerabilities.

SKN's primary internal vulnerabilities are the large exposure of its banking sector to government debt and, as the debt-for-land swap program concludes, the banking sector's exposure to land prices. With the restructuring of government debt to domestic banks nearly complete, non-performing loans as a share of total loans have increased to 10.5 percent, causing banks to pull back on lending. The authorities and IMF staff are monitoring the impact of the restructuring on domestic banks closely. The Eastern Caribbean Central Bank's (ECCB) quarterly stress tests, as updated, have confirmed that the banking sector is sufficiently well-capitalized 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 (although its use has not been necessary thus far).

Overall Assessment

SKN remains 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 commitment of the SKN government 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, and almost all targets have been met.
- Successful restructuring of Paris Club and other external debt and bonds in 2012, and significant progress in debt restructuring of domestic creditors in the context of the ongoing 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 to ensure continued adjustment and reform implementation by SKN.
- 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 SKN is likely to be repaid in full.

Jamaica

On May 1, 2013, the IMF Executive Board approved a four-year Extended Fund Facility (EFF) in the amount of \$926 million for Jamaica. The main pillars of the program are: (i) structural

reforms to boost growth; (ii) actions to improve price and non-price competitiveness; (iii) upfront fiscal adjustment, supported by extensive fiscal reforms; (iv) debt management operations that place public debt on a sustainable path, while protecting financial system stability; and, (v) improved social protection programs to help the most vulnerable. The fourth review of the IMF program was approved by the IMF Board on June 20, 2014. All fiscal and structural program targets for the review were met at end-March 2014. A disbursement of \$70.8 million was approved, bringing total funding disbursed under the program to \$412.3 million.

An inflexible currency and unsustainably expansionary policies contributed to a current account deficit that reached nearly 15 percent of GDP in 2012 and led to a significant loss in Jamaica's foreign exchange reserves. Since program approval, the currency has substantially adjusted toward its equilibrium level, the macroeconomic situation has stabilized and Jamaica has begun to rebuild reserve buffers. Economic performance for Jamaica's fiscal year 2014 (ended March 2014) was broadly in line with the program framework, with small but positive real GDP growth of 1 percent, and a smaller current account deficit, driven by a weaker currency and lower demand for imports. The government executed the necessary expenditure reductions to meet the primary fiscal surplus target of 7.5 percent of GDP.

During its 2014 fiscal year, Jamaica concluded far-reaching tax reforms, including the streamlining and reduction of tax expenditures, and adopted a fiscal rule aimed at entrenching discipline and lowering total debt to 60 percent of GDP by fiscal year 2026. Jamaica introduced reforms to support the development of collective investment schemes, streamlined business registration process, tabled a Bankruptcy and Insolvency Act, created a central collateral registry, and approved new forms of collateral in order to facilitate access to finance for SMEs. Reform focus is now turning to complementary areas such as tax and customs administration, public financial management, the framework for monetary policy, and improving the business environment.

Debt Status

Since December 2012, debt-to-GDP has dropped from 147 percent to 140 percent at end-March 2014, below the projected level of 143 percent. As growth-enhancing reforms take hold, Jamaica's debt position should continue to improve as revenues are bolstered and GDP growth directly contributes to a lower debt-to-GDP ratio. The new fiscal rule places a floor of the overall fiscal balance with the goal of reducing debt-to-GDP to 60 percent by 2026. Furthermore, the rule requires expenditure cuts should cumulative deviations from the fiscal balance threshold exceed 1.5 percent of GDP, and triggers automatic cuts in primary spending should cumulative deviations exceed 3.5 percent of GDP. The rule will be phased in after the conclusion of the EFF so that program targets do not overlap.

Debt Management Strategy

The government's primary objective is to place Jamaica's public debt on a downward trajectory, aimed at achieving a 96 percent debt-to-GDP ratio by 2020. In order to meet this objective, the government is committed to running primary surpluses that reduce the need for additional debt and allow for a reduction in outstanding debt. Reaching the goal will likely require more than

the planned fiscal consolidation and debt restructuring and will likely entail debt-asset swaps or asset sales. To support restoration of debt sustainability, the authorities implemented a debt exchange in early-2013 which will contribute 8.6 percentage points of reduction in the public debt ratio by 2020. The IMF baseline analysis projects a continued decline in debt. However, the IMF notes this baseline assumption is sensitive to lower-than-expected growth, contingent liability shocks emerging from the financial sector, and higher-than-expected external financing needs in case of a current account shock.

Vulnerabilities

Jamaica's tourism sector is dependent on economic conditions in the United States, Canada, and the United Kingdom. Jamaica is also highly vulnerable to commodity price shocks and weather-related natural disasters. 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.

Jamaica's primary internal vulnerability is the large exposure of its banks and securities dealers to government debt. The Financial Sector Support Fund, established with financing from the IMF as part of the previous program and bolstered under this program, will provide a liquidity backstop to financial institutions (banks, securities dealers, insurance companies) if required to help address vulnerabilities arising in the financial sector due to the debt exchange.

Overall Assessment

Jamaica is heavily indebted and vulnerable. However, its IMF-supported program, combined with the debt restructuring, provides the best opportunity for the country to return to a sustainable debt path and mitigate its vulnerabilities.

