LEGAL

MONETARY AND CAPITAL MARKETS

Public debt management, Transparency and the impact of Covid-19

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MCM and LEG Departments

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I. Sovereign Debt Management and COVID -19

1. ELEMENTS OF SOUND DEBT MANAGEMENT

- Sound government debt management is important for the smallest Heavily Indebted Poor Countries as well as the major economies

- Government's debt portfolio contains complex exposures that create substantial risk for the government and the country's financial stability—particularly where large amounts of foreign-currency debt and short-term debt are involved

- Prudent debt management **reduces the financial risk the government faces**, lowers the economy's vulnerability to financial shocks, strengthens the market infrastructure and institutions needed to support an efficient domestic financial market, and helps foster sound public sector governance practices

Objectives of Prudent Debt Management

To meet government's financing needs within tolerable cost/risk limits and to develop domestic capital markets

Key issues:

a. Establishing clear **debt management objectives** and supporting them with a sound governance framework, a prudent cost and risk management strategy and accompanying portfolio management policies;

b. An efficient **organizational structure**; appropriate management information systems; and a strong in-house risk management culture-clear delegation of responsibilities

c. Establishing reporting procedures to ensure that the government's debt managers are accountable for implementing the debt management responsibilities delegated to them.

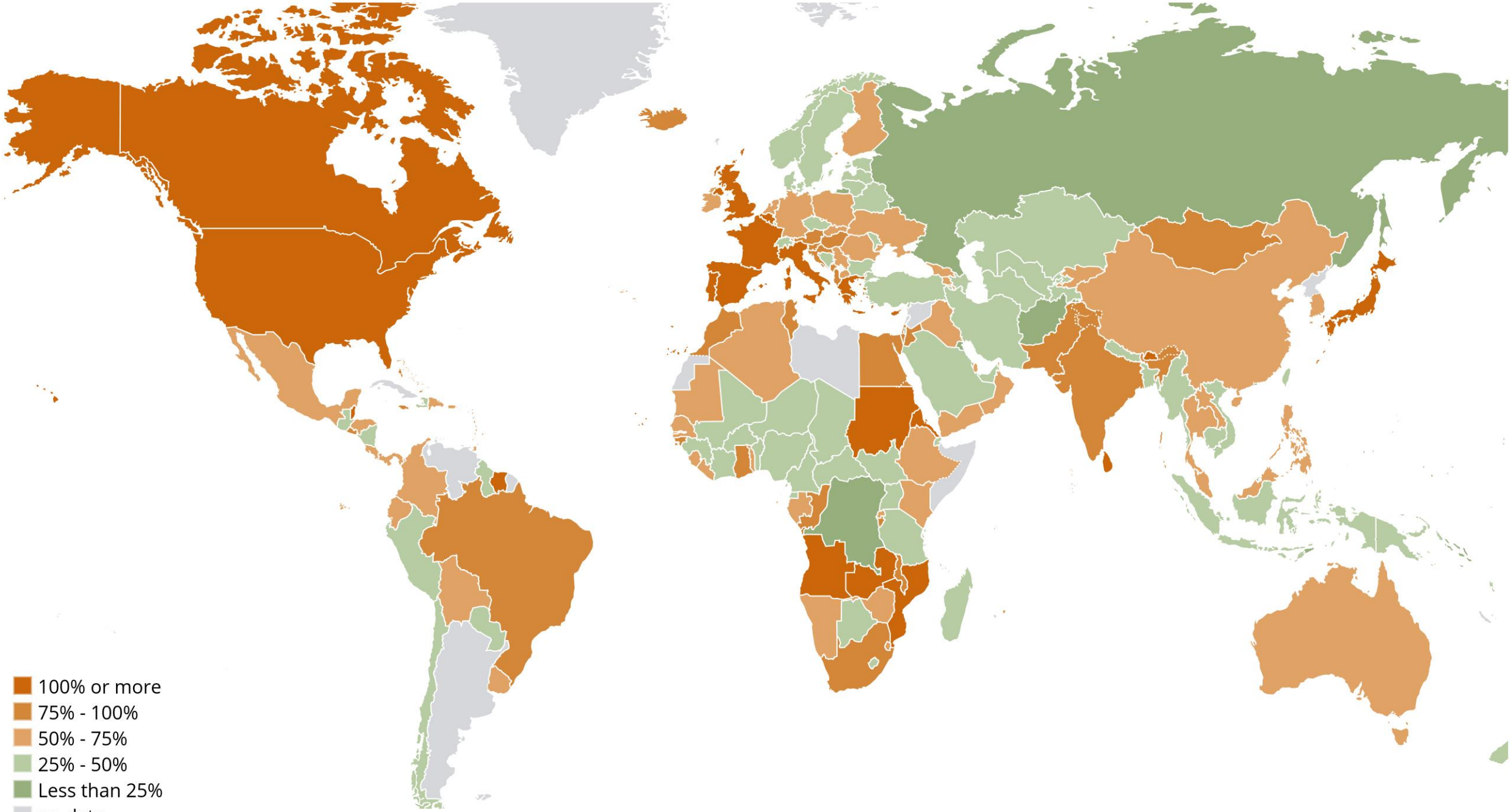
IMF/WB Debt Management Guidelines and Stockholm principles – useful guides.

2. DEVELOPMENTS IN DEBT AND THE IMPACT OF COVID-19

- Global public debt levels were elevated already before the COVID-19 pandemic.
- Pandemic added to financing strains as countries sought to mitigate the health and economic effects of the pandemic, while fiscal revenues are falling due to lower economic activity.
- This has pushed debt levels to new heights close to 100 percent of GDP globally.
- The ability to carry debt varies widely among countries.
- Debt vulnerabilities have increased especially in low-income countries and some emerging market economies.

