

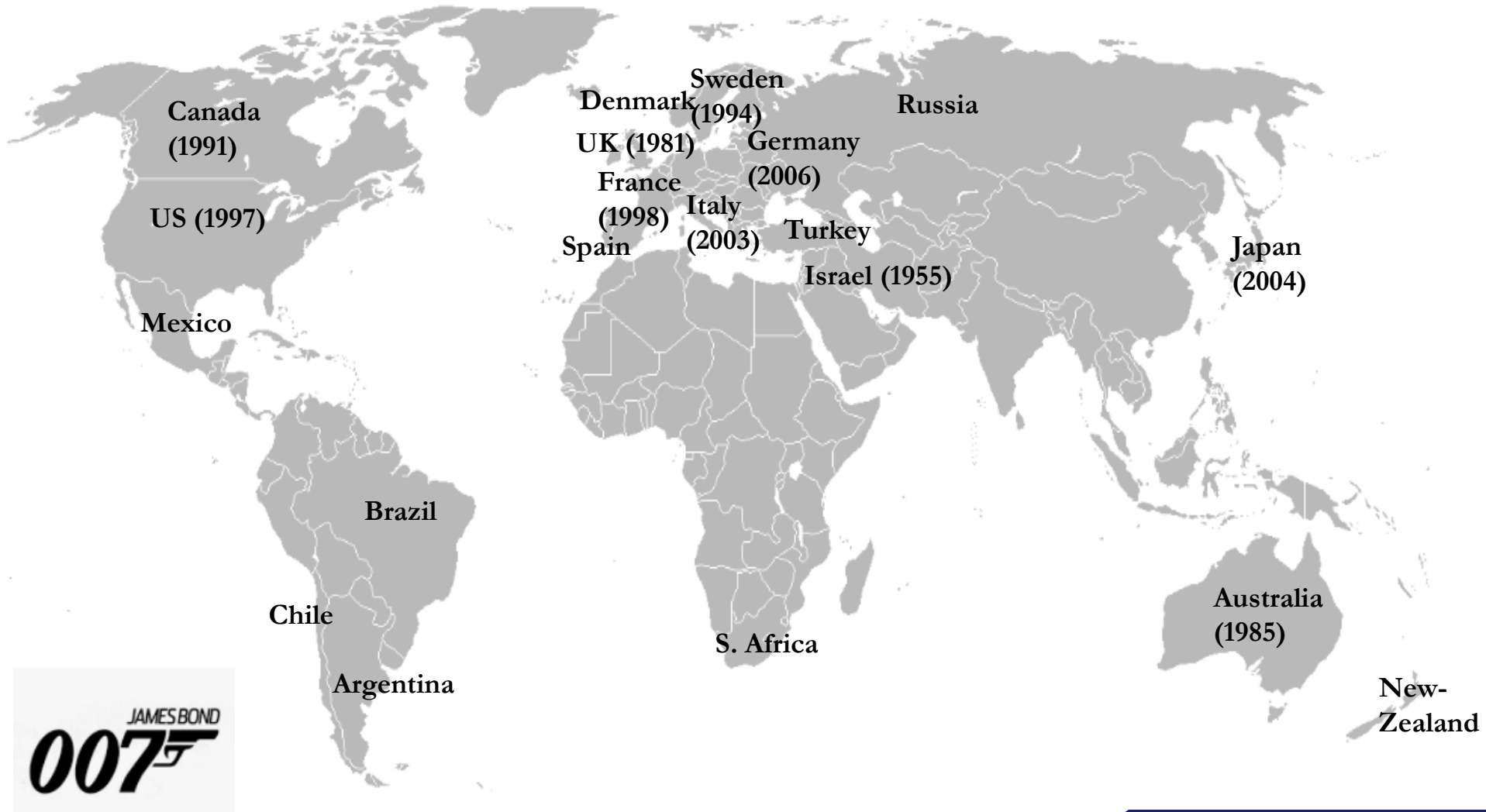
What is the Role of Inflation-Linked Bonds for Sovereigns?

