EXTERNAL DEBT ANALYSIS: THE DUAL FACE OF COUNTRY RISK

**Liquidity Risk**
- Debt Service Ratio: \( \frac{P+I}{X} \)
- Interest Ratio \( \frac{I}{X} \)
- Current account/GDP
- Growth rate of exports/ Average external interest rate

**Solvency Risk**
- Debt/Export ratio
- Debt/GDP ratio
- Debt/Reserves
- ST Debt/Total Debt
- ST Debt/Reserves
- Reserve/Import ratio
LIQUIDITY AND SOLVENCY THRESHOLDS

Flow variable
▶ Liquidity = Debt Service ratio < 33% of X
Interest/X ratio < 25%

Stock variable
▶ Solvency = Debt/GDP < 66%*
Debt/Exports < 150%
Reserves/months of Imports > 6 months

* average debt crisis threshold 1970-2010 Reinhart/Rogoff (Maastricht)

THE COMBINATION OF HIGHER INTEREST RATES IN 2017-25 TOGETHER WITH SLOWING GROWTH (AND INVESTMENT) AND WEAK OIL AND COMMODITY PRICES, SHARPLY INCREASES THE THREAT OF LARGE-SCALE DEFAULTS

Default Waves
Percentage of countries in external default or restructuring, 1800-2015

Dashed line includes countries with significant and chronic arrears to their official creditors.
NUMBER OF SOVEREIGN DEBTOR COUNTRIES IN DEFAULT/YEAR

Source: Standard and Poor’s, Crédit Agricole S.A.

WESTERN INDUSTRIALIZED COUNTRIES IN THE XIX° CENTURY VS EMCS IN THE XX° AND XXI° CENTURIES

External sovereign defaults since 1800

Selected countries (number of defaults)

Source: Carmen Reinhart and Kenneth Rogoff

* Data from 1990
TOTAL SOVEREIGN DEBT IN DEFAULT BY CREDITOR (US$ BILLION)


Argentina: Defaulted on more than USD80 billion of sovereign foreign currency bonds in December 2001, most of which were held by non-residents. Debt default partially cured in 2005, but some holdout investors remained, constraining the rating to 'RD' until July 2010.

Dominican Republic: Distressed debt exchange in 2005 affected more than USD1.1 billion of eligible foreign currency-denominated bond debt.

Ecuador: Missed coupon payment on its 2012 global bonds followed by an announcement that the government would selectively default on all global bonds. The rating was lowered to ‘RD’ in December 2008.


Moldova: USD75 million eurobond restructured in 2002, followed by a Paris Club deal.

Russian Federation: Exceptionally, Fitch dates sovereign default to August 1998. Although this was when the Russian Federation defaulted on its local currency debt, it began to incur arrears on foreign currency debt owed to the Paris Club official bilateral creditors very quickly afterwards. Defaults on foreign currency debt instruments held by private creditors occurred in 1999, although payments on Russian Federation eurobonds were maintained and honored.

Uruguay: Distressed debt exchange in March 2003 affecting more than USD5 billion of sovereign foreign currency debt, mostly held by non-residents.

Jamaica: A coerced debt exchange in February 2010 affected the country’s domestic debt, which included foreign currency denominated instruments to which Fitch’s foreign currency rating applied.

RD – Restricted default.
WHO’s WHO?

Five main groups of private and official creditors:

1. The IFIs: IMF and World Bank + RDBs
2. The Paris Club of OECD governments
3. Private suppliers: trade debt
4. The London Club of international banks
5. Institutional investors (pension and investment funds, hedge funds): Eurobond holders
## 1. The Paris Club

http://www.clubdeparis.org/sections/donnees-chiffrees/chiffres-cles

### The Paris Club in 2017

#### Key Numbers

<table>
<thead>
<tr>
<th>Description</th>
<th>Number</th>
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<tr>
<td>Total amount of agreements</td>
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</tr>
<tr>
<td>Total amount of debtor countries</td>
<td>90</td>
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<tr>
<td>Total amount of debt</td>
<td>583 Billion $</td>
</tr>
<tr>
<td>Total amount of countries in &quot;Classic Terms&quot;</td>
<td>60</td>
</tr>
<tr>
<td>Total amount of countries in &quot;Houston Terms&quot;</td>
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<tr>
<td>Total amount of countries in &quot;Neples Terms&quot;</td>
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</tr>
<tr>
<td>Total amount of countries in &quot;Cologne Terms&quot;</td>
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PARIS CLUB DEBT RESTRUCTURING