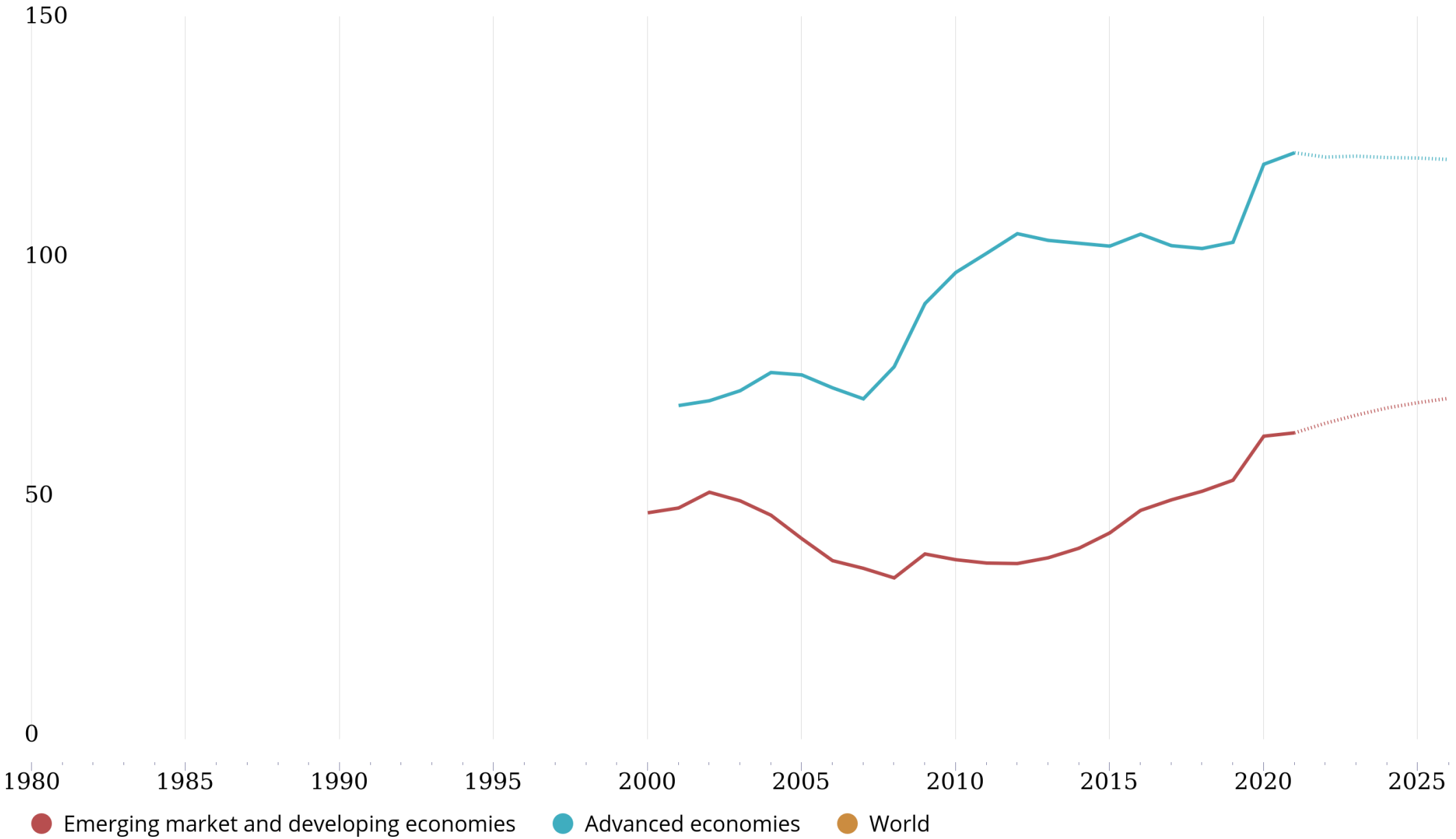
IMF DataMapper

General government gross debt (Percent of GDP, 2021)



IMF DataMapper

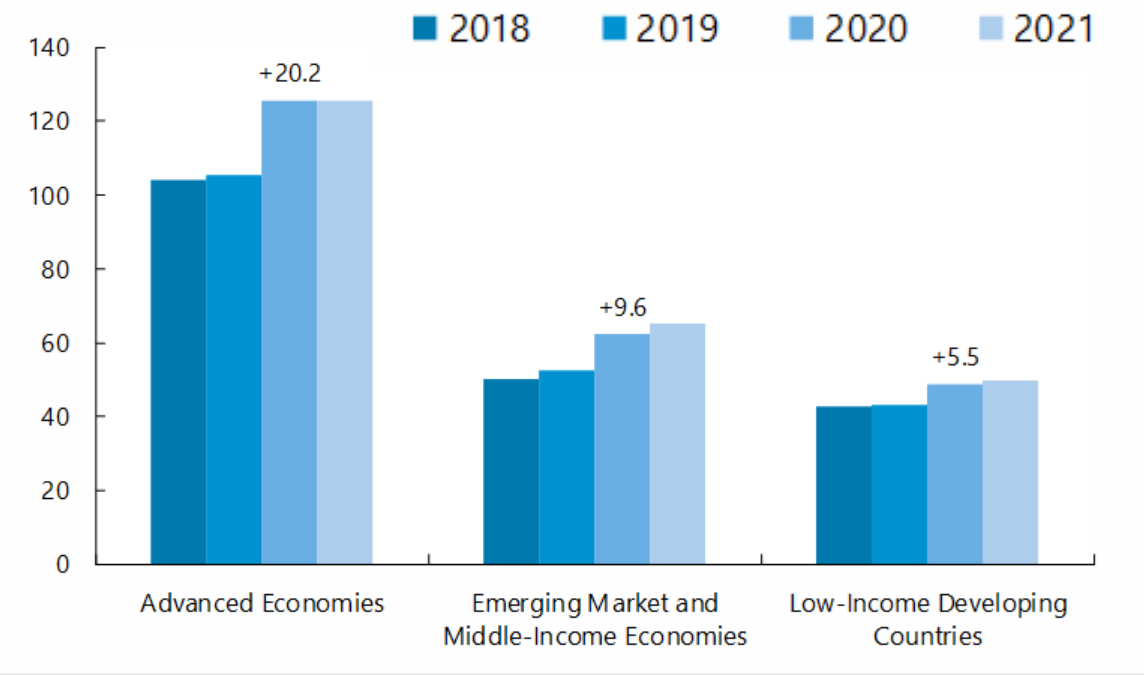
General government gross debt (Percent of GDP)



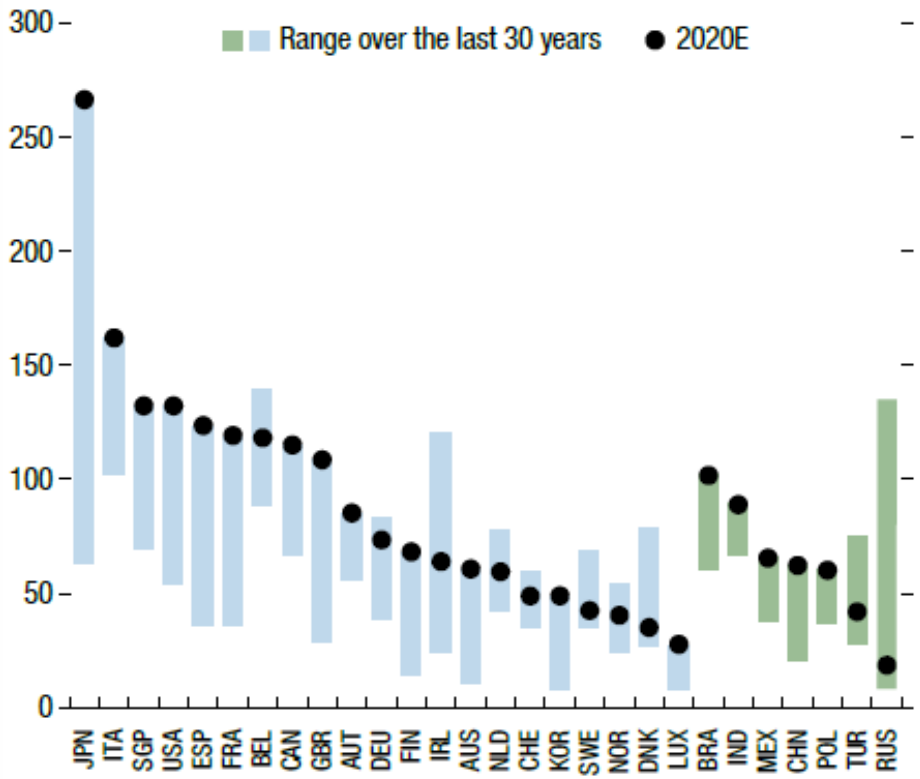
©IMF, 2021, Source: World Economic Outlook (April 2021)

