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
June 2013

Introduction

Consistent with section 1501 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010*,[1] 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 and Nevis (SKN), Jamaica, and 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, Jamaica, 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 and Nevis

On July 27, 2011, the IMF Executive Board approved a three-year $84 million Stand-By Arrangement (SBA) for SKN. The fourth review of the IMF program was approved by the IMF Board on November 30, 2012. All quantitative performance criteria under the program for the end-June 2012 reference period were met, and the structural benchmarks were also completed. A waiver of applicability was granted for performance criteria for end-September 2012, because data were not yet available to assess performance. A disbursement of $4.9 million was approved, bringing total funding disbursed to SKN under the program so far to approximately $66 million. The fifth and sixth reviews of SKN's program are expected to be discussed by the IMF Executive Board in July. These joint reviews, which will assess program performance through end-March 2013, were delayed primarily due to a delay in the passage of the 2013 budget caused by elections in Nevis and political uncertainty in St. Kitts. The budget was finally passed in May.

St. Kitts and Nevis has made significant progress in restructuring its public debt and implementing a debt-for-land swap, resulting in a sharp decline in general government gross debt to under 100 percent of GDP at the end of 2012. The overall fiscal balance for the first half of 2012 reached a surplus of $23 million (3.1 percent of GDP), significantly above the program target floor of a $19 million deficit. Revenue from direct taxes and the citizenship-by-investment program exceeded program expectations, offsetting weaker receipts from taxes on goods and services and international trade. The IMF estimates the overall fiscal balance for the year 2012 reached a surplus of $18 million (2.4 percent of GDP), which would again

[1]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 . . . ."

substantially exceed program objectives. The authorities' 2013 budget aims at an overall surplus of 2.5 percent of GDP.

In addition, the authorities completed all program structural benchmarks for end-June and end-September 2012, including an update to the stress test of the banking system and plans for public land sales and civil service reforms. The current review (joint fifth and sixth) will measure progress against end-Dec. 2012 and end-March 2013 benchmarks.

Debt Status

Following the Paris Club meeting in May 2012, the United Kingdom cancelled its debt claim in June 2012. Moreover, to facilitate the restructuring of domestic debt through a debt/land swap, 1,200 acres of land were transferred to the land asset management company (Special Purpose Vehicle, or SPV) commissioned with selling the land. Combined with the debt exchange concluded in April 2012 with bondholders and external commercial creditors, these operations have contributed to reduce public debt from 153.6 percent of GDP at end-2011 to 89.3 percent of GDP at end-2012.

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 government debt to under 90 percent of GDP at end-2012. In addition, under the program the government is committed to continuing to run primary surpluses to reduce the need for additional debt and allow for a reduction in outstanding debt.

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 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 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. 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 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. 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.

Fiscal performance for Jamaica's fiscal year 2013 (ended March 2013) slightly outperformed projections, with the central government primary surplus improving to 5.4 percent of GDP (versus a projection of 5.2 percent), mainly owing to a decline in primary expenditure. The fiscal year 2014 budget, tabled in Parliament in April, is in line with the government's program and targets a central government primary surplus of 7.5 percent of GDP. Work is progressing on the tax reform agenda, and on actions to improve public financial management and the business climate. Unsustainable policy settings had resulted in a significant loss in Jamaica's foreign exchange reserves, but since program approval, the situation has stabilized and Jamaica has begun to rebuild reserve buffers.

Debt Status

Since the last report to Congress on Jamaica's IMF program approved on May 1, no further data on Jamaica's debt have been released. As noted in the last report, as of December 2012 (the latest date for which data is available), the Jamaican government's debt was $19.8 billion, equivalent to 147 percent of 2012 GDP. The private debt restructuring, completed in February 2013, will improve debt dynamics. In addition, 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.

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. It has also identified options for debt swaps and guarantees aimed to contribute two percent of GDP in debt reduction by 2020.

Vulnerabilities

Jamaica's primary external vulnerabilities are its exposure to the U.S. and UK economies, natural disasters, and oil price shocks. Jamaica's tourism sector is dependent on an economic recovery 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 banking sector 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 – and will continue to be – safeguarded by the following:

- Completion of measures prior to program approval to enhance the starting point of the IMF program. For example, the government has reached agreement with public sector unions representing more than 81 percent of workers to limit wage increases and secured cabinet acceptance of the elimination of discretionary tax waivers.

- 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 third review of Greece's progress under the program was concluded on May 31, 2013, and the total amount disbursed under the IMF program has risen to approximately $8.5 billion. Greece completed all of the measures it had undertaken to implement for the review. Fiscal performance through end-March was running slightly ahead of program targets, bank recapitalization is nearing completion, and competitiveness has improved, in part due to wage adjustment following reforms that have increased labor market flexibility. 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 2012 and on track to meet its targets for 2013. The overall fiscal deficit for 2012 is estimated to have been 6.3 percent of GDP, compared to a program target of 6.7 percent. The deficit is projected to come down to 4.1 for 2013. Moreover, Greece's primary deficit fell to 1.3 percent of GDP for 2012, compared to a program target of 1.5 percent, and is projected to be in balance this year.

The IMF, along with the European Commission and the European Central Bank, has engaged fully with the Greek government, elected last June, to ensure that the program remains on course. Through its Task Force for Greece, Europe is providing technical assistance to help

Greece deliver on its EU-IMF program commitments, through measures focused on enhancing competitiveness, growth, and employment.

A recently published IMF report assessing Greece's first IMF-EU program, approved in 2010, concludes that overly optimistic economic assumptions and shortfalls in the EU institutional capacity to deal with crises contributed to Greece's first program going off track. Greece's current (second) program has drawn lessons from the weaknesses of the first program. The current program is based on more realistic macroeconomic assumptions and revised fiscal multipliers that better reflect the current growth and interest rate environment, and includes €50 billion for bank recapitalization. Moreover, since the first program, Europe has made significant progress on institutional reforms to strengthen the foundations of the currency union and on tools to bolster financial stability.

Debt Status

Greece's public debt is estimated to have reached 157 percent of GDP in 2012 and is projected to peak at 175 percent of GDP this year, declining gradually thereafter. Staff's debt sustainability analysis (DSA) continues to show Greek debt declining to the target of 124 percent of GDP in 2020 under the baseline scenario. The public and private debt restructurings last year helped reduce government debt, but the economic recession is still weighing on Greece's debt dynamics.

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 124 percent by 2020. To this end, the government is committed to reducing debt by undertaking fiscal consolidation under the program. Measures are aimed at achieving and maintaining a primary surplus through effective expenditure controls and reforms to increase revenue collection. The achievement of primary surpluses, projected to be reached in 2014, will reduce the need for additional debt and allow for a gradual reduction in outstanding debt. In addition, the Greek government has committed to undertake significant privatizations to raise further revenues. While this process is moving forward, efforts need to be stepped up to avoid further delays. 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, but these will take time to implement and bear fruit. Greece's expected gradual downward debt trajectory 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. 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 last year's 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 and reform benchmarks. Greece met its performance criteria for the first three reviews and is on track to meet its fiscal target for 2013.

- 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 conduct a new set of bank stress tests. Greece's competitiveness has also improved, in part through labor market reforms, and its current account deficit has narrowed.

- 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 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.

- 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 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 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.