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Government of Peru

FAQ on Peru's Bonos de la Deuda Agraria

Summary

In this report we look at [Peru's \(A3 stable\)](#) Bonos de la Deuda Agraria (BDAs), how we incorporate them into our analysis, what they mean for the sovereign's creditworthiness and how they could affect the fiscal accounts:

- » **What are the BDAs and what is their status?** In 1969, the military government of General Juan Velasco Alvarado expropriated rural land holdings throughout Peru. In lieu of cash payments for the expropriated lands, the government issued BDAs as compensation. By the 1990s, the majority of BDA holders ceased collecting coupon payments given the loss of monetary value due to hyperinflation. The BDAs remain an unpaid liability of the government through the end of their tenor.
- » **What is the total amount of BDAs outstanding?** The exact figure is unknown. The registration process to identify holders is still ongoing. Despite two Constitutional Court rulings to update the value of the bonds, (one which suggests that they be updated based on a dollar indexation calculation), the updated value remains disputed. BDA holders insist on a consumer price index (CPI)-based methodology for updating the value of the bonds that could bring their value to \$5.1 billion, while we estimate that the value, using the dollar-based methodology suggested by the Constitutional Court, would be around \$500 million.
- » **How does Moody's incorporate the BDA instruments into its analysis?** Moody's does not rate the BDA instruments. The BDAs are compensatory instruments for the land expropriations. The BDAs are ruled by local law and their original terms do not specify any form of indexation either to inflation or foreign currency. In general, Moody's sovereign ratings reflect the ability and willingness of sovereign issuers to repay their private sector debt instruments according to the original contractual terms of the bonds. In our view, the current legal and valuation disputes on the BDAs do not alter the government's willingness and ability to remain current on its foreign and domestic market debt.
- » **What would be the effect of the BDAs on Peru's fiscal accounts?** We believe that the effect would be limited and manageable. The amount would likely be paid out over time, rather than as a one-time payment. This would spread the cost over a number of years and, as the economy expands, constitute a decreasing burden on the fiscal accounts. Under all scenarios, in addition to cash payments, the government could also exchange the BDAs for market instruments.

1) What are the BDAs?

In 1969, the military government of General Juan Velasco Alvarado approved the [Ley de Reforma Agraria](#) enabling it to expropriate rural land holdings throughout Peru. These plots of land were transferred to the state and then distributed to peasants and small farmers organized in cooperatives. In lieu of cash payments for the expropriated lands, the government issued BDAs as compensation. Three classes of BDAs were issued in local currency with tenors of 20, 25 and 30 years, each class paid a nominal coupon between 4%-6%. The [Ministry of Agriculture](#) estimates that between 1969 and 1979 just under 9.07 million hectares (22.4 million acres) were expropriated from 15,826 landholdings.

2) What is the status of the BDAs?

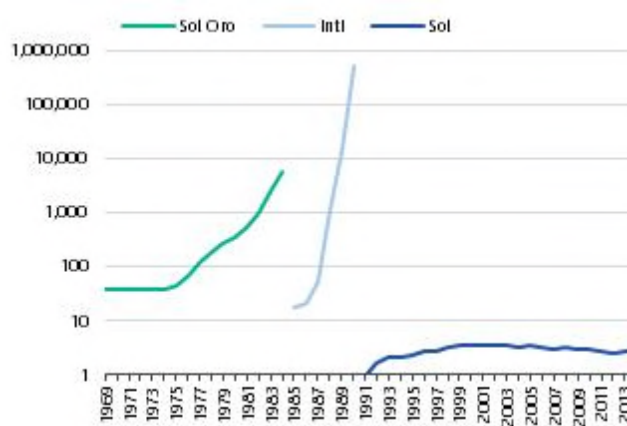
To receive coupon payments, BDA holders had to present the coupon cut-out of the BDAs in person at the Banco Agrario, which would request transfers from the Ministry of Economy and Finance for the payments. Average yearly inflation increased from 6.3% in 1969 to 67.7% in 1979. Hyperinflation in the 1980s further decreased the value of the BDAs, and as a result, the majority of BDA holders ceased collecting coupon payments given the loss of monetary value (see Exhibit 1). As BDA holders were no longer approaching the Banco Agrario, by the early 1990s the Banco Agrario was no longer requesting funds from the ministry to make the payments. The BDAs remain an unpaid liability of the government through the end of their tenor. The local currency was redenominated in 1985 and then again in 1991 (see Exhibit 2). In 2001, Peru's Constitutional Court (Tribunal Constitucional, TC) issued a ruling stating that the government pay the BDAs but also update their nominal value on an actuarial basis. Nevertheless, the TC did not specify a methodology for updating the value of the bonds, leading to lengthy disputes between all stakeholders.