- Official bilateral debt (government to government) is renegotiated under the auspices of the Paris Club since 1956
- Since then, the 21 Paris Club creditors have reached 433 agreements concerning 90 debtor countries.
- Total amount of debt covered = $583 billion
- Only official debt + officially-guaranteed credits (Coface, Hermes, ECGD, US Eximbank...)
- Total claims on EMCS end-2016: $310 billion

- 10 times meetings/year, for negotiation sessions or to discuss the situation of the external debt of debtor countries or debt related methodological issues (sometimes with the IIF)
- Russia joined in 1997 and Brazil in end-2016, as sizeable lender in African countries such as Nigeria, Angola and Mozambique.

PARIS CLUB: 7 DEBT RESTRUCTURING GUIDELINES

1. Consensus
2. Comparability of treatment
3. Solidarity among creditors with on-going information exchanges
4. Case by case treatment of debt crisis
5. Conditionality based on IMF adjustment program and monitoring
6. No restructuring of « post-cut off date » debt so as to preserve access to new financing
7. Secretariat provided by French Treasury
THE FOUR KEY RULES OF THE PARIS CLUB

1. **Consensus**: no decision can be taken within the Paris Club if it is not the result of a consensus among the participating creditor countries.

2. **Conditionality**: debt treatments are applied only for countries that need a rescheduling and that implement reforms to resolve their payment difficulties. In practice conditionality is provided by the existence of an appropriate programme supported by the IMF, which demonstrates the need for debt relief.

3. **Solidarity**: Creditors agree to implement the terms agreed in the context of the Paris Club.

4. The Paris Club preserves the **comparability of treatment** between different creditors, as the debtor country cannot grant to another creditor a treatment less favourable for the debtor than the consensus reached in the Paris Club.
PRE AND POST CUT-OFF DATE DEBT?

- Time + Money = To preserve new money and market access, only **pre cut-off date** debt is eligible to debt relief negotiations through rescheduling, refinancing, debt conversion and debt reduction.

PARIS CLUB DEBT RESTRUCTURING

- From debt rescheduling to debt reduction and debt conversion:
  - 09/1990: Houston terms: debt service rescheduling (15/8) for countries with GDP per capita <$1345
  - Toronto 1988: 33% debt reduction: Menu approach
  - 12/1991: "London terms" for 23 poorest countries: 50% reduction of eligible debt payments or consolidated debt in NPV, with promise of considering « stock reduction »
  - Naples 1994 67% NPV (flow rescheduling) for EMCS with per capita GDP<US$500 and D/X ratio >350%
  - Lyon 1996 HIPC 80% debt stock rescheduling
  - Cologne June 1999: debt stock reduction up to 80%
« LONDON TERMS » DEBT RESTRUCTURING

“London Terms”: 12/1991: Paris Club creditors agreed to implement a new treatment on the debt of the poorest countries to raise the level of debt cancellation from the 33.33% as defined in Toronto terms to 50%.
23 countries benefited from London terms until mid-1990s, when these terms were replaced by Naples terms.

London terms included the possibility for creditor countries to conduct, on a bilateral and voluntary basis, debt swaps with the debtor country.
These swap operations in principle could be carried out without limit on official development aid loans, and up to 20% of the outstanding amount or 15 up to 30 million SDR for non-ODA credits.

PARIS CLUB DEBT RESTRUCTURING UNDER THE « LONDON TERMS »

► Non-ODA credits cancelled to a 50% level through one of the four following options:
1. "debt reduction option": 50% of the claims treated cancelled (after possible topping-up), the outstanding part being rescheduled at the appropriate market rate (23 years repayment period including 6-year grace and progressive payments).
2. "debt service reduction option": claims rescheduled at a reduced interest rate (23 years repayment period with progressive payments).
3. "moratorium interest capitalization option": claims rescheduled at a reduced interest rate (23-year repayment period including 6-year grace and progressive payments).
4. "commercial option": claims restructured at the appropriate market rate over a longer period (25-year repayment period including 14-year grace): non-concessional option.

