

Debt Sustainability Considerations and Implications for Debt Management

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Key Messages

- ▶ Fiscal and External Sustainability mirror imbalances in the economy
 - Debt is an outcome – it's solution is a means to an end
 - External financial account flows reflect investor perception
- ▶ Temporary fixes help, but do not solve permanent/persistent problems
- ▶ A holistic solution to fundamentals mitigates both sustainability challenges
- ▶ Debt management is more than managing debt

Where are we now?



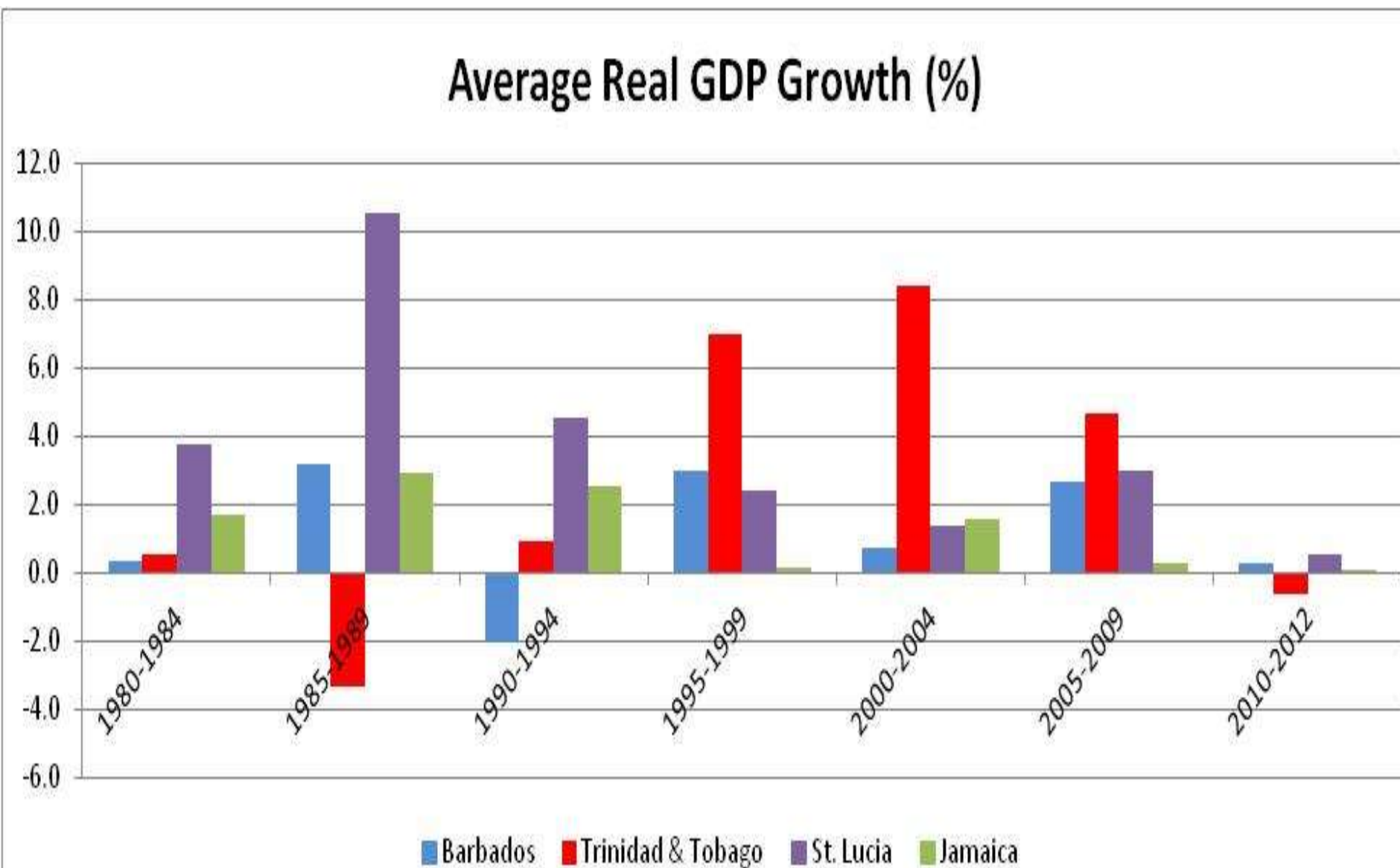
What is debt?

- ▶ Definition:
- ▶ Total debt consists of all liabilities that are debt instruments – a financial claim requiring payment of interest and/or principal by the debtor to the creditor at a date or dates in the future
- ▶ Public debt
- ▶ Net indebtedness of country

Current context

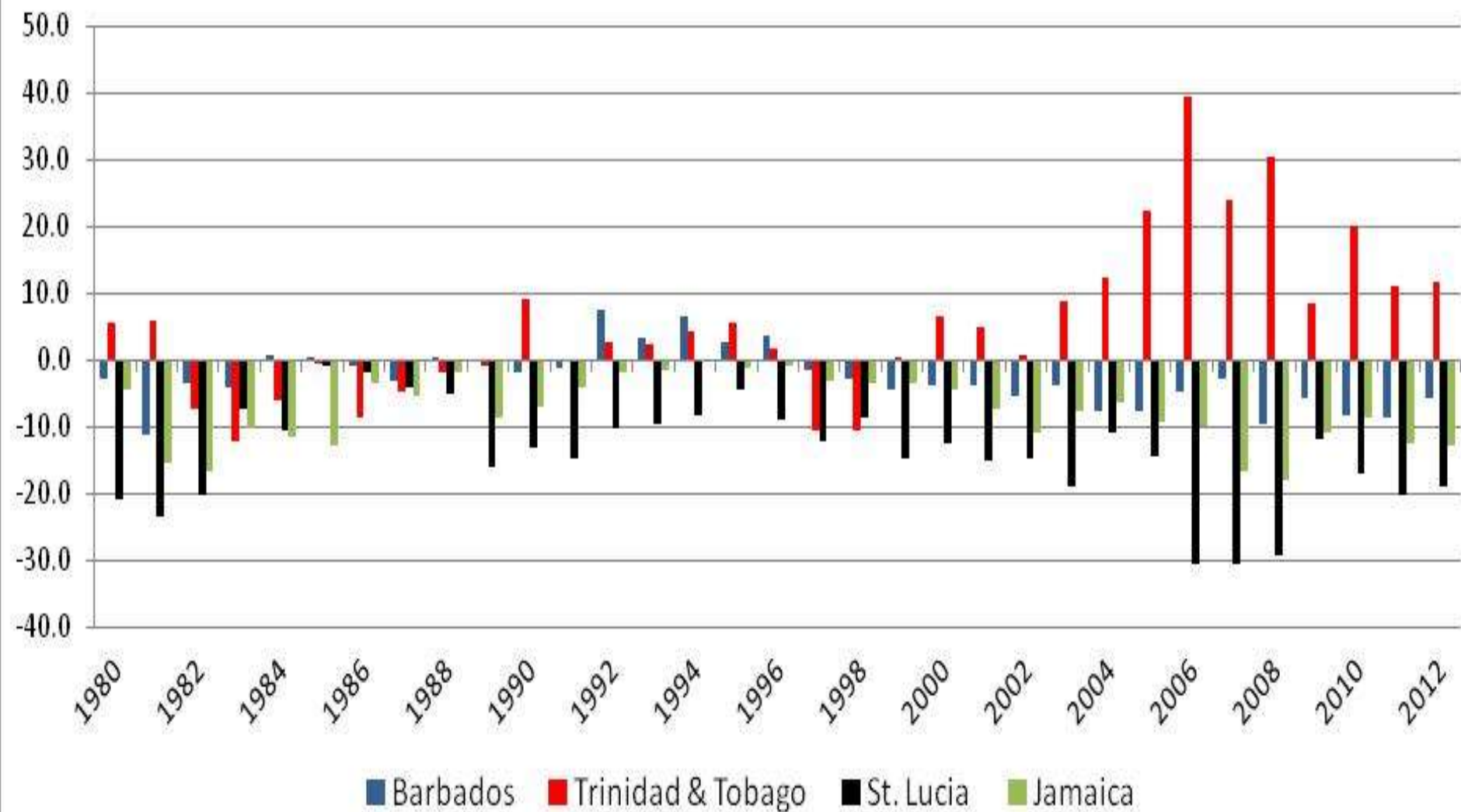
- ▶ High public debt levels (stock)
- ▶ High net indebtedness to the ROW (stock)
- ▶ Concerns about sustainability (low growth, high deficits, high future debt servicing costs – flows)
- ▶ Credit worthiness –– adverse rating assessments and higher borrowing costs

