GOVERNMENT OF ST. KITTS AND NEVIS

2015 – 2017
MEDIUM-TERM
DEBT MANAGEMENT STRATEGY
UPDATE

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Ministry of Finance

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ACRONYMS

ATM	-	Average Time to Maturity
ATR	-	Average Time to Re-fixing
DMU	-	Debt Management Unit
EC	-	Eastern Caribbean
Ex-Im Bank	-	Export-Import Bank of the Republic of China
GDP	-	Gross Domestic Product
GOSKN	-	Government of St. Kitts and Nevis
IDMU	-	Investment and Debt Management Unit
IMF	-	International Monetary Fund
KFAED	-	Kuwait Fund for Arab Economic Development
KWD	-	Kuwaiti Dinars
MTDS	-	Medium-Term Debt Management Strategy
NIA	-	Nevis Island Administration
SBA	-	Stand-By Arrangement
SDR	-	Special Drawing Rights
SKNANB	-	St. Kitts-Nevis-Anguilla National Bank
T-Bills	-	Treasury Bills

I. INTRODUCTION

In December 2012, the Government of St. Kitts and Nevis (GOSKN) developed a Medium Term Debt Management Strategy (MTDS) for the period 2013 – 2015 that would guide the management of the Government's debt portfolio as the Government continued its comprehensive debt restructuring exercise that began in 2011. The Strategy sought to secure the gains that had already been realized as a result of the restructuring and focused on actions that would be necessary for further debt reduction.

An updated Strategy was published in December 2014, which presented a path that would guide the continued decline in the Government's debt stock over the period 2015 – 2017 and the management of the portfolio so that debt sustainability could be maintained. Risk parameters were also developed for monitoring and mitigation purposes.

It is imperative that the Debt Management Strategy be periodically reviewed to take into consideration any pertinent developments that may impact the Government's debt management objectives. Therefore, the MTDS is now being updated based on an assessment of the debt position of the Government compared to the debt management objectives and cost and risk targets that were outlined in the 2015 – 2017 MTDS. The update is intended to provide a guide for achieving a sustainable level of debt and debt service payments for 2017.

II. DEBT MANAGEMENT OBJECTIVES

The GOSKN maintains its objective to steadily reduce the public debt to ensure debt sustainability over the medium to long term. This will continue to be done in a manner that reduces cost and risk, and that is consistent with the sound management of public finances and the macroeconomic framework. To ensure the continued achievement of this objective, the Government intends to:

- Achieve a Debt-to-GDP ratio of 62.1 percent by 2017;
- Continue to minimize the cost of the debt and the associated risks inherent in the debt portfolio;

- Achieve an Average Time to Maturity (ATM) of 8 years or above;
- Re-establish the Government's presence on the capital market; and
- Accelerate efforts to create sinking funds to secure financing for large future debt service obligations and other contingencies.

III. OVERVIEW OF THE 2015 - 2017 MEDIUM-TERM DEBT MANAGEMENT STRATEGY

The main focus of the 2015 – 2017 MTDS is the reduction of the public debt burden over the medium-term to ensure debt sustainability while minimizing costs and risks embedded in the debt portfolio. The 2015 – 2017 MTDS reaffirms the Government's commitment to reducing the Debt to GDP ratio and debt service payments. Through the establishment of indicative targets, the Strategy also considers the management of risks associated with the overall portfolio, in particular, interest rate, foreign currency, and refinancing risks. The achievement of the debt management objectives as outlined in the 2015 - 2017 MTDS is largely hinged on the Government's ability to accelerate the payments of selected high cost debt instruments, and to refinance others in order to benefit from more favorable terms. The Strategy also proposes borrowing on concessional terms, where feasible, to reduce debt servicing cost.

IV. KEY ACCOMPLISHMENTS IN 2015 AND 2016

The following are the main achievements that resulted thus far from the implementation of the 2015 – 2017 MTDS:

1) **Debt stock reduction through restructuring/refinancing activities**

   A. The execution of a Debt Prepayment Strategy led to:

      i. The full repayment of debts owed to the Export-Import Bank of the Republic of China (Ex-Im Bank) which totaled $41.5m.

      ii. The repayment of the International Monetary Fund (IMF) Stand-By Arrangement (SBA) loan in April 2016, ahead of the IMF's original schedule of 2018. This included the prepayment of $30.0m in the fourth quarter of 2015.