Recent Debt Developments increased debt stocks especially in advanced countries; Growth collapses and fiscal support have led to sharp rises in debt. Triggered many sovereign debt rating downgrades

General Government Debt (2018-21)
(in percent of GDP)

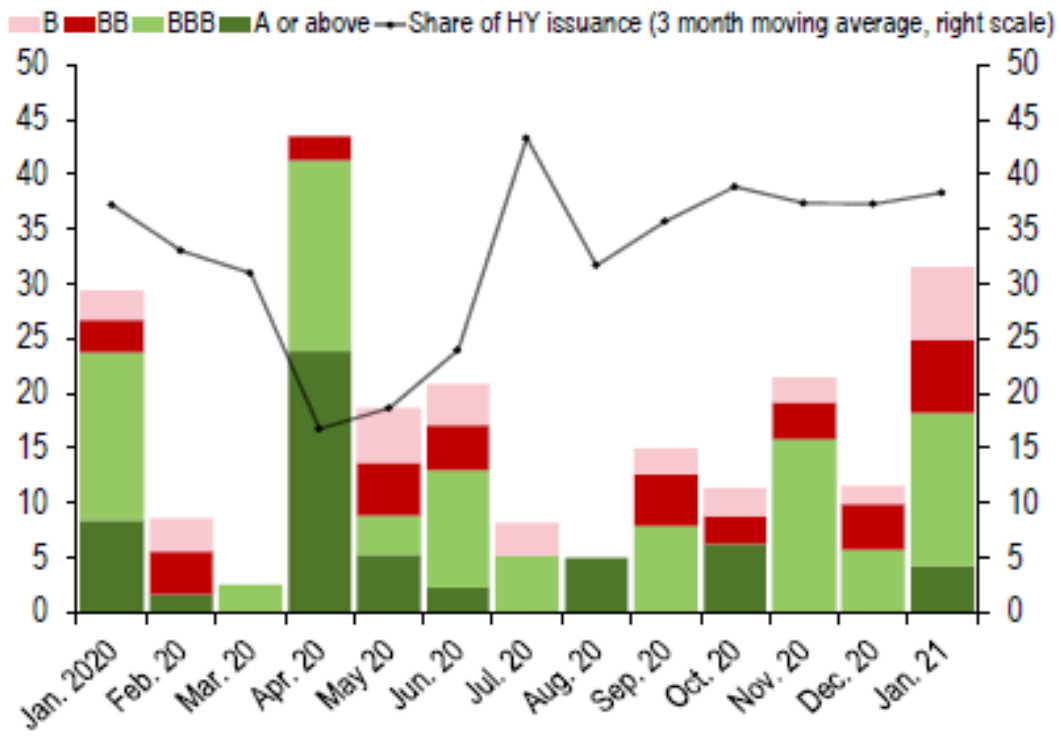


Sovereign Debt to GDP
(in percent of GDP)



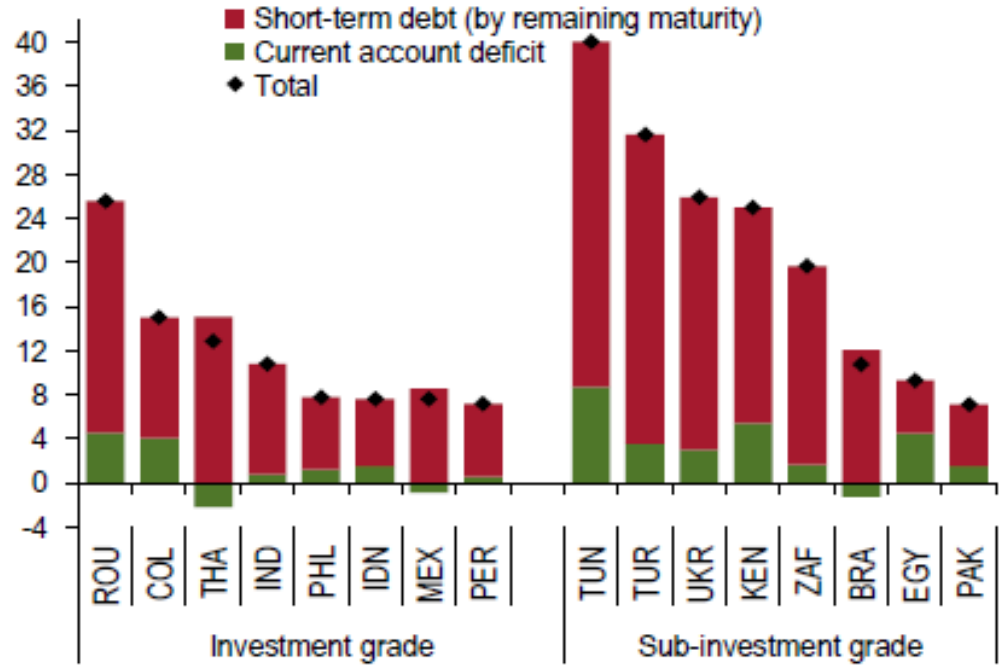
Recent Debt Developments in EMs

EM Sovereign Bond Issuance
(in billions of US dollars; share in percent)



Sources: Bondradar; and IMF staff calculations.

