

PDM NETWORK *Newsletter*

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Dear Partner, this *Newsletter* contains a list of the latest resources uploaded both in the documentation and in the event areas of the PDM Network website (www.publicdebt.net.org). The PDM Network has its main objective in the joint cooperation among its participants regarding the quantity and quality of information available on the website. So far, it is very appreciated a stronger collaboration in this field, **signalling to the Network Secretariat** any documents, news and events of interest at publicdebt.net.dt@tesoro.it.

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New Documents

PAPERS

Credit Derivatives: Systemic Risks and Policy Options? (2009)

Kiff John*, Elliott Jennifer*, Kazarian Elias*, Scarlata Jodi*, Spackman Carlyne* (*IMF)

Abstract: Credit derivative markets are largely unregulated, but calls are increasingly being made for changes to this "hands off" stance, amidst concerns that they helped to fuel the current financial crisis, or that they could be a cause of the next one. The purpose of this paper is to address two basic questions: (i) do credit derivative markets increase systemic risk; and (ii) should they be regulated more closely, and if so, how and to what extent? The paper begins with a basic description of credit derivative markets and recent events, followed by an assessment of their recent association with systemic risk. It then reviews and evaluates some of the authorities' proposed initiatives, and discusses some alternative directions that could be taken.

Financial Sector Surveillance and the IMF (2009)

Gola Carlo*, Spadafora Francesco* (*IMF)

Abstract: The global financial crisis has magnified the role of Financial Sector Surveillance (FSS) in the Fund's activities. This paper surveys the various steps and initiatives through which the Fund has increasingly deepened its involvement in FSS. Overall, this process can be characterized by a preliminary stage and two main phases. The preliminary stage dates back to the 1980s and early 1990s, and was mainly related to the Fund's research and technical assistance activities within the process of monetary and financial deregulation embraced by several member countries. The first "official" phase of the Fund's involvement in FSS started in the aftermath of the Mexican crisis, and relates to the international call to include financial sector issues among the core areas of Fund surveillance. The second phase focuses on the objectives of bringing the coverage of financial sector issues "up to par" with the coverage of other traditional core areas of surveillance, and of integrating financial analysis into the Fund's analytical macroeconomic framework. By urging the Fund

to give greater attention to its member countries' financial systems, the international community's response to the global crisis may mark the beginning of a new phase of FSS.

Government Debt Impacts on Interest Rates as Well as Entrepreneurship; A Panel Data Analysis for Western Europe, Japan and the United States (1990 – 2006) (2009)

Georgiou Miltiades N. (University of Thessaly)

Abstract: The contribution of the present paper is twofold. First, it will be pointed out that government debt has a positive effect on interest rates. Second, it will be shown that interest rates have a negative impact on entrepreneurship. In short, it will be concluded that government deficit (through the interest rate increase) is an obstacle to entrepreneurial activities, that in turn hinders economic growth. Panel data analysis will be used for the period 1990 – 2006 and data will be elaborated through the Eviews software package.

The Economic Consequences of Mandatory IFRS Adoption for Debt Financing (2009)

Kosi Urska*, Florou Annita* (*University of Macedonia)

Abstract: This paper examines whether the mandated introduction of International Financial Reporting Standards (IFRS) affects the source and cost of corporate debt. Using a global sample of public and private debt issues completed during 2000-2007 we find that mandatory IFRS adopters are more likely to issue public bonds than to borrow privately. Moreover, we find that mandatory IFRS adopters pay lower bond yield spreads; in contrast, we find no significant effect on the cost of private loans. Taken together, we document that mandatory IFRS adopters are more likely to raise debt from a larger pool of capital at a lower cost. These findings are consistent with IFRS enhancing the quality and comparability of accounting information. Our findings also suggest that mandatory IFRS adoption is beneficial primarily for bond investors, who rely much more on financial statements and have much less monitoring and renegotiating privileges compared to private lenders. Finally, we show that the positive consequences of IFRS for debt financing are present only in countries with stricter rule enforcement, higher control of corruption and lower financial risk. Overall, our study is the first to document that mandatory financial reporting under IFRS has beneficial

effects for debt markets and in particular the public debt market but only when the country institutions are strong.

