Linking Fiscal and Debt Management Policies – The Role of Debt Sustainability Analysis

Seán Nolan

International Monetary Fund

December 3, 2014

Deb Sustainability Analyses

- The Tool Box
  - Handling Debt Portfolio Risks
  - Handling Macro-Fiscal Shocks
- Handling Contingent Liabilities
- Role in Fund –Supported programs

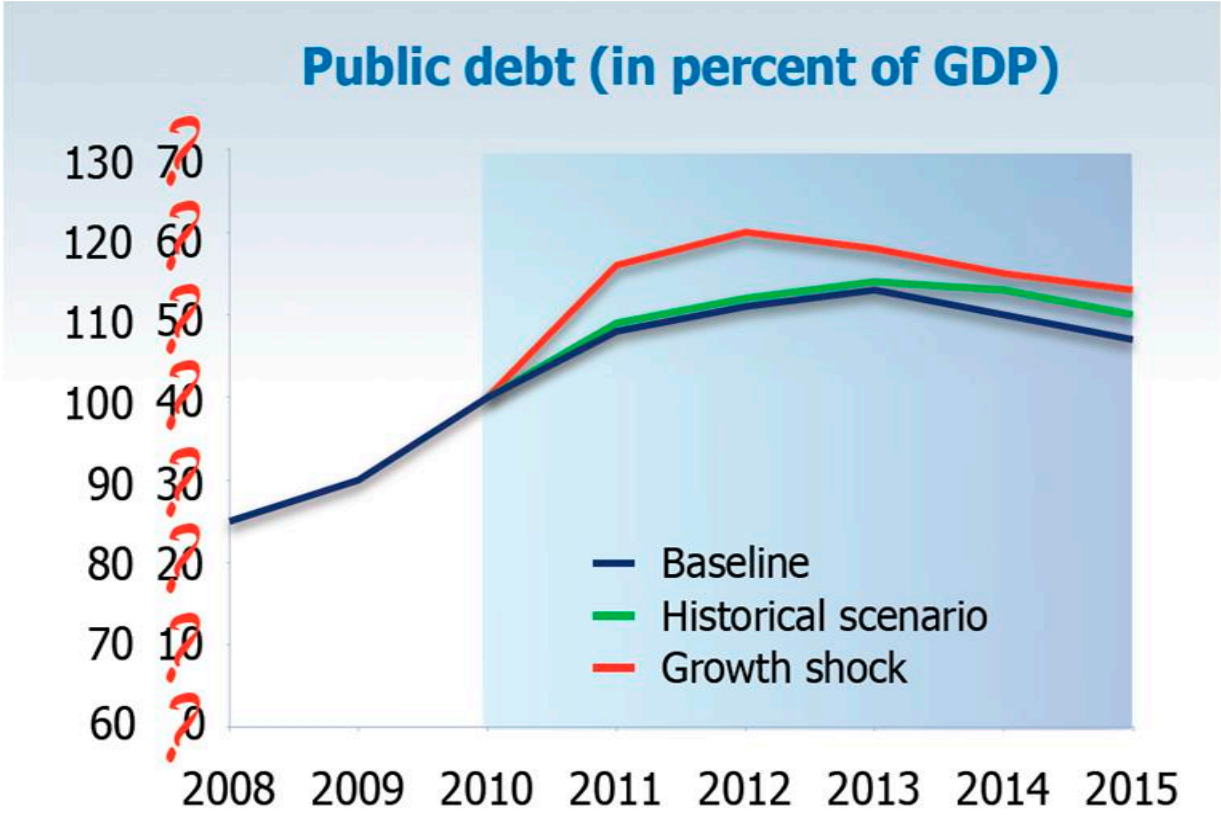
I. Debt Sustainability Analysis

The Tool Box

DSAs: Origins and Lessons

- LIC DSF was introduced in 2005: most recent review in 2012, joint Bank-Fund product
- MAC DSA was introduced in 2002, major refinements in 2011
- MAC DSA 2011 review identified several areas for improvement, including:
  - Realism of baseline assumptions
  - Risks associated with the debt profile
  - Analysis of macro-fiscal risks (including contingent liabilities)

