UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

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Effective Debt Strategies in the Current Macroeconomic Environment

by

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Effective Management Debt Strategies in the Current Macroeconomic Environment

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Current Macroeconomic Environment

Weakened global growth projections and shifting patterns of activity

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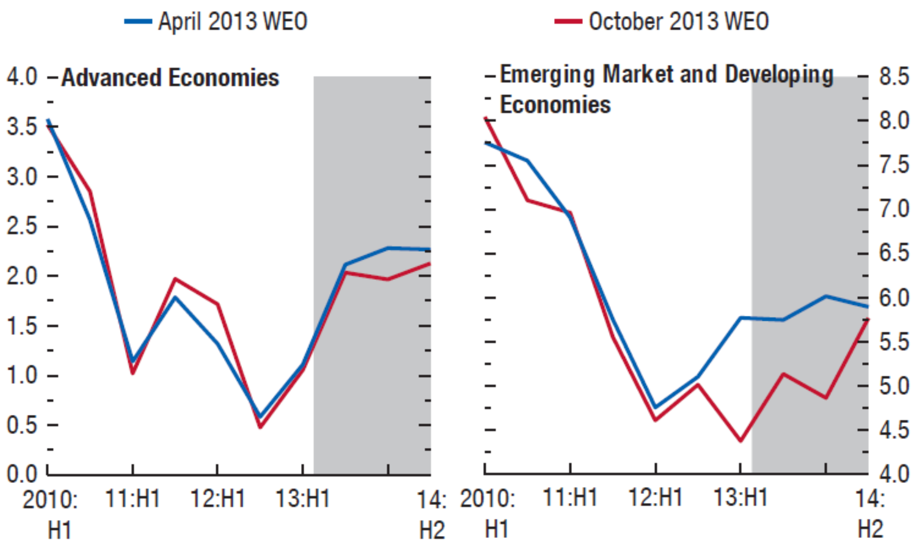
GDP growth
Annualized quarterly percent change



Source: IMF

US

- Activity slowly accelerating from subdued levels
- Relatively strong private demand
- Large fiscal adjustments and political uncertainty about fiscal policy

Europe

- Growth beginning to resume but still very weak
- Policy actions reduced some tail risks and stabilized financial markets

Japan

- Vigorous rebound in 2013, but will loose likely steam as fiscal policy tightens

EMEs

- Growing number of EMEs tracking lower and off cyclical peaks
- Capital flow and exchange rates volatility, interest rates increased

Weakened financial and macroeconomic conditions in emerging market economies

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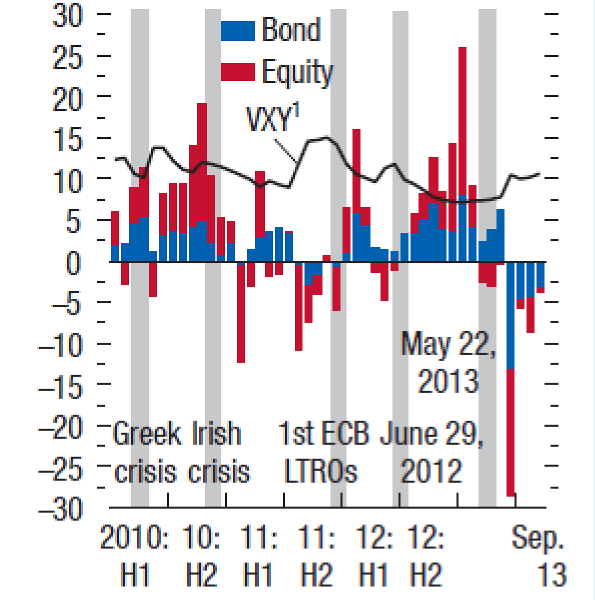
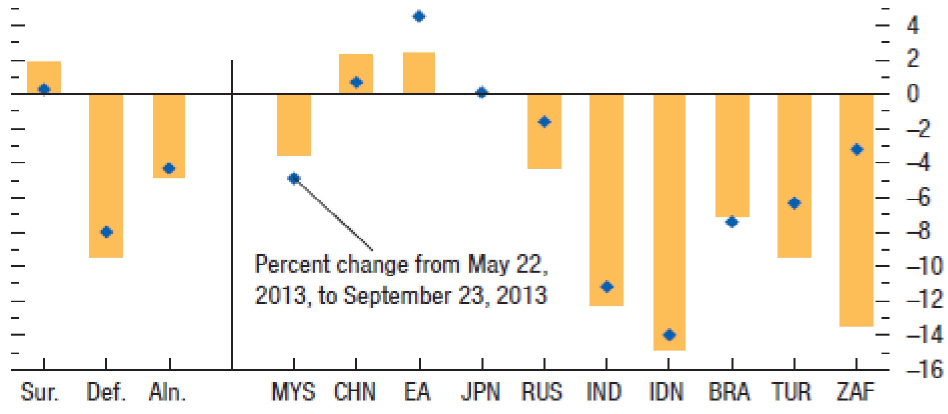
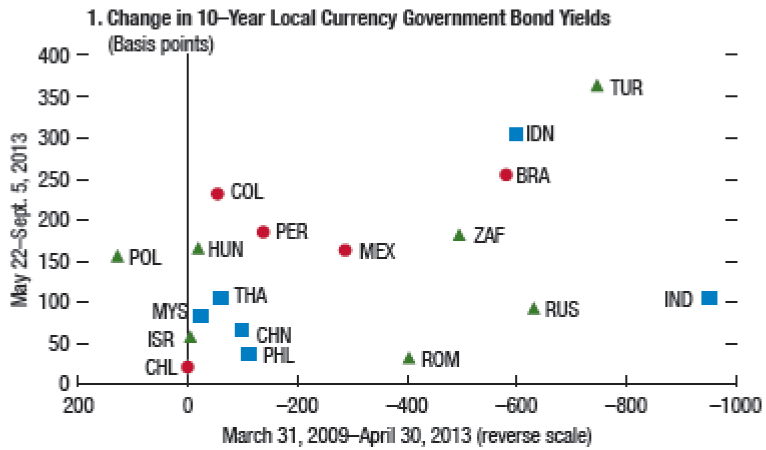
Net capital flows to EMs
USD bn, monthly flow