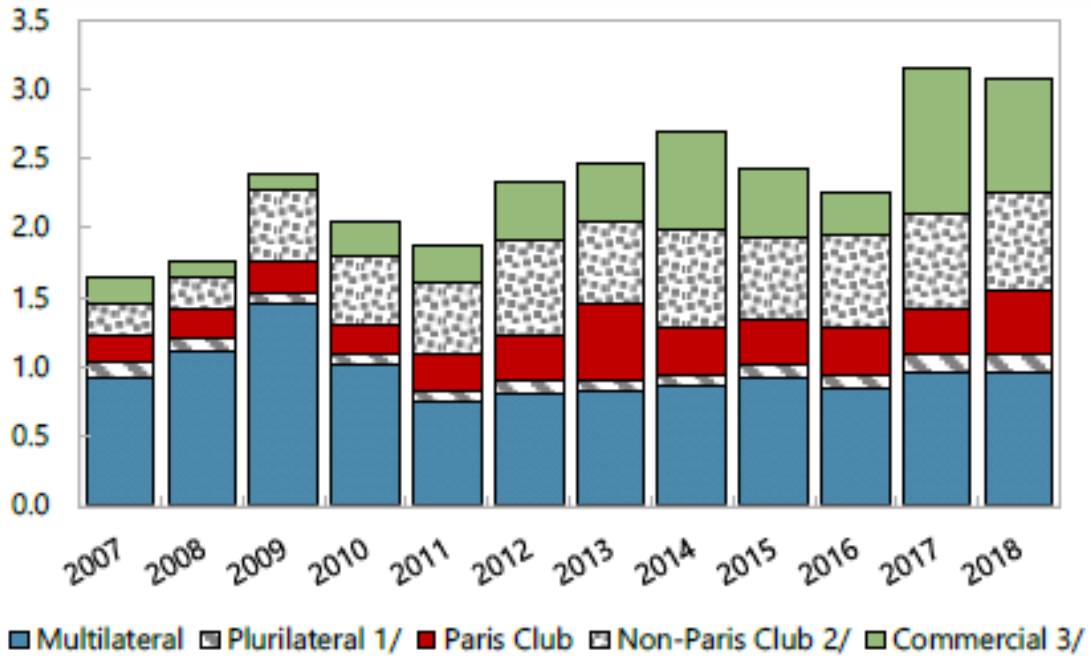
2021 Gross External Financing Needs
(in percent of GDP)



Sources: National authorities; and IMF staff calculations.
Note: Brazil, Romania, South Africa, Thailand, and Ukraine report intercompany lending in their gross external financing needs.

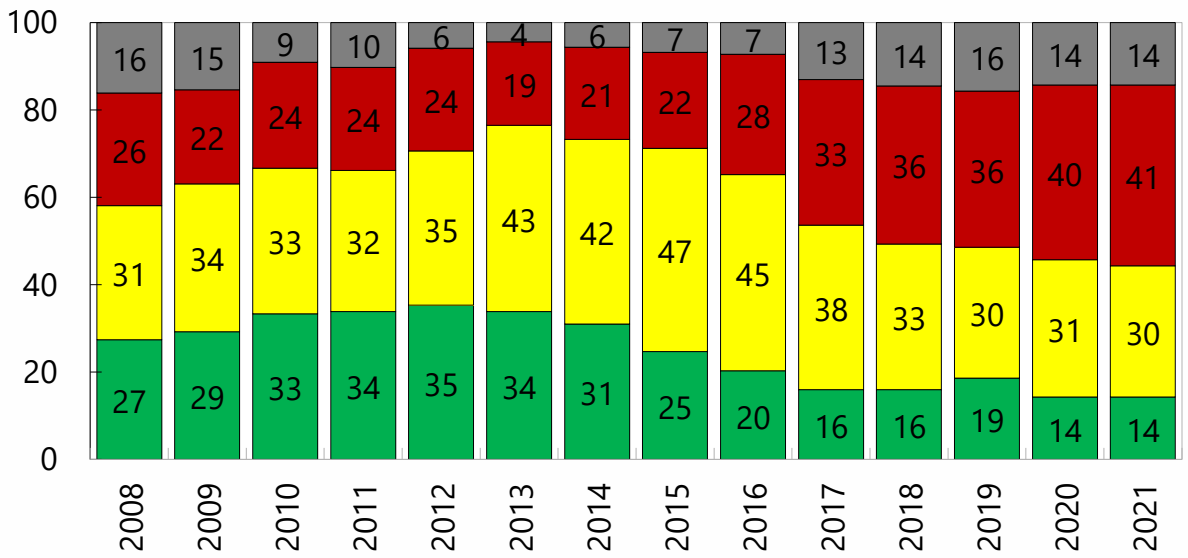
Recent Debt Developments in LICs
Short-term debt distress risks remain significantly above their pre-pandemic levels

Debt by Creditor Type
(in percent of GDP)



Source: DRS Database

Evolution of Risk of Debt Distress
(% of LICs with DSAs)