► ODA credits rescheduled at an interest rate at least as favorable as the original concessional interest rate applying to these loans (30-year repayment period including 12-year grace and progressive repayment).
VIETNAM AND THE PARIS CLUB 12/93

- Amounts treated = $544 million
- Repayment profile treatment = London terms (50% debt cancellation)
- Cutoff date= January 01, 1990
- Participating creditors: AUSTRALIA, AUSTRIA, BELGIUM, DENMARK, FRANCE, GERMANY, ITALY, NETHERLANDS, NORWAY, UNITED KINGDOM, UNITED STATES OF AMERICA

CÔTE D’IVOIRE DEBT RELIEF AGREEMENT 11/2011

- Paris Club external debt relief following the approval by the IMF of a new 3-year arrangement under the Extended Credit Facility on November 4, 2011.
- “Cologne terms” for implementation of the HIPC initiative debt relief = 80%
- On an exceptional basis, considering the Republic of Côte d’Ivoire’s limited capacity of payment, creditors have agreed to defer and reschedule over a ten-year period the repayment of maturities due on short term and post-cut off date debts; and, over an eight-year period the arrears on those claims. They also agreed to defer all the interest due on the amounts treated.
- These measures are expected to reduce the debt service (including the arrears) due to Paris Club creditors between 1st July 2011 and 30 June 2014 by more than 78% which corresponds to $1822 million, of which $397 million cancelled.
Hello SKEMA FMI! HELP!

IMF
2 COUNTRY RISK
TRAJECTORIES IN 2017?

<table>
<thead>
<tr>
<th></th>
<th>VIETNAM</th>
<th>PHILIPPINES</th>
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<td>Current Account/GDP</td>
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<tr>
<td>Debt/GDP</td>
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<tr>
<td>Debt/Exports</td>
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<td></td>
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<tr>
<td>Reserves/Imports (months)</td>
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</table>
The London Club of debt restructuring

DEBT RESTRUCTURING OF LONDON CLUB DEBT

▶ Commercial banks’ claims on EMCs and OECD countries
▶ Debt renegotiation workouts
WHAT IS THE « LONDON CLUB »?

Since the 1970s, countries facing default have used the London Club process to restructure sovereign debt owed to banks.

The London Club has evolved as an ad hoc forum for restructuring negotiations. Each London Club is formed at the initiative of the debtor country and is dissolved when a restructuring agreement is signed.

Ad hoc London Club "Advisory Committees" are chaired by a leading financial bank.

Advisory Committees have included representatives from nonbank creditors (fund managers holding sovereign bonds).

WHAT IS THE « LONDON CLUB »?

ad hoc forum for restructuring negotiations.

Each London Club is formed at the initiative of the debtor country.

London Club "Advisory Committees" are chaired by a leading financial firm with representatives from a cross-section of international banks.


IIF + Economic Subcommittee = macroeconomic, BOP analysis and debt sustainability reports to the Advisory Committees.

Source: IIF
WHAT IS THE IIF?

▶ The Institute of International Finance, Inc. (IIF), is the world’s only global association of financial institutions.
▶ Created in 1983 in response to the international debt crisis, the IIF has evolved to meet the changing needs of the financial community.
▶ Members include most of the world’s largest commercial banks and investment banks, as well as insurance companies and investment management firms. Among the Institute’s Associate members are MNCs, trading companies, ECAs, and multilateral agencies.
▶ The Institute has > 450 members headquartered > 70 countries.

THE IIF= A GLOBAL BANKING UNION

IIF Member Breakdown

[Diagram showing the distribution of IIF members by category]
**IS THERE LIFE AFTER ARREARS AND DEFAULT?**

Bank loans may be delinquent on their repayments or in default of the loan entirely = loss for the bank on expected income

\[ \text{Arrears + Default} = \text{accounting losses in banking portfolios} \]

Loan-loss reserves (provisions against NPLs)

In the event of a loss, instead of taking a loss in its cash flows, the bank will use the amount set aside to cover the loss.

