PDM NETWORK Newsletter

Number 2/ March - April 2022
ISSN 2239-2033

This bimonthly newsletter lists all papers, reports, courses and other events about public debt management recently uploaded by the PDM Network Secretariat on the website www.publicdebtnet.org. The documents considered as most interesting by the PDM Network Secretariat are highlighted with a light grey background. The PDM Network bimonthly Newsletter is published on January, March, May, July, September and November. The PDM Network Secretariat welcomes cooperation on information published on the website. Thus, please feel free to suggest any documents, news and events relevant to public debt management issues by contacting the Secretariat at the following email: publicdebtnet.dt@mef.gov.it.

Contents

Highlight............................................. 1
Special Focus ....................................... 2
Documents............................................. 2
Reports............................................... 15
News................................................... 16

Events and Courses ......................... 16
PDM Network in Figures ............... 19
Special Thanks ................................. 19
Our Subscribers................................. 19

Highlight

Italian Treasury, OECD, World Bank Public Debt Management Network
The Public Debt Management Network is pleased to announce that the 2nd Public Debt Management Conference will be held in Rome, Italy, on May 26-27, 2022. This year’s conference will address specific challenges related to assessing debt sustainability in the post-COVID environment, demand for government securities in the long term and debt management (re)actions during crisis times. During the two days, presentations of papers selected by the conference’s organizing committee on topics relevant to the debt management community will be followed by audience discussions.

Click the links below for more info:

>> PDM Network
>> Emerging Markets Weekly Newsletter
>> Bimonthly Newsletter
Special Focus

OECD Sovereign Borrowing Outlook 2022

OECD

This edition of the OECD Sovereign Borrowing Outlook reviews the impact of the COVID-19 crisis for sovereign borrowing needs, funding conditions and funding strategies as well as outstanding debt for 2020 and 2021, and provides projections for 2022 for the OECD area. It discusses public debt management efforts to support government Environmental, Social and Governance (ESG) agendas through investor relations and ESG-labelled sovereign bonds, and identifies strategic challenges and key elements of good practices in light of country experiences.

Documents

Debt Policy

The Legal Profile of Russian Eurobonds: Engineered against Speed (2022)
Juan P. Farah Yacoub - World Bank

This paper provides an overview of the Russian Federation’s default history, the legal characteristics of the bonds, and potential issues for litigation should a default materialize. The paper’s main argument is that although it is not impenetrable, this Eurobond stock is more protective of the debtor than that of the usual emerging market country. It achieves this through preservation of all the defenses available under current law and the presence of broad language in key provisions. For instance, clauses providing for payment in a different currency if “reasons beyond its control” stop the debt or from paying in the denomination currency have drawn attention. The paper analyzes this and other characteristics, providing initial assessments on how the issues could play out. While the bonds’ characteristics could slow progress toward obtaining judgments when compared to other sovereign debts, they do not prevent them. Collecting on the judgments would be, as usual, the harder part. Ultimately, litigation over these debts could last along time; other creditor versus foreign sovereign episodes involving less debtor-friendly instruments have lasted 15 years, and resolution and recovery would be highly contingent on political factors. Finally, the paper provides non-lawyers a general roadmap of debt litigation against foreign sovereigns in the United States and the United Kingdom.

How to Attract Non-Resident Investors to Local Currency Bonds: The Cases of Ukraine, Panama, Colombia, and Brazil (2021)
Antonio Velandia, Leandro Secunho - World Bank