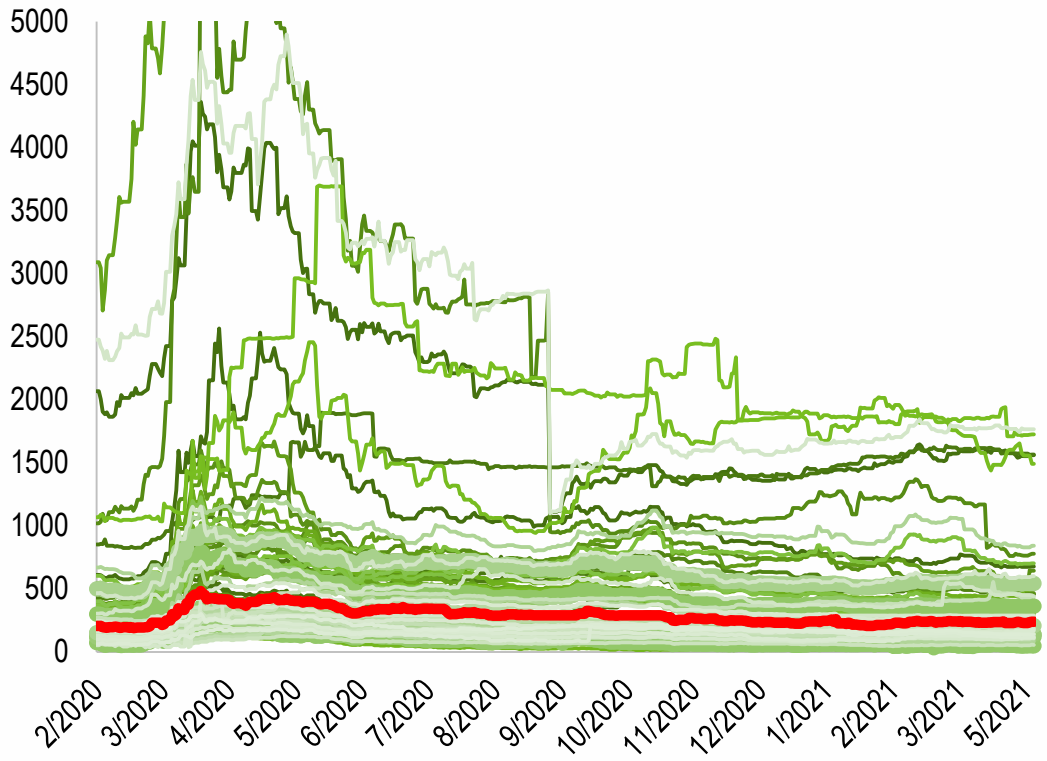


As of February 19, 2021

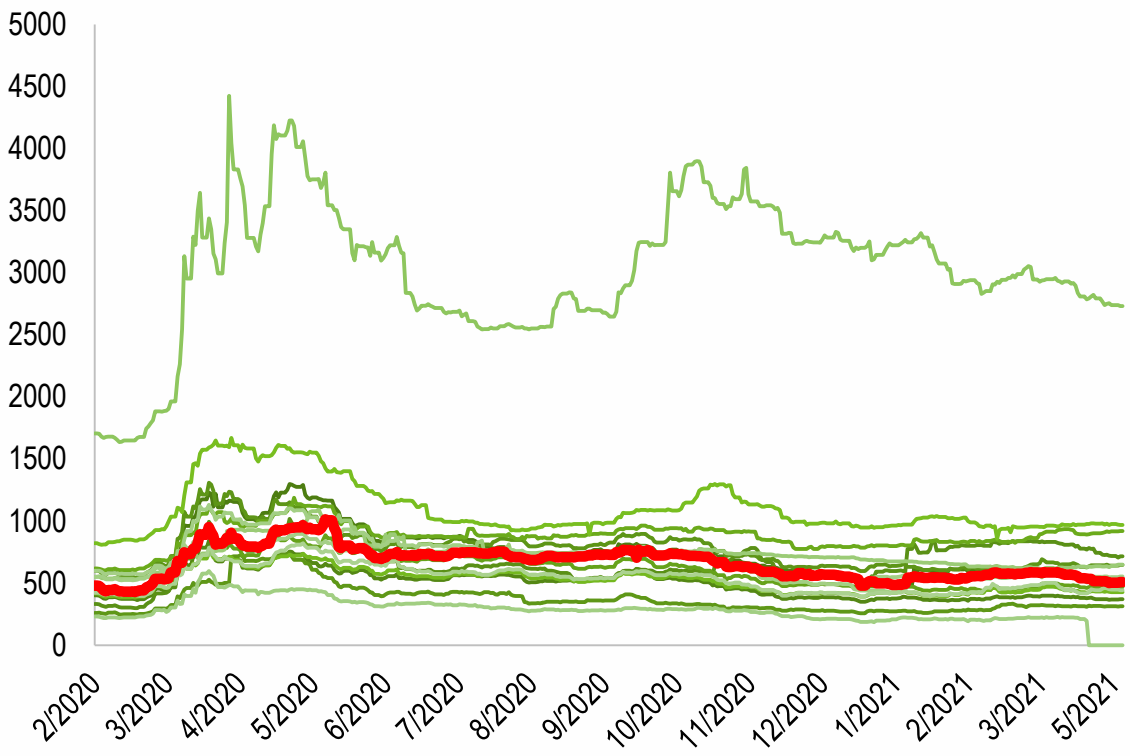
Source: LIC DSA database

What markets say about debt risks in EMs and LICs

Evolution of spreads in EMs



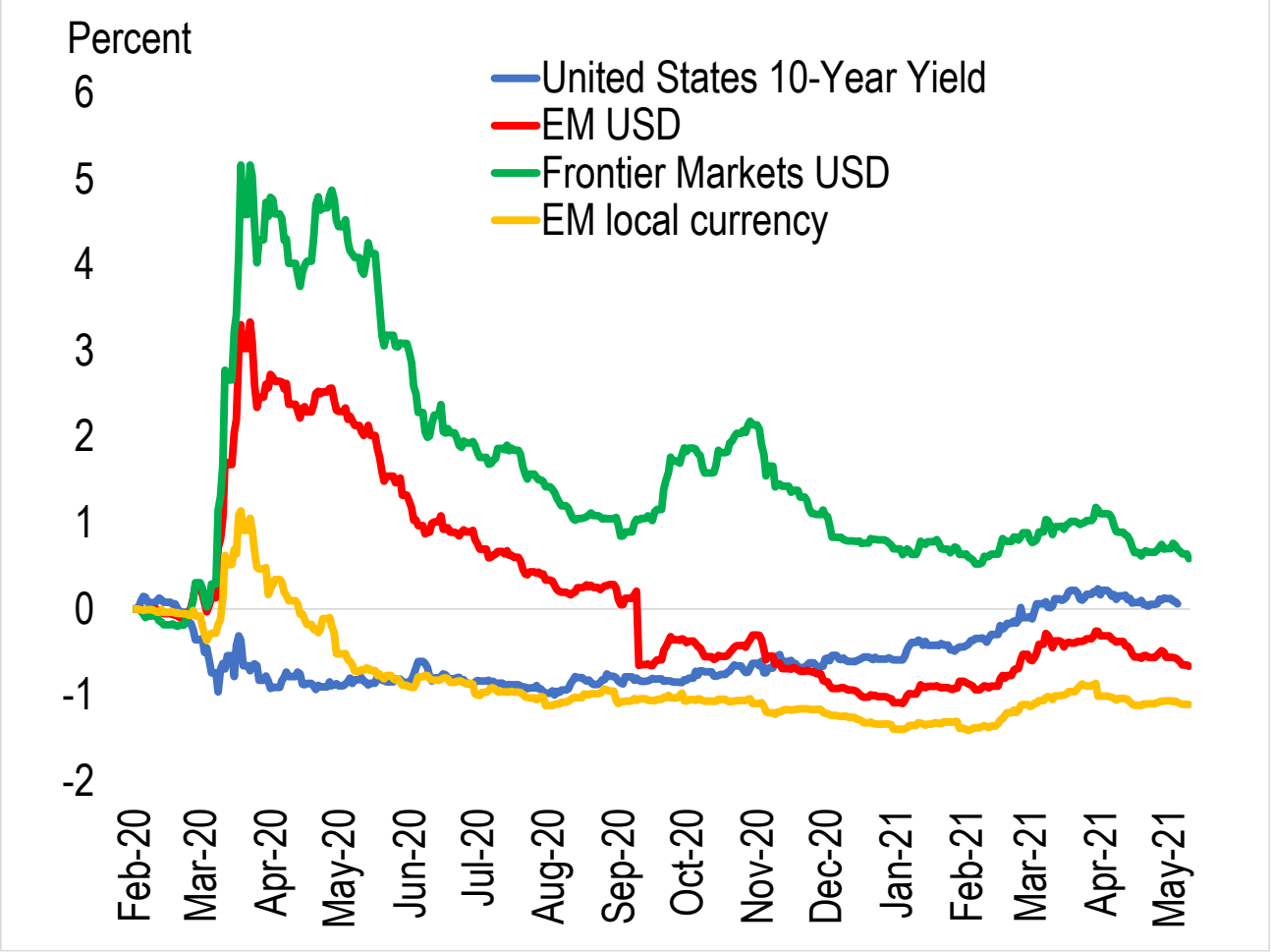
Evolution of spreads in LICs



Note: The red lines indicates the median for EMs and LICs respectively.