Nominal exchange rates
Percent change from Jan. 1, 2013, to Sep. 23, 2013



Change in 10-year local currency government bond yields
Basis points



Source: IMF

Downside risks

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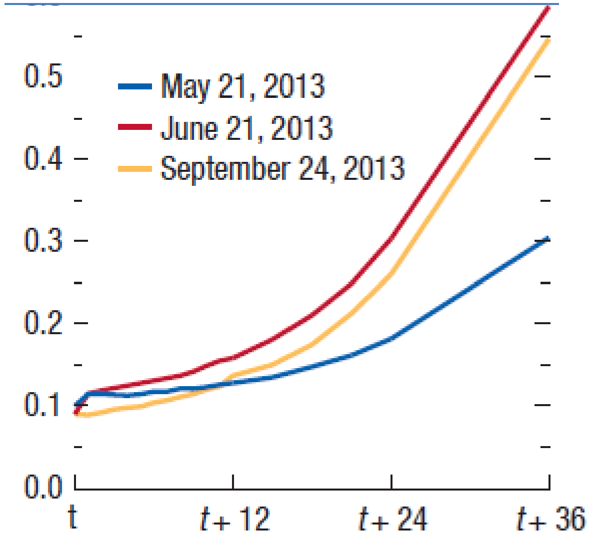
Major global macroeconomic risk factors

- **Stagnation in the Euro area**
  - Adjustment fatigue and policy backtracking
  - Stalled financial reintegration or further fragmentation
  - No progress on banking union
- **Deadlock over US fiscal policy**
  - Continuation of sequester
  - Political deadlock over debt ceiling adjustments
  - Potential default
- **Risks related to unconventional monetary policy**
  - Timing and communication around actual tapering of asset purchases
  - Volatility in international capital flows
- **More disappointments in emerging markets**
  - Interaction with unwinding risks
  - Feedback loops between deleveraging, weakening balance sheets and further growth disappointments
  - Regional and country specific growth slowdowns, e.g. due to lack of structural reforms (e.g., India, Brazil, Mexico) and failure to move from investment and credit to consumption led growth in China

US policy rate expectations
Percent; months on x-axis



Source: IMF

Lessons from external shocks: global financial crisis of 2008 - 2009

Large capital outflows in the last quarter of 2008

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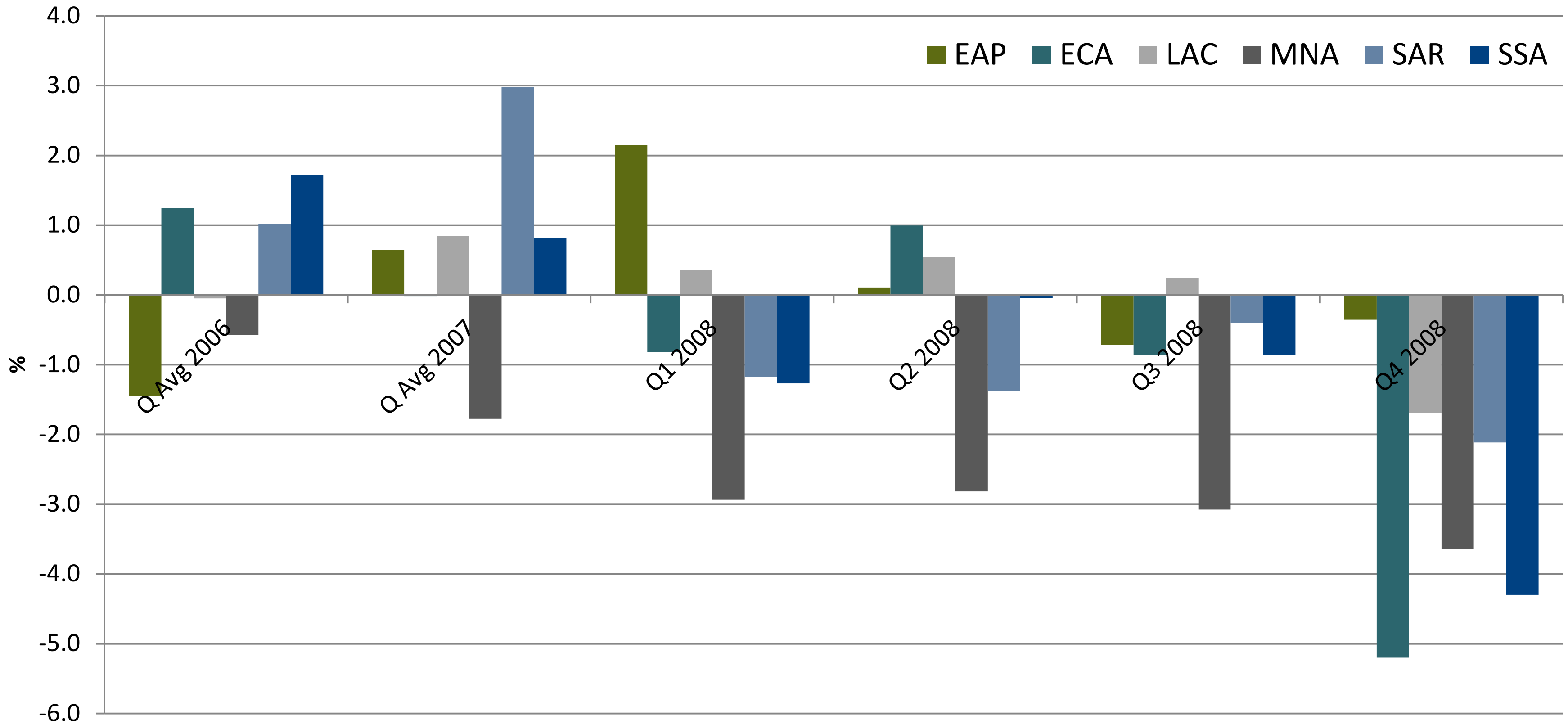
- Major challenge to debt managers, especially in countries still dependent on external funding.

