DEBT MANAGEMENT

El Salvador congress approves use of SDRs for early debt repayment

Talks with IMF stalled as country tackles $24 billion debt load

Ben Margulies

05 Aug 2022

FOLLOW
International Monetary Fund (IMF)

National Palace of El Salvador, San Salvador

POPULAR NOW
ECB uses bond reinvestments to support Italy and Spain
South Sudan president fires sixth governor
HSBC Reserve Management Trends 2022 - Central Banking

El Salvador's legislature ordered the central bank to convert more than $360 million worth of IMF special drawing rights (SDRs) into dollars and transfer these to the finance ministry, as the country struggles to convince investors it will repay its debts.

The funds will be used to buy back sovereign bonds ahead of their 2023 and 2025 maturation dates. But many analysts warn the measure will have little effect given the high debt load and deep governance issues.

The legislature, in its July 26 session, also approved the use of $200 million from the Central American Bank for Economic Integration to support the debt repurchase plan.

RELATED ARTICLES
- Tackling private-sector debt in the wake of the pandemic
- BoE's Pill says UK facing strong 'inflationary momentum'
- Norges Bank flags rising cyber threats
- Fed nominee Barr plans to re-evaluate capital and liquidity rules

El Salvador's president Nayib Bukele **announced** the debt buy-back plan on Twitter on July 26, the same day the legislature approved it. He said that his government would "make a transparent, public and voluntary purchase offer" to bondholders.

He claimed that he would disprove media claims that the country was struggling to repay its debts. "El Salvador has the liquidity not only to pay all of its commitments when they are due, but also purchase all of its own debt (till 2025) in advance," he tweeted.

The debt buyback plan applies to two bond issues: $800 million in eurobonds due in January 2023, and another $800 million to pay in 2025. The IMF estimated that El Salvador's total debt load equalled 85% of GDP at the end of 2021, or more than $24 billion.

Alejandro Zelaya, the finance minister, told wire service *Agencia Efe* that the plan "is totally within the rules of the market". He said the plan would represent "a savings for the republic", though bondholders would not be obliged to sell back their assets.

Zelaya also said El Salvador was working with a "restructuring bank", a "private bank" and "we will announce it once we launch the operation".

The International Monetary Fund issued about $650 billion worth of SDRs in August 2021, to provide extra financing during the Covid-19 pandemic. El Salvador received 275.3 million SDRs. Put another way, El Salvador would use virtually all of its 2021 SDR tranche for the debt repurchase.

The Central Reserve Bank of El Salvador had net international reserves totalling slightly less than $3.5 billion in June 2022. These included $575.6 million in SDR holdings. The transfer would thus amount to slightly more than 10% of the value of the net international reserves.

Richard Francis, an analyst for Fitch Ratings, tells *Central Banking* "El Salvador's international liquidity metrics have deteriorated over the last two years" and that the debt buyback plan would worsen these figures.

Jamie Reusche, a vice-president at Moody's ratings agency, says because El Salvador uses the US dollar as its own currency, its reserves mainly serve to ensure dollar supply. Reusche and Francis note that most of the reserves derive from private banks' deposits with the Central Reserve Bank.

Daniel Gros, a former director of the Centre for European Policy Studies, a Brussels-based think-tank, calls the plan "a fool's errand" that was too small to effectively lessen El Salvador's debt load. "A buyback can make sense if certain circumstances, ie if the country is really able to pay back everything and is serious about achieving this 'whatever it takes'," Gros says. "But this is not the case of El Salvador."

Fabiano Borsato, chief operating officer of New-York based Torino Capital, takes a more positive view of the debt buyback programme. The initiative "could be the best move available for Bukele's administration" given its inability to access capital markets. Borsato also believes that the SDR transfer will not undermine the international reserves.

Patricio Vimberg, an associate director at S&P Global Ratings in Mexico City, says the debt buy-back was probably meant to signal El Salvador's willingness and ability to pay its debt. However, S&P already expected El Salvador to pay the 2023 eurobond, while the debt buy-back does not solve longer-term problems – meaning El Salvador's low credit rating, CCC+, would likely not improve as a result.

El Salvador has been seeking a $1.3 billion funding package from the International Monetary Fund since March 2021. Talks remain stalled. Borsato believes that the debt buy-back plan likely will not trouble the IMF, as debt relief is a standard and intended use of SDRs.

The central bank, the president's office and the finance ministry did not respond to requests for comment.

Governance concerns

The IMF has been more troubled by El Salvador's adoption of a law, passed in June and in effect since September, that made bitcoin legal tender in the country. Bukele, who had pushed for the law, proposed a $1 billion issue of bitcoin-backed debt instruments in late 2021, though this initiative appears to have stalled.