Domestic Product



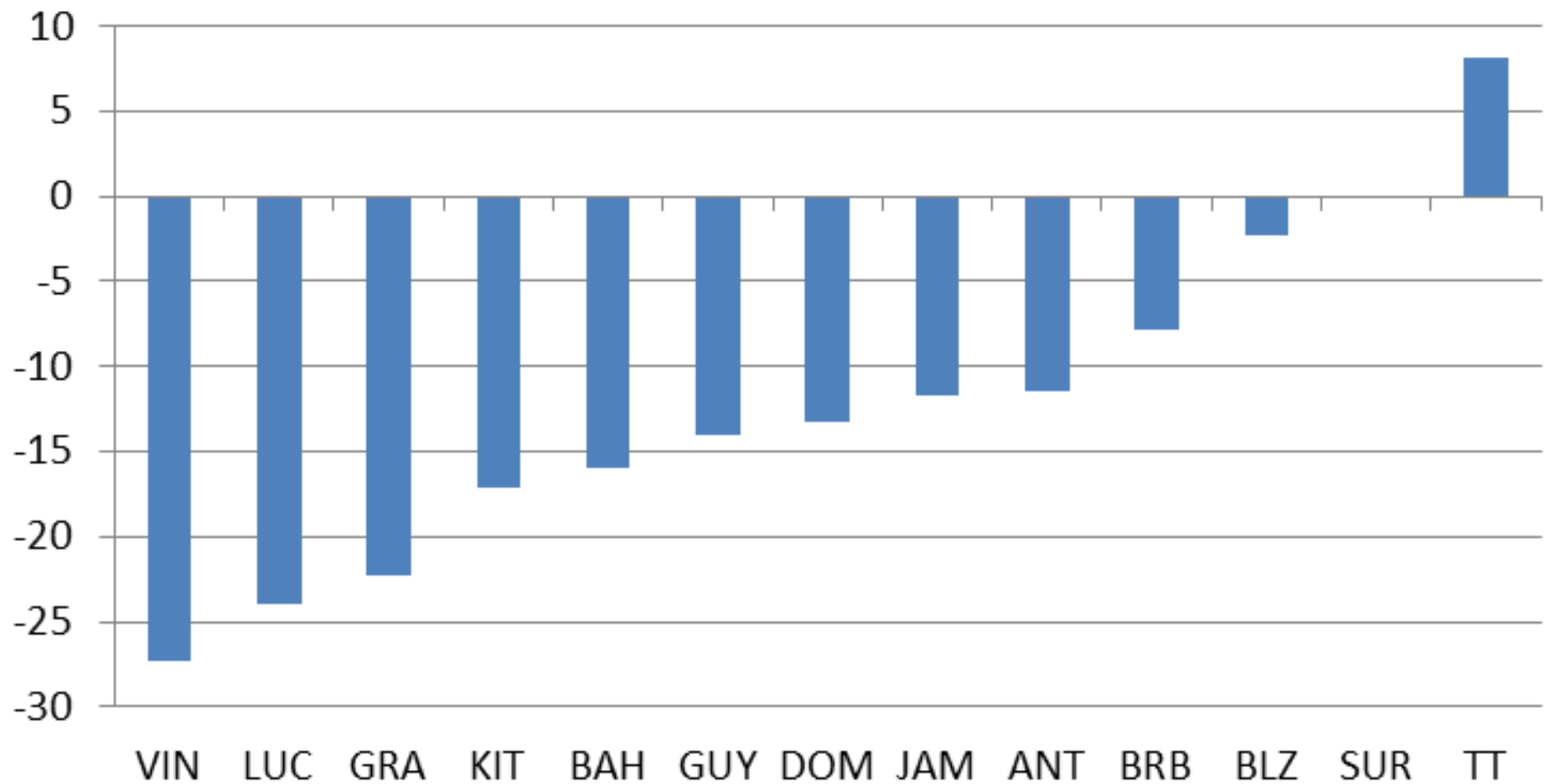
National Savings

Current Account (% of GDP)



Current Account

Current Account (2012, % of GDP)