Exhibit 1
Average yearly inflation
(% change year-on-year, log scale)



Source: Central Bank and Moody's Investors Service

Exhibit 2
End of period exchange rate
(Local currency units per dollar, log scale)



Source: Central Bank and Moody's Investors Service

In 2013, the TC issued a writ of execution stating that the updated value of the BDAs should be derived from indexing them to their equivalent in dollars (without defining the starting point for the conversion) and applying the interest rate on United States Treasury bonds. The outcome was once again disputed by various stakeholders. In 2014, the government issued two decrees that outlined the process of registering and validating the bonds, updating their value and the administrative procedure for eventual payment.

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3) What is the total amount of BDAs outstanding?

The exact figure is unknown. At the time of the expropriations, the enabling law allowed for up to 15 billion soles oro (the local currency in 1969) to be used for compensation. In 2006 the Ministry of Economy and Finance stated that 13.3 billion soles oro were issued in the form of BDAs (using the prevailing fixed exchange rate of 38.7 soles oro/\$ in 1969-1974 the amount comes to \$343.3 million). The registration process to identify holders is still ongoing. The valuation dispute on the outstanding BDAs is still ongoing, as BDA holders insist on a consumer price index (CPI)-based methodology for updating the value of the bonds. The [Alianza por el Pago Justo de los Bonos Agrarios](#) (an association of BDA holders) estimated their value by end-2014 at \$5.1 billion using the CPI-based methodology. Using the dollar-based methodology suggested by the TC, we estimate that the total amount would be around \$500 million.

4) How does Moody's incorporate the BDA instruments into its analysis?

Moody's does not rate the BDA instruments. The BDAs are compensatory instruments for the land expropriations. The BDAs are ruled by local law and their original terms do not specify any form of indexation either to inflation or foreign currency. In general, Moody's sovereign ratings reflect the ability and willingness of sovereign issuers to repay their private sector debt instruments according to the original contractual terms of the bonds. Moody's sovereign ratings speak to credit risk only and do not reflect inflation risk or market risk. In our view, the current legal and valuation disputes on the BDAs do not alter the government's willingness and ability to remain current on its foreign and domestic market debt.

5) What would be the effect of the BDAs on Peru's fiscal accounts?

We believe that the effect would be limited and manageable. Peru's gross public debt/GDP ratio of under 23% is significantly below the 'A' category median of 40%, and we expect fiscal deficits below 3% of GDP through 2017.

Under the dollar-based methodology for updating the value of the BDAs, we estimate that the government's liability would represent 0.3% of GDP. The amount would likely be paid out over time, rather than as a one-time payment. This would spread the cost over a number of years and, as the economy expands, constitute a decreasing burden on the fiscal accounts.

Even under a worst case scenario, using the CPI-based methodology, the liability would represent less than 2.6% of GDP. Spread out over a number of years, the payouts would not materially affect the sovereign's fiscal dynamics or its creditworthiness. Under all scenarios, in addition to cash payments, the government could also exchange the BDAs for market instruments.

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