B. The refinancing of arrears owed by the Nevis Island Administration (NIA) to the Kuwait Fund for Arab Economic Development (KFAED) in August 2015.

C. The full repayment of the La Vallee Greens Limited Exchange and Facility Agreement with the St. Kitts-Nevis-Anguilla National Bank (SKNANB) which resulted in a reduction of $14.2m in the domestic debt stock.

2) **Debt Service Cost Reduction –** Effective May 2016, the interest rates offered on each category of Treasury Bills were reduced by 1.0 percentage point to bring the rates closer to market rates. This has translated to lower interest payments by the Government.

3) **Concessional Financing –** Borrowing by the Central Government and State Owned Entities from multilateral and bilateral sources on concessional terms were undertaken within the MTDS framework.

4) **Strengthening of the Investment and Debt Management Unit**

   A. The scope of the Debt Management Unit (DMU) was expanded to include investment functions. The DMU was therefore renamed the Investment and Debt Management Unit (IDMU).

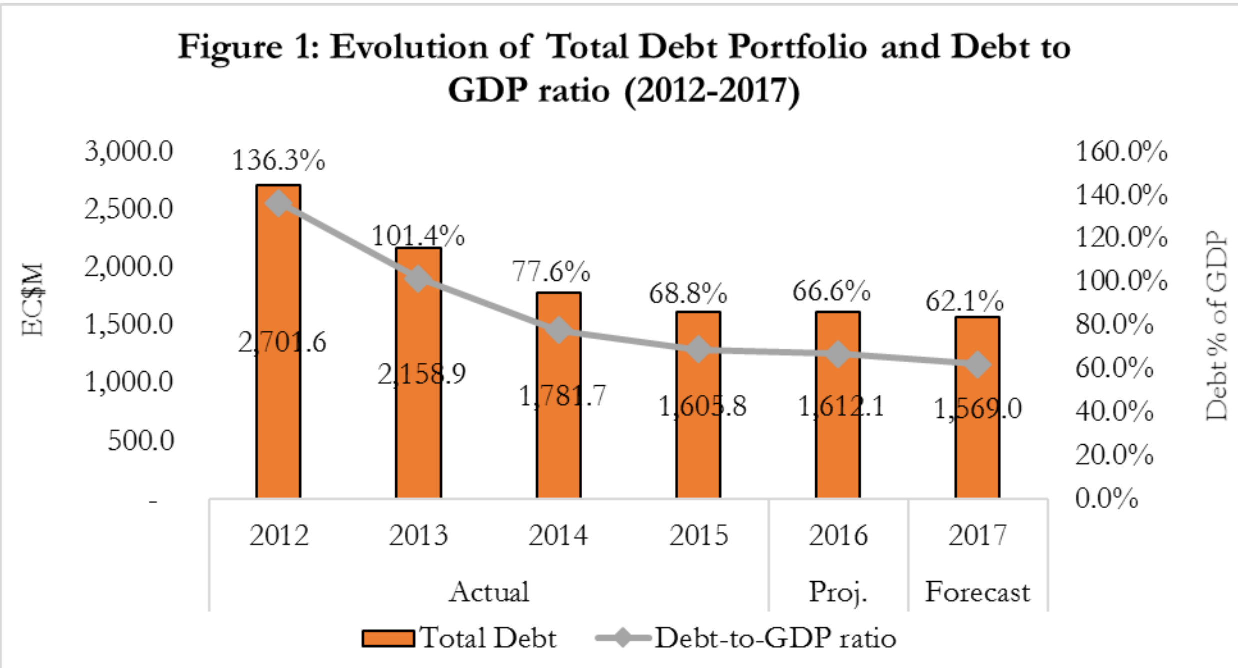
   B. The Unit's Front, Middle, and Back Offices were centralized within the Office of the Financial Secretary in June 2015. This has resulted in increased efficiency and better management of the debt portfolio by the IDMU.