Is There Any Contagion in Emerging Debt Markets? (2009)

Ismailescu Iuliana (Lubin School of Business), Kazemi Hossein B. (University of Massachusetts)

Abstract: This paper tests for contagion in emerging debt markets following Russia and Argentina's government defaults. Using techniques that have been previously suggested for contagion tests in stock markets we find that debt and stock markets respond differently to financial crises. Volatilities and correlations do not increase significantly during default episodes and no evidence supporting spillover effects is found. However, we find evidence of contagion in extreme returns during both crisis periods as well as in the entire sample period. We conclude that contagion in emerging bond markets is more likely driven by their high linkages than by crisis episodes.

The Role of Covenants in Public and Private Debt (2009)

Bazzana Flavio (University of Trento), Broccardo Eleonora (University of Trento)

Abstract: Covenants are particular clauses in debt contracts of firms that restrict business policy, giving creditors the possibility of putting precise actions into force - normally early repayment - when the covenants are violated. We refer to the Agency Theory of Covenant (ATC), which assumes that as long as the offsetting benefits exceeds the costs of the constraints imposed by the covenants, the lender will include covenants in their debt contracts. The goal of this paper is to provide a theoretical model that explains the empirical findings of research on public (bonds) and private (bank loans) debt, by highlighting the role of coordination costs among debtholders. Our study introduces two innovative aspects to the existing literature: (1) an emphasis on the covenant violation costs, and (2) the formalisation of a market equilibrium approach. In particular, we formalise the renegotiation costs of the lender, and we identify the effect of the degree of coordination on the renegotiation costs and, ultimately, on the efficiencies in the use of covenants. With regard to, the second point, as far as we know, our paper is the first to present an equilibrium market model for two types of debt contracts with covenant. For the first type, we consider a firm issuing a bond with covenant in the primary market, whereas in the second the firm borrows a syndicated bank loan with covenant. In both models we (1) find that

there is a minimum coordination level which guarantees the covenant efficiency, and we (2) identify the optimal covenant threshold.

Risk Involved in International Debt Investment in Emerging Markets (2009)

Suleman Muhammad Tahir

Abstract: The purpose of this research paper is to find how much risk is involved in investing emerging market debt. Emerging markets are becoming a hub for foreign investors either that is an equity or debt investment. The risk is the important element for investors. As for emerging markets the most important risk that investor can face is exchange rate and political risk. I used Augmented Dickey-Fuller to carry out unit roots and johansen cointegration analysis of exchange rates and political risk in emerging markets. My result shows that individual variables are integrated order one, means unit root exist. This shows that political risk tends to follow a random walk. My finding suggests that there is a long run relationship between political risk and exchange rate. As the political risk increase exchange rate also fluctuate with relation to political situation.

The Effect of Institutions, Geography, Development Assistance and Debt Crises on Public Debt Management (2009)

Melecky Martin (World Bank)

Abstract: Using survey data on debt management strategies, this paper studies whether the probability that a country has a debt management strategy, publishes its debt strategy, and uses a benchmark-based strategy is affected by democratic accountability, institutional quality, past debt crises/defaults, IFIs development assistance, and participation in debt management programs. We find that countries located in Latin America and Caribbean are less likely to have developed a debt management strategy and, if they have, they are less likely to publish it. In contrast, countries located in Middle East and North Africa is less likely to use quantitative benchmarks in formulation of their debt management strategy. A country is more likely to have developed a debt management strategy if it has an experience of a past debt crisis, but not of repeated debt crises. Institutional quality and democratic accountability could significantly contribute to emergence of more transparent and accountable debt management strategies in developing countries. IFIs' technical assistance on public debt management could be enhanced

by IFIs conducting their own, prior diagnostic reviews.

Default Risk Premia on Government Bonds in a Quantitative Macroeconomic Model (2009)

Juessen Falko*, Linnemann Ludger*, Schabert Andreas* (University of Dortmund)

Abstract: This paper examines the pricing of public debt in a quantitative macroeconomic model with government default risk. Default may occur due to a fiscal policy that does not preclude a Ponzi game. When a build-up of public debt makes this outcome inevitable, households stop lending such that the government has to default. Interest rates on government bonds reflect expectations of this event. There may exist multiple bond prices compatible with a rational expectations equilibrium. We analyze the conditions under which expected default risk premia can quantitatively rationalize sizeable spreads on public bonds. Sovereign default risk premia turn out to emerge at either very high debt to output ratios, or if the variance of productivity shocks is large.