A spike in external interest rates was quickly reversed, but both external and local rates have recently tightened

Change in Bond Yields Since February 2020



Notes: EM USD line shows the J.P. Morgan EMBI Global Maturity 7-10 years Blended Yield index. Frontier Markets USD is the J.P. Morgan Next Generation Markets Index Composite Blended Yield index. EM local currency line is the J.P. Morgan GBI-EM Yield to Maturity.

3. DEBT MANAGEMENT RESPONSES TO COVID-19

<u>What could debt managers do?</u>

- Significant Covid-19 changes are a trigger for revising Debt Management Strategy and Annual Borrowing Plan
- Enhanced communication and coordination between debt management, monetary, fiscal, and financial sector regulatory authorities is vital during a crisis period, both with respect to policies and specific measures or interventions
- Where possible, debt managers can engage in cash-neutral Liability Management Operations (LMOs) to push out redemptions
- May be a trigger for using cash buffers – but requires careful evaluation
- Not included here is the massive liquidity injections through emergency lending facilities from the IFIs

See IMF (2020). *Debt Management Responses to the Pandemic.*

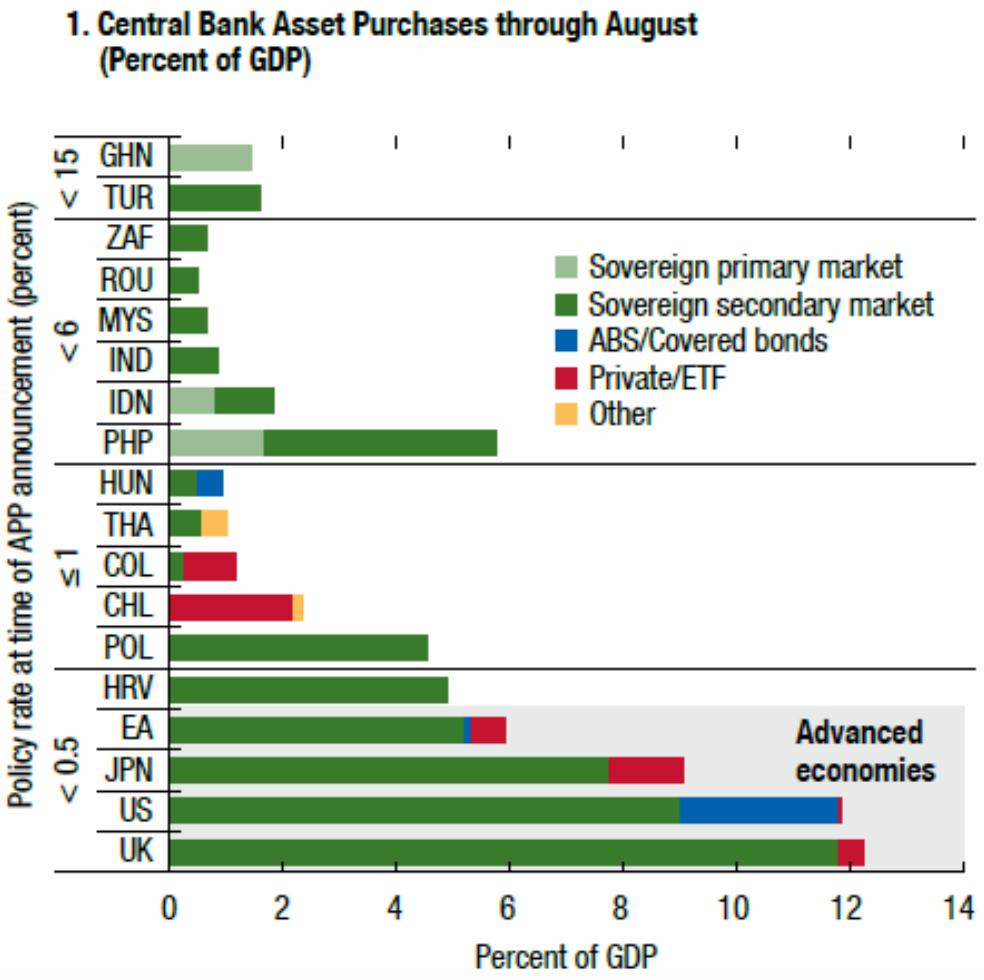
3 Cont. DEBT MANAGEMENT RESPONSES TO COVID-19

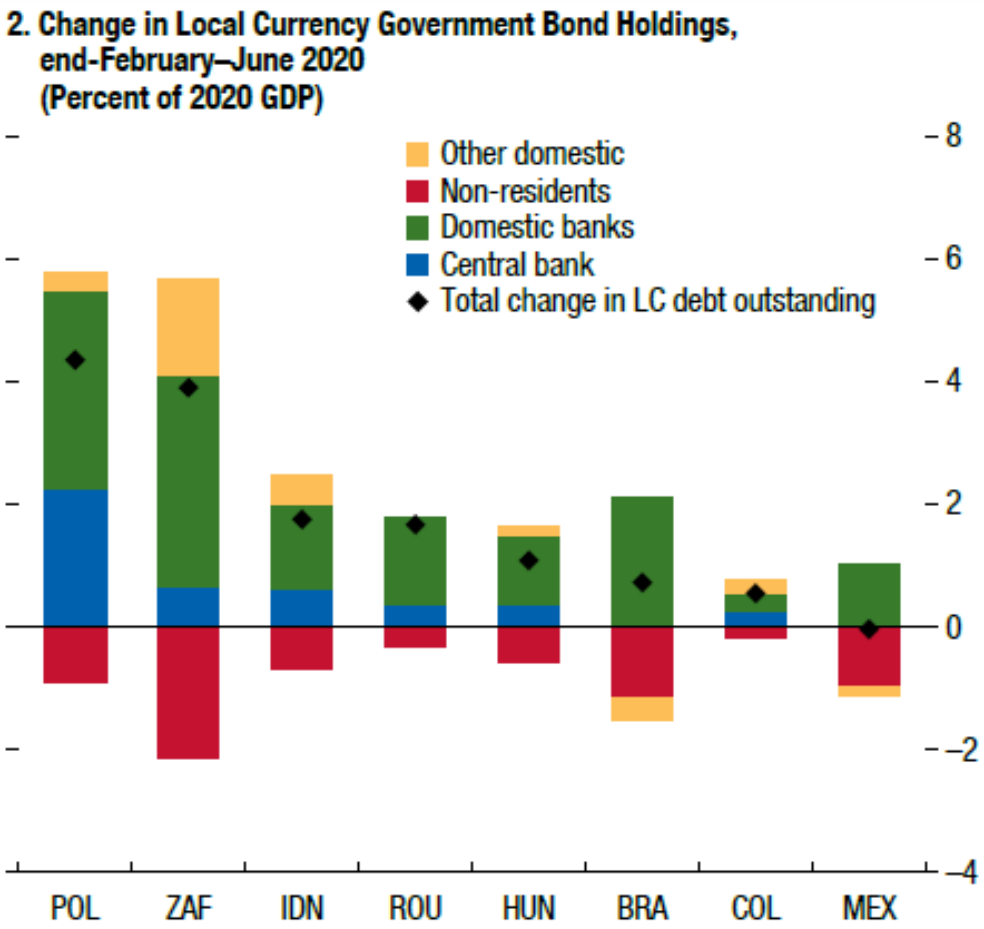
- Sovereign debt managers should stand ready to modify their domestic issuance mix, in terms of securities and methods.
- The rebalancing of issuance towards shorter maturity instruments should take account of the financial sector's needs
- In countries that have issued securities in international markets, debt managers should continuously assess their ability to finance, and refinance, in those markets.
- Debt managers should advise the fiscal and monetary authorities to refrain for as long as possible from resorting to direct government borrowing from the central banks.