Lior David-Pur

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Ministry of Finance, Israel

**2018 Sovereign Debt Management Forum
The World Bank**

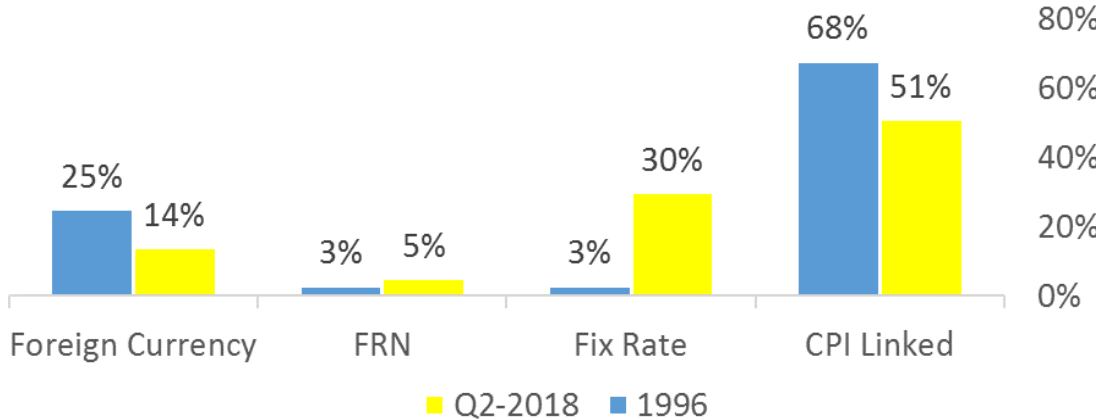
“The Name is *Bond...Indexed Bond*”



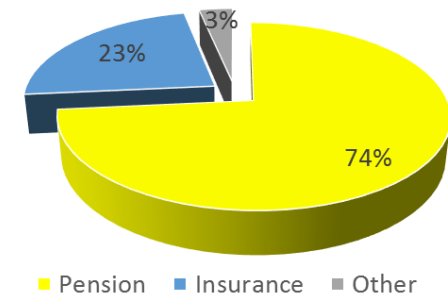
The Israeli Story



Ministry of Finance

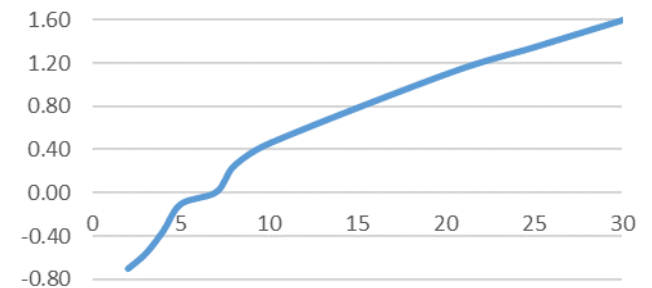


Non-Tradable Debt = 29%



Tradable Debt = 22%

Government CPI linked curve

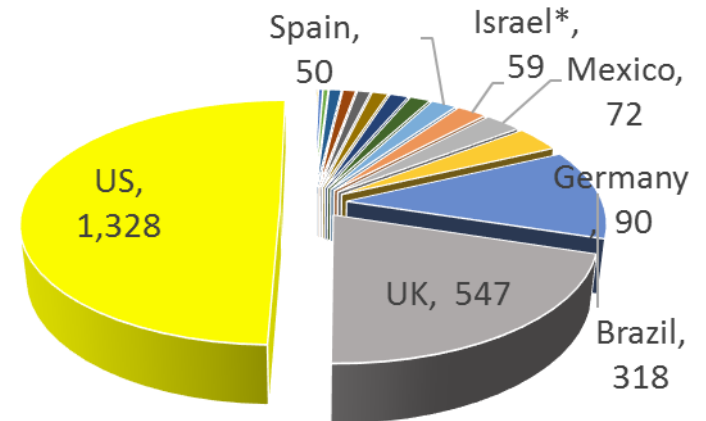
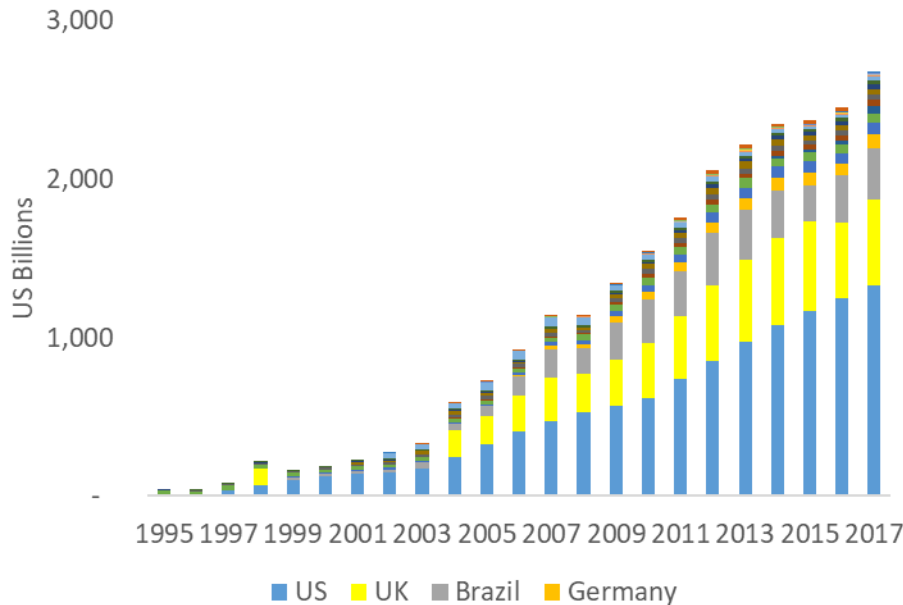