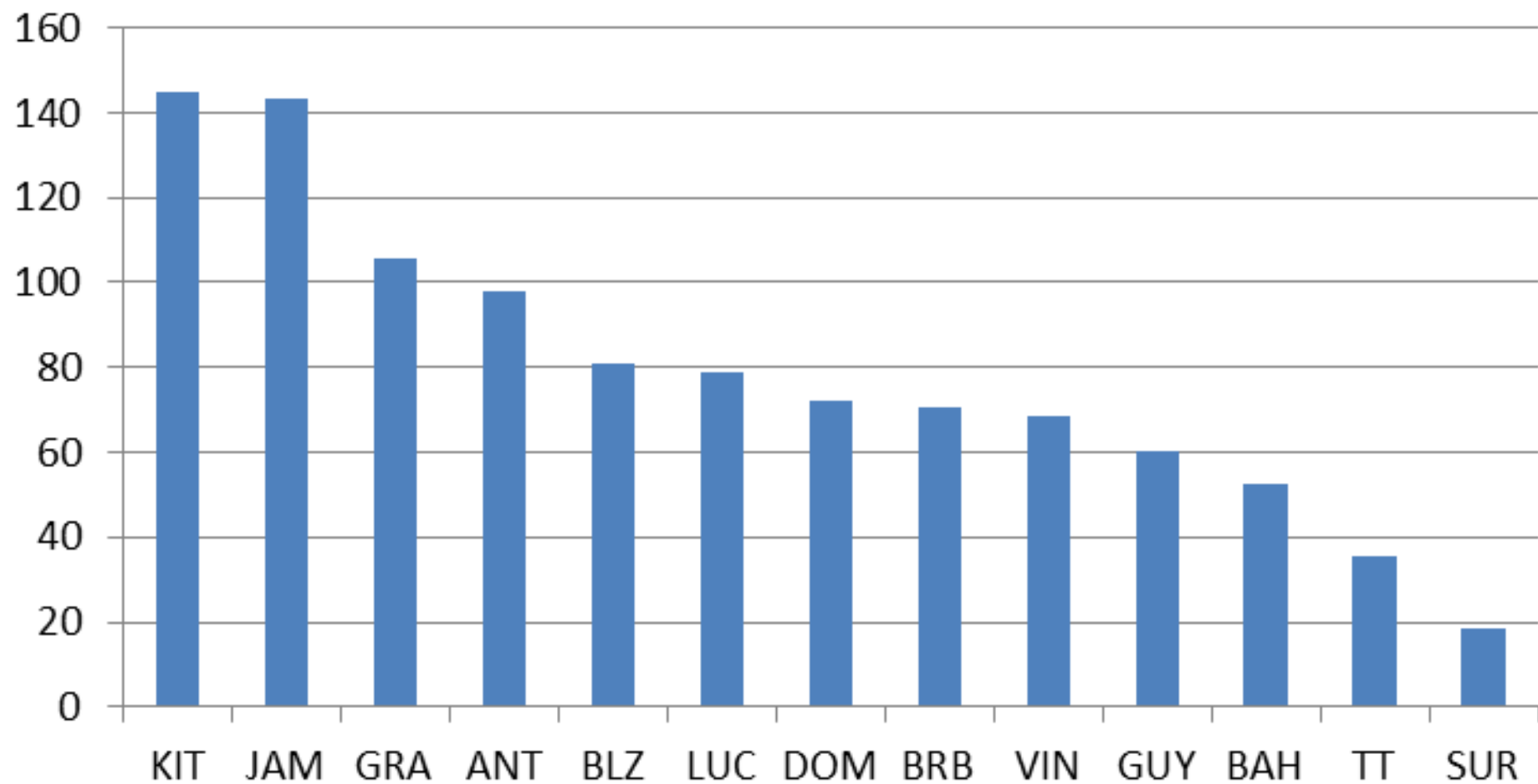


Net Indebtedness

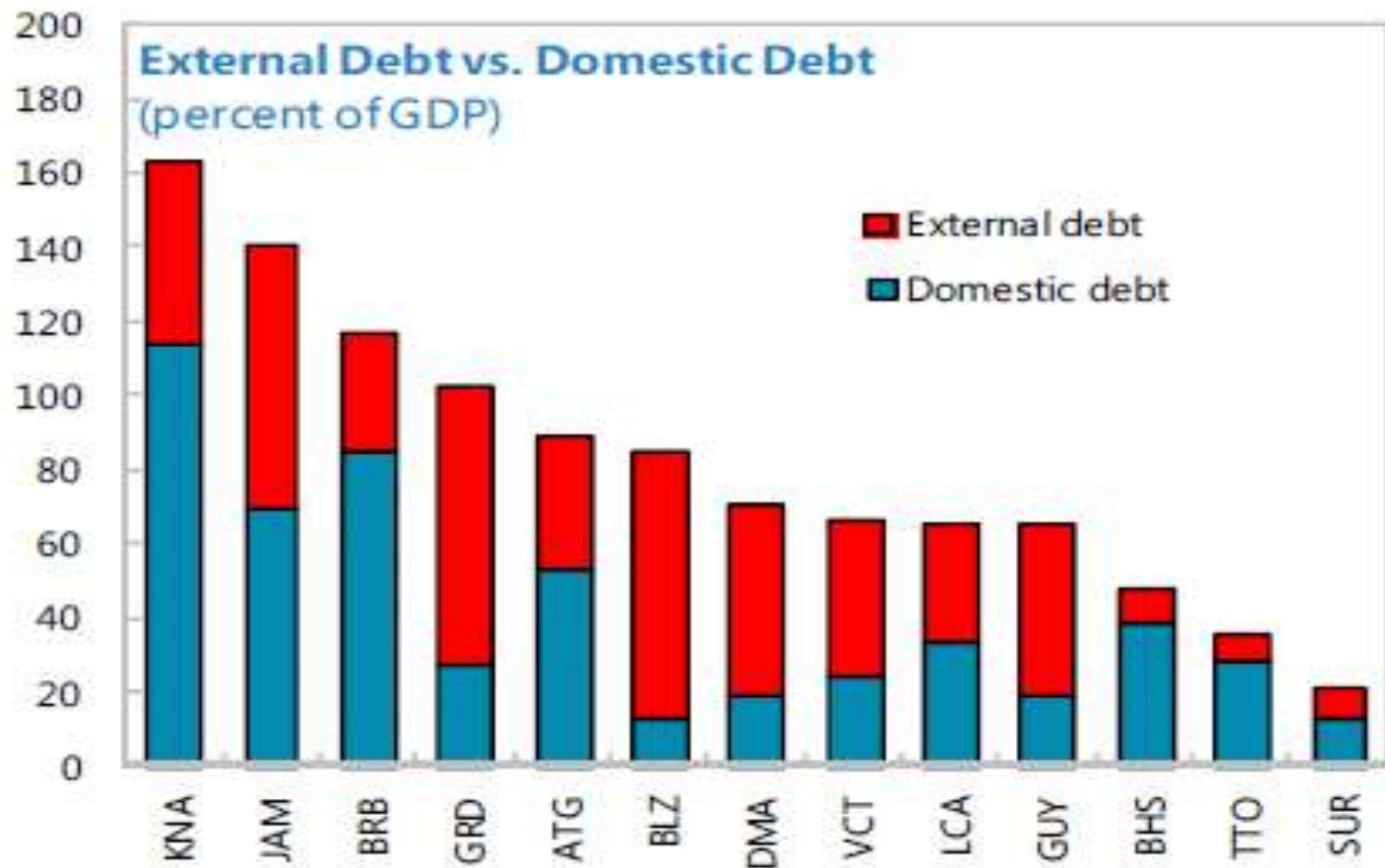
- ▶ Cumulates to net indebtedness to RoW:
 - Portfolio flows, debt, FDI, Reserve depletion?
 - From what sources – institutions, countries?
 - Reversibility – temporary or permanent?
 - For what purpose – real activity, asset booms, speculation?
 - Benefits – short/long term; ad hoc/integrated

Gross Public Debt

Gross Public Debt (2012, % of GDP)

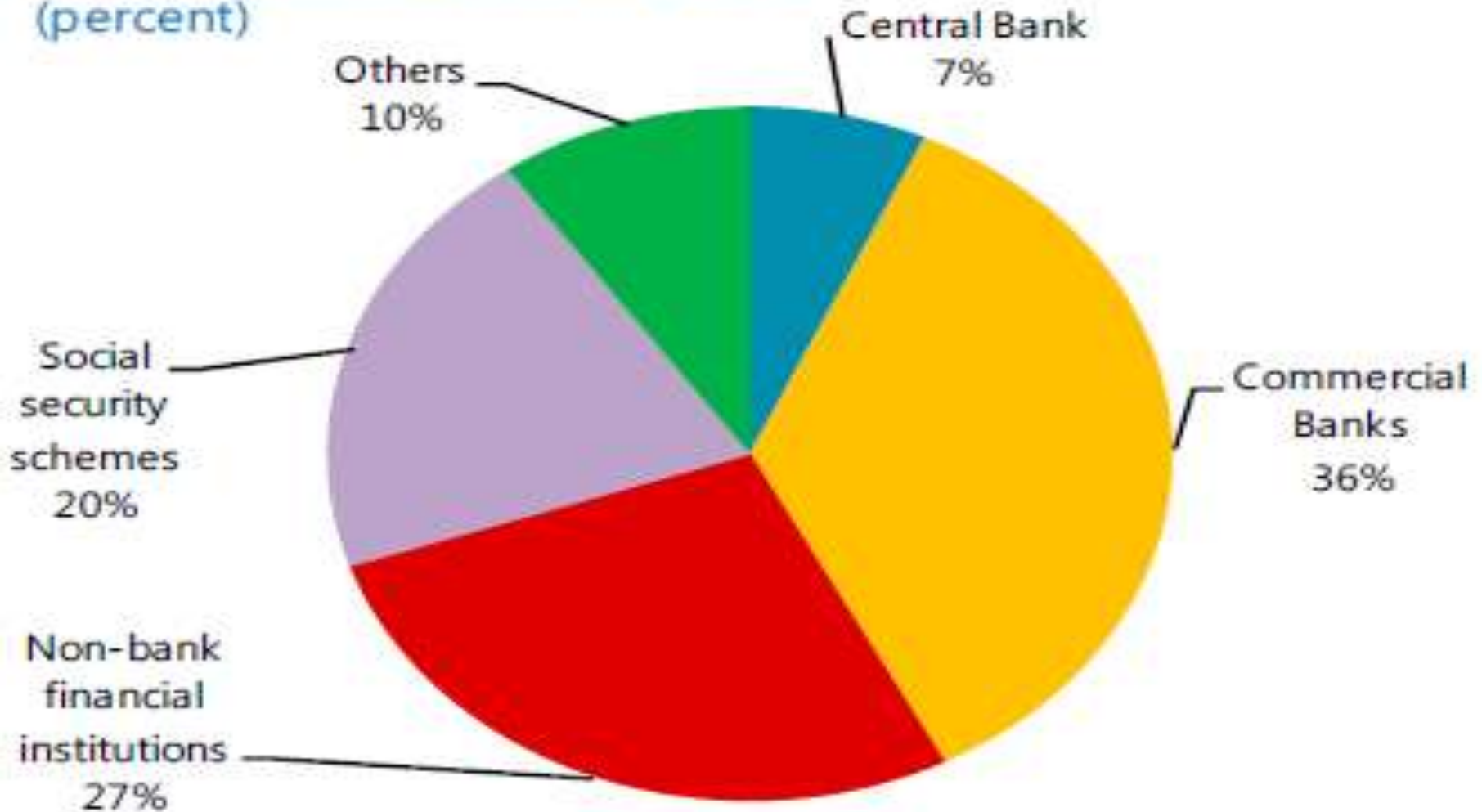


Debt – 59% Domestic (2010)