Debt Maturity, Credit Risk and Information Asymmetry: the Case of Municipal Bonds (2009)

Daniels Kenneth N.*, Ejara Demissew Diro (University of New Haven), Vijayakumar Jayaraman* (*Virginia Commonwealth University)

Abstract: Using a system of equations approach, this paper empirically tests the impact of credit quality, asset maturity, and other issuer and issue characteristics on the maturity of municipal bonds. The authors find that under conditions of lower information asymmetry that prevails in the municipal sector, higher-rated bonds have longer maturities than low-rated bonds. This result differs from that observed in the corporate sector. Overall, our results support the asset maturity hypothesis. In addition, our analysis finds that fundamentals matter. Issue features that provide additional protection or convenience to the investor tend to increase debt maturity.

Fiscal Variables and Bond Spreads: Evidence from Eastern European Countries and Turkey (2009)

Nickel Christiane, Rother Philipp, Ruelke Jan C.

Abstract: The authors investigate the impact of fiscal variables on bond yield spreads relative to

US Treasury bonds in the Czech Republic, Hungary, Poland, Russia and Turkey from May 1998 to December 2007. To account for the importance of market expectations the authors use projected values for fiscal and macroeconomic variables generated from Consensus Economics Forecasts. Moreover, we compare results from panel regressions with those from country (seemingly unrelated regression) estimates, and conduct analogous regressions for a control group of Latin American countries. The authors find that the role of the individual explanatory variables, including the importance of fiscal variables, varies across countries.

The Behavior of Emerging Market Sovereigns' Credit Default Swap Premiums and Bond Yield Spreads (2009)

Adler Michael (Columbia University Business School), Song Jeong (Morgan Stanley)

Abstract: The authors test whether credit risk for Emerging Market Sovereigns is priced equally in the credit default swap (CDS) and bond markets. The parity relationship between CDS premiums and bond yield spreads, that was tested and largely confirmed in the literature, is mostly rejected. Prices below par can result in positive basis, i.e. CDS premiums that are greater than bond yield spreads and vice versa. To adjust for the non-par price, we construct the bond yield spreads implied by the term structure of CDS premiums for various maturities. The authors are able to restore the parity relation and confirm the equivalence of credit risk pricing in the CDS and bond markets for many countries that have bonds with non-par prices and time varying credit quality. The authors detect non-parity even after the adjustment mainly in countries in Latin America, where the bases are larger than the bid-ask spreads in the market. The authors also find that the repo rates of bonds decrease around episodes of credit quality deterioration, which helps the basis remain positive.

Domestic Debt Structures in Emerging Markets: New Empirical Evidence (2008)

Mehl Arnaud*, Reynaud Julien* (*ECB)

Abstract: This paper explains why public domestic debt composition in emerging economies can be risky, namely in foreign currency, with a short maturity or indexed. It analyses empirically the determinants of these risk sources separately, developing a new large dataset compiled from national sources for 33 emerging economies over 1994-2006. The paper

finds that economic size, the breadth of the domestic investor base, inflation and fiscal soundness are all associated with risky public domestic debt compositions, yet to an extent that varies considerably in terms of magnitude and significance across sources of risk. Only inflation impacts all types of risky debt, underscoring the overarching importance of monetary credibility to make domestic debt compositions in emerging economies safer. Given local bond markets' rapid development, monitoring risky public domestic debt compositions in emerging economies becomes increasingly relevant to global financial stability.

