Puerto Rico Official Says Island Will Default on Agency Debt.

Puerto Rico said it won't make a bond payment due Saturday, putting the commonwealth on a path to default and promising to initiate a clash with creditors as it seeks to renegotiate its $72 billion of debt.

The government doesn't have the money for the $58 million of principal and interest due on Public Finance Corp. bonds, Victor Suarez, the chief of staff for Governor Alejandro Garcia Padilla said during a press conference Friday in San Juan.

"We cannot make the payment tomorrow because we do not have the funds available," Suarez told reporters. "This payment will be made as we address how to restructure the government's debt prospectively."

The default marks an escalation in the debt crisis that's been racking the island, where officials are pushing for what may be the biggest restructuring ever in the municipal market. Puerto Rico bond prices have slipped amid speculation that the island won't be able to repay what it owes as its economy stagnates and residents leave for the U.S. mainland.

"An event like this is significant enough that it could hurt prices for Puerto Rico bonds," said Richard Larkin, director of credit analysis at Herbert J Sims & Co. in Boca Raton, Florida. "I can't believe a default on debt with Puerto Rico's name will go unnoticed."

Island officials had said that Puerto Rico may skip the payment on the Finance Corp. bonds, which can be made as late as Monday because Aug. 1 is a Saturday. The Finance Corp., which has borrowed to help balance the government's budget, has about $1 billion of debt outstanding.

No Appropriation

The securities are paid for with money appropriated by the legislature, unlike general-obligation bonds that are protected by the commonwealth's constitution and have a claim on its tax money. That leaves bondholders with little recourse because the commonwealth hasn't guaranteed repayment and the legislature isn't obligated to allocate the funds.

Faced with a budget shortfall, lawmakers didn't provide the money when they passed the annual spending plan. Island officials said that Puerto Rico's available cash was limited to funding essential services such as health and safety.

Puerto Rico Government Development Bank President Melba Acosta said in a statement Friday that a separate $169 million debt-service payment for the bank's bonds will be made.

Shared Sacrifice

Garcia Padilla said in June that the commonwealth cannot pay all of its obligations, following years of borrowing to paper over budget shortfalls, and that bondholders need to share in the sacrifice to help steady the island's finances. Officials plan to draft a debt-restructuring plan by Sept. 1.

The governor has drawn opposition from investors including OppenheimerFunds Inc., which said it will fight to ensure that the commonwealth repays its debt. A report by three former International Monetary Fund economists, which was commissioned by a group of hedge funds, said the island can balance the budget without a broad debt restructuring.

Puerto Rico’s economy has contracted every year but one since 2006 and is projected to decline by 1.2 percent this year. The island’s population shrunk 7 percent in the past decade. Another 245,000 residents are estimated to leave by 2025 as they seek employment on the U.S. mainland. Puerto Rico’s June jobless rate of 12.6 percent is more than double what it is in the U.S.

Essential Problem

“The essential problem in Puerto Rico is the economy and the outmigration of individuals,” said Phil Fischer, head of municipal research at Bank of America Corp. in New York. “And neither of those seems to be improving.”

While Garcia Padilla surprised investors by pushing for a restructuring, two months after he said it would be a mistake to default, the island’s worsening debt crisis hasn’t rippled through the municipal-bond market. Municipal bonds in July had their strongest return since January as investors recognized that Puerto Rico’s problems are unique.

The commonwealth’s securities have traded at distressed levels for two years. General obligations maturing July 2035 and originally sold in March 2014 at 93 cents on the dollar traded Friday at an average of 69.5 cents on the dollar, according to data compiled by Bloomberg. The average yield was 12.1 percent.

Puerto Rico debt has lost 10.8 percent this year through July 30, the worst for the period since at least 2007, S&P Dow Jones Indices show.

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