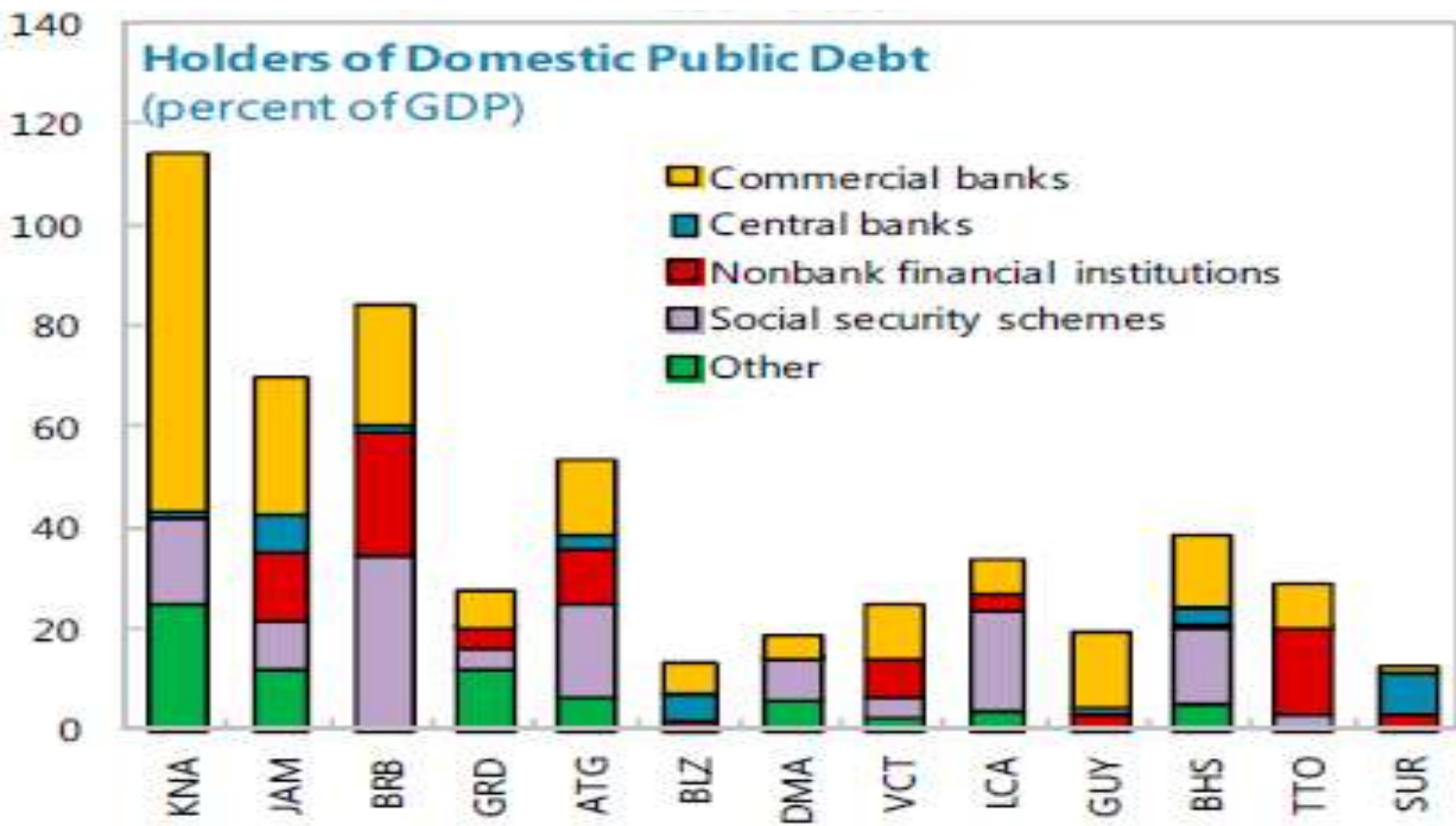


Caribbean Domestic Debt – 2010

Composition of Domestic Debt
(percent)