Quarterly Portfolio Flows (% of GDP)



Source: Portfolio flows from IMF *IFS;* GDP from World Bank *WDI*

Impact of the global financial crisis on spreads of USD borrowing by emerging market sovereigns

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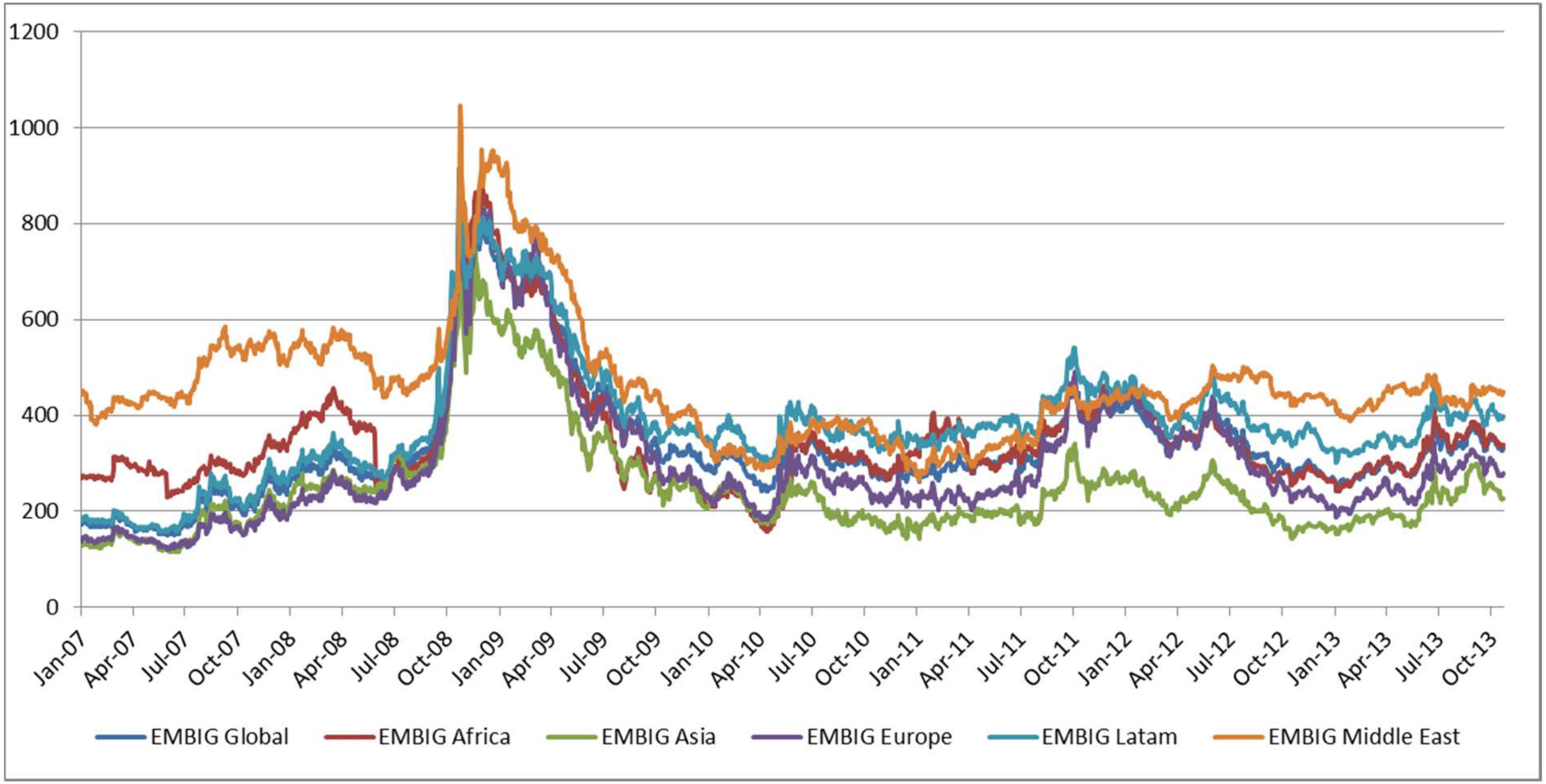
EMBIG Global and EMBIG by Regions
Spreads over UST in basis points; Jan. 2, 2007 to October 23, 2013



Source: Bloomberg

The impact of the crisis on local currency bond yields was mixed

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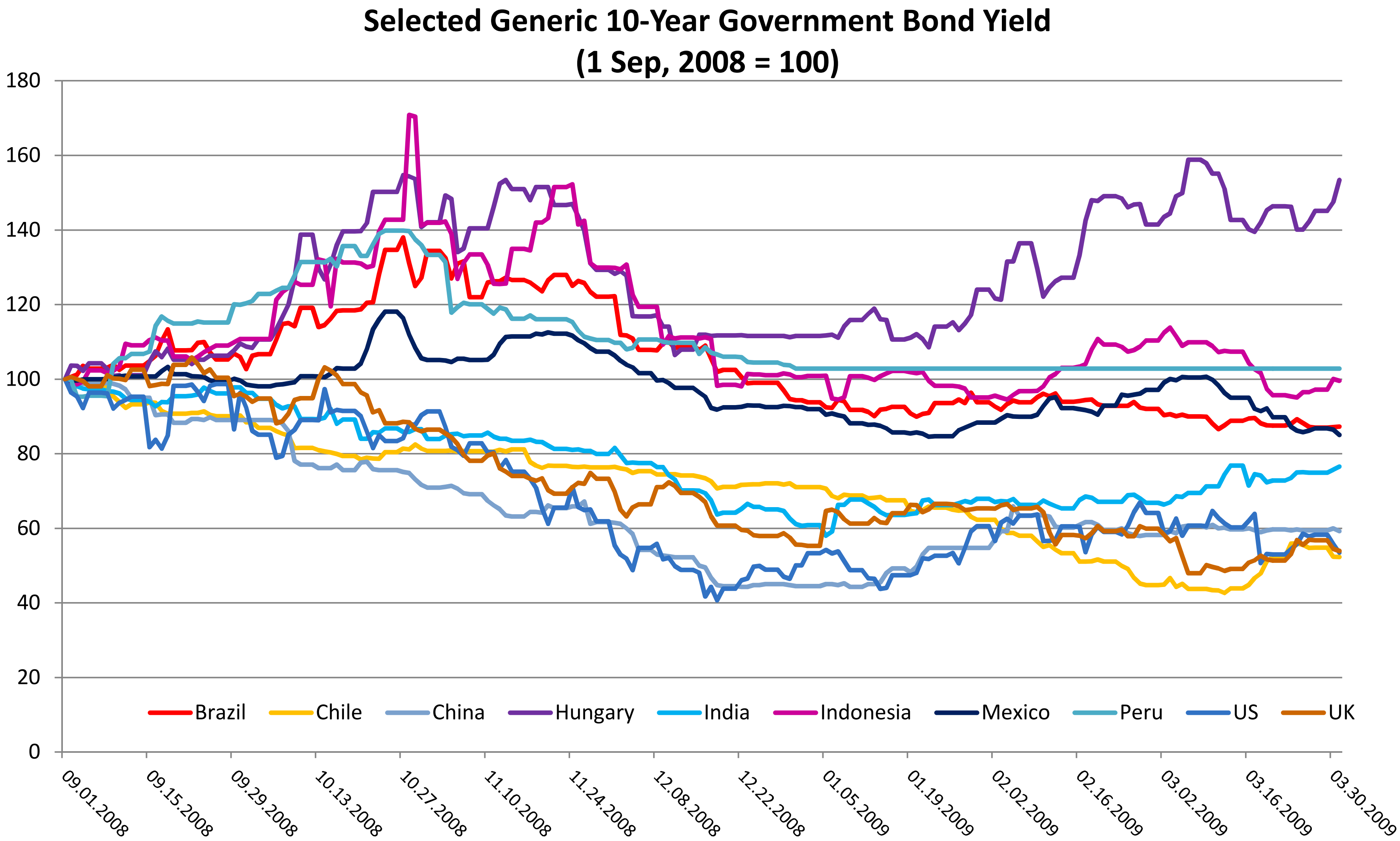