The provision is tax deductible and can be used in the bank’s capital (Bâle III)

- **Expected income loss**
- **Loan-loss provision**
- **Loan sale at market value**
- **Discounted debt trading**
- **Debt swaps**
SECONDARY MARKET PRICES OF CUBA’S LONDON CLUB DEBT

(1990-2016 in percent of face value)

IVORY COAST’S SECONDARY MARKET DEBT PRICE
(1986-2016 IN % OF FACE VALUE)
HYPER-EXOTIC DEBT PRICES

- Myanmar 20%
- Cambodia 20%
- Mongolia 22%
- North Korea 10%
- Argentina (2033 bonds)= 62% following ruling by NY court in 11/2012
- Cuba Loans 10-35%
- Cuba Trade 15%
- Albania 36%
- Bosnia 36%
- Serbia 44%
- Irak Bonds 90%
- Libya 25-35%
- Syria 6-11%
- Yemen 30%
- Angola 60%
- Ethiopia 60%
- Senegal 35%
- Sudan 11-14%
- Uganda 14-16%
- Zimbabwe 1-4%

EMCS SECONDARY MARKET DEBT PRICES

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<tr>
<th>COUNTRY / ISSUE</th>
<th>Low Price</th>
<th>High Price</th>
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<tbody>
<tr>
<td>Angola / Trade</td>
<td>50.000%</td>
<td>55.000%</td>
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<tr>
<td>Angola / Loans</td>
<td>55.000%</td>
<td>59.000%</td>
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<tr>
<td>Cameroon / Trade (non-HIPC)</td>
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<td>DR, Congo / Loans, Trade (non-HIPC)</td>
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<td>20.000%</td>
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<td>82.000%</td>
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<td>Kenya / Trade</td>
<td>39.000%</td>
<td>49.000%</td>
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<tr>
<td>Mozambique / Trade (non-HIPC)</td>
<td>20.000%</td>
<td>26.000%</td>
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<td>Senegal / Loans, Trade (non-HIPC)</td>
<td>12.000%</td>
<td>16.000%</td>
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<td>Uganda / Trade (non-HIPC)</td>
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<td>16.000%</td>
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<td>Zambia / Loans, Trade (non-HIPC)</td>
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<tr>
<td>Zimbabwe / Trade</td>
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<tr>
<th>COUNTRY / ISSUE</th>
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<tr>
<td>Azerbaijan / Hyper-Exotics</td>
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<td>Bosnia / Trade</td>
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<td>Georgia / Trade</td>
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<td>Serbia / Trade</td>
<td>44.000%</td>
<td>54.000%</td>
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<td>Turkmenistan / Trade</td>
<td>23.000%</td>
<td>33.000%</td>
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<td>Ukraine / Trade</td>
<td>16.000%</td>
<td>25.000%</td>
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<tr>
<td>Uzbekistan/Trade</td>
<td>20.000%</td>
<td>24.000%</td>
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<th>COUNTRY / ISSUE</th>
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<td>Egypt Trade</td>
<td>65.000%</td>
<td>75.000%</td>
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<td>Iraq / Paris Club</td>
<td>84.000%</td>
<td>89.000%</td>
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<tr>
<td>Iraq / Bonds</td>
<td>91.000%</td>
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<td>Libya / Trade</td>
<td>25.000%</td>
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<td>Syria / Trade</td>
<td>6.000%</td>
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<th>High Price</th>
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<tr>
<td>Mongolia / Trade</td>
<td>22.000%</td>
<td>32.000%</td>
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<tr>
<td>North Korea / Loans, Certificates</td>
<td>9.000%</td>
<td>12.000%</td>
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Weak Liquidity:
Angola, Nicaragua, Cameroon, Albania, Congo, Tanzania, Zaire (Rep. Democr.), Zambia, Iraq, North Korea

Limited Liquidity:
Cuba, Egypt, Jordan, Madagascar, Panama, Jamaica, Ivory Coast, Senegal

Moderate Liquidity:
Nigeria, Morocco, Costa Rica, Bulgaria, Peru, Russia, Vietnam

Good Liquidity
Brady Bonds + Eurobonds= Argentina, Brazil, Ecuador, Mexico, Philippines, Poland, Venezuela. South Africa, Turkey