- On-The-Run Tenors: 10Y, 30Y
- Off-The-Run: All tenors use switch auctions
- Both principal and interest are CPI-linked
- Indexation: Calculated by Israel's Central Bureau of Statistics
- No floor limit



Fact #1

There is an Increasing Trend of Inflation-linked Bond Issuance Globally

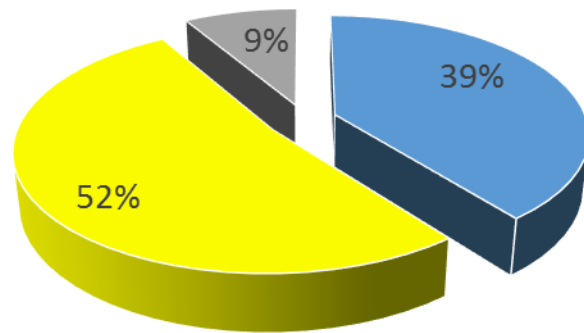




Advantage #1

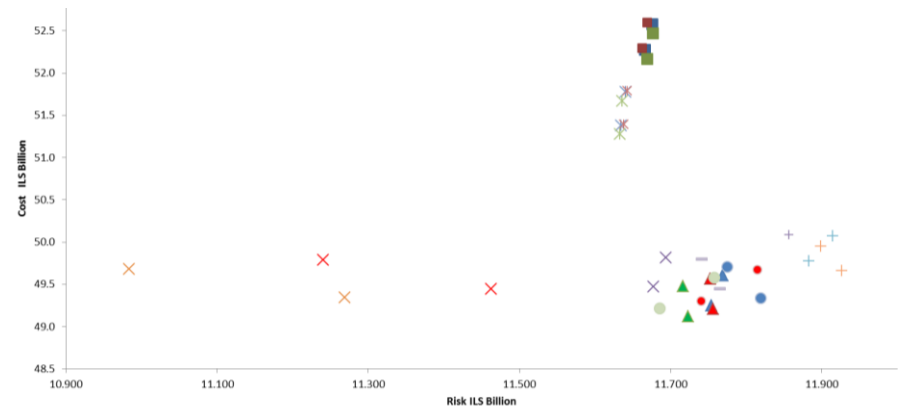
Supply-Side Consideration

Diversified Source of Funding*