Source: Bloomberg LP, Datastream

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Some lessons learned…

- Sound macroeconomic policy was elemental to buffer the impact and for subsequent recovery
- Prudent debt management pre-crisis played a role in enhancing EMs resilience: focus on refinancing, interest rate and exchange rate risks. During 2000 – 2009, major changes in debt portfolios[1]:
  - Average ratio of external to domestic debt dropped from 0.75 to 0.22.
  - Average life tripled from 1.3 years to 4 years in Latin America, and increased from 6.7 years to 9.4 years in Asia.
  - Ratio of floating and short-term fixed-rate debt to fixed rate debt dropped from 2 to 0.7.

- Debt managers had room to maneuver, adapt, and absorb risk.
- Countries with larger, more developed bond markets fared better.

1 Public Debt Management in Emerging Market Economies: Has This Time Been Different? Phillip R. D. Anderson et al.

Framework for developing a medium-term debt management strategy

Designing a debt management strategy requires analysis of choices, constraints and trade-offs

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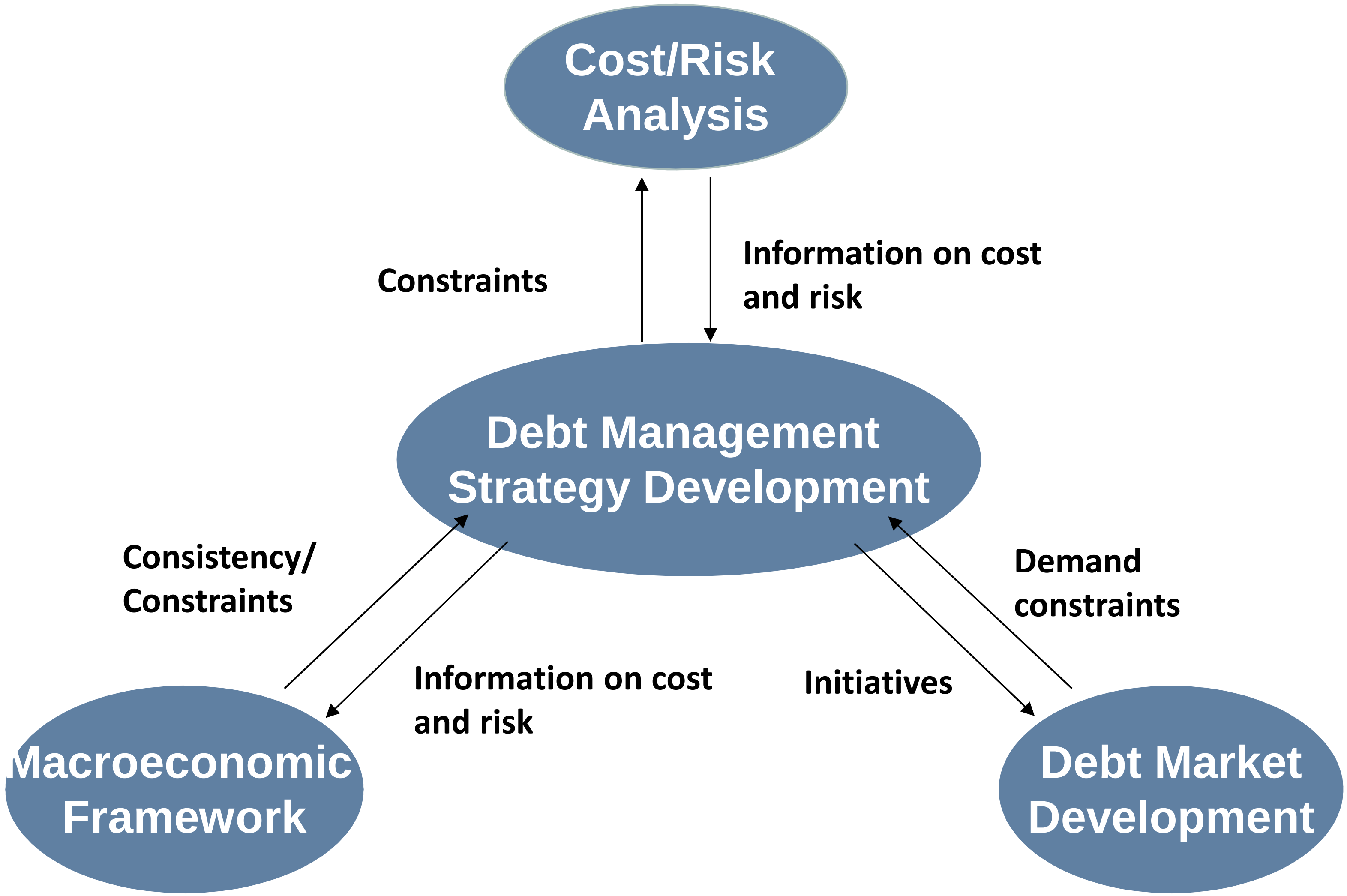

Medium-term debt management strategy framework follows 8 steps

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1. Objectives and scope of the debt management strategy
2. Current debt strategy and cost and risk of existing debt
3. Potential sources of finance
4. Macro and market environment
5. Review key structural factors
6. Analysis of alternative debt management strategies
7. Review of fiscal, budgetary, and market constraints
8. Propose and approve MTDS

