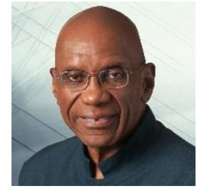
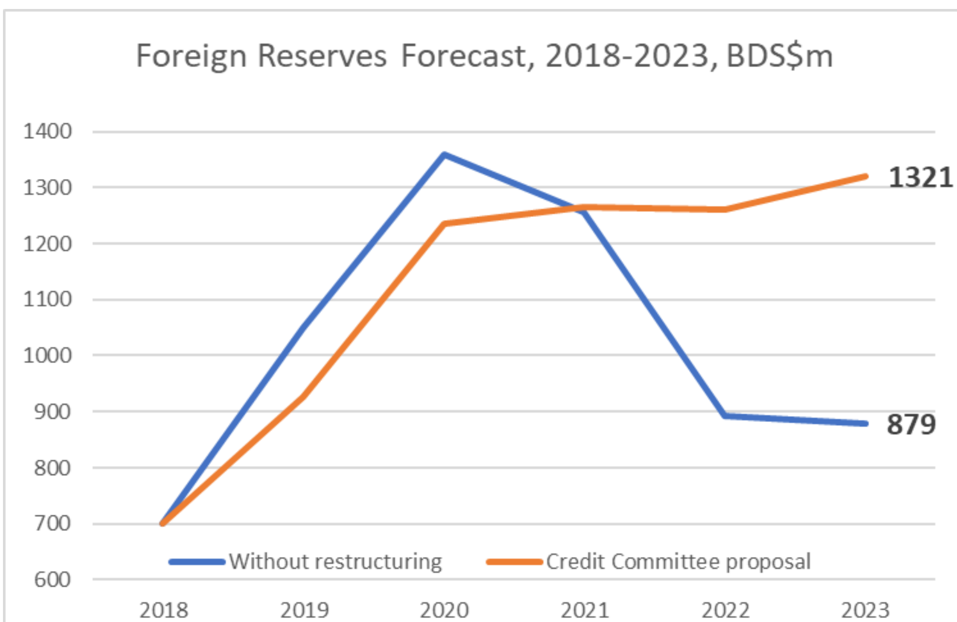


Economic Letter, December 2018

The Threat of Barbados Dollar Devaluation Remains

Prime Minister Mottley's unprecedented achievement in securing financial support from the IMF, the Interamerican Development Bank and the Caribbean Development Bank, has averted an imminent threat of devaluation. However, even though the risk of immediate devaluation has lifted, it has not gone away. Loans from the international financial institutions have bought the Barbados Government some time; Government must use this breathing space to negotiate a mutually satisfactory agreement with holders of US dollar-denominated bonds. In the absence of debt restructuring which is agreeable to the holders of those bonds, the threat of devaluation re-emerges in three years' time.

On Page 16 of the October Report on Barbados, the IMF Staff presented a forecast of the foreign reserves of the Central Bank of Barbados to 2023. That forecast is shown as the blue line in the accompanying chart. It can be seen that foreign reserves fall drastically in 2021 and 2022; by 2023 Central Bank's foreign reserves will have fallen to BDS$879 million, a gain of less than $200 million in five years. The 2023 reserves level is below the Central Bank's minimum target of three months of imports. Unless Government negotiates a restructuring of the US dollar debt which is satisfactory to all parties, the exchange rate peg will once more be in danger.



Sources: IMF Staff Report, October 2018, my calculations.

The orange line in the chart shows an alternative foreign reserves projection, based on a debt restructuring proposal which has been sent to PM Mottley by a committee representing holders of US dollar bonds. As can be seen, this proposal ensures that the Central Bank holds on to foreign reserve gains, ending the period with an amount of BDS$1,321 million. With this level of foreign reserves, the exchange rate peg would be secure.

The proposal offered by the External Creditor Committee would consolidate five US dollar bonds into a single medium-term issue that would attract a competitive market interest rate. Government would no longer need to repay US$350 million of maturing debt in 2021 and 2022; Barbados' sovereign credit rating would immediately improve, and Government and its agencies would regain access to US dollar loans.

On January 14, 2010, I opened my first Press Conference as Governor of the Barbados Central Bank by displaying a 20 dollar Barbados currency note. I reminded my audience that the foundation of the Government's economic sovereignty was the confidence that our dollar could be exchanged for 50 US cents. I cited the examples of countries of the Far East, who have shown that adequate stocks of foreign reserves are the surest way to maintain control of a country's exchange rate, to achieve whatever target the country chooses. That is a lesson we must never forget. Now that the Central Bank's foreign reserves are on the way to recovery, Government must take the next step to ensure that the foreign reserve gains are not lost. A proposal which meets the Central Bank's foreign reserves needs, and at the same time is acceptable to the holders of US-denominated Government debt, is now in the hands of the Prime Minister and her advisers.

Technical note: My foreign reserve projections are based on the table entitled "External financial requirements and sources" on Page 16 of the IMF Staff Report on Barbados (October 2018). In the absence of a mutually agreed restructuring of US dollar debt, the "Exceptional financing (restructuring)" must be subtracted from the (negative of) the "Change in reserve" in 2021, 2022 and 2023. The proposal offered by the External Creditor Committee eliminates this restructuring finance need entirely, preserving the foreign reserve gains shown in the table. The cost to Government would be an annual interest payment which could be accommodated without impairing the foreign reserve projections for 2019 and 2020, as indicated by the fact that the "restructuring requirements" for those years are negative in the IMF table.