Examples of Debt Management Responses

DM Response	Types of response
Changes in Issuance Strategy	• Increased short-term borrowing from domestic market • Increased FX issuance • Increased use of retail instruments • Use of cash buffers
Changes in Issuance Mechanisms	• Increases in non-competitive bidding • Overallocation at operations • Use of off-market sales or private placements • Increased auction frequency
Use of Liability Management Operations (LMOs)	• Targeted LMOs to retire off-the-run securities • Exchange operations for International Bonds
Central Bank Support	• Primary market purchases • Increased secondary market purchases • CB Repos

Central Bank Support Offsetting Non-resident Outflows





Hardly any new debt restructurings/defaults in EMEs …

	Announced restructuring before pandemic	Announced restructuring during pandemic
Restructuring completed	Argentina (restructuring announcement 12/2019, completed 9/2020)	Ecuador (restructuring announcement, 4/2020, completed 8/2020)
Restructuring or default ongoing	Venezuela (in default since November 2017; Lebanon (crisis since 10/2019; default, 3/2020)	Suriname (default, 4/2021)

There has been little change in LICs undergoing debt restructurings or rated "in distress", according to the LIC-DSF

February 2020

Congo, Rep. of
Eritrea
Gambia
Grenada
Mozambique
Sao Tome and Principe
Somalia
South Sudan
Sudan
Yemen
Zimbabwe

May 2021

Chad
Congo, Rep. of
Eritrea
Ethiopia
Grenada (long-standing, small arrears)
Mozambique
Sao Tome and Principe
Somalia
Sudan
Yemen
Zambia (first LIC post-pandemic default)
Zimbabwe

4. RETURNING TO SOUND DEBT MANAGEMENT PRACTICES

- Post-crisis there will be a need to unwind interventions that have been a departure from sound practices.
- Debt managers will want to undertake an evaluation of risks that crystalized during the crisis, and assess the adequacy of the debt management response
- Going forward, debt managers will need to re-assess existing debt management strategies over the medium term, taking into account larger debt portfolios where the cost-risk profile will have altered significantly.

Debt Restructuring – Looking Forward

- DSSI
  - 73 countries eligible (IDA + Angola 4 multilateral arrears cases)
  - In November, the G20 agreed an Addendum to the April 2020 Term Sheet and DSSI extension through June 30, 2021
  - Private sector participation encouraged on a voluntary basis: IIF has released an addendum to the Terms of Reference to facilitate voluntary private sector involvement in DSSI through June 30, 2021
  - IMF/WBG staff continue to support DSSI implementation

- Common Framework
  - Endorsed by G20 Finance Ministers and Central Bank Governors Meeting on 13 November 2020
  - Case by case approach with Fund supported program
  - Debt treatment need and envelope: based on DSA from IMF WBG and consistent with the parameters of an IMF supported program

Strengthen Institutional Coordination

Communication between debt management, monetary, fiscal and regulatory authorities critical

Debt managers may also be required to assume new responsibilities – e.g. where there are government interventions, including guarantee schemes

What can the government cash managers do differently?

Cash pooling

- Can we widen the Treasury's pool of cash resources?
- Conversely, how do we avoid further cash fragmentation?

Cashflow forecasting

- What can we do to make forecasts more reliable?

Institutional strengthening

- What institutional measures will better support crisis management?

Cash balance management

- Are there any unconventional financing sources that can be tapped?
- How should the available safety nets be used?

Looking Ahead – Reducing Debt Vulnerabilities

- **IMF-WB Multipronged approach (MPA) to debt vulnerabilities in LICs:** Including strengthening capacity development on debt management, with focus on debt transparency.

- **New IMF analytical work**
  - Local Currency Bond Market Development
  - Use of State Contingent Debt Instruments
  - Sovereign Debt Restructuring Framework

- **New tools and training**
  - Medium-term Debt Management Strategy Massive Open Online Course (MOOC)
  - New Borrowing Plan Tool
  - Rollout of new training courses on debt reporting, monitoring and IR

Effective Communication and Market Access

- **Stockholm Principles (2010)** on managing sovereign risk and high levels of public debt place strong emphasis on communication.
- **Emphasis on transparency and 'Investor' Relations** to minimize information asymmetries that lead to negative investor perceptions. IR has a clear role to play in maintaining and restoring market access.
- Effective communications and consultation underpinned by **Transparency, Accessibility, Predictability and Accuracy.**
- **IIF criteria** for evaluating good IR practices an excellent starting point.
- <u>IR practices relevant for debt managers at all stages of market development.</u>

II. Governance and transparency issues for public debt management during the COVID-19 pandemic — legal underpinnings

Legal framework for emergency financing, borrowing authorization and other debt management operations

- **Under rapidly-moving conditions, traditional public financial management legal frameworks, in some cases, may have not provide adequate flexibility**
  - Supplementary budgets
  - Omnibus COVID-19 Laws
  - Use of emergency law-making powers
  - Creation of extrabudgetary funds
  - Suspension of fiscal rules

- **Balancing flexibility and accountability**
  - Targeted purpose /rules on use (borrowing purpose)
  - Regular reporting
  - Accountability and special oversight

Preexisting vulnerabilities in the legal framework impacting debt transparency during COVID-19

- ***Debt coverage*.** Including,
  - lack of a comprehensive coverage of all public sector entities, and
  - inadequate coverage of public debt instruments.