Conclusion

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- The turbulence and tail risk observed in recent crises highlight the importance of considering extreme scenarios when analyzing risks in the debt portfolio
- Particular attention should be paid to refinancing and liquidity risks: market dislocation can precipitate a sovereign debt crisis
- Access to domestic market financing can reduce risk and also supports financial sector development; however developing domestic debt markets is a long term process
- Effective communication with stakeholders is helpful in turbulent times, but needs to be established before a crisis hits

Appendix

External debt declined relatively before global financial crisis

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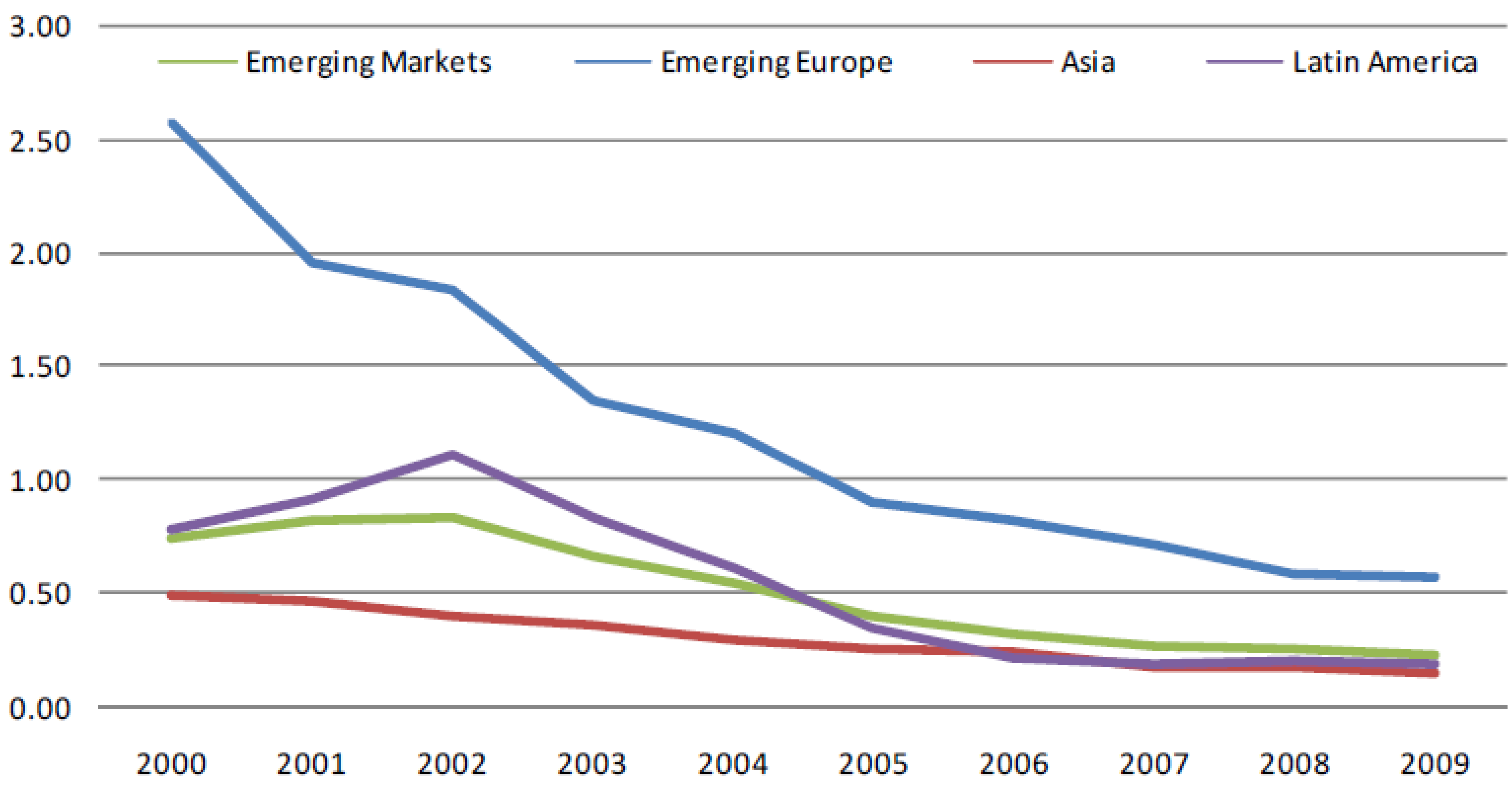
Ratio of external to domestic debt



Note: USD-linked domestic debt reallocated to external

Source: JP Morgan *EM Debt and Fiscal Indicators (2009) and BIS Financial Stability and local currency bond markets (2008)*