Driven by abundant liquidity and searching for better returns, many foreign investors became
well acquainted with bonds denominated in the local currencies of emerging market countries. As documented by the country cases in this paper, Debt Management Offices (DMOs) in these countries happily embraced access to a "new" funding source and a more diverse investor base. The note explores how countries attracted foreign investors for local currency financing. DMOs have used several avenues to sell local currency securities to non-resident investors: from issuing Credit Linked Notes, or, Global Bonds offshore; to facilitating non-resident access to the domestic local currency bond market either by building a bridge with an International Clearing Securities Depository (ICSD), or, by fully integrating them through their participation in the local CSD. Countries, including Chile, Peru and Ukraine, frequently used Credit Linked Notes (CLNs) in the initial stages of local currency domestic bond market development. Others, such as Brazil and Colombia at times and Uruguay more frequently, relied on local currency Global Bonds. These securities save non-residents from the uncertainty of the local jurisdiction and the hurdles of the local clearing and settlement for which investors are willing to accept lower yields than the ones paid by domestic government securities. Neither of these avenues bring non-resident investors directly to the domestic bond market which is desirable if the DMO wants to reap the benefits of a more liquid and transparent market and potentially lower government’s borrowing costs. The participation of non-residents in the domestic bond market would require building a bridge with an ICSD, or, relying on the local CSD. The bridge has been the solution in countries where custody and settlement processes pose unsurmountable obstacles for non-residents to jump into the domestic debt market; successful experiences of this avenue include countries like Mexico, Chile and Peru. The alternate avenue is to develop a local infrastructure robust enough so that non-residents do not miss the ICSD; this has been the path chosen by Colombia and Brazil. No alternative has emerged as a superior solution and each arrangement must be assessed under the context of the particular country. TAGS: Debt Policy; Debt composition; Sovereign debt market; Foreign Debt; World Bank

Cost and Risk

The impacts of disaster risk on sovereign asset and liability management (2022) World Bank

Implicit contingent liabilities, such as those generated by natural disasters, are often not quantified in the government balance sheet. However, when they materialize, they place pressure on government finances that may raise interest expenditures and financial risks. Understanding the impacts of disaster risk on sovereign assets and liabilities plays a key part in understanding the potential impact of sovereign disaster risk finance strategies which allow governments to reduce the costs and risks of disasters using prearranged financing and insurance methods. Applying the Sovereign Asset and Liability Management (SALM) framework is a new and comprehensive way of looking at the potential impact of a disaster on the public sector balance sheet through assets and liabilities. This paper introduces a framework that identifies three channels through which natural disaster will impact SALM. This framework is applied in three case studies, Peru, Serbia and New Zealand to derive lessons about the potential impact of natural disasters on the sovereign balance sheet and highlight the importance of accounting for disaster impacts across public sector balance sheets. The application of SALM can increase countries’ resilience to financial shocks posed by disaster risk through improved understanding of the impacts of disaster risk on both sides of the sovereign balance sheet. Going forward it could even be used to define a country’s risk tolerance to disaster risk,
monitor changes in this position and help to inform policy design on disaster risk and where needed support the introduction of financial instruments to manage disaster risk. **TAGS:** Cost and Risk; Sovereign ALM; Contingent Liabilities; Financial stability; World Bank

---

**Leverage of Local State-Owned Enterprises, implicit Contingent Liabilities of Government and Economic Growth (2022)**

Yixuan Duan, Min Guo, Yixuan Huang - China University of Petroleum, University of International Business and Economics, Chinese Academy of Fiscal Sciences

Local state-owned enterprises (SOEs) working together with local governments can promote economic growth. However, an increase in the implicit contingent liabilities of local governments due to implicit guarantees given to SOEs has a negative effect on economic growth. The classical socialist theories and the economic stability in each financial crisis of China show that the macroeconomic efficiency of SOEs is more important than the microeconomic efficiency, and microeconomic efficiency in neoclassical economic theory cannot reflect the nature of SOEs. It is of great practical and theoretical significance to make a more comprehensive and accurate judgment on the efficiency of SOEs. This paper constructs an index of local governments’ implicit contingent liabilities in 31 provinces based on the 488 local SOEs to study the impact of implicit contingent liabilities, and the time period is the year 2007 to the year 2020. Our findings show that an increase in local SOEs’ assets suppresses economic fluctuations at the cost of increasing government’s implicit contingent debt and has a negative impact on economic growth. Unlike the fiscal influence path of explicit debt, implicit contingent debt restrains local economic growth through financial markets. The deleveraging of local SOEs and improving their efficiency can improve the overall efficiency of local funds and reduce the negative effect of local governments’ implicit contingent liabilities on economic growth. **TAGS:** Contingent Liabilities; Debt and recession; Subnational debt; Financial stability