OTHER WEB RESOURCES

Kenya's Bond Platform to Reduce 'Liquidity Premium' on Yields (2009)

Bloomberg.com - November 19th 2009

Japan's Bonds Fall as Supply Concern Outweighs Deflation Signs (2009)

Bloomberg.com

Getting it together at last (2009)

The Economist - November 12th 2009

Survival of the quickest (2009)

The Economist - November 12th 2009

Public debt totals Bt4 billion at end-September (2009)

The Nation - November 12th 2009

Tomorrow's burden - America's debt crisis will be chronic, not acute (2009)

The Economist - October 22nd 2009

Egypt Response to the Global Crises (2009)

Egyptian Ministry of Finance

Municipal Bond Credit Report 2009 Q3 (2009)

SIFMA

On Monetary and Financial Stability—Past, Present and Future (2009)

IMF

The 2009 Crisis and the Developing Countries (2009)

Oxford Policy Management

Not so fast (2009)

The Economist - November 13th 2009

The Estonian exception (2009)
The Economist - October 29th 2009

Dredging the debt (2009)
The Economist - October 29th 2009

Looking for a way out (2009)
The Economist - November 13th 2009

Down in the dumps (2009)
The Economist - November 5th 2009

NETWORK NEWS

BMI views: Vietnam: SBV raise rates to 12% in 2010
Business Monitor International

Poland: The Public Finance Sector Debt Management Strategy in the years 2010-2012

Polish Ministry of Finance

IMF chief says global economy in holding pattern

LSE - Finance & Stock Market News

The Public Finances, borrowing requirement and debt, No. 60 – 2009

The Bank of Italy

Managing Debt Newsletter - 01 October 2009

The Crown Agents

MPDD News - September 2009

United Nations Economic and Social Commission for Asia and the Pacific - Macroeconomic Policy and Development Division

Annual Reports & Guidelines: please go to the "Information Corner" on www.publicdebt.net.org

Events, Courses

UPCOMING

NEW

25 November 2009 - 26 November 2009; OECD Conference Centre - Paris
19th OECD Global Forum on Public Debt Management

26 November 2009 - 27 November 2009; OECD Conference Centre - Paris
4th OECD Forum on African Public Debt Management

10 December 2009 - 11 December 2009; Renaissance Moscow Hotel, Moscow
V International Conference "Russian Financial Market 2009-2010: REPO & Securities Lending"

10 December 2009 - La Maison de l'Amérique Latine, 217 Boulevard Saint Germain, Paris
Les Premières Rencontres des Professionnels des Marchés de la Dette et du Change

15 February 2010 - 17 February 2010; Ljubljana, Slovenia
Course: Financial Stability Reports

22 March 2010 - 26 March 2010; Ljubljana, Slovenia
Course: Central Banking - Instruments and Goals

26 May 2010 - 28 May 2010; Ljubljana, Slovenia
Course: Integration of Cash and Debt Management

7 September 2010 - 22 October 2010; Online
Debt Rescheduling with the Paris Club (UNITAR / PFT Online Course)

PREVIOUSLY SIGNALLED

2 December 2009 - 4 December 2009; Rome
XVIII International Tor Vergata Conference on Money, Banking, and Finance

14 December 2009 - 18 December 2009; Joint Vienna Institute
Workshop on Debt Management Performance Assessment Tool and Debt Sustainability Framework

17 December 2009 - 17 December 2009; Pôle Universitaire Léonard de Vinci PARIS LA DEFENSE (France)

4th International EIF Job Market in Finance and Accounting

8 February 2010 - 18 March 2010; Online
Course-Advance Risk Management (UNITAR / PFT Online Course)

24 March 2010 - 26 March 2010; Montego Bay, Jamaica
Caribbean Bank Insolvency Conference

3 May 2010 - 17 June 2010; Online
Course-'Millennium Development Goals And Debt Management' (UNITAR / PFT Online Course)

Communication Corner

LAUNCH OF THE NEW WEBSITE!

The PDM Network Secretariat is pleased to announce you that by the end of this month the newly-redesigned website www.publicdebt.net will be on-line, with an overall public and private area enhancement which allows users easier access to any information or document, in particular to the new Forum Area.

e-LEARNING COURSE MATERIALS

The PDM network website hosts material from e-learning course "Audit of Public Debt" organized by UNITAR thanks to Enrique Cosio-Pascal contribution. This course is downloadable from the learning area in the "Information corner", Section "Learning Area" and is oriented toward those auditors that would be participating to internal or external audit of public debt management.

In the Learning Area you can find Henry Stewart Talks: on-line seminars on Government Debt Management: Fundamentals, practical issues and recent developments.