■ CPI Linked ■ Fix Rate ■ FRN

Efficient Debt Portfolio

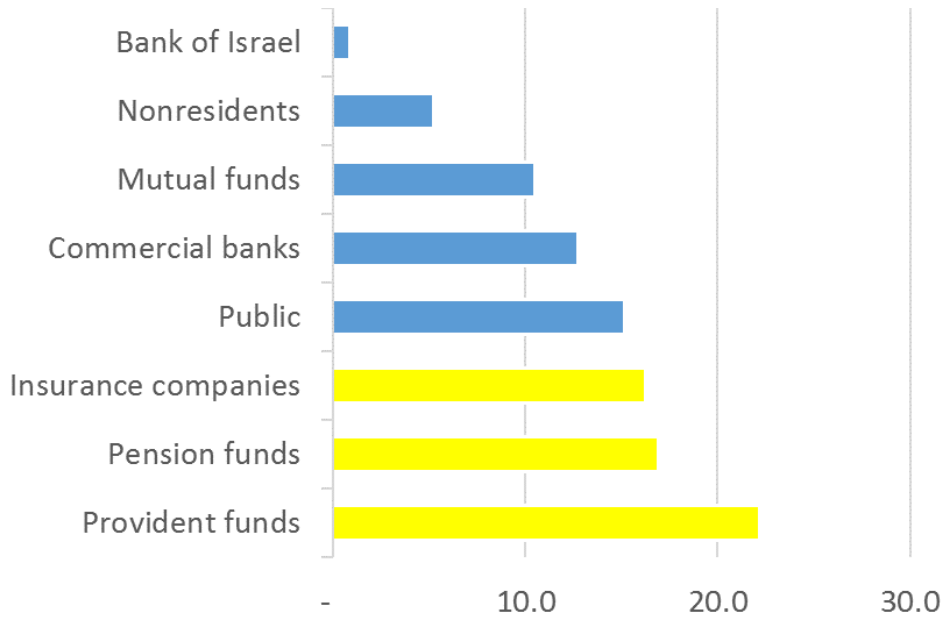




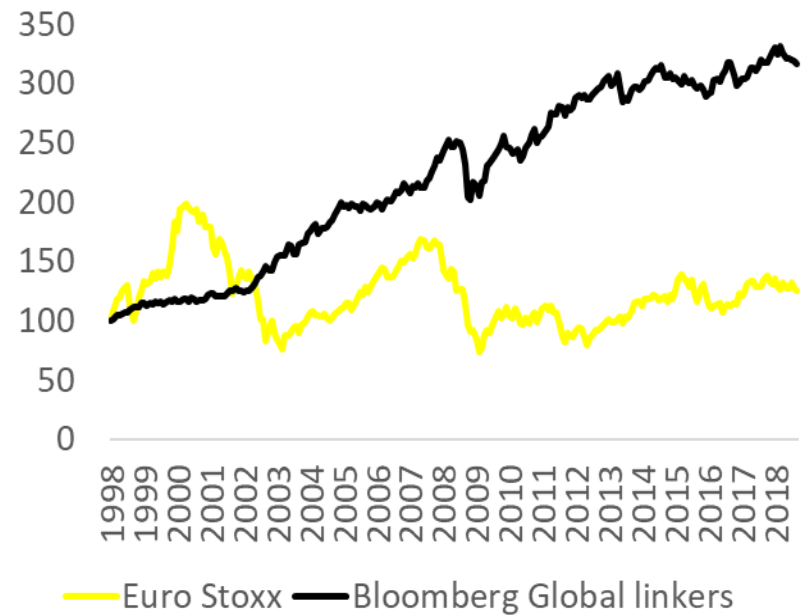
Advantage #2

Demand-Side Consideration

Increasing Investor Base



Diversification



Long-term-saving holdings = 55%

Correlation = -0.3



Other Possible Advantages

Cyclical benefits

Correlation with government revenues ?

Positive credibility feedback ?

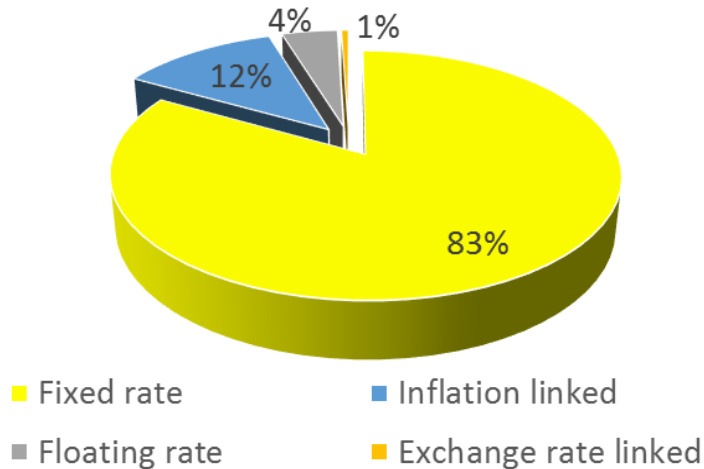
Inflation expectation ?