"Hidden debt" cases reveal that public debt can originate either from

- entities outside the central government that may have their own frameworks for authorization and/or disclosure, or from types of liabilities that are not considered within the definition of public debt

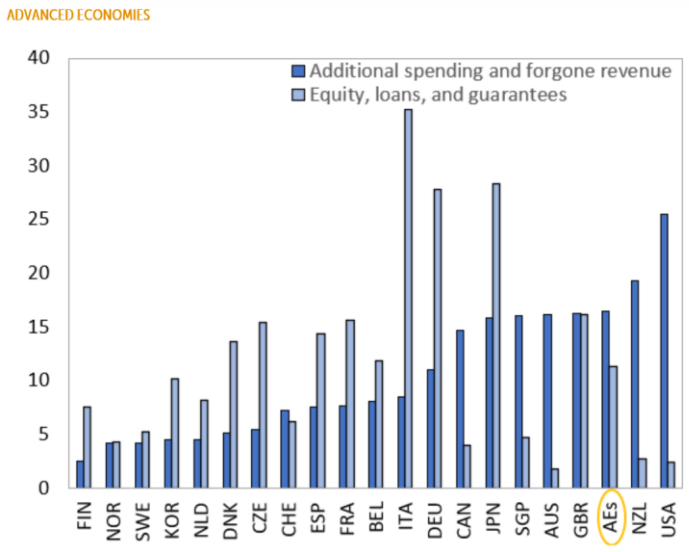
Preexisting vulnerabilities in the legal framework impacting debt transparency during COVID-19 (cont'd)

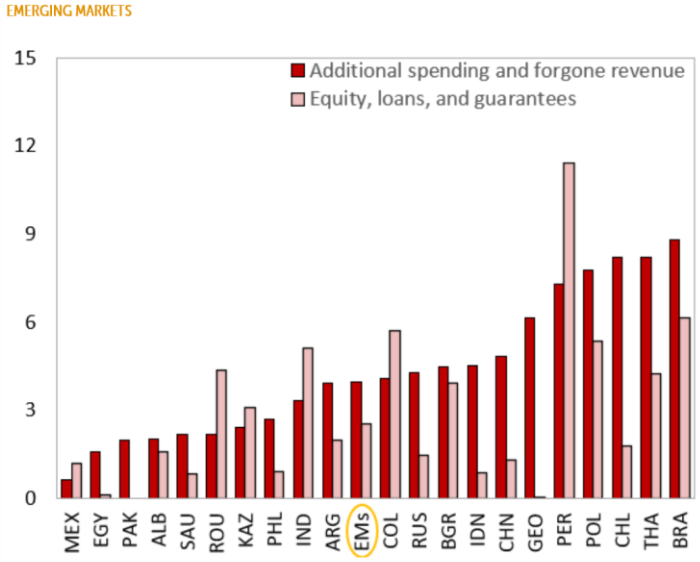
Reporting requirements. Weaknesses often arise in:

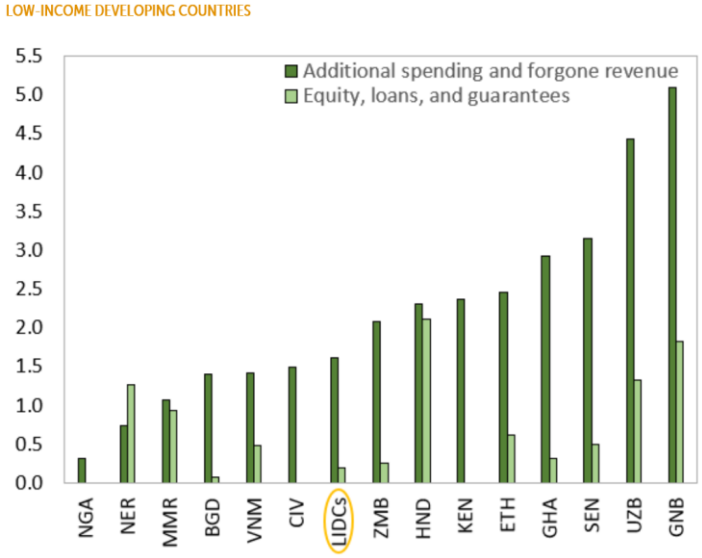
- ***ex-ante public disclosure on borrowing activities***, such as publication of a medium-term debt strategy (MTDS), annual borrowing plan,
- ***public disclosure requirements on specific debt operations***
  - Some types of instruments (e.g., loans, bilateral credit facilities, and non-standard instruments such as collateralized loans, advanced sales of commodities, and financing associated with commodity purchase and sale agreements, arrears) may often not be subject to the same disclosure requirements
- ***ex-post public disclosure requirements***, such as
    - Debt management reports (commonly to Parliament on an annual basis)
    - Debt bulletin (stock composition, debt flows, contingent liabilities, cost-risk indicators and others)

Legal issues impacting debt transparency during COVID-19 – specific fiscal measures

Country Fiscal Measures in Response to COVID-19:
The case of lending operations, debt assumptions, government guarantees, and others







Source: Fiscal Monitor Database of Country Fiscal Measures in Response to the COVID-19 Pandemic, April 2021

Good practices for contingent liabilities legal frameworks

- **Several countries** have granted individual government guarantees to SMEs and corporations or put in place public guarantee schemes in favor of creditworthy but temporarily distressed borrowers. Public debt managers often have the legal mandate to authorize, monitor and report these operations.

- **While types and structures of this fiscal support vary widely, there are some key common legal underpinnings that could be put in place**:
  - Define clearly the roles and responsibilities in each phase (issuance, monitoring, reporting); establish a central oversight body; integrate information with the budget process; define disclosure and reporting requirements.

- **For loan guarantees:** risk mitigation tools to contain overuse, excessive fiscal risks such as:

quantitative limits (on stock and/or on the flow)	contractual (e.g. financial information sharing obligations, use of loan proceeds, sanctions)
credit risk assessment	recovery
partial guarantee issuance	budget reserve requirements
fee (flat or risk based)	centralized oversight

In this context, SAIs may face challenges to perform their mandate…

Key legal underpinnings for SAI's governance framework in the context of the pandemic:

- Mandate of SAI's for auditing emergency financing
- Adequate powers of the SAI. Including:
  - *Define scope and coverage of emergency financing audit*
  - *Access to Information and data* – impact by COVID-19 crisis.
  - *Publication of Audit Reports* –including legal requirements for comprehensiveness, timeliness and publicity of audit report findings.
- Legal mechanism for the follow-up of audit findings
- Autonomy/Independence including financial
- Referral to/coordination/cooperation with enforcement agencies

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