The IMF said in its most recent Article IV report, published early this year, that "bitcoin use carries significant risks and bitcoin should not be used as an official currency with legal tender status". The CEPR's Gros says policies like the bitcoin law "will make investors look very sceptically at this buy-back".

Reusche explains the bitcoin law as an attempt to improve competitiveness by opening up cryptocurrency trading and mining as a new economic sector. "However, there has been little evidence of an inflow of cryptocurrency investments or entrepreneurs into the country. The use of bitcoin for everyday transactions and in remittances from abroad is marginal".

Borsato and Reusche both say Bukele's increasingly autocratic style of government is a cause for concern. Borsato mentions "the high risk of debt unsustainability and questions regarding the validity of the separation of powers and the rule of law in the country", while Reusche describes "extensive governance and transparency concerns given the country's weakened system of checks and balances".

S&P's Vimberg acknowledges that the bitcoin law has worried the IMF and others. But he stresses that El Salvador's problems with weak governance and high debt levels predated Bukele. "We have always been pessimistic about the institutions in El Salvador," he says.

Bukele was elected in 2019, and his party and its allies won a sweeping majority in congress in 2021. In May 2021, the new congress voted to replace the judges of the supreme court section which judges the constitutionality of laws. The supreme court then ruled in September that Bukele could seek a second term in office.

The Bukele administration has also sent a proposal to congress to abolish the country's statistical agency. The law would transfer many of the agency's responsibilities to the central bank. A legislative committee backed the proposal on July 29. The statistics agency is responsible for computing the consumer price index.

FOLLOW
Select the topics you're interested in to receive regular updates.
International Monetary Fund (IMF)
VIEW ALL FOLLOW TOPICS

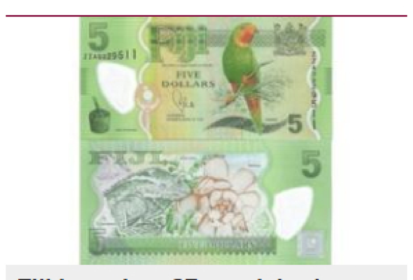
Topics: Bitcoin | Bonds | Central Reserve Bank of El Salvador | Cryptocurrency | Debt | El Salvador | Fitch Ratings | International Monetary Fund (IMF) | Reserves | Sovereign debt | Special drawing right (SDR) | US dollar | Debt Management | Debt management | Fiscal policy

YOU MAY ALSO ENJOY

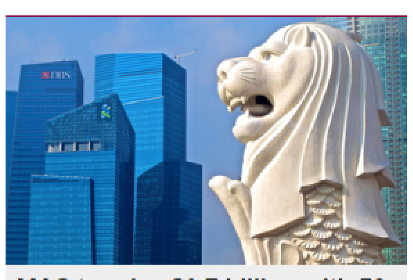

Mauritius governor defends central bank's funding of government
15 SEP 2020

Bank Negara Malaysia set to implement consumer credit law
16 NOV 2021

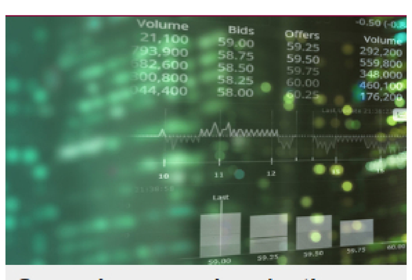

Central bank boards often used for stability decisions
8 AUG 2022

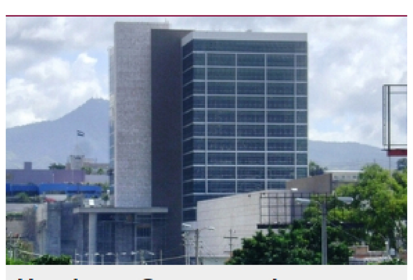

Fiji launches $7 varnished banknote
29 MAR 2022

MORE ON DEBT MANAGEMENT


MAS to raise $1.7 billion with 50-year green bonds
05 AUG 2022

IMF approves $4 billion payment for Argentina
27 JUN 2022


Sovereign green bonds: the reserve portfolio's panacea?
08 JUN 2022 | CBJ


Honduran Congress clears way for SDR loan
17 FEB 2022

MOST READ
1 ECB uses bond reinvestments to support Italy and Spain
2 The case for restoring the role of monetary aggregates
3 CBDCs could hugely improve cross-border payments – ECB's Bindseil
4 RBA hits out at further delay to new clearing system
5 Czech central bank halts tightening