Average maturities increased before the global financial crisis

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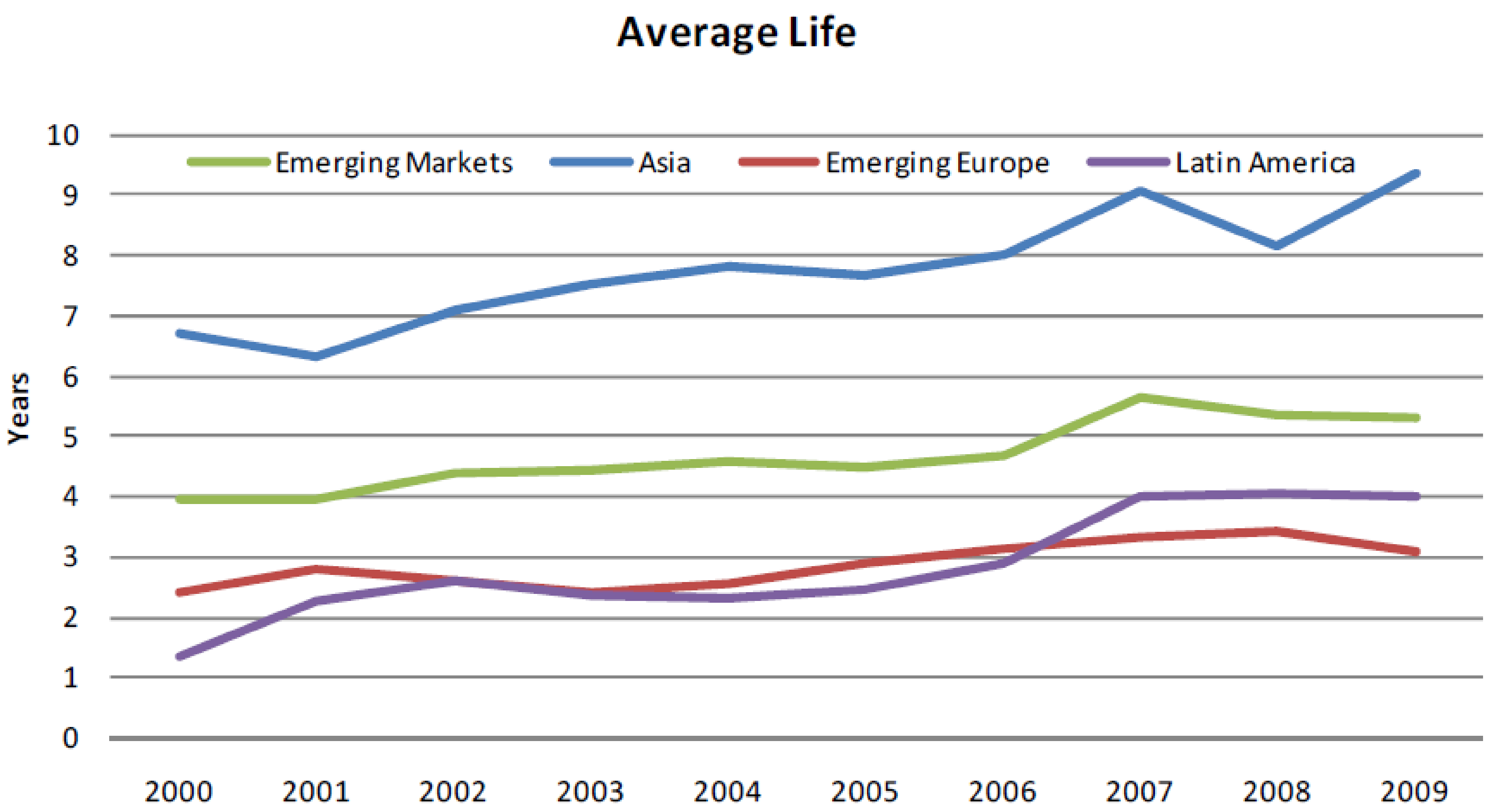

Source: JP Morgan *EM Debt and Fiscal Indicators (2009) and BIS Financial Stability and local currency bond markets (2008)*

Share of floating rate debt was reduced before the global financial crisis

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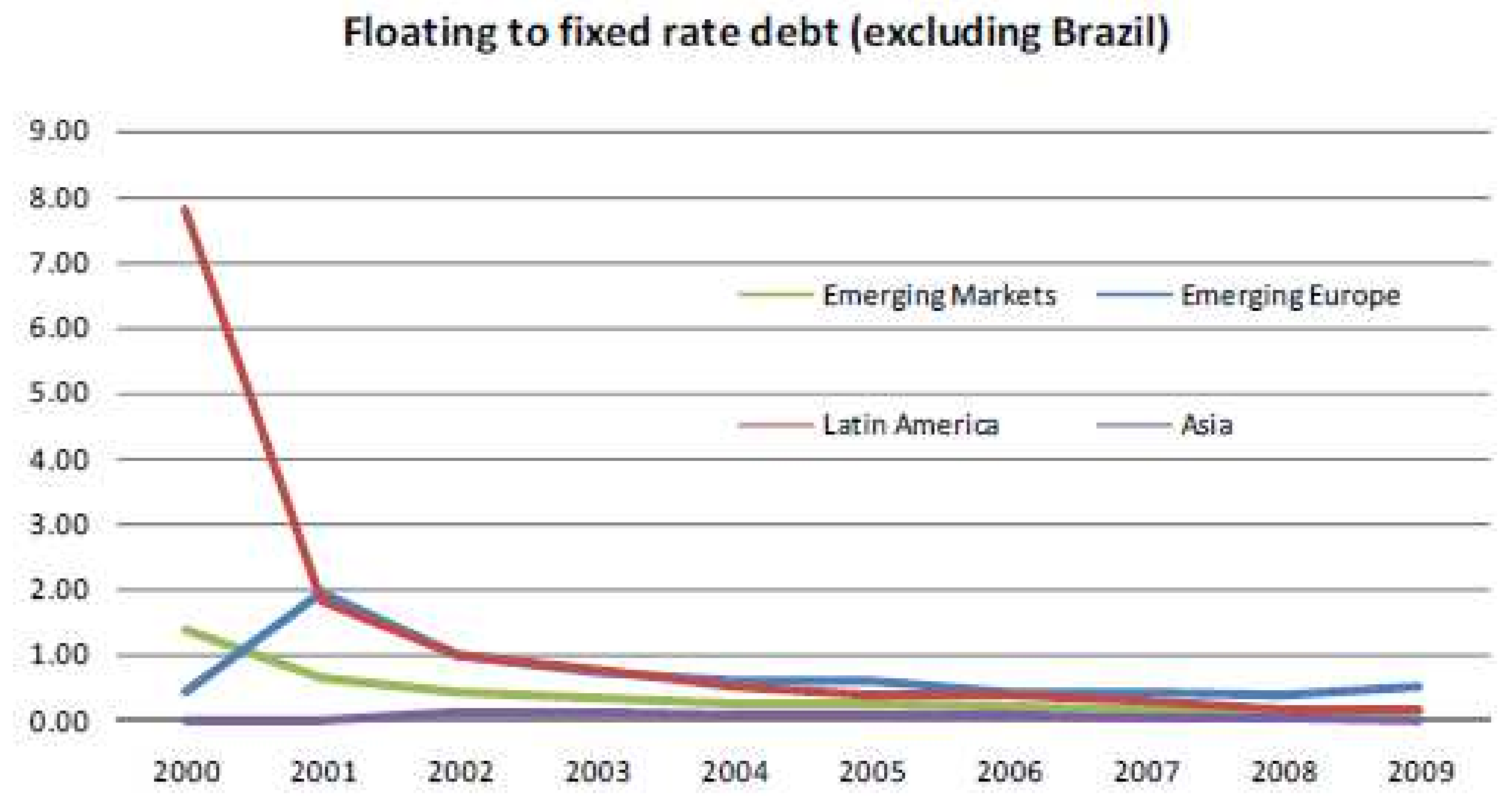

