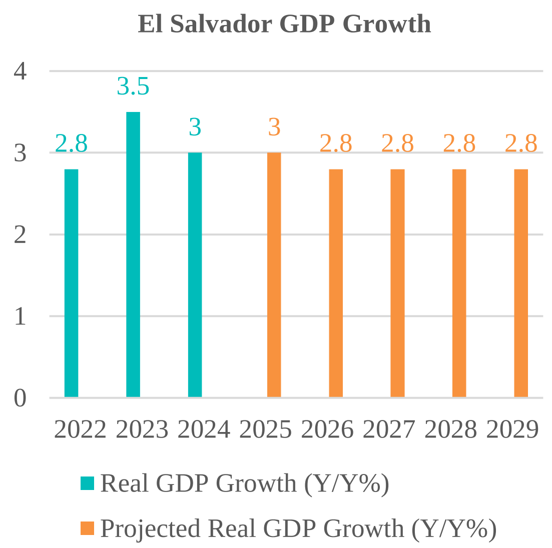
Aurora Public Debt Report: Bukele Bestrides Bitcoin and Bretton Woods
January 24, 2025

The Tearsheet

- El Salvador's recent economic success has paved the way for a staff-level agreement with the IMF. This agreement could unlock up to USD 3.5 billion in loans, including contributions from non-IMF international development institutions, aimed at supporting the country's economic growth.
- As part of the agreement, the IMF requires El Salvador to revoke Bitcoin's status as legal tender, a condition seen as essential for managing financial risks. While the IMF has become more open to crypto assets, El Salvador's National Bitcoin Office has stated that Bitcoin will continue to be recognized as legal tender, highlighting potential tensions within the administration.
- Alongside the IMF deal, El Salvador has secured a USD 1 billion debt-for-nature transaction, modeled on recent examples undertaken by Ecuador, and this trend is likely to continue.
- For Latin American governments, particularly right-leaning ones, DFN swaps present a unique opportunity to deliver tangible and easily measurable economic benefits while simultaneously supporting environmental initiatives in a way that avoids negatively impacting local elites or businesses. Given these incentives and the strong global appetite for such deals, we anticipate a significant increase in their adoption.

1. A Long and Winding Road with the IMF

- Following years of often tense negotiations, the IMF and the Government of El Salvador reached a staff-level agreement on December 18, 2024, under the Extended Fund Facility (EFF).
- The agreement, totaling approximately USD 1.4 billion, aims to support the government's reform agenda. The 40-month program, and subsequent disbursement of financing, is now pending approval by the IMF Executive Board, something contingent on the government of El Salvador implementing the agreed upon reforms.
- Additional development loans of USD 2.1 billion can now be accessed via the World Bank and the Inter-American Development Bank, bringing the total potential funding to USD 3.5 billion.
- The IMF's press release highlights El Salvador's strong post-pandemic economic performance, driven by robust remittances and tourism. The program aims to sustain this growth.



Source: IMF

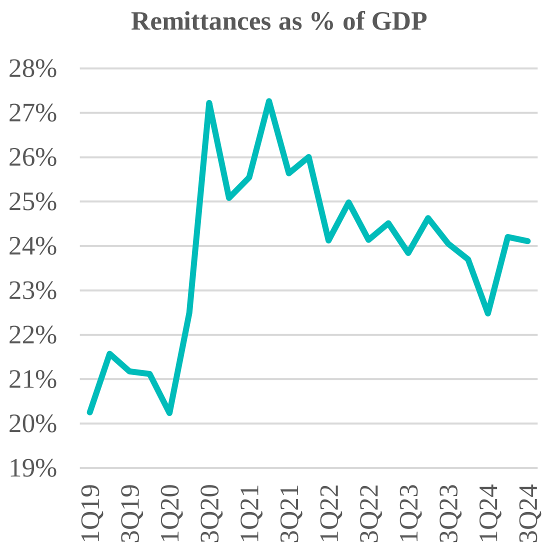
Key Elements of the Program:

Program Elements	Fostering Fiscal Sustainability	Enhancing Fiscal Governance	Improving Business Climate	Strengthening Financial Resilience	Mitigating Digital Assets Risks
Program Objectives	1. Reduce borrowing costs 2. Ensure public debt follows a clear downward trajectory	Strengthen: 1. Fiscal Transparency 2. Accountability 3. Anti-corruption measures 4. Anti-money laundering policies	1. Streamline bureaucratic governance 2. Create a more favorable business environment	1. Build liquidity buffers for financial institutions 2. Bolster the central bank's gross reserves	1. Address financial risks of El Salvador's Bitcoin project 2. Enhance regulation of digital assets

- In the immediate aftermath of the agreement, on January 7, 2025, Fitch Ratings upgraded El Salvador's Long-Term Foreign Currency Issuer Default Rating (IDR) from "CCC+" to "B-." The upgrade was attributed, in part, to the "reduction in financing needs and easing of financing constraints supported by the regaining of market access, and recently announced IMF program."