Previously, for MACs the focus was mainly on debt trajectories



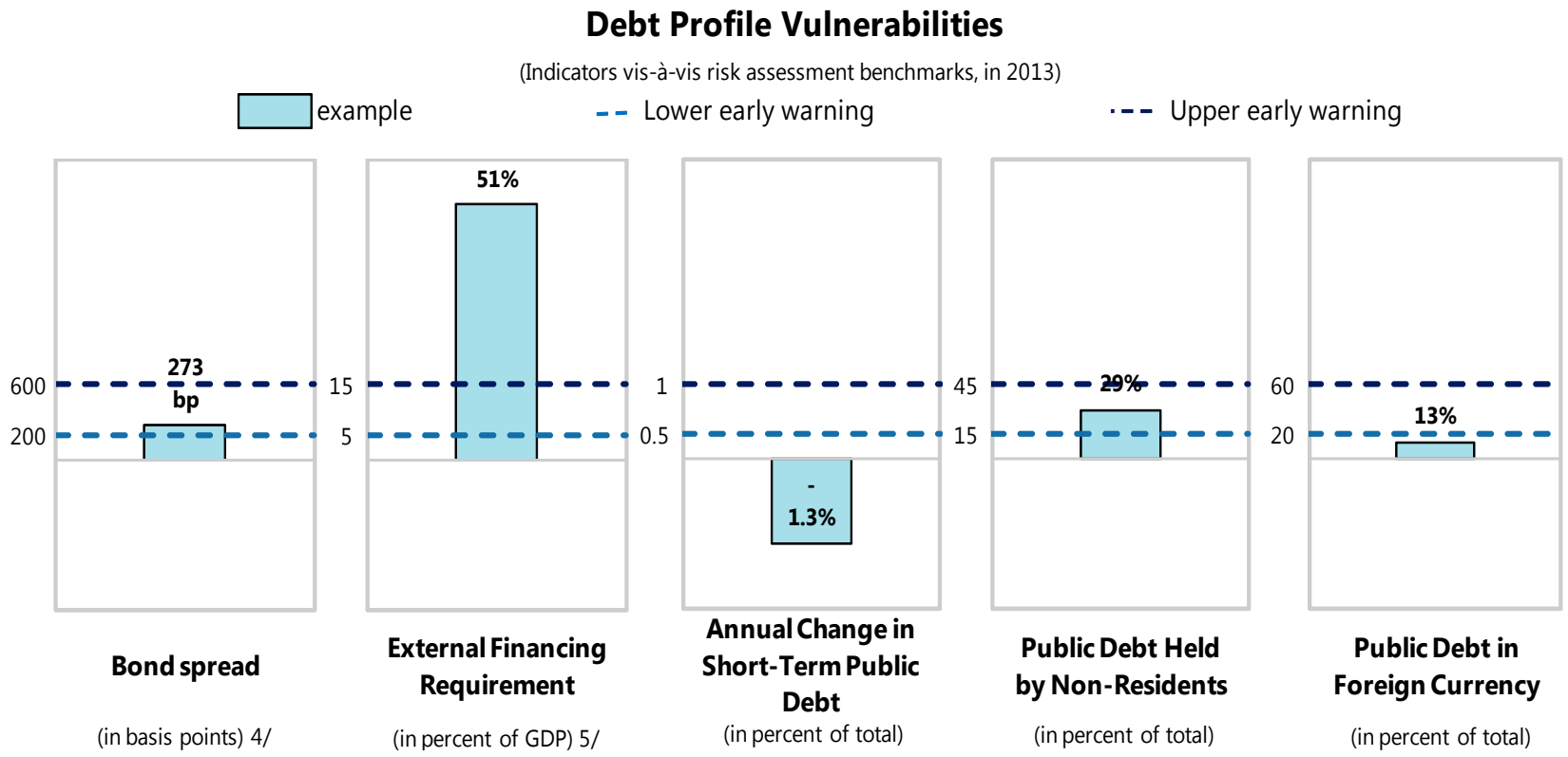
What's missing

- Debt profile risks
- Contingent liability risks
- ……

Public DSAs and Debt Profile

- Public debt vulnerabilities are associated not only with the level of debt, but with its profile
- Debt portfolio characteristics—maturity, currency composition, and the creditor base—have received much attention in the analysis of public debt distress
- The Fund's MAC DSA brings these (and other) elements together in its new risk-based approach to public debt sustainability
- The DSA assesses risks from the debt profile by comparing a set of indicators to early warning benchmarks