Source: JP Morgan *EM Debt and Fiscal Indicators (2009)* and BIS *Financial Stability and local currency bond markets (2008)*

Global Financial Conditions

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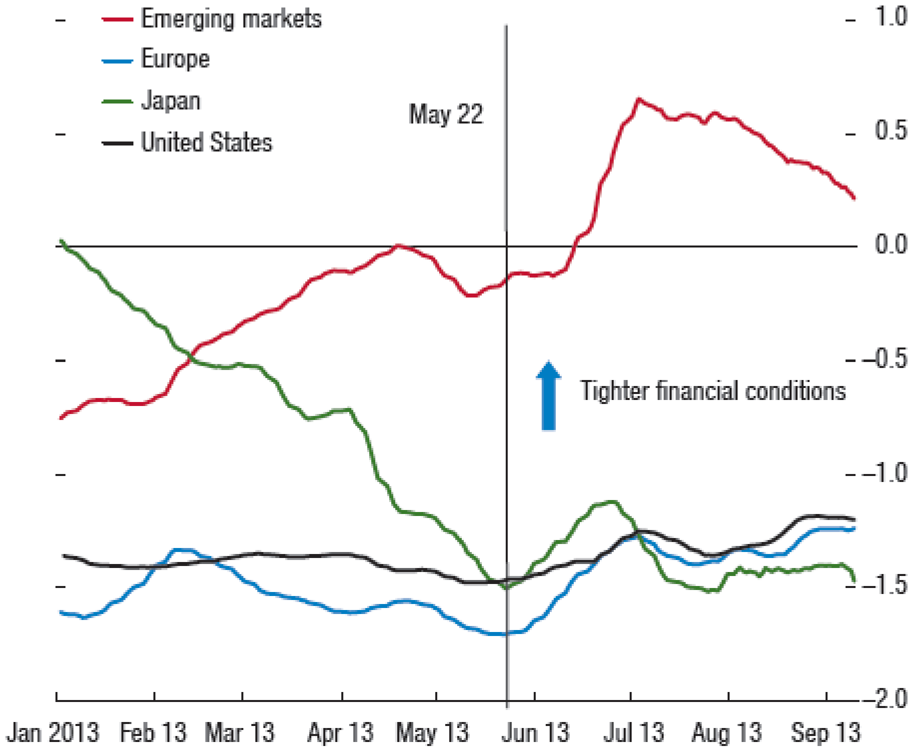
Figure 1.4. Global Financial Conditions
(Index; normalized, two-week moving averages)



Source: Goldman Sachs Financial Conditions Index.

Growth changes 2011 – 2013 in BRICS

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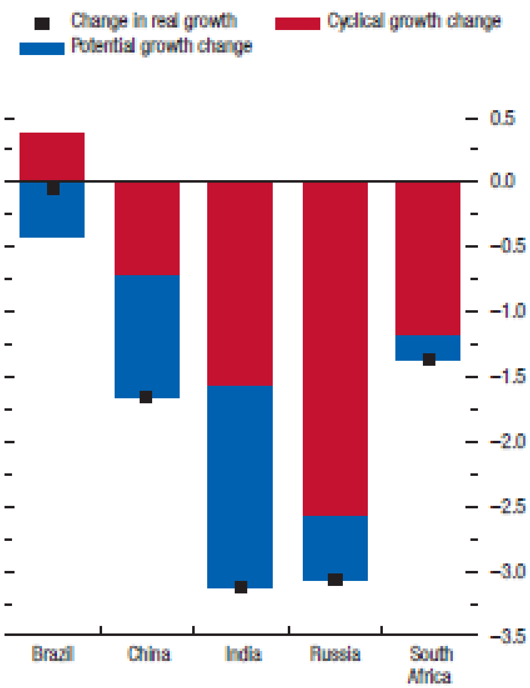
Figure 1.2.2. Composition of 2011–13 Growth Changes[1]
(Percentage points)



Source: IMF staff calculations.
[1]Multivariate filter estimates of the composition. See Table 1.2.1.

Bond flows from advanced economies to EMEs in last 10 years

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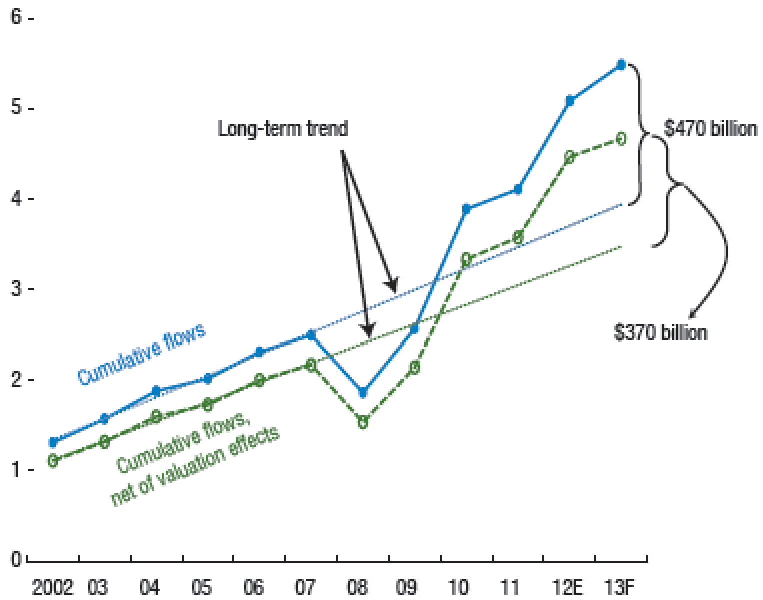
Figure 1.15. Above-Trend Bond Flows from Advanced to Emerging Market Economies
(Percent of advanced economies' GDP)



Sources: IMF Consolidated Portfolio Investment Survey (CPIS); JP Morgan; and IMF staff calculations.
Note: E = estimate; F = forecast. The long-term trends were extrapolated from the 2002–07 period to remove the effects of the global financial crisis and unconventional monetary policies. Data for 2012–13 were calculated from the trend of 2009–11 and estimates. Advanced economies = Bermuda, Canada, Cayman Islands, France, Germany, Hong Kong SAR, Italy, Japan, Jersey, Luxembourg, Netherlands, Singapore, Switzerland, United Kingdom, and United States.