   C. The staff complement was strengthened through the employment of an additional Debt Analyst in September 2016.

V. REVIEW OF THE DEBT PORTFOLIO AND FORECAST FOR 2017

i. Total Public Sector Debt Dynamics: 2012 - 2017

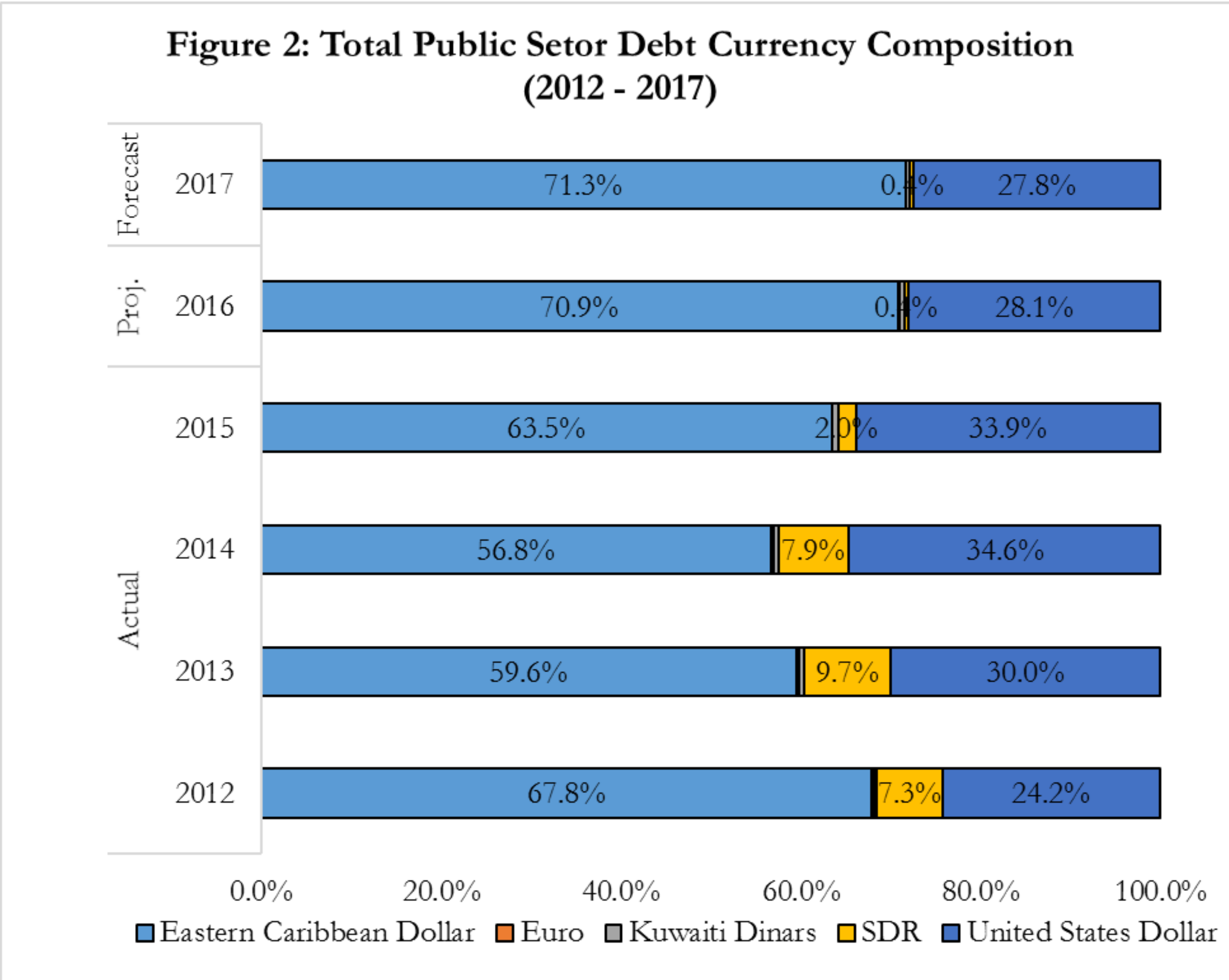
At the end of 2015, Total Public Sector debt stood at $1,605.8m or 68.8 percent of GDP. This represented a decline of $175.9m or 9.9 percent when compared to the end of 2014. The contraction in the debt stock was primarily a result of the impact of principal repayments to the IMF for the SBA loan and the full repayment of debts owed to the Ex-Im Bank.