MAC DSA: Debt Profile Benchmarks



MAC DSA: Key Outputs

Example Public DSA Risk Assessment

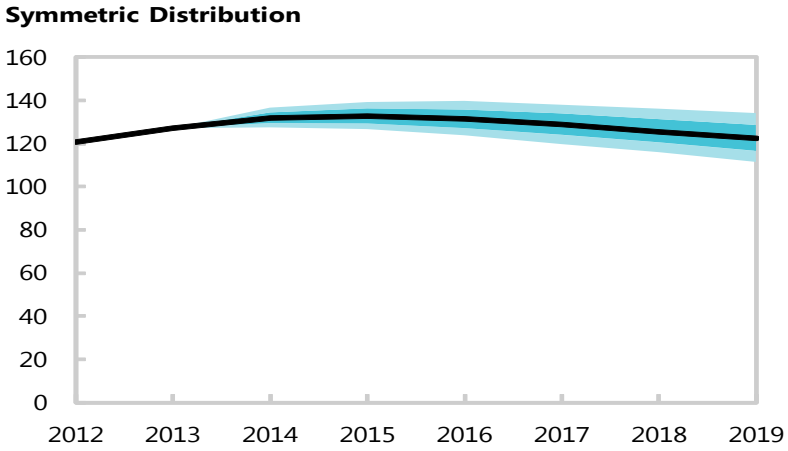
Heat Map

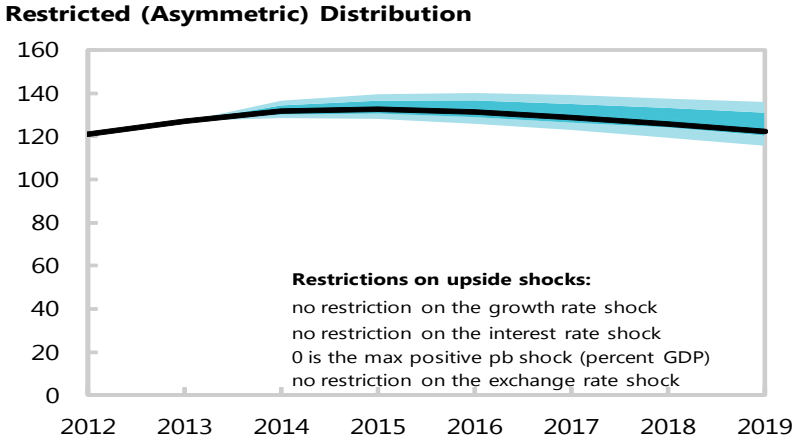
Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

Evolution of Predictive Densities of Gross Nominal Public Debt

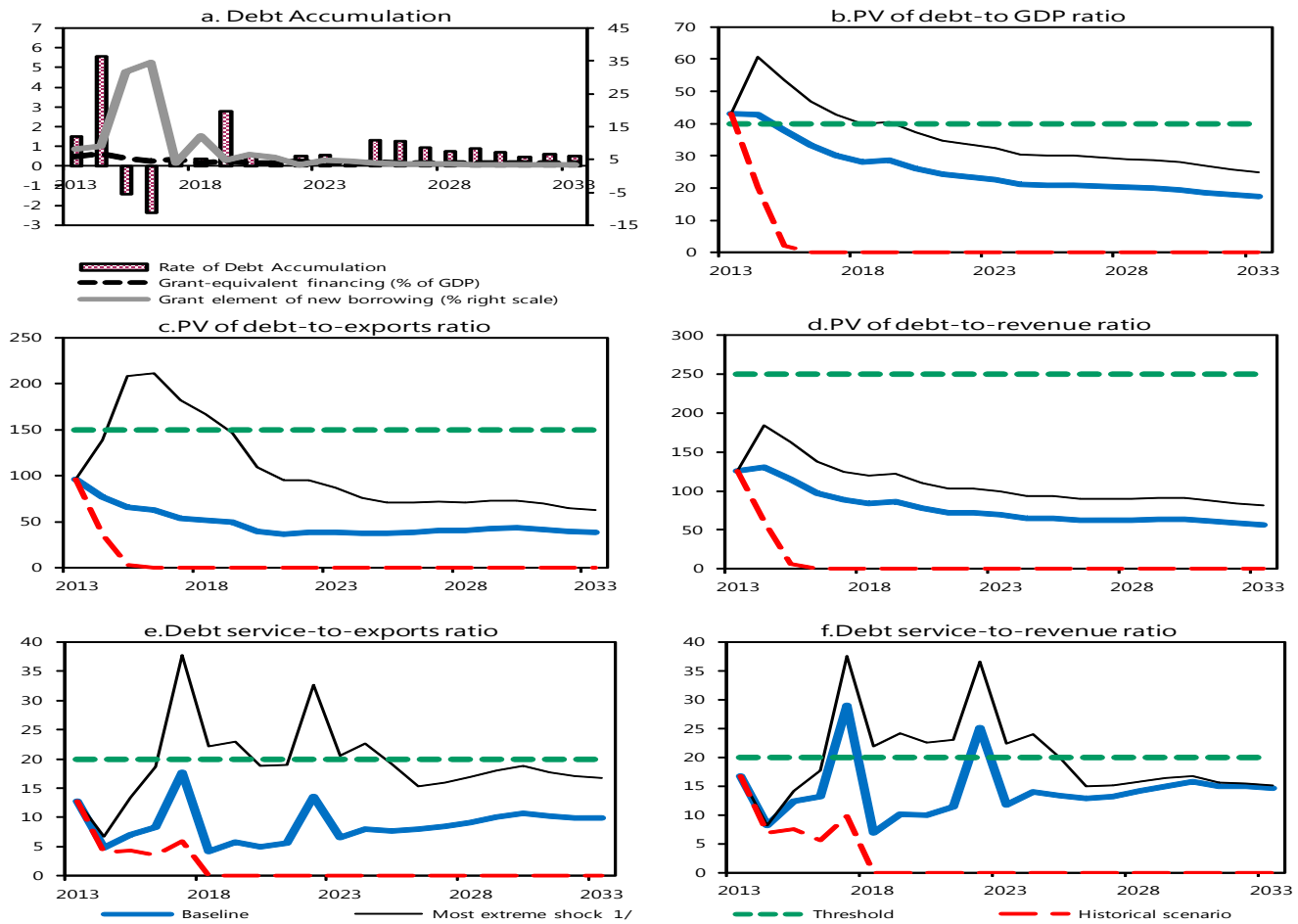
(in percent of GDP)