Impact of portfolio inflows on LX bond yields, 2009-12

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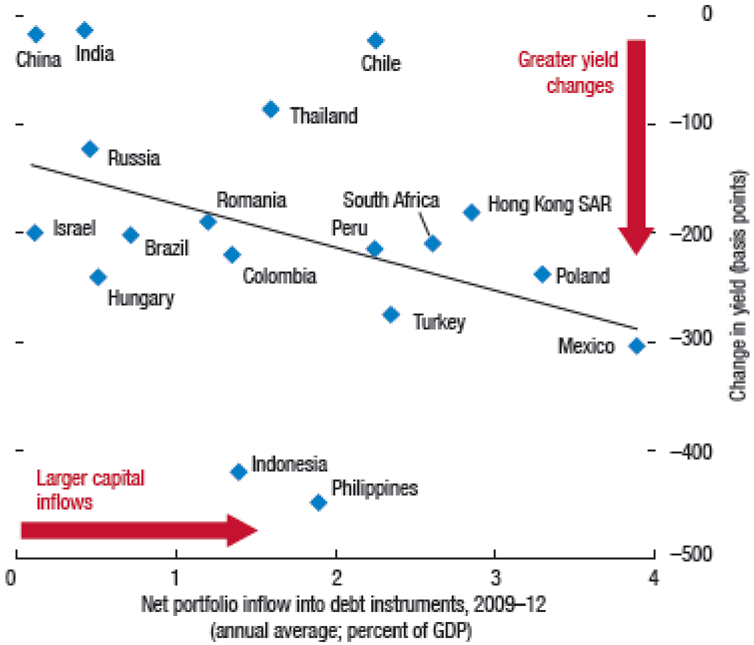
Figure 1.17. Impact of Portfolio Flows on Local Currency Bond Yields



Sources: Bloomberg, L.P.; CEIC Data; Haver Analytics; IMF International Financial Statistics database; and IMF staff calculations.
Note: The vertical axis shows the deviation of the mid-May 2013 10-year local government bond yield from its average since 2005.

Vulnerabilities in EMEs

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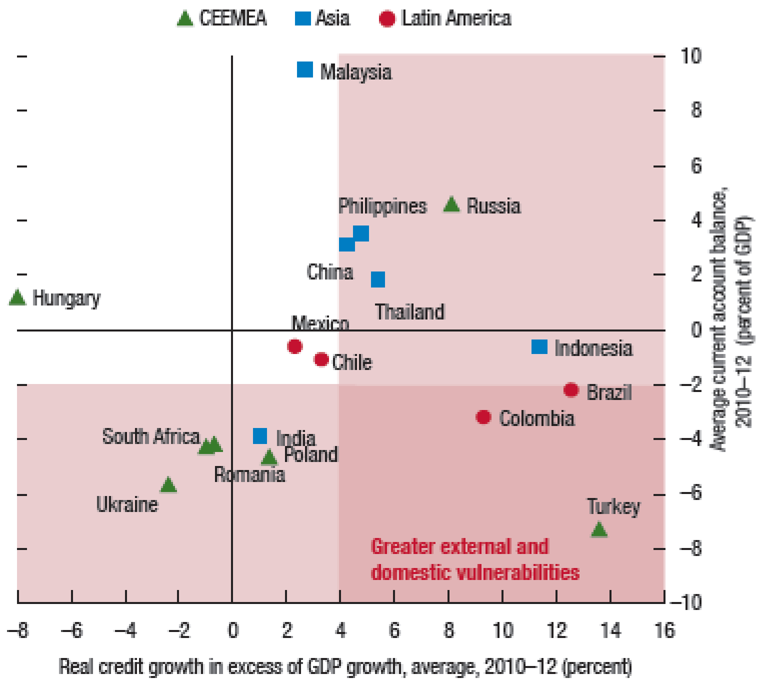
Figure 1.28. External and Domestic Vulnerabilties



Sources: IMF, International Financial Statistics and World Economic Outlook databases.
Note: CEEMEA = central and eastern Europe, Middle East, and Africa.

Potential impact of reversal in capital flows on bond yields

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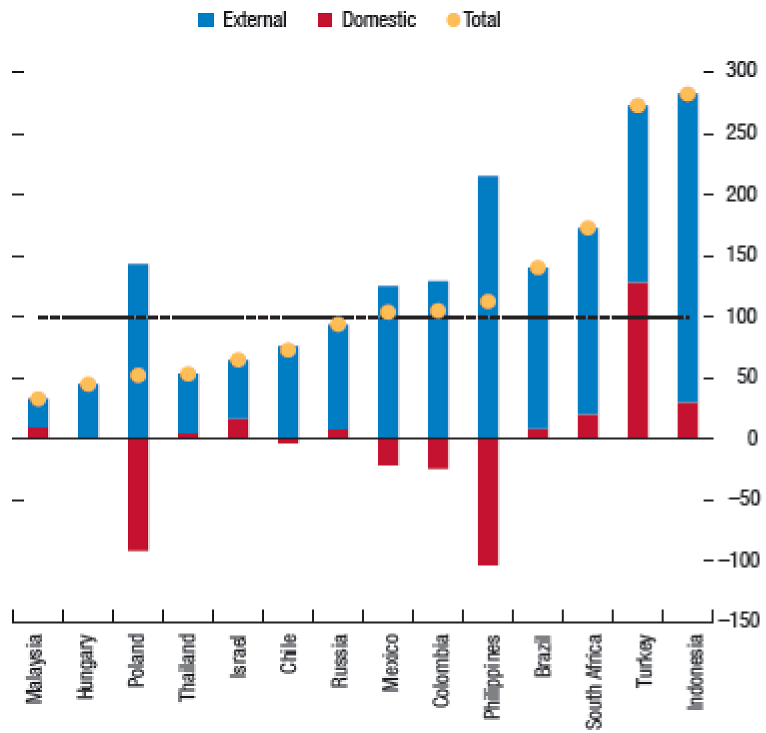
Figure 1.32. Estimated Impact on Bond Yields from a Reversal of Capital Flows and Other Factors
(Basis points)



Source: IMF staff calculations.
Note: The shock consists of a 100 basis points rise in U.S. Treasury yields, a 30 percent reduction in foreign holdings, and a 10 percentage point rise in the VIX. Values of domestic variables are those used in the October 2013 WEO forecasts for 2014 (for debt-to-GDP ratios, real GDP growth, and fiscal balances), and the policy rate is assumed unchanged.

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Disclaimers

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