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
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 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

Debt Profile Vulnerabilities
(Indicators vis-à-vis risk assessment benchmarks, in 2013)

- **Bond spread**: 273 bp
- **External Financing Requirement**: 51%
- **Annual Change in Short-Term Public Debt**: -1.3%
- **Public Debt Held by Non-Residents**: 29%
- **Public Debt in Foreign Currency**: 13%

**Example**

- Lower early warning
- Upper early warning
Example Public DSA Risk Assessment

Heat Map

Evolution of Predictive Densities of Gross Nominal Public Debt
(in percent of GDP)

Symmetric Distribution

Restricted (Asymmetric) Distribution

Restrictions on upside shocks:
- no restriction on the growth rate shock
- no restriction on the interest rate shock
- 0 is the max positive pb shock (percent GDP)
- no restriction on the exchange rate shock
Revised DSA for MACs

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
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
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.
Revised DSA for MACs

Contingent Liability (CL) Risks in MAC DSAs

### Relevant for countries with financial sector vulnerabilities

<table>
<thead>
<tr>
<th>Triggers</th>
<th>AEs</th>
<th>EMs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private sector credit-to-GDP (3-year cumulative level change)</td>
<td>30%</td>
<td>15%</td>
</tr>
<tr>
<td>Loan-to-deposit ratio</td>
<td>1.5</td>
<td>1.5</td>
</tr>
</tbody>
</table>

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
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
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

Thank you