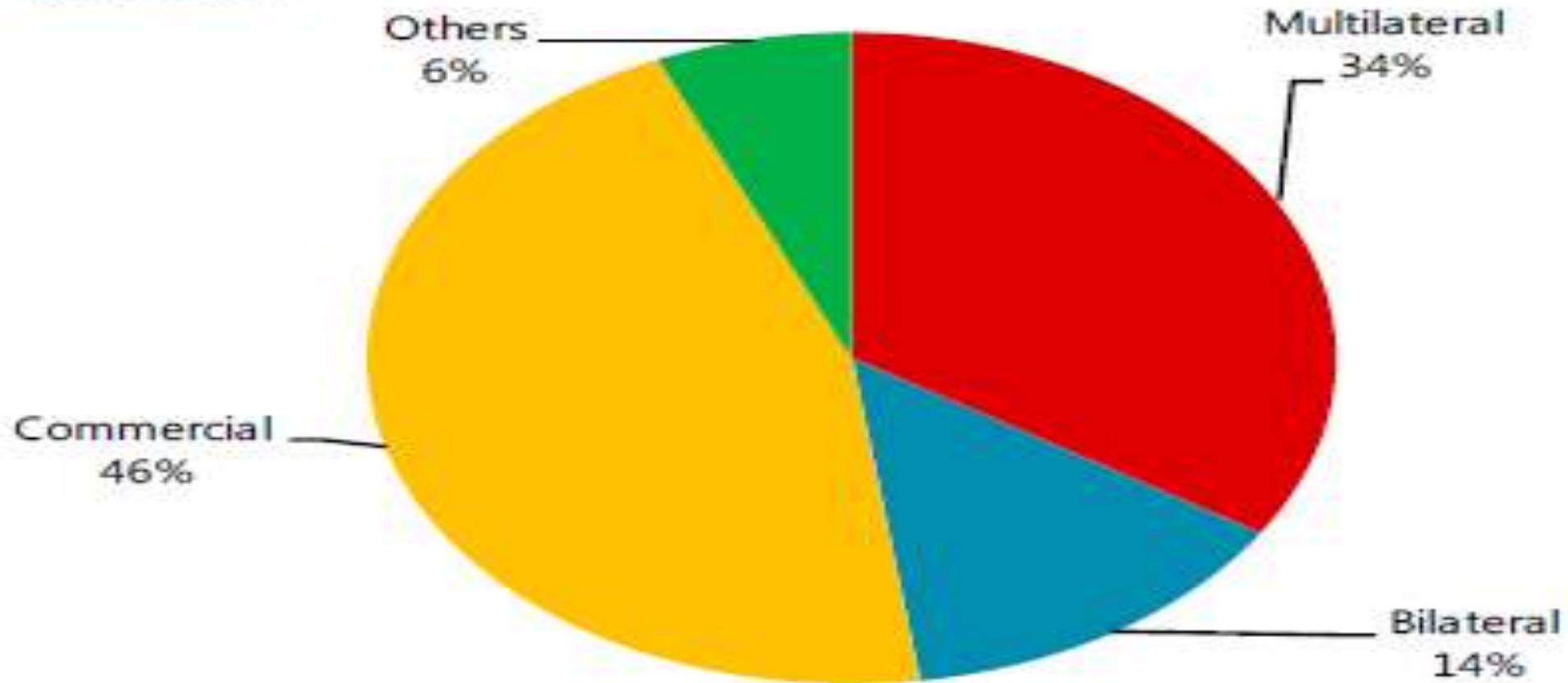


Domestic Debt

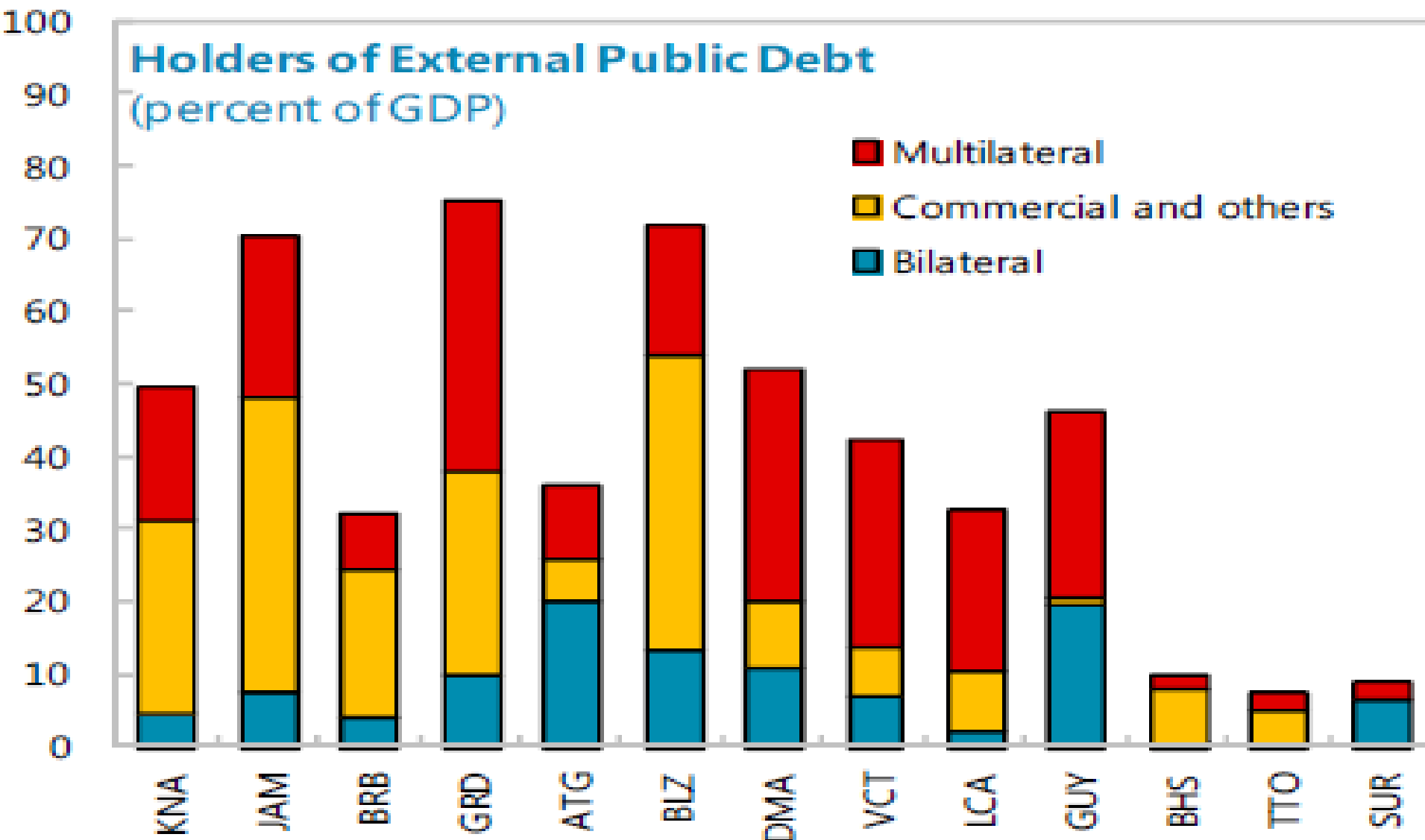


Caribbean External Debt – 2010

Composition of External Debt
(percent)



External Debt



Caribbean: Public Debt Composition, 2010

Sovereign Ratings

Country	Sovereign Ratings*
Trinidad and Tobago	A-
Bahamas	BBB+
Barbados	BBB-
Suriname	BB-
St.Vincent & the Grenadines	B+
Jamaica	B-
Grenada	B-
Belize	C

*Median ratings published by Moody's, S &P, and Fitch, 2012

Source: IMF Caribbean Small States, February 2013

Debt Sustainability and Dynamics

Current Debate

- ▶ Reducing public debt
 - Fiscal austerity
 - Fiscal stimulus
- ▶ How?
 - Assessment
 - Medium term debt management strategy
 - Risk/cost framework


Debt dynamics

- ▶ Debt Sustainability Analysis (DSA)
- ▶ Evaluates country's **capacity to finance its policy agenda and service the ensuing debt without unduly large adjustments that may compromise its macroeconomic stability and/or that of its economic partners**
- ▶ Reflects a country's solvency, liquidity, and adjustment capacity

Debt dynamics

- ▶ **Solvent** if the present value (PV) of current and future primary expenditure (net of interest) is no greater than the PV of current and future income receipts.
- ▶ **Liquid** if able to rollover maturing debt obligations in an orderly manner
- ▶ **Sustainability**: solvency + liquidity + no expectation of unrealistically large adjustment

Related Concepts

- **Vulnerability:** risk of insolvency or illiquidity
 - Social and political **limits to adjustments** can determine willingness (vs. ability) to pay
 - **Contingent claims** (such as various debt guarantees) are hard to measure, but are likely to be exercised in a crisis.
 - **Financing costs** (interest rates) vary, reflecting general market developments and specific country circumstances
- 

Evolution of Government Debt

$$D_t - D_{t-1} = -PB_t + iD_{t-1} - (M_t - M_{t-1})$$

PB = primary budget balance (net of grants and privatization receipts)

iD = interest payments (net)

ΔD = government borrowing (non-Central Bank)

ΔM = financing by money emission (Central Bank)

Relationship between primary balances, debt accumulation and inflation:

$$dk = -p + (r - y)k - \frac{\pi + y}{v}$$

Change in debt
ratio

Primary
balance

Real interest
rate minus real
GDP growth

Debt to GDP
ratio in
previous
period

Seigniorage/GDP,
incl. inflation tax

Is The Debt Process Stable?

- ▶ Debt dynamics is unstable when the real interest rate is higher than the real GDP growth rate – even when the primary balance is 0, the debt/GDP ratio will increase (for low inflation).
- ▶ Can determine paths to achieve specific debt targets
- ▶ Fiscal deficits involve a trade-off between debt accumulation and the rate of inflation.
- ▶ Can study the sensitivity between debt increase and inflation for any primary balance.

How To Reduce the Debt/GDP ratio?

$$dk = -p + (r - y)k - s$$

$$dk = 0 \quad \Rightarrow \quad s + p = (r - y)k$$

- ▶ Stabilization of the debt/GDP ratio requires:
 - a **primary surplus** ($p > 0$)
 - **sufficient seigniorage from money emission** ($s > -p$ if a primary deficit)
 - combination enough to cover debt service obligations