IMF resources are safeguarded by the following:

- Completion of measures prior to program approval to enhance the starting point of the IMF program. Performance under the IMF program has been very strong, and all targets have been met.
- Completion of a debt restructuring process in an open and transparent manner, with constructive Jamaican government engagement with creditors.
- IMF financial support and policy guidance, which will help to fill Jamaica's financing gap, and mitigate vulnerabilities by backstopping the banking sector during the debt restructuring, and ensuring sound policies.
- Strong IMF program conditionality and rigorous reviews. Program conditionality agreed to by the government focuses on the following areas: maintaining government fiscal surpluses at a level consistent with achieving debt reduction over the medium-term; strengthening public financial management; and, enhancing competitiveness.
- The IMF's preferred creditor status, ensuring that it is repaid ahead of all other creditors.

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

Greece

On March 15, 2012, the IMF Executive Board approved a four-year Extended Fund Facility (EFF) for Greece, making available approximately \$36 billion in funding. The fifth review of Greece's progress under the program was concluded on May 30, 2014, and the total amount disbursed under the IMF program has risen to approximately \$15.4 billion. Greece met all but one of the fiscal quantitative program targets, and requested a waiver for the performance criterion related to domestic arrears clearance. Greece accelerated reforms in product and services sectors, where its performance had lagged, and continued to make progress in the area of tax administration. Greece's economic reform program is part of a broader European Union (EU) effort to promote European and global financial stability, which remains critical to ensuring a robust U.S. economic recovery. It is very much in the interest of the United States that the IMF – with its vast experience designing credible economic adjustment programs – is engaged alongside the European Union to help restore macroeconomic and financial stability in Europe and globally.

Greece is carrying out a necessary and ambitious fiscal adjustment, having exceeded its program fiscal targets for 2013. The economy is expected to expand in 2014 following six years of recession and a cumulative decline in real output of 25 percent. The overall fiscal deficit for 2013 is estimated to have been 3.2 percent of GDP, compared to a program target of 4.1 percent. The deficit is projected to shrink to 2.7 percent of GDP in 2014. Moreover, Greece achieved a primary fiscal surplus of 0.8 percent of GDP for 2013, compared to a program target of achieving fiscal balance, and is projected to be in surplus of 1.5 percent of GDP in 2014. The current account surplus was 0.7 percent of GDP, the first surplus in decades, driven by strong tourism receipts, oil exports, and low demand for imports. In April 2014 the Greek government re-accessed international capital markets for the first time in four years by issuing €3 billion of 5-year bonds.

Debt Status

Greece's public debt is estimated to have risen to 175 percent of GDP in 2013 and is projected to decline slightly to 174 percent of GDP this year. The extraordinary fiscal adjustment underway and a return to economic growth should help improve Greece's debt dynamics.

Debt Management Strategy

The Greek government's primary objective continues to be placing its public debt on a downward trajectory. To this end, the government is committed to reducing debt by undertaking fiscal consolidation under the program. Measures are aimed at maintaining a primary surplus through effective expenditure controls and reforms to increase revenue collection. IMF staff's debt sustainability analysis (DSA) shows Greek debt declining to 128 percent of GDP in 2020

under the baseline scenario and 117 percent of GDP by 2022. Staff show that the achievement of primary surpluses will reduce the need for additional debt and allow for a gradual reduction in outstanding debt. However, worse-than-expected deflation, underperformance in privatization of state assets, and failure to gain competitiveness through structural reforms could adversely affect Greece's debt trajectory.

Vulnerabilities

The Greek authorities have committed to an ambitious package of reforms to regain growth and competitiveness, but these will take time to implement and bear fruit. The expected pace of decline in debt is highly vulnerable to growth shocks and program delays. The greatest risks to debt sustainability are program implementation delays (in particular, privatization and reforms of the tax administration, public financial management, and public administration) and weaker-than-expected economic performance in the euro area. Privatization targets were revised downwards in the most recent review, reforms in the labor market slowed, and public administration reform came up against legal restrictions on merit-based personnel decisions. Greece's banks face substantial and still-rising volumes of bad loans on their balance sheets, and stronger efforts from the authorities are needed to improve the insolvency framework, facilitate bad debt resolution, and restore bank balance sheets to health. The prospect of having to endure high public debt for many years itself poses an added risk to debt sustainability. Public and political support for continued adjustment could wane, and investor concerns about debt sustainability could further delay economic recovery and, hence, debt reduction.

Overall Assessment

Greece is heavily indebted and vulnerable. However, its EU/IMF-supported economic reform program, following on the 2012 restructuring of government debt, provides the best opportunity for the country to return to a sustainable debt path. The IMF program was carefully designed to address the significant vulnerabilities facing Greece, limit the IMF's own exposure, and to enhance the likelihood of the IMF being repaid.

IMF resources will be safeguarded by the following:

- Strong commitment of the authorities to meet the program criteria. Greece met nearly all its performance criteria for the fifth review, including achieving primary fiscal and external current account surpluses, and is on track to meet its fiscal target for 2014.
- The Greek government has made significant progress in restructuring and recapitalizing the banks, and vulnerabilities will be tamed through plans to strengthen bank governance, reduce household and corporate debt, and clean up balance sheets.
- 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 be even higher.

- The IMF program includes strong conditionality. 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.
- Greece's European partners have committed to provide debt relief as needed to ensure financing under the program and beyond. The Eurogroup (the 17 finance ministers of the countries in the euro area monetary union) has made financing assurances to provide long-term support to Greece on adequate terms, provided that Greece continues to adhere to program policies. This commitment was not explicit under Greece's first program and is a key element of the financing assurances under the current program.
- 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 period).
- 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.