Baseline Percentiles: 10th-25th 25th-75th 75th-90th





LIC External DSA



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2023. In figure b. it corresponds to a One-time depreciation shock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a Exports shock

DSA for LICs: Times are a changing for some

- For most LICs, debt portfolio management is “passive” as debt managers have less influence over the design of the debt portfolio composition than in MACs
- But changing financing landscape and more market access is highlighting the relevance of debt portfolio risks
- Improving public debt management capacity in LICs remains a priority
- The Joint IMF/WB Debt Management Facility (DMF II) will make important contributions in this regard

II. Contingent Liability Risks

Contingent Liability (CL) Risks in DSAs

- Risks from contingent liabilities should inform both fiscal and debt management policies and strategies
- Analysis of the risks posed by CLs has become important for the assessment of public debt sustainability
- Assessment of banking sector CL is now an integral part of the MAC DSA
- But depending on country circumstances, other types of contingent liability risks may be also relevant

Contingent Liability (CL) Risks in MAC DSAs

Relevant for countries with financial sector vulnerabilities

Triggers	AEs	EMs
Private sector credit-to-GDP (3-year cumulative level change)	30%	15%
Loan-to-deposit ratio	1.5	1.5
Also look at:		
5-year average growth in nominal house prices	7.5%	

Financial sector CL shock

Shock of 10 percent of banking system assets

One standard-deviation shock to growth

Primary balance deteriorates, interest rate increases, inflation decreases

Other CLs: natural disasters, PPPs, SOEs

Contingent Liability (CL) Risks in LICs

- In LICs large public investments needs cannot all be financed by public debt without jeopardizing debt sustainability

- Public private partnership (PPP) arrangements offer burden sharing with the private sector, but also exposes public sector to fiscal risks

III. DSAs in Fund-Supported Programs

DSAs in Fund-Supported Programs

- In Fund programs debt conditionality is generally expected when a country has significant debt vulnerabilities

- For countries using the LIC DSF, debt vulnerabilities is informed by the assessed risk of external debt distress or, where relevant, by the assessed overall risk of debt distress

- For countries using the MAC DSA debt vulnerabilities is assessed by the set of standard indicators in the MAC DSA

Useful Links on IMF's Website

- Guidance Note on DSA for Market-Access Countries: http://www.imf.org/external/np/pp/eng/2013/050913.pdf
- Guidance Note on the Joint Bank-Fund Debt Sustainability Framework for Low-Income Countries: http://www.imf.org/external/np/pp/eng/2013/110513.pdf
- IMF's online DSAx course: http://www.imf.org/external/mmedia/view.aspx?vid=3335115563001

  https://www.edx.org/course/debt-sustainability-analysis-imfx-dsax#.VH3WC4UhAyp

Thank you