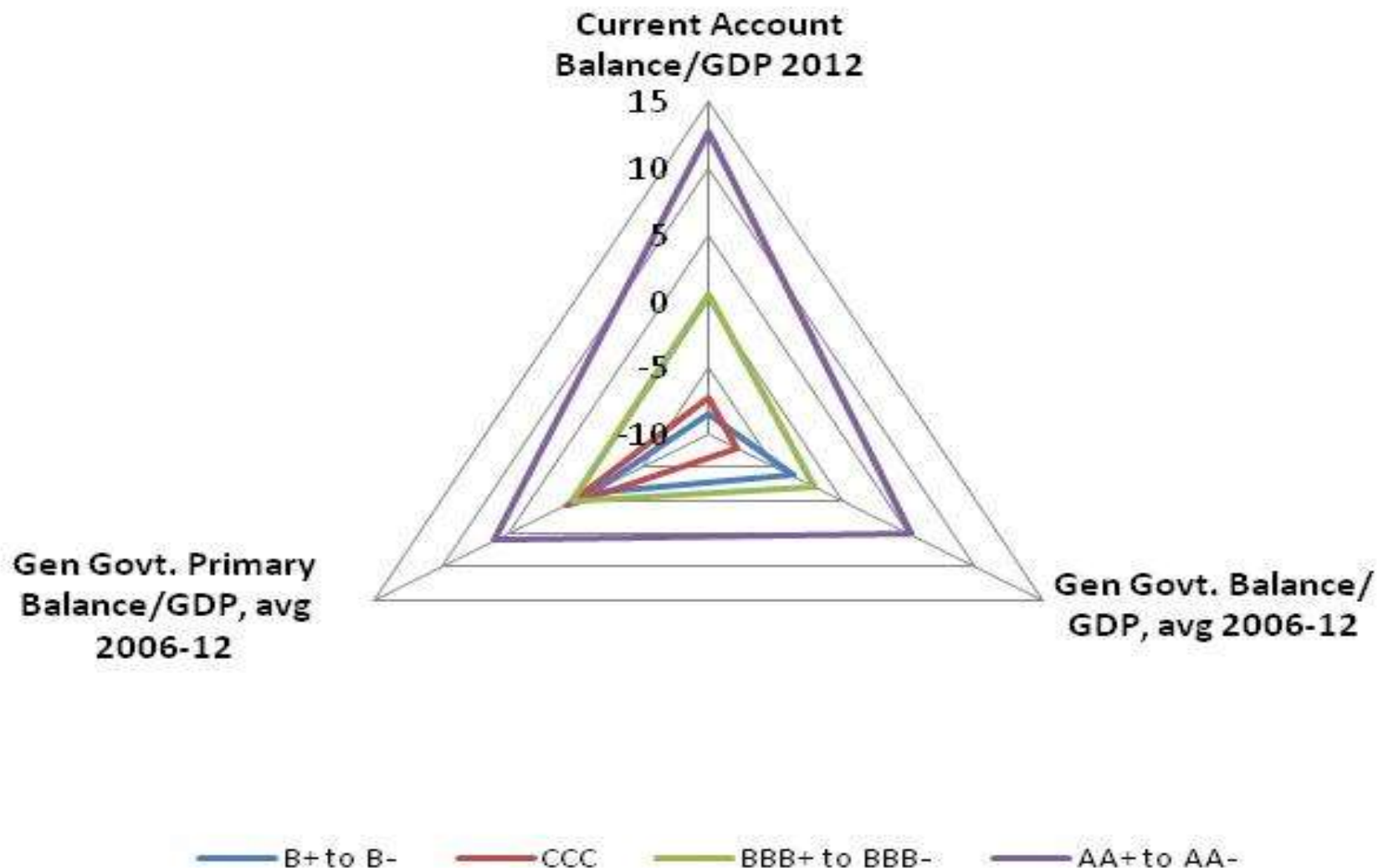
→ the debt/GDP ratio will not be stabilized if the **fiscal policy** is too loose (large negative p), while the **monetary policy** is too tight (small s)

Revealed Market Perceptions

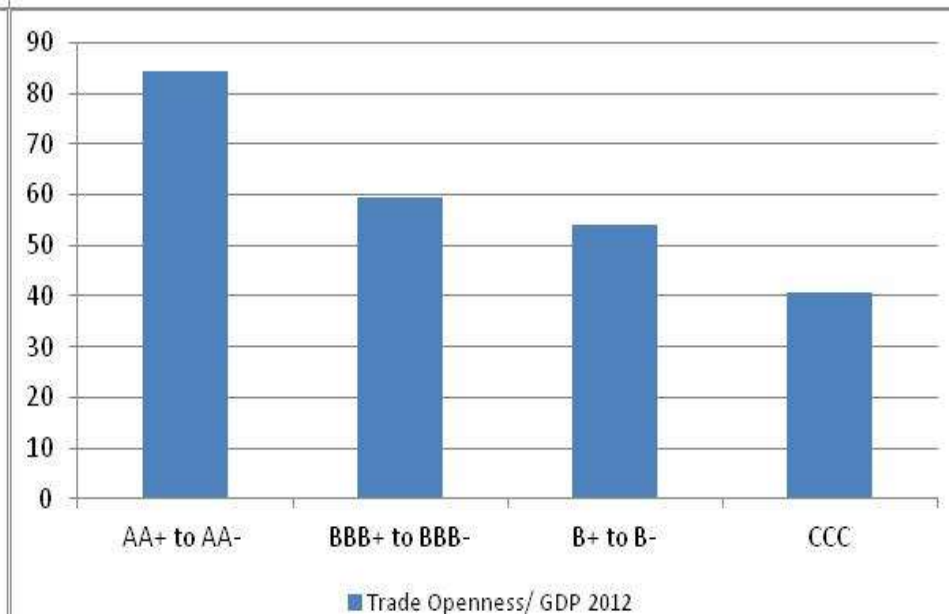
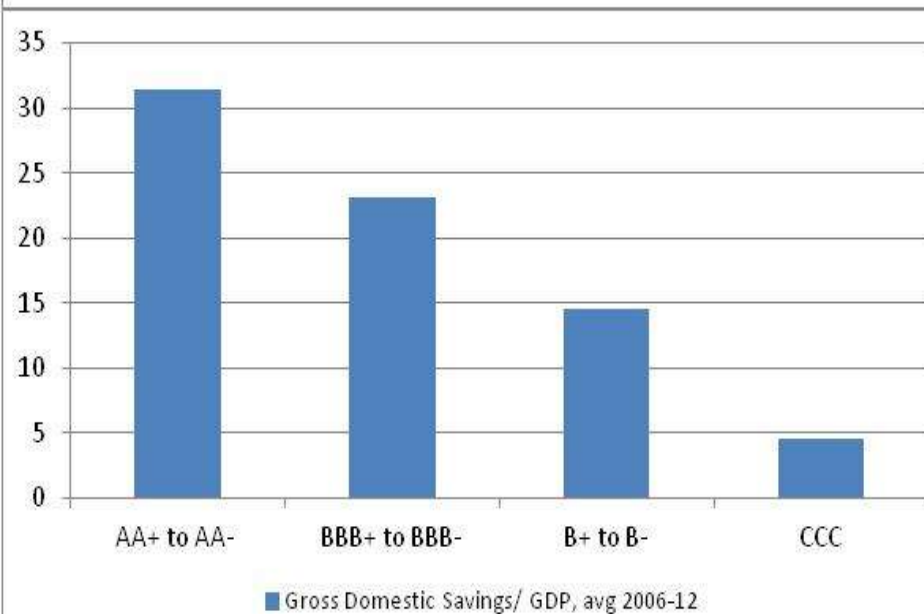
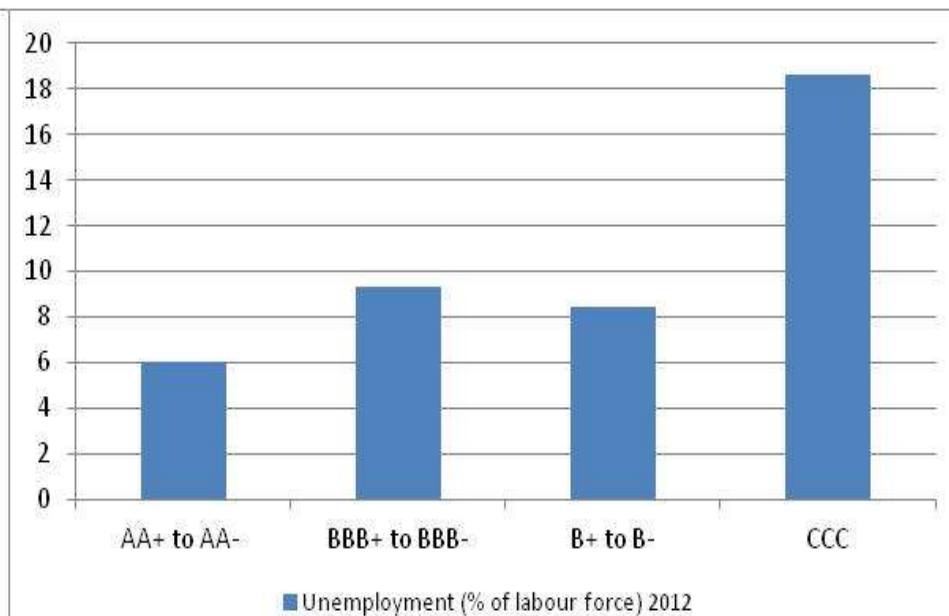
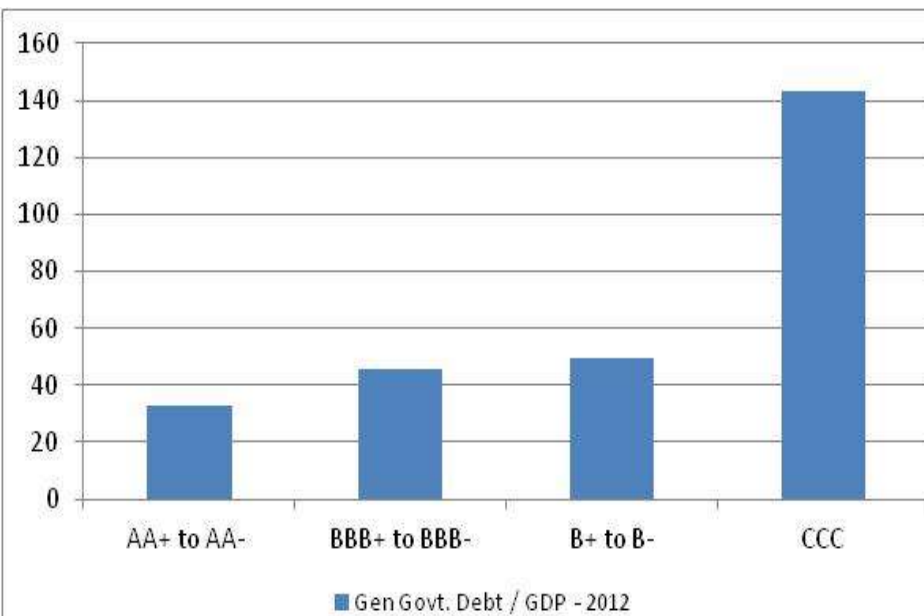
Debt interactions

