

# Cayman Islands' Proposed Bond Issue:

## Q&A WITH MARLA DUKHARAN

### CAYMAN'S PROPOSED USD400 MILLION BOND

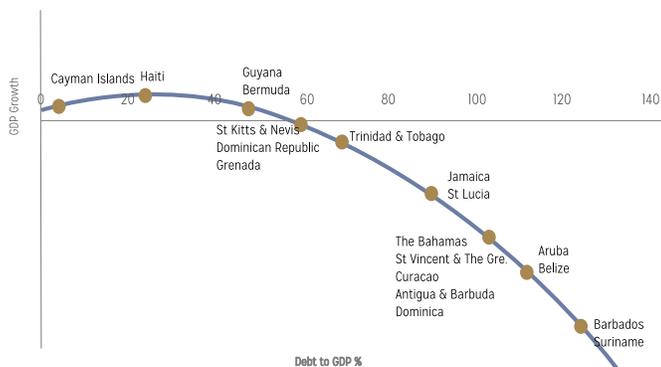
Marla shares her views on the most common questions we have received with respect to the recently proposed and widely debated USD400 million bond issue in the Cayman Islands.

#### Q. What do you think about Cayman borrowing at this time? This is not something we normally see the Cayman Islands do.

A - Like with many other metrics, Cayman is an outlier as it relates to its fiscal position and its debt level. Most Caribbean countries are heavily indebted and unsustainably so. But not Cayman. In spite of the crisis in 2020, which led most Caribbean countries to increase their debt to GDP by an average of 20 percentage points, for the Cayman Islands, debt to GDP declined. Debt to GDP in the Cayman Islands stood at around 5% in 2021.

#### Growth and Debt: Caribbean

GDP growth percent and debt-to-GDP percent, 2021



Source: IMF, various Central Banks, Statistics Authorities and Finance Ministries, Marla Dukharan

As demonstrated in the chart above, empirical research shows that below 30% debt/GDP, there is a positive relationship between each additional dollar of debt and growth, until you get to about 55% debt/GDP when the relationship becomes negative. This means that below 55%

debt/GDP, each additional dollar of debt actually causes GDP to expand. This is where Cayman lies.

What Cayman had been practicing under the last administration, which is partly why I called it the best-run economy in the region, is counter-cyclical fiscal policy. Simply put - in times of plenty, you save, and in lean times you draw on those reserves to spend in order to maintain a smooth/stable level of Government spending over time. No wild gyrations like we see in T&T for example. This is partly why Roy McTaggart and Marco Archer before him, will get my praise every time. They got this right. As such, Cayman can afford to borrow now if it truly needs to in these perilous and uncertain times. BUT whether such borrowing makes sense now, depends not just on the fact that debt is low, but on whether Cayman actually needs to borrow, what the Government will spend these borrowed funds on, and it also depends on the terms and conditions of the borrowing.

Does the Government not already have funds in reserve? What items specifically is the Government seeking to finance with debt? Can these expenditure items be financed from reserves and/or from current fiscal revenue? Do the returns on the project(s) being financed cover and therefore justify the borrowing? These are very important questions that every Government would be well advised to consider and respond to, before taking a decision to borrow, at any time and on any terms.

The last thing we would want to see is Cayman fall into the debt trap that most of the Caribbean is already in. On the other hand, if there are opportunities for justified, bankable projects that will support long-term sustainable growth and socio-economic development, now may be the right time to consider borrowing for these initiatives.

And finally - at the risk of repeating myself again - if Cayman were to establish a sovereign wealth fund to place its fiscal surpluses and draw on to finance growth/transformational projects, it would greatly reduce if not eliminate the need for borrowing - if done properly, which, if anyone can, Cayman can.

**Q. The Minister of Finance says he wants to raise USD400 million for refinancing. What are your thoughts on this?**

A - These are very uncertain times and raising debt should not be taken lightly, even when your debt/GDP is below 10% - because GDP can shrink quickly and that ratio can become 30% for example, in short order. But if used wisely, a country in Cayman's position could benefit in the long term from borrowing IF it did not have the funds to finance those important and necessary expenditure items, AND once the terms and conditions of the borrowing make sense relative to the project it is financing. Refinancing existing obligations to capitalize on better terms and conditions is always a good idea. The Minister of Finance said he is seeking to "pay less interest every year," which would be a desirable outcome indeed. However, the current rising interest rate environment may pose a challenge to achieving this outcome.

In 2020, the last Government arranged a precautionary line of credit with a consortium of domestic banks for USD403 million at 3.2% per annum from what I recall - but I stand to be corrected. It may prove difficult via commercial debt to beat that rate now, especially with the Fed poised to tighten. US 30 year treasuries yielded 1.68% on December 3rd 2021, and today closed at 2.1% - and this is the risk-free rate, which are usually the lowest rates available for USD borrowing. But there is also the option for the Government to borrow on non-commercial terms from the Caribbean Development Bank for example, which is perfect for socio-economic development related projects, and this type of financing could prove to be quite competitive compared to commercial terms and conditions.

**Q. What are reverse mortgages being discussed? Is it a good idea for the Government to borrow for this purpose to lower the cost of their social welfare benefits? How does that work?**

A - When you borrow money from the bank to buy property, typically that loan is called a mortgage, and the property is held by the bank as collateral for the loan until it is paid off. When you have paid the mortgage in full, the property becomes yours. When you own the property already, and it is not held as collateral for any loan, you can take a reverse mortgage where the bank in effect 'buys' the property from you by paying you an agreed sum of money each month for a number of years until the total agreed

amount is paid, usually close to the market value of the property. All the while, you are able to continue occupying the property. When the bank has paid you in full for the property, it then belongs to the bank. In other words, you are able to 'monetize' the asset you own while being able to continue using it. This product is especially attractive to the elderly who own property but whose pensions/cash flow are insufficient to support their needs.

Cayman is not just an outlier from a fiscal management standpoint, as mentioned earlier, but it is quite unique in being a private sector-led economy, where the Government is not the main driver of economic activity. And this is exactly why Cayman was able to record healthy growth rates alongside fiscal surpluses for years before the pandemic. This is why unemployment was low. A private sector-led economy is not something I think Cayman should change - the rest of the Caribbean is a sad testament to this.

I do not know for sure as I have not done the research, but if it is indeed the case that there are many Caymanians who own property and need financial assistance which they receive from the Government (or anyone else), it makes sense for them to take reverse mortgages to supplement their income and eliminate the need to ask for help. However, based on my cursory assessment of the situation, I do not believe that it is necessary or prudent for the Government or any state-owned entity to engage in this type of activity.

Cayman has one of the best-regulated financial sectors. The domestic commercial banks are well capitalized and liquid, and I believe they are therefore best-placed to go to the market with a reverse mortgage product. Perhaps the Cayman Islands Bankers Association can comment on their willingness and ability to go to market with such a product in Cayman, which the Cayman Islands Monetary Authority will have to regulate like any other.

Reverse mortgages have the potential to improve the lives of Caymanian homeowners and reduce the Government's social welfare bill, while giving the banks an opportunity to mobilize their liquidity. Everyone wins with this approach, the way I see it. The banks are better-equipped to deal with the property that they will end up owning at the end of the reverse mortgages. I can't imagine that the Government is equipped to handle nor would want to be burdened with this type of activity.

The formula of a private sector-led economy works well in Cayman. If it ain't broke, don't fix it.