GOVERNMENT OF SAINT LUCIA
DEBT MANAGEMENT STRATEGY

Introduction

"Debt management is the process of establishing and executing a strategy for managing the government's debt in order to raise the required amount of funding, achieve its risk and cost objectives and to meet any other sovereign debt management goals the government may set.[1]" In this regard, the main objective of public debt management is therefore to ensure that government's financing needs and its payment obligations are met at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk.

Since the declaration of independence debt management in the ECCU member countries has been evolving, as countries had to develop ways of coping with their acquired debt burdens. In this light the high rate of debt accumulation of the Eastern Caribbean member territories over the last ten years signals the need for proper debt management policies and sustainable debt levels. The implications of this increased debt burden on both the monetary and fiscal position of these territories given their changing economic performance and the changes in the composition of their debt portfolio, also highlights the degree of importance that should be given in efficient debt management. This becomes even more important with the advent of the RGSM which requires that Governments take a more structured and proactive approach to debt management. In order to an ultimate reduction in the cost of borrowing through a market based framework, that allows voluntary participation by investors, Governments must be prepared to take the necessary steps to properly manage their fiscal affairs to reduce uncertainty among investors.

Debt management should encompass the main financial obligations over which the central government exercises control. The concept of institutional arrangements and information flows for managing a country's debt portfolio involves the development of a

[1] IMF , Guideline for Public Debt Management , 2001

formalised structure to manage debt, which allows for the smooth movement of information between creditors and borrowers and between the various departments and units involved in the debt contraction process. Debt management must fit within the context of the fiscal policy stance and the borrowing plans established by government. It involves adapting and implementing debt management strategies, which ensure that new borrowing does not lead to unsustainable debt profiles, and macroeconomic imbalances. In addition, debt managers should ensure that their policies and operations are consistent with the development of an efficient government securities market.

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The Government of St. Lucia debt can be categorized firstly into Domestic and External debt and further into non-tradable and tradable debt.

The Government debt and investment programs and initiatives are run under the Office of the Director of Finance (ODOF) in a unit referred to as the Investment Analysis and Debt Monitoring Unit. Prior to the establishment of the Unit various departments under the Ministry of Finance handled the Government's investment and debt functions. The realization that debt and investment analyses embrace the same principles was a major consideration in combining the two functions in one area.

One of the main objectives of managing government debt is to provide the government with stable and consistent financing at a minimum cost subject to the necessary risks and constraints. Also one of the main objectives of investment is the attainment of the best returns given the risk profile of the government. In developing an appropriate debt and investment management strategy the following are some critical issues that one must be cognizant of:

1. The need to finance deficits through regional borrowing without the need to rely on external or foreign sources.
2. The optimal mix between domestic and foreign debt.
3. Fixed rate versus variable rate debt.

4. Callable debt.
5. The maturity structure of public debt (short-term versus long-term debt).
6. The Redemption of Bonds
7. The setting up of sinking funds.
8. Investing in other countries debt.
9. Investment options available.

Given the level of liquidity in the domestic and regional sectors it is currently cheaper to raise funds in the region. Approaching the international market will mean that the government will have to obtain an international rating. St. Lucia is regarded as an emerging market country and during times of economic downturn the economies of those countries perform less favourable. This increases the spread between benchmarks and emerging market debt thereby rendering emerging market debt more expensive. The experience of the Government of Grenada and St. Kitts and Nevis has shown that financing obtained from the regional market is less costly that what is obtained internationally. Foreign currency debt exposes governments to exchange rate risk and can create the risk of a financial crisis as experienced by the Asian and Latin American countries.

The financial crisis of the 1990's has increased focus on the structure and composition of Government debt. The maturity structure of debt is important, as it is less expensive to issue short-term debt as opposed to longer-term debt. However a high proportion of short-term debt tends to increase the probabilities of default as investors may suddenly decide not to roll over maturing debt or increase required yields of new debt. It has been noted that in emerging markets with liberalization and deregulation; adequate attention had not been paid to the maturity profile of the debt portfolio. The maturity decision was left to borrowers whose main consideration was cost. Hence the high level of short-term borrowing as governments tried to minimize cost. The financial crises of emerging markets in the 90's indicated how risky this decision was. Therefore there is need to determine an optimal mix between short-term, medium-term and longer–term borrowing.

To increase the flexibility of it debt structure a government should issue debt imbedded with certain options. A Call option is very relevant, as it will give a government the opportunity to make use of certain interest rate environments. In instances where interest rates are declining it would be in the best interest of a debt issuer call their existing debt and reissue at a lower interest rate. Options give the right and not the obligation therefore it may not hurt to incorporate them in bonds. There is the possibility that the pricing mechanism may take the option into consideration and marginally reduce investor proceeds from the issuance of the bond.

The Government will attempt to place less reliance on the overdraft facility that generates interest at approximately 11 percent per annum. Alternatively the regional Government Securities Market will be utilized in that respect. Given the high level of liquidity in the market short-term funding can be sourced on the regional market at costs ranging between 3.97 and 5.0 percent. As a result the overdraft facility will be used less frequently in the coming months. In this regard the Government of St. Lucia intends to raise an additional $25 million in Treasury bills on the RGSM in the three months maturity horizon.

The government will attempt to raise as much as it can on the RGSM with the remaining from regional financial institutions.

An integral part of the government's debt strategy is the development of the government bond market. Development of an active government bond market can benefit the government by providing an alternative non-inflationary source of financing, fostering of a healthy capital market and improving the functioning of the financial system. An active government bond market does have indirect benefits through better monetary management, enhanced transparency and a widening of investment opportunities. Government bond markets also provide easier benchmarking of corporate bonds and a more efficient determination of the time value of money.

With respect to Debt Restructuring this initiative involves the conversion of a portion of Government's existing Treasury bill stock into long-term bonds. It will be more cost effective and administratively less onerous if part of the current stock of Treasury bills were restructured. The restructuring will take the form of an extension of the maturity profile and the use of the Regional Government Securities Market (RGSM) platform to issue the securities. Also the current interest rate environment is regarded as favourable and the possibility exist that interest rates may start trending upward in the near future. Therefore the opportunity exists for Government to lock-in a relatively low interest rate between 6.5 percent and 7.5 percent for an extended period of time as opposed to the current practice of paying on average 7.5 percent on a short-term basis.

It is Government's intention to make greater use of the Treasury bills issued through the RGSM primarily for cash management purposes than the more expensive overdraft borrowings which government has traditionally relied upon. The Government's entry into the Regional Government Securities Market in January 2004 indicated that regional investors are willing to accept 5.5 percent on the Government of St. Lucia one-year debt. The experience of another government have shown that interest rate of below four (4) percent can be obtained on debt of three months maturity. Currently, overdraft interest averages 10.5 percent per annum. Therefore a greater use of the RGSM can result in significant savings in interest payments on government short-term borrowings.