- ▶ Analytics of sovereign ratings
 - Real sector indicators
 - Political factors
 - Monetary and financial indicators
 - External indicators
 - Fiscal indicators

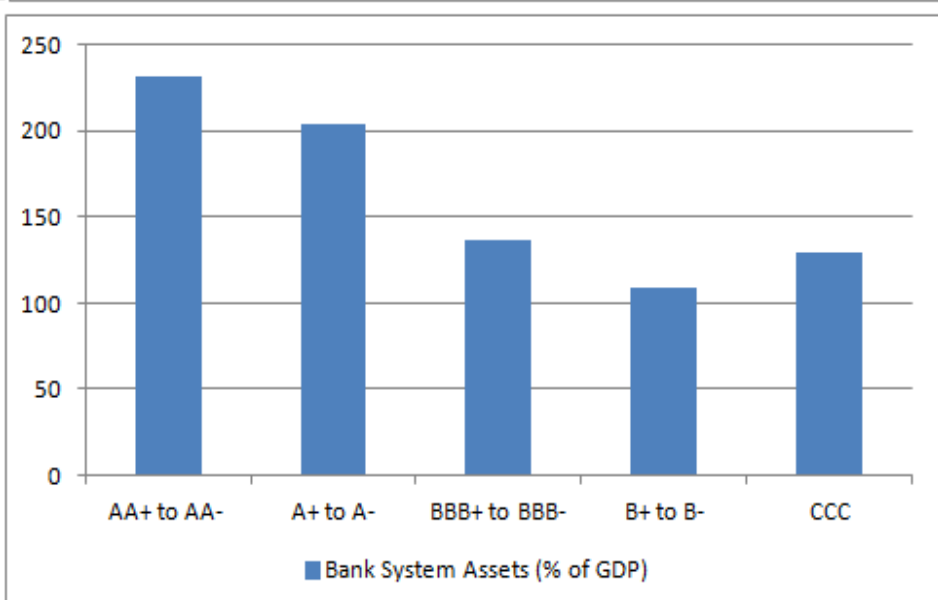
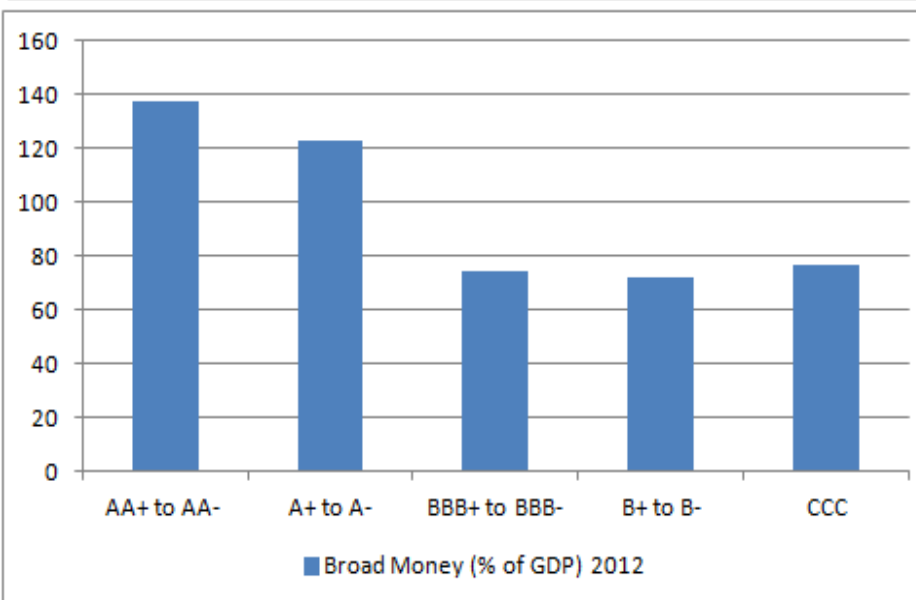
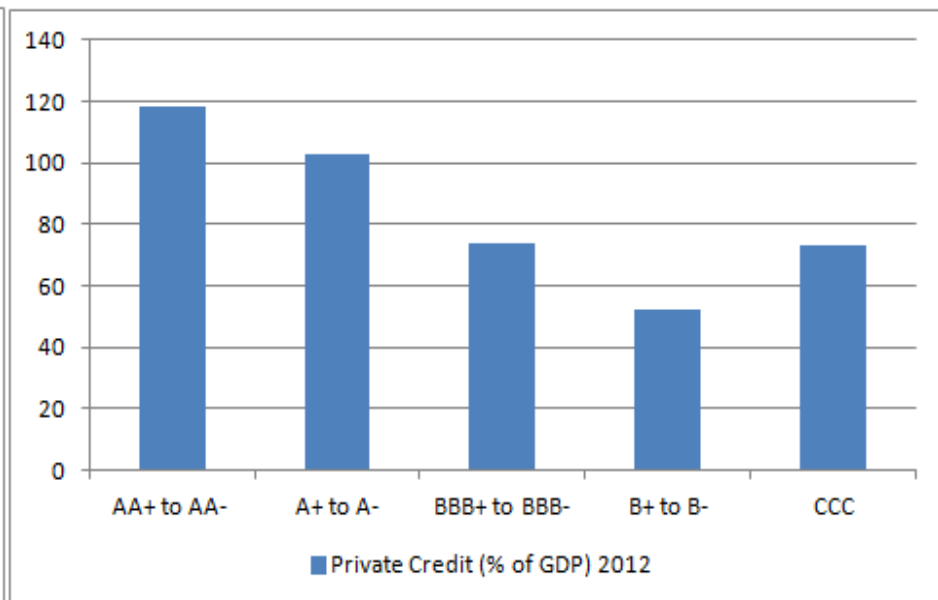
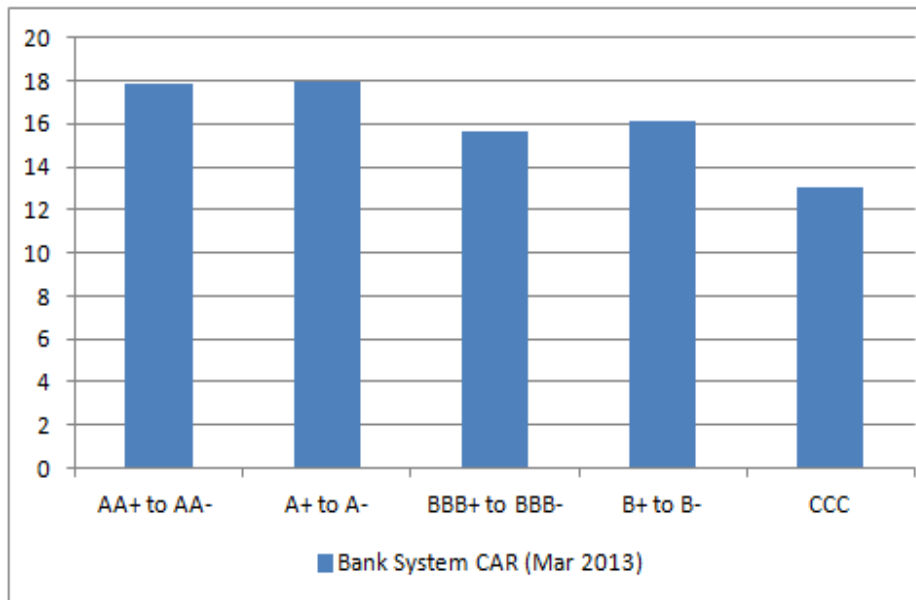
Financing is key – credit rating?