2. Bitcoin vs. Bretton Woods

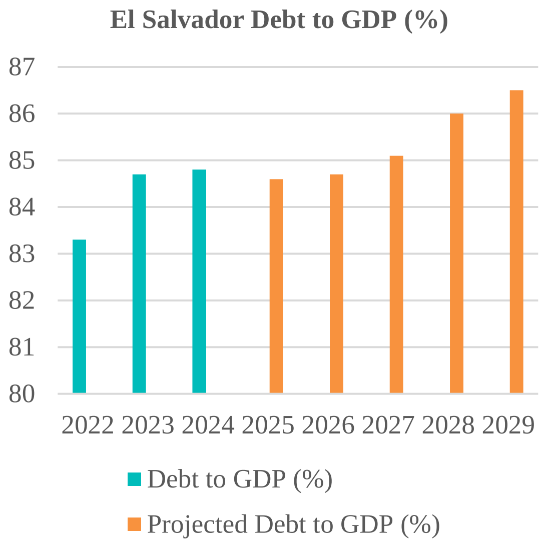
- The IMF agreement reflects as much a pragmatic shift toward the acceptance of crypto assets by the lender of last resort as it does a greater willingness to compromise on the part of the Bukele government.
- In 2021, El Salvador's National Assembly passed Decree No. 57, making Bitcoin legal tender. Businesses were required to accept Bitcoin as payment, and the law included measures to prevent money laundering.
- The IMF's opposition to the decree was immediate and vocal, highlighted in its 2021 Article IV Consultation for El Salvador. The report detailed the significant risks associated with adopting cryptocurrency as legal tender, including threats to financial stability and consumer protection. That same year, the IMF formally recommended revoking Bitcoin's legal tender status.