---

**Primary Markets**

**Sovereign Cocos (2022)**

Juan Carlos Hatchondo, Leonardo Martinez, Kursat Onder, Francisco Roch - Western University, International Monetary Fund, Ghent University

The authors study a model of equilibrium sovereign default in which the government issues cocos (contingent convertible bonds) that stipulate a suspension of debt payments when the government faces liquidity shocks in the form of an increase of the bondholders' risk aversion. The authors find that in spite of reducing the frequency of defaults triggered by liquidity shocks, introducing cocos increases the overall default frequency. By mitigating concerns about liquidity, cocos make indebtedness and default risk more attractive for the government. In contrast, cocos that stipulate debt forgiveness when the government faces the shock, achieve larger welfare gains by reducing default risk. **TAGS:** Primary market; Sovereign defaults; Cost and Risk

---

**Subnational Debt**

**Subnational Regional Growth, Debt Thresholds and Sustainability (2022)**

Alfonso Mendoza-Velázquez, Heidi J. Smith, Diego Mendoza-Martínez - Universidad Popular Autónoma del Estado de Puebla, Universidad Iberoamericana Ciudad de México, Universidad de las Américas Puebla

This research employs Mexico’s state level data from 2001-2016 to examine the nexus between debt sustainability and regional economic growth. Following the ideas of
Reinhart and Rogoff 2010 and Ilzetzki, et al 2019, the research seeks to establish the threshold between debt and regional growth. There is a need to understand whether increasing debt exerts benign effects on regional GDP growth in centralized fiscal systems prevalent in emerging countries and whether these effects differ by type of financing. The study employs the dynamic panel approach by Arellano and Bond (1991) to control for different types of endogeneity and the Seo and Shin (2016) kink model to estimate debt thresholds. The results point to a weak but positive association between debt and GDP growth, which differs by type of debt. Subnational debt thresholds of local governments locate at 67% as a share of guaranteed resources—lower than those reported at the national level. Employing debt as a share of GDP the authors find a much lower debt threshold (3.25%) which is explained by the fiscal interrelations architecture of federal systems with high local government dependence on federal transfers and subject to soft budget problems. The study finds economic growth is more sensitive to commercial bank debt and capital market debt than other types of debt. **TAGS:** Subnational debt; Debt and growth; Debt sustainability

**Local Government Implicit Debt and the Pricing of LGFV Bonds (2022)**
Laura Xiaolei Liu, Yuanzhen Lyu, Fan Yu - Guanghua School of Management, UCLA Anderson School of Management, Claremont McKenna College

Chinese local governments have issued a large number of local government financing vehicle (LGFV) bonds since 1994 when the Budget Law was promulgated, where local governments were prohibited from raising debt on their own. Although LGFV bonds are implicitly backed by governments, there has been no consensus on which level of government is expected to bail out the issuer in the event of financial distress. Based on the public disclosures of bond-issuing firms, the authors create a proxy for total municipal implicit debt using the total outstanding interest-bearing debt of LGFVs under the jurisdiction of a local government, and further analyze the impact of this debt on a LGFV bond’s credit spread in both the primary and secondary markets. In this way, the authors can also identify the level of government that is considered as an implicit guarantor. The authors find that a LGFV bond’s credit spread is positively correlated with local governments’ implicit debt ratios and that their correlation changes with government policies and macroeconomic conditions. The Yunnan Highway default event focused investors’ attention on the implicit debt of municipal governments. After the later release of the State Council Directive No. 43, which governs local governments’ debt swap arrangements, provincial governments’ implicit debt ratios became another key pricing factor. These results suggest that investors’ views about which level of government is the implicit guarantor change over