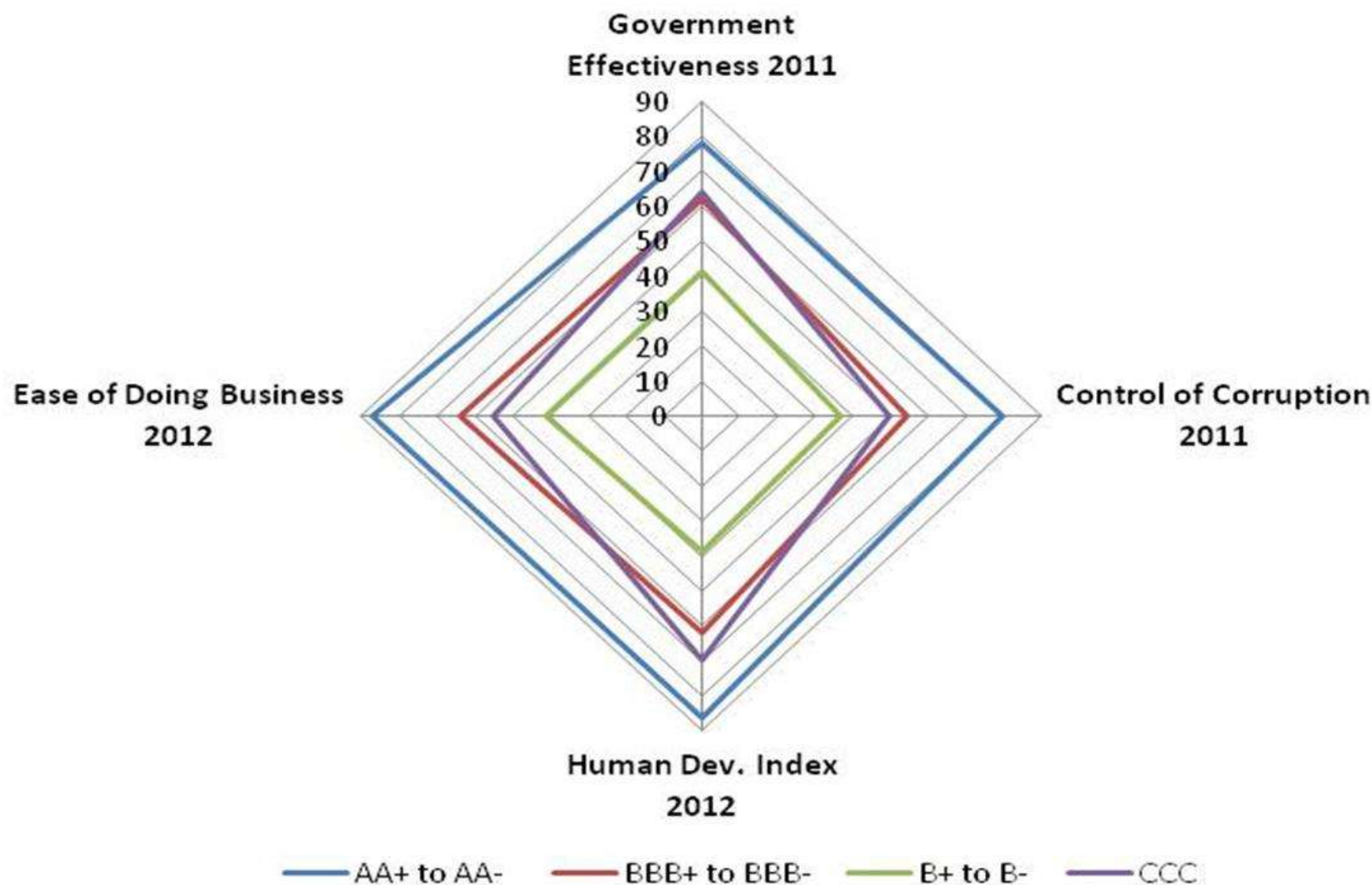
Financing is Key – Credit Rating?



Financing is key – credit rating?



Financing is key – Credit Rating?



The Challenge: Reducing Debt is more than Debt Management

Lessons from debt episodes

- ▶ Successful debt reductions require fiscal consolidation and pro-growth policies that address structural weakness – a comprehensive solution
- ▶ Fiscal consolidation works best through persistent structural reforms (vs. temporary fiscal measures)
- ▶ Debt reduction takes time

Role of the Debt Manager?

- ▶ Technician/adviser/overseer/super czar?
- ▶ Advocate for holistic solution?
- ▶ What is appropriate institutional setting?
 - Independent custodian of national trust?
 - A “Dependent” with leverage?
 - Unit in MoF/Central Bank or ‘functional’ group?
- ▶ Constitutional support or ad hoc practice?

Role of Government

- ▶ Commit to fiscal responsibility and better public financial management
- ▶ Facilitate growth
 - Improve environment for doing business
 - Provide foundation infrastructure (for example, invest in human capital)

Role of Financial Sector

- ▶ Facilitate growth
 - Modernize infrastructure in institutions
 - Efficient clearance and settlement systems to reduce transaction costs and risks
 - Create innovative financing models

Role of Regulators

- ▶ Facilitate growth through legal and judicial reform:
 - Comprehensive financial sector and services laws (standardization; enforcement)
 - Property and shareholder rights
 - Bankruptcy laws
 - Access to collateral

Role of Private Sector

- ▶ Responding to opportunity and challenge
 - Develop viable businesses (independent of support)
 - Embracing international competitiveness
 - Promoting excellence – foster R&D through partnerships/communities of practice

Role of individuals

- ▶ Engage in national dialogue
- ▶ Commit to pursuit of excellence
- ▶ Embrace good governance and accountability

Conclusion

- ▶ Debt reduction is not an end in itself, but a means to promoting national welfare
- ▶ Requires an integrated economic sustainability plan
- ▶ Debt Management has to be fully merged with economic policy
- ▶ Is there a case for independent functional DMUs?

Thank You.