The debt is projected to increase slightly by $6.3m to $1,612.1m (66.6 percent of GDP) at the end of 2016. The projected increase in the debt stock is primarily a result of the overall impact of the reclassification of budgetary arrears for fuel to debt. At the end of 2017, the debt is forecasted to decrease by $43.1m relative to the 2016 projection to reach $1,569.0m (62.1 percent of GDP) (see Figure 1 above).

ii. Currency Composition of the Total Debt Portfolio

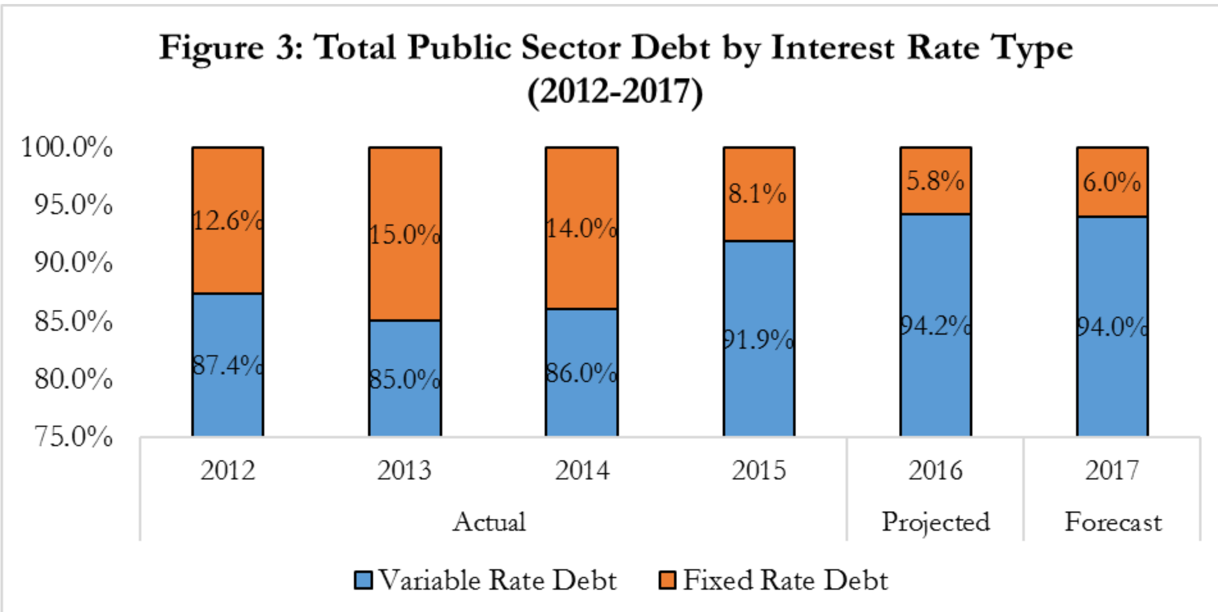
Figure 2 shows the currency composition of the Public Sector's debt. As at December 2015, the Eastern Caribbean (EC) dollar instruments accounted for 63.5 percent of the debt, while the US dollar instruments accounted for 33.9 percent. The remaining 2.6 percent was comprised of debt instruments in Special Drawing Rights (SDR) (2.0 percent), Kuwaiti Dinars (KWD) (0.5 percent) and Euros (0.1 percent).



For the projected 2016 and forecasted 2017 period, the EC dollar is expected to remain the dominant currency in the debt portfolio. At the end of the 2017, the share of the EC dollar debt is forecasted to increase to 71.3 percent while the share of the US dollar debt is expected to decline to 27.8 percent. Debt denominated in SDR, KWD and Euro is also expected to decline to 0.9 percent, minimizing the level of foreign currency risk within the debt portfolio.

iii. Interest Rate Composition of the Total Debt Portfolio

The total public debt portfolio is comprised of mainly fixed rate debt with this category consistently above 90.0 percent over the Strategy period. At the end of December 2015, the share of fixed rate debt was 91.9 percent while variable rate debt accounted for 8.1 percent. The percentage share of variable rate debt is forecasted to decline to 6.0 percent at the end of 2017 as the IMF SBA loan that carried a variable rate was repaid and no longer forms part of the debt portfolio.



VI. ACTION PLAN – 2017

To ensure the continued achievement of the debt management objectives, the following will be considered and/or pursued in 2017:

1) Reduce the rates applicable to the National Savings Scheme and the Government Savings Bank to be in line with prevailing rates offered in the local market. The downward adjustment in the rate would result in decreased interest expense and would contribute favorably to the overall fiscal performance over the short to long term.
2) Identify any other means by which to reduce debt service costs and associated risks.

3) Contain the growth in the debt stock and seek concessional financing for any new borrowing for capital projects.
4) Further strengthen the IDMU through training of staff.
5) Contain Government Guaranteed Debt – Government guaranteed debt will continue to be managed and granted only after conducting risk assessments to measure the impact of new borrowing on the Public Sector Debt portfolio.