E-MAIL NOTIFICATION SERVICE FOR PARTNERS

We are glad to remind that a **notification service** is provided on the Network website for Partners. By this service, they will receive an e-mail when a new document or event is uploaded onto the website in the category of their choice (i.e. primary market, secondary market, or other categories or macro-categories). **To activate the service** Partners should access in the private area of the website and choose the "GO" button in the "Mailing List" box. They can click on the categories they are interested in and, after clicking again on "subscribe" they will receive an email whenever a new document is uploaded in the preferred category. For any assistance contact the PDM Secretariat at Publicdebt.net.dt@tesoro.it

Participating Institutions in PDM Network

OECD: Australian OFM, Austrian DMA, Belgian DMA, Belgian Central Bank, Canadian Foreign Affairs and International Trade, Czech Central Bank, Czech MoF, Danish DMO, Danish Central Bank, Dutch Central Bank, Dutch DMA, Dutch MoF, Finnish Treasury, Finnish MoF, French Central Bank, French DMA, French MoF, German Central Bank, German MoF, German FA, Greek DMA, Greek MoF, Greek Central Bank, Hungarian DMA, Hungarian MoF, Icelandic DMA, Irish NTMA, Irish MoF, Italian Central Bank, Italian MoF, Japanese MoF, Japanese Central Bank, Luxembourg MoF, Mexican MoF, New Zealander DMO, Norwegian MoF, Polish MoF, Polish Central Bank, Portuguese Central Bank, Portuguese DMA, Slovak MoF, Slovak DMA, Spanish Central Bank, Spanish MoF, Swedish DMO, Swedish MoF, Swiss State Secretary for Economic Affairs SECO, Turkish Treasury, US GAO, UK Central Bank, UK DMO, UK Treasury.

Non OECD: Albanian MoF, Angolan National Bank, Brazilian MoF, Brazilian Central Bank, Bulgarian MoF, Chilean Central Bank, Chinese MoF, Colombian MHCP, Cyprian Central Bank, Cyprian MoF, Dubai DMO, Dubai Government, Egyptian MoF, Estonian MoF, Ethiopian MoF, Ghanaian Central Bank, Ghanaian MoF, Hong Kong Monetary Auth., Indian Reserve Bank, Indian NIPF, Israeli MoF, Israeli Central Bank, Kenyan MoF, Latvian DMO, Lebanese MoF, Lesotho MoF, Lithuanian MoF, Macedonian MoF, Malawian Reserve Bank, Maltese Treasury, Maltese Central Bank, Moldovan MoF, Moroccan MoF, Nigerian DMO, Pakistani MoF, Papua New Guinean Treasury, Romanian MoF, Romanian Central Bank, Rwandan MoF, Singaporean MoF, Slovenian MoF, Solomon Islands MoF, South African National Treasury, Sri Lanka Central Bank, Thai MoF, Ugandan Central Bank, Uruguayan MoF.

Multilateral Institutions: OECD, European Commission, ADB, African Development Bank Group, Asian Development Bank Institute, Commonwealth Secretariat, Debt Relief International, European Central Bank, European Bank EBRD, Inter-American Development Bank, IFC, International Monetary Fund, MEFMI, WAIFEM, World Bank, UNCTAD.

Universities: Columbia University, George Washington University, Harvard University, London Business School, Stanford University, University of Bologna, University of Brussels, University of Cambridge, University of California, University of Milan, University of Molise, University of Padua, University of Rome "La Sapienza", CRIEP (Italy), University of Rome "Tor Vergata".

Others : Barclays Capital, Center of Excellence in Finance, Centre for Planning and Economic Research, Devfin Advisers AB, Finance for Development-FMO, ICMA, ISEDA, KFW Bankengruppe, Japan Bank for International Cooperation, Mckinsey & Company, Inc. International, Michele Robinson Consult, Oxford Policy Management, Pragma Corporation, Public Debt Finance, Reykjavik Academy, Sifma-Epda, Storkey & Co. Ltd.

Some Figures...

On 2nd December 2009, the number of documents of the PDM Network website is 860. The number of total users is 389. Among them, Partners are 300, of which 143 are sovereign debt managers coming from emerging and advanced countries