Sovereign Debt Management Forum 2014

Summary Note for Plenary Session 1

What is the current outlook for sovereign borrowers?

I. Summary of session

This opening plenary session was moderated by Ms. Madelyn Antoncic, Vice President and Treasurer of the World Bank. It was divided into two parts. Firstly, the keynote speaker Mr. Marcelo Giugale, Senior Director of the Macroeconomics & Fiscal Management Global Practice of the World Bank Group delivered a presentation on the state of the world's macro-economy. His presentation was followed by a panel of senior debt managers debating the challenges of managing debt under capital flow volatility. The panelists were: Branko Drcelic, Director General of the Public Debt Administration of the Republic of Serbia; Ambroise Fayolle, Chief Executive Officer of the *Agence France Trésor*; Carlos Liñares, General Director of the Public Debt and Treasury of Peru; and Chandrasiri Siriwardana, Assistant Governor of the Central Bank of Sri Lanka. The panel was followed by a Q&A session.

II. Key insights from presentations and discussion

Mr. Giugale focused his presentation on three main messages coming from the network of macroeconomists of the Bank that cover more than 130 countries: (i) concerns about global growth – there is little optimism that the economies of the world will do better in 2015 than they did in 2014; (ii) lots of risks on the horizon – some new risks added to other older and outstanding ones; and (iii) that the two traditional remedies - monetary and fiscal policy - were already used – now it's the time to focus on structural reforms and work on boosting aggregate supply instead of aggregate demand.

Following these messages, Mr. Giugale suggested an agenda with a set of new conceptual issues including: (i) the debate on growth and inclusion, efficiency and equity, and markets and people; (ii) monetary policy diversions; (iii) challenges of implementing the so defended "infrastructure push"; (iv) the role of emerging markets in developed countries' growth; (v) the loose of global trade elasticity to global growth; (vi) the debut issues of emerging and frontier markets and its sustainability in the medium-term; and (vii) the challenges of fiscal federalism in low-income countries.

After the presentation, the debt managers panel begun by discussing the challenges on the aftermath of the financial crises, how the financing activities have changed over the last years, and what were the main challenges and opportunities. Mr. Siriwardana (Sri Lanka) started highlighting that public debt management has been a key function in the country, particularly in light of the twin deficits Sri Lanka

has run for a very long period. Sri Lanka has increased its reliance in the capital markets, both domestic and external, supported by improvements in the macroeconomic background. This increase was a consequence of the gradual decreasing of concessional financing availability. The country became more frequent in the international markets, being able to extend maturities and reduce borrowing costs, while developing the domestic market at the same time.

Mr. Liñares (Peru) highlighted the important changes in the structure of the Peruvian debt in the last years, supported by sustained growth and generation of surpluses over the last decade. He mentioned that three years ago the country started to implement a strategy to develop the domestic market and de-dollarize the debt portfolio. Mr. Liñares underscored how the performance of the Peruvian economy and the scarcity of Peruvian securities in the international markets contributed to the success of the last international market operations, which included a recent switch tender offer. The increase in the liquidity in the secondary market and the coordination with the Central Bank were pointed as challenges for the medium term.

Mr. Fayolle (France) said that there were no major changes to the main sources of financing for France – they keep basically issuing in Euros, 10% being in inflation-linked securities. What has dramatically changed though was the environment in which France had to issue – having to raise much higher amounts on the one side to finance higher deficits, but facing decreasing interest rates on the other side – sometimes even with negative interest rates below one year. Mr. Fayolle stressed (i) the need to be more flexible in terms of being able to answer to the demand from investors; (ii) the need to increase the dialogue with the investor base to make sure that what the debt office does is consistent with investors' demands; and (iii) the need to have an active debt management strategy, making larger use of liability management operations. As challenges going forward, he pointed out two sources of uncertainty: (i) what will be the impact of the monetary policy in the near future; and (ii) what will be the impact of the new regulations in the market.