VII. REVIEW OF KEY RISK PARAMETERS

A range of portfolio benchmarks and targets for various risk indicators were outlined in the 2015 – 2017 MTDS to guide the management of costs and risks associated with the debt portfolio. The risk indicators and parameters are periodically assessed to ensure that the risks embedded in the debt portfolio do not breach the indicative thresholds. This risk monitoring serves to guide management activities particularly as it relates to currency composition, loan maturity, interest rate, and instrument type. The following is an analysis of projected trends for the main risk indicator groupings for the 2016 and 2017 fiscal year ends.

Table 1: - Performance of Key Risk Indicators compared to MTDS 2015 – 2017 Risk Parameters

Risk Indicators	Baseline	Original MTDS Forecast	Projection	Original MTDS Forecast	Revised Forecast	Risk Parameters (Targets)
	Sep-16	Dec-16	Dec-16	Dec-17	Dec-17	
Sustainability Indicators						
Debt-to-GDP ratio	64.6%	61.6%	66.6%	57.3%	62.1%	57.3% of GDP by 2017
Central Government Debt Service to Exports	6.5%	16.7%	8.9%	6.8%	8.6%	Should not exceed 15.0%.

Risk Indicators	Baseline	Original MTDS Forecast	Projection	Original MTDS Forecast	Revised Forecast	Risk Parameters (Targets)
	Sep-16	**Dec-16**	**Dec-16**	**Dec-17**	**Dec-17**	
Central Government Debt Service to GDP	2.4%	5.1%	3.3%	2.1%	3.3%	Should not exceed 5.0% of GDP.
Fiscal Indicators						
Central Government Debt Service to Tax Revenue	12.1%	29.4%	12.4%	11.7%	13.2%	Should not exceed 35.0% of Tax Revenue.
Interest Expenditure as a % of Tax Revenue	3.6%	8.0%	4.4%	6.7%	4.0%	Should not exceed 15.0% of Tax Revenue.
Risk Management Indicators						
Refinancing Risk Indicators						
Average Time to Maturity (ATM)	9.7 years	10.0 years	9.2 years	10.6 years	9.0 years	Should not fall below 8 years.
Total Debt Maturing in 1 year (% of Total)	33.6%	35.0%	36.3%	34.4%	36.8%	Should not exceed 25.0% of total debt.
Interest Rate Risk Indicators						
Average Time to Re-fixing (ATR)	9.4 years	9.8 years	8.9 years	10.5 years	8.7 years	Should not fall below 8 years.
Cost of Debt (Weighted Average Interest rate)	4.1%	4.7%	4.1%	4.6%	4.0%	Should not exceed 5.0%.

Risk Indicators	Baseline	Original MTDS Forecast	Projection	Original MTDS Forecast	Revised Forecast	Risk Parameters (Targets)
	Sep-16	Dec-16	Dec-16	Dec-17	Dec-17	
Total Debt Re-fixing in 1 year (% of Total)	39.8%	39.4%	42.2%	37.6%	42.8%	Should not exceed 40.0%.
% Share of Variable Rate Debt	6.2%	6.6%	5.8%	4.5%	6.0%	Should not exceed 15.0% of total debt.
FX Rate Risk Indicator						
% of FX debt (excluding US dollar)	1.1%	3.4%	1.0%	1.7%	1.0%	Should not exceed 10.0% of total debt.
Guarantees and Non-Concessionality Indicators						
% Share of Publicly Guaranteed Debt	38.1%	34.9%	36.7%	33.4%	38.5%	Should not exceed 40.0% total debt.
% of Non-Concessional Borrowing (Domestic)	45.7%	77.8%	51.7%	77.0%	50.2%	Should not exceed 60% of Domestic debt.
% of Non-Concessional Borrowing (External)	13.0%	14.3%	12.5%	13.8%	12.2%	Should not exceed 30% of External debt.

i. Sustainability Indicators

The **Debt to GDP ratio** is expected to reach 66.6 percent at the end of 2016, 5.0 percentage points above the forecast that was made in the 2015 - 2017 MTDS. The ratio is forecasted to reach 62.1 percent at the end of 2017, 4.8 percentage points higher than the forecast made in the 2015 – 2017 MTDS. The following that were not anticipated at the time the MTDS was prepared in 2014 contributed to the higher ratios that are being projected:

- The reclassification of budgetary arrears for fuel as debt;
- The contraction of a loan by the Development Bank of St. Kitts and Nevis to facilitate the Fresh Start Project for Small and Medium Sized Enterprises;
- The contraction of a loan by the National Housing Corporation to construct middle income houses;
- The contraction of a loan by the Ministry of Education to upgrade the Technical and Vocational Educational and Training programmes;
- The contraction of a loan to finance the replacement of street lamps in St. Kitts and Nevis with LED lamps.

