Press Summary – January 14, 2019

Espacios Abiertos, San Juan, Puerto Rico

It has been more than a year since Hurricane Maria hit Puerto Rico, bringing more suffering to an economy that was already in an economic downward spiral.

Though Maria was a tragedy, it also created an opportunity to rewrite a flawed fiscal plan that had been certified by the Oversight Board in March 2017. A study commissioned by Espacios Abiertos and led by public debt crises expert Martin Guzman from Columbia University had shown that the old fiscal plan was based on unsound premises and that it failed to establish an appropriate basis for calculating how much debt restructuring Puerto Rico would need. The study also shed light on the necessary debt relief to restore the sustainability of the island's public finances.

Over the last year, Guzman has been leading another project that analyzes the latest fiscal plans and the recent deal with the COFINA bondholders. Some of the conclusions will be shared in this conference.

The new plan had to be fundamentally different than the previous one if Puerto Rico was to have a chance for recovery. The island has now a new fiscal plan and a deal with the COFINA bondholders. Besides, the Board projects that Puerto Rico will receive about $74 billion of federal aid over the next decade, a substantial amount that could certainly help Puerto Rico's short and long term recovery if it includes a reasonable comprehensive economic plan and an appropriate debt restructuring.

But the way in which the events have been evolving is worrisome. While the latest fiscal plan revised some of the assumptions of the old plan in a sensible direction, it still offers an overoptimistic view of the consequences of the proposed reforms for the future of the island. What's even worse, the COFINA deal poses a serious risk of a failed debt restructuring, which would leave Puerto Rico trapped in a destabilizing dynamics of recession.

The COFINA deal: $11.8 billion in current interest bonds, with a coupon of almost 6 percent will be exchanged into $9.6 billion of new bonds with an average coupon of 4.5 percent, and $ 6 billion of capital appreciation bonds will be exchanged by $2.4 billion of a new capital appreciation bonds—but beware of the numbers on the last one as they mislead the actual debt burden (this is not a regular bond: it does not pay a coupon, bit has a structure of "accreting" payments that lead to increasing payments over time, which can easily confuse non-experts on the actual debt burden that it entails). While these numbers have been advertised as "relief" or "savings" for the Puerto Rican taxpayers, the reality is less rosy than it has been suggested. There are a number of subtleties that must be taken into consideration to understand the full implications of this deal.

The COFINA deal is not a simple exchange of old bonds by new bonds with lower value. Bondholders are gaining with this exchange in a number of important ways. And Puerto Ricans are paying for it. First, while the old bonds were a mix of senior and junior bonds, the new bonds are all senior. The old junior bonds get the largest reduction but they gain seniority. Effectively, the deal has improved rather than decreased the bondholders expected recovery value, as reflected by the increase in the prices of those bonds over the last year.

Second, the payment structure is such that the payment on the bonds will rise over time by a magnitude that can hardly be sustained. Under the deal, the annual debt payments would increase from $420 million in fiscal year 2019 to almost $1 billion in fiscal year 2041. These rising payments would be sustainable if Puerto Rico's economy were to grow proportionally over the same period, but this is not a reasonable expectation (and it is not even the expectation of the Board, as revealed in the latest fiscal plan).

If the deal is approved, it will see the island paying about $33 billion to creditors on a principal of just $17.8 billion. And on bonds that are all senior now, that should be discounted at a low interest rate. This does not seem to constitute much savings.

Concluding:

- The current COFINA deal only makes sense if the other groups of Puerto Rico's creditors get virtually nothing. The arithmetic is simple. The ability to pay that our computations as well as those from others who arrived to similar results with different methodologies, implies that this generosity with the COFINA bondholders leaves almost nothing to other claimants.
- On the other hand, the COFINA deal sets a dangerous precedent. If similar terms are agreed with creditors who hold General Obligation bonds, Puerto Rico will be forced to default again or else suffer massive cuts to public spending that will put the economy again into a destabilizing spiral of recession and outmigration instead of allowing the economy to prolong its recovery.
- Interestingly and importantly, the current rebound in activity comes not from austerity but from the expansionary new federal spending. This is consistent with the notion that Puerto Rico was in an aggregate demand constrained regime—one that required the opposite of downsizing government spending.
- COFINA bondholders will be getting far more than what they could have expected a year ago. Prices of both COFINA and general obligation bonds have steadily increased, owing to a political game over disaster relief funds that has been playing out against the interests of Puerto Rican citizens.

- The sustainability of Puerto Rico’s debt restructuring needs to be assessed and addressed comprehensively. This isn’t happening.
- Overall, Puerto Rico's oversight board is still supporting too much debt service and too much austerity while displaying excessive faith in structural reform, and it is addressing one piece of the debt puzzle at a time in a way that will likely prove inconsistent.
- Overestimating debt payment capacity can leave a country with an overhang of unpayable debt, leaving the economy under a mantra of uncertainty that repeals investments and that eventually ends in another costly restructuring. There is plenty of evidence about the negative consequences of following the road that Puerto Rico is travelling—Greece being the most famous recent example.
- Despite a strong consensus among economists that Puerto Rico needs a radically different economic and debt-restructuring plan, the relevant policymakers do not seem to be listening. If the island’s liabilities are not properly restructured, it will remain in a debt trap.