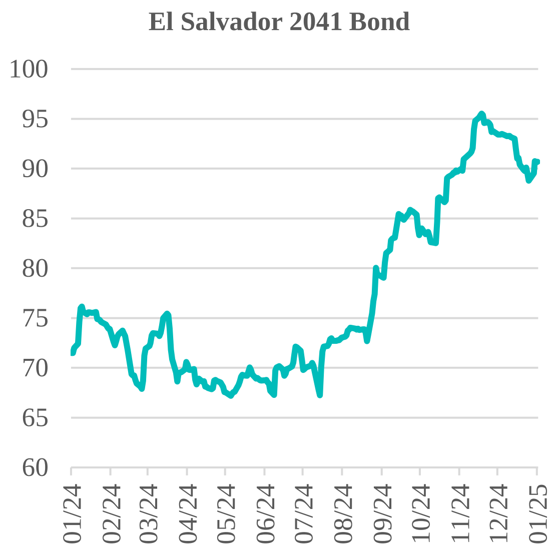
Source: Banco Central de Reserva

- In order to boost the use of the assets, El Salvador created and funded a national e-wallet program (Chivo), but the system never really took off, and only around 1% of international remittance payments—the country's principal economic driver—were made via electronic wallet last year.
- The issue went further than Chivo—Bitcoin itself failed to win hearts and wallets. According to a 2024 study by Universidad Centroamericana José Simeón Cañas, around 80% of Salvadorans had not used Bitcoin in the previous year, and a full 92% had not done so between January and May of 2024. Additionally, more than 3 in 4 Salvadoreans reported never having used it at all.
- This limited adoption of Bitcoin among Salvadorans appears to have opened a middle path forward. El Salvador would make Bitcoin's private sector adoption "voluntary" and ensure public sector use is "confined," according to the IMF's press release.
- In a 2023 report, the IMF concluded that the implementation of Bitcoin in El Salvador has been slow because this asset is "largely not an accepted medium of exchange," opening the door to an eventual agreement.
- More specifically, to implement this compromise, El Salvador will need to reform Art. 7 of the Bitcoin Law, revoking Bitcoin's status as legal tender but potentially still allowing for its voluntary use. This approach seeks to balance regulatory compliance with the Bukele government's broader pro-cryptocurrency ambitions and efforts to rebrand the nation.
- It bears noting that, following the IMF agreement, the Salvadorean National Bitcoin Office director, Stacy Herbert, declared that crypto assets would remain legal tender, indicating potential internal disagreements within the Bukele administration.
- Our base case nonetheless does assume that Decree No. 57 will be amended to revoke Bitcoin's status as legal tender. Nevertheless, the government can promote the voluntary use of Bitcoin, particularly incentivizing its use in remittances.
- The proposed reform may appear to be a *volte face* from El Salvador's bold Bitcoin strategy, but it could also signal a pragmatic recalibration. This shift seeks to balance the risks of cryptocurrency adoption with the practicalities of engaging multilateral institutions like the IMF.
- We do not believe that the upcoming legislative reform will signal the end of El Salvador's crypto ambitions under Bukele. The government continues to increase its Bitcoin reserves and has attracted players like Tether, reinforcing its commitment to establishing itself as a hub for crypto-related innovation and investment.
- Revoking Bitcoin's status as legal tender does not necessarily hinder El Salvador's plan to become a hub for technology and crypto assets. On the contrary, removing its legal tender status could enhance the perception of crypto assets as decentralized financial tools.
- For investors, this compromise could mitigate some financial risks associated with Bitcoin's legal tender status while maintaining El Salvador's focus on cryptocurrency adoption. Effective regulatory measures, particularly in anti-money laundering, will play a key role in determining the stability and feasibility of this balanced approach.

3. Eco-nomics: the Green Path to Debt Relief



Source: IMF



Source: Bloomberg

- In 2024, El Salvador continued its longstanding efforts to reduce its debt burden through bond buyback programs, leveraging strong economic performance and expectations of closer ties with the incoming Trump administration.
- In October 2024, the country completed a USD 1 billion debt buyback linked to an environmental initiative, touting it—in characteristic Bukele style—as the largest debt-for-nature swap in history.
- Although the claim may be debatable—Ecuador completed a USD 1.6 billion DFN swap tied to the Galápagos in 2023—the global enthusiasm for debt-for-nature swaps, which incentivize creditors to reduce debt in exchange for commitments to fund nature conservation projects, remains undeniable.
- For governments, particularly right-leaning ones, DFN swaps currently provide a rare opportunity to deliver tangible (and highly visible) economic benefits while supporting environmental causes in ways that will not adversely affect local elites and business.
- While not a new concept, with antecedents dating back as far as the latter Cold War years, DFN swaps have historically been limited in scope. However, increasing focus on climate change in recent years has reinvigorated interest in these mechanisms, aligning the objectives of sovereign debtors, creditors, and international institutions to promote conservation and climate adaptation.
- As Lee Buchheit noted in 2021, green restructuring can reduce coordination costs in sovereign debt negotiations by involving non-traditional players—such as international organizations—willing to support these deals if debt relief is allocated toward environmental goals.
- For the El Salvador deal, JPMorgan provided a USD 1 billion loan to buy back USD 1.031 billion in bonds at a discount, generating an estimated USD 352 million in debt relief. These funds were allocated primarily to the Río Lempa Conservation and Restoration Program.

- The U.S. International Development Finance Corporation (DFC) supported the deal by providing political risk insurance, while the Corporación Andina de Fomento (CAF) contributed a USD 200 million standby letter.
- These partnerships, justified by the environmental goals of the project, were crucial in facilitating coordination with JPMorgan.
- Despite their potential, DFN swaps are not without challenges. Environmental projects tied to these agreements often attract scrutiny from local communities and NGOs. For example, Ecuador’s Galápagos transaction faced criticism from the Centro de Derechos Económicos y Sociales (CEDE) over transparency concerns, leading to an internal investigation by the Inter-American Development Bank.
- Nonetheless, Ecuador is moving forward with a second major DFN transaction focused on Amazon preservation, and we anticipate that El Salvador will again follow suit, aggressively leveraging DFNs as highly visible "wins" that align with both environmental and financial objectives.
- More broadly, DFN swaps are poised to remain an attractive option for Latin American governments, particularly conservative ones, as they deliver measurable economic benefits alongside environmental progress without disrupting local elites or businesses. Given strong global interest in these agreements, their adoption is expected to proliferate in the coming years.

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