As a result of the above, the **Central Government Debt Service to Exports ratio** and the **Central Government Debt Service to GDP ratio** are projected to slightly exceed the MTDS forecast for 2017. However, these two indicators are expected to perform well within the target.

ii. Fiscal Indicators

Similarly, the **Central Government Debt Service to Tax Revenue ratio** is expected to exceed the 2015 - 2017 MTDS target by 1.5 percentage points as the principal payments associated with the reclassified fuel arrears will impact debt servicing. The outstanding amount will be paid over a 5-year period. At the end of 2017, **Interest Expenditure as a Percentage of Tax Revenue** should perform favorably and is expected to be an improvement over the 2015 – 2017 MTDS forecast by 2.7 percentage points. The likely positive outturn is primarily as a result of the expected performance of tax revenues. It should be noted that for the projected year 2016 and the forecast year 2017, the outturn for all fiscal indicators is expected to be well within the respective risk targets that were set in the 2015 – 2017 MTDS.

iii. Refinancing Risk Indicators

The **Average Time to Maturity (ATM)** and the **Total Debt Maturing in One Year** deteriorated mainly due to an increase in the NIA's T-Bills portfolio and overdraft facility. These ratios are expected to improve over the short to medium-term as the NIA is in the process of refinancing its overdraft balance to a long-term loan. While the ATM is not expected to breach the risk parameter at the end of 2017, the Total Debt Maturing in One Year is forecasted to continue to exceed the risk threshold by 11.8 percentage points.

iv. Interest Rate Risk Indicators

The **Average Time to Interest Rate Re-fixing (ATR)** and the **Cost of Debt (Weighted Average Interest Rate)** should perform favorably relative to the 2015 – 2017 MTDS targets. It is anticipated that the outturn for these two risk indicators will result in ratios that fall below their respective thresholds. The **Percentage Share of Variable Rate Debt** for 2016 is expected to exhibit a positive performance when compared to the forecast under the 2015 – 2017 MTDS but will likely underperform slightly in 2017 due to the variable component of the new loan for the street lighting project. The Percentage Share of Variable Rate Debt is significantly within the parameter, which indicates that the portfolio has minimal exposure to interest rate fluctuations. In contrast, **Total Debt Re-Fixing in One Year** is expected to breach the risk parameter due to the high stock of T-Bills and overdrafts within the debt portfolio.

v. Foreign Exchange Risk Indicators

The baseline result for the **Percentage Share of Foreign Currency (excluding US dollar)** was 1.1 percent. The revised forecast showed that it will likely be constant at 1.0 percent at end December 2016 and 2017. These results would represent an improved performance when compared to the projections of the 2015 - 2017 MTDS of 3.4 percent for 2016 and 1.7 percent for 2017.

vi. Guarantees and Non-Concessionality Indicators

As guided by the 2015 - 2017 MTDS, borrowings by Public Corporations were contracted on concessional terms. For this reason, indicators relating to guarantees and concessionality performed favorably, all within the risk thresholds. The **Percentage Share of Publicly Guaranteed Debt** is expected to increase in 2017 as a consequence of the contraction of the loan by NHC and the increase in the T-Bills and overdraft of the NIA. The **Percentage Share of Non-Concessional Domestic Borrowing** remains high although it falls within the threshold. The high interest rates on the NIA's overdraft facilities and T-Bills as well as the short-term nature of these instruments, contribute to a high ratio for domestic non-concessional loans. However, the majority of the external debt is contracted on concessional terms resulting in the favorable performance of the **Percentage Share of Non-Concessional External Borrowing** relative to the MTDS forecast and the risk target.

VIII. CONCLUSION

The Government's continued management of its debt along with prudent fiscal and economic measures have resulted in an improvement in the debt sustainability position from 2012 and is expected to continue over the medium term. The overall cost of borrowing has decreased resulting in lower levels of debt service payments. The projected decrease in the Total Public Sector Debt over the medium term indicates a low risk of debt distress. In addition, the large majority of debt indicators remain within their respective thresholds, which is consistent with preserving debt sustainability.