Mr. Drcelic (Serbia) pointed out the major transformation the local Serbian market went through since 2008, where it became more evident the need to develop a market. Serbia has also become a regular issuer in the external market since 2012 and Mr. Drcelic highlighted the need to closely follow the international capital markets. He also stressed the success of the use of a World Bank guarantee when coming back to the international markets after more than 100 years of absence. At the same time that Serbia implemented measures to develop the local market and increase its access to the international market, the country pays close attention to take the opportunity to borrow money at lower costs from multilaterals when possible. On challenges for the near future, Mr. Drcelic mentioned the continuation of the extension of the yield curve, the introduction of a primary dealers (PD) system, and having Serbia becoming part of the JP Morgan domestic bond index. He also stressed the need to have an adequate level of cash buffers to cope with periods of volatility.

Sri Lanka, Peru, and Serbia have implemented a number of measures to develop their local markets. In the case of Sri Lanka, the domestic market was opened for foreigners in 2007 and the share of non-residents gradually increased since then. Mr. Siriwardana underscored the significant changes that took

place in the last 6 years, particularly measures to improve liquidity in the secondary market such as improvements in the PD system. Sri Lanka was able to increase the average maturity of domestic debt by issuing more long-term bonds, supported by the political and macroeconomic stability. A yield curve was established and now covers the whole spectrum of maturities, from 3 months to 30 years, what increases liquidity in the secondary market.

In Peru, a number of measures were also put in place to promote the development of the local market such as new regulation for the PDs, opening of auctions to institutional investors, publishing of auctions' calendars, and more frequent issuances in the market. An increase in the local participation vis-à-vis non- residents was observed due to these measures. Both in Sri Lanka and Peru the participation of institutional investors – pension funds and insurance company – contributed significantly to the development of the local market.

Serbia experienced a quick development of the local market, starting from a virtually non-existing market. The debt office started by issuing 3 and 6-month bills and gradually introduced longer-term bills and bonds, reaching the issuance of a 10-year bond in local currency in 2014. It was also supported by a strategy of attracting non-residents to the local markets, who now account for around 40% of the local market.

The panelists expressed the need to be cautious about non-resident participation in the local market, while acknowledging their contribution to its development. Sri Lanka decided to keep a cap, currently at 12.5%, for the share of non-residents and Mr. Siriwardana pointed out how they clearly saw the potential volatility arising from non-resident investment during the peak of the 2008 financial crises. In Peru, the share of non-residents is around 40%, after peaking to 60% a year ago. Mr. Liñares mentioned that the measures implemented to develop the domestic market also had the goal of reducing this share, as they are aware of the potential vulnerabilities that it may bring.

Peru has been one of the most active issuers of global depositary notes (GDN). According to Mr. Liñares, they were very attractive for foreign investors and helped Peru to increase the share of domestic debt, but may also be a source of volatility. Peru has been working to broaden the domestic investor base also by improving its communication strategy, trying to have a constant dialogue with the different groups of investors.

Mr. Faoyolle reinforced Mr. Liñares' message on the need to find the right balance between a strong domestic base and a foreign investor base as diversified as possible, both in geographic terms and by type of investor. He further emphasized the need to have a developed domestic investor base because these investors are the ones who will be there when you need them. The lesson from France is that although its very time consuming to keep in touch with the investor base, it certainly pays off as the more diverse the investor base is the better to reduce refinancing risk.

Finally, Mr. Faoyolle said that it's early to assess the impacts of recent regulatory changes in the debt markets. On the one hand, high quality issuers benefited a lot from the mandatory increase in buffers in

the banking sector. On the other hand, he expressed concerns on the future ability of the PDs to perform the tasks they are supposed to and on the functioning of the repo markets.

III. Conclusion and issues for further discussion

Most of the topics debated during this session are still on-going. It would be certainly interesting to hear in future fora about the development of the domestic markets, what were the new measures introduced and what has worked best. Similarly, it will be of interest to debate how debt managers will navigate during the unfolding story of monetary policy tightening in the developed countries. Furthermore, as pointed out before, the impact of the regulatory changes is still unclear and is a crucial point to be debated in the near future.