Fact #2

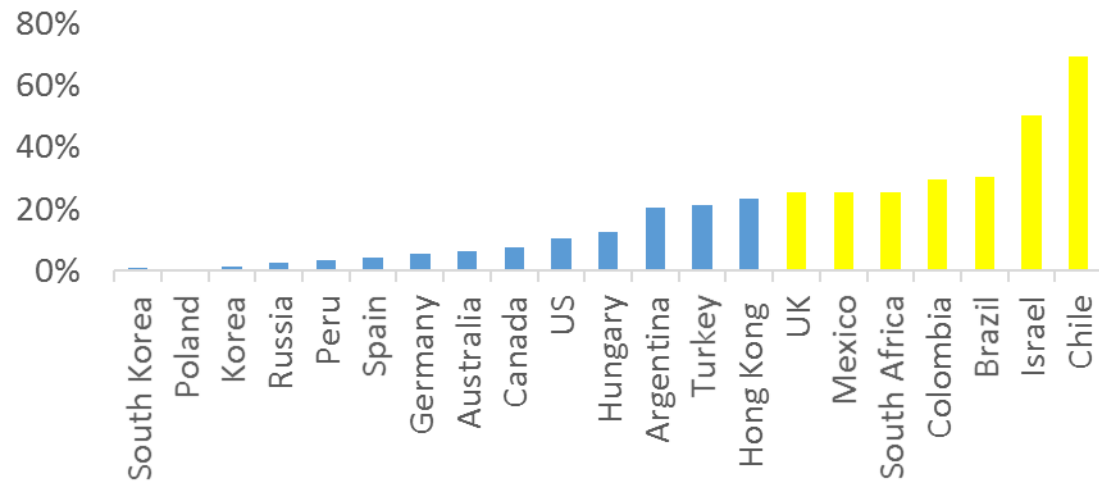
Despite Increasing Trend, Share of Inflation-Linked Bonds Remains Relatively Low Globally

Amount Outstanding:

\$22 trillion USD



For 14 out of 21 Countries, Share Of Linkers is Below 25%



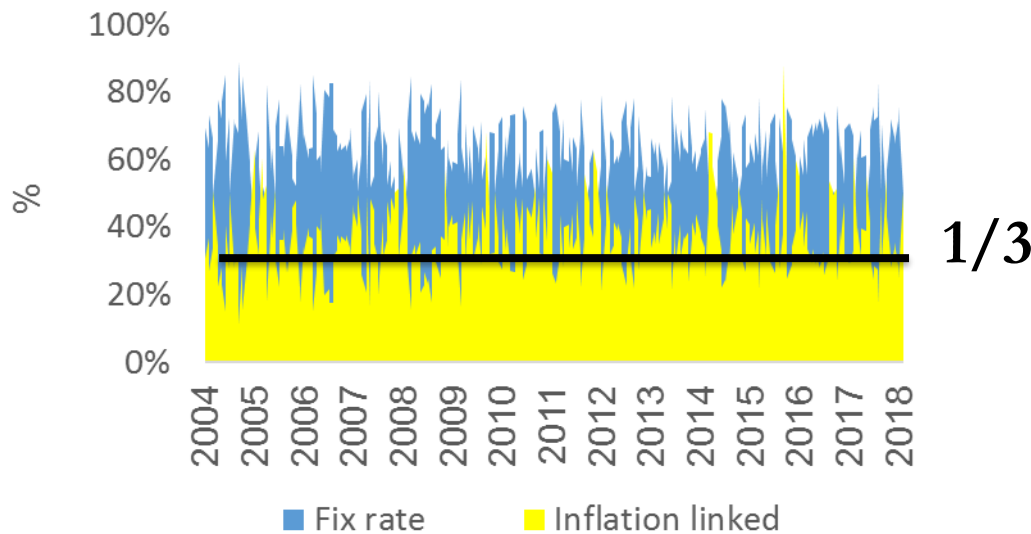


So why don't debt
managers issue more
inflation-linked bonds?

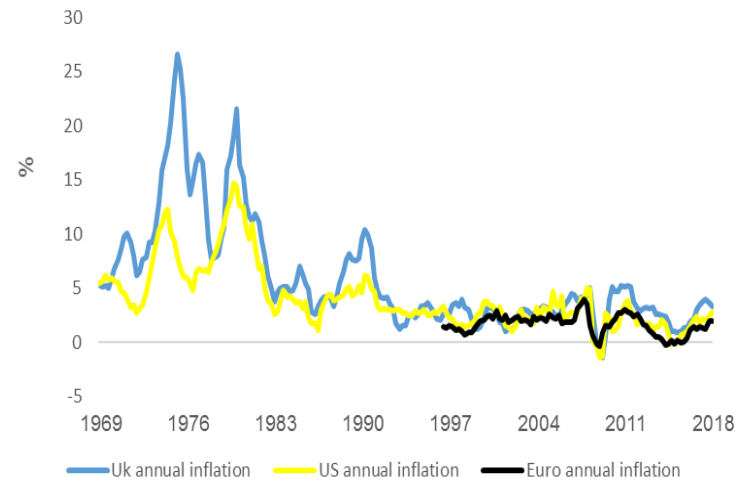
Linkers are Less Liquid

Volatility

Daily Volume of Israel Government Bonds



Volatility in Interest Payment, Deficit, and Debt



	Volatility %	All period	10 Years	5 Years
UK		5.2	3.0	0.9



Other Possible Disadvantages

Cannibalization ?

Complexity (pricing, seasonality)

Index Reliability

Case Study



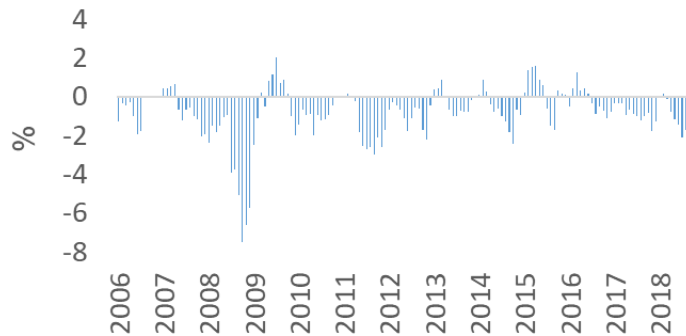
Ministry of Finance

$$\text{Breakeven Inflation} \approx \frac{1 + \text{nominal yield}}{1 + \text{real yield}} - 1$$

US

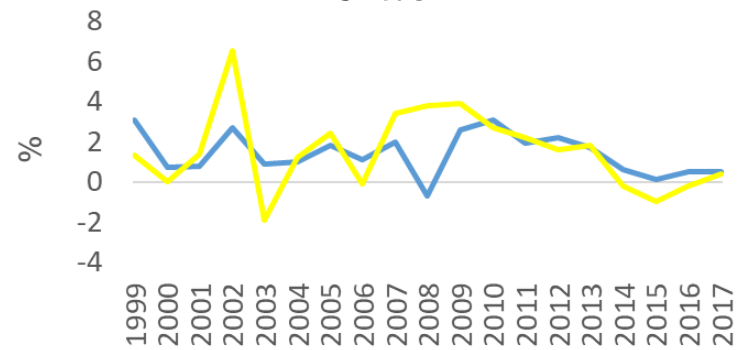


— US breakeven 1Y — US annual inflation

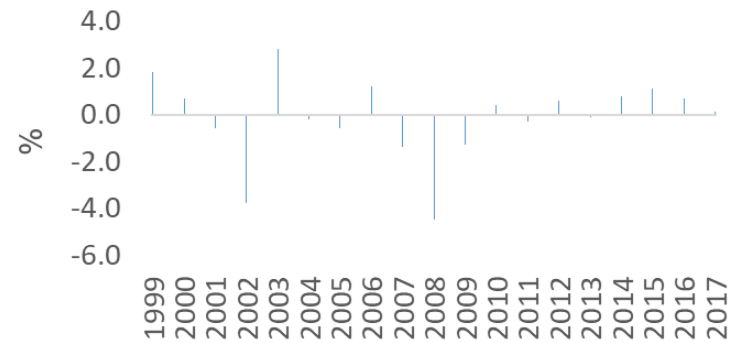


■ Difference (breakeven-inflation)

Israel



— Israel breakeven 1Y — Israel annual inflation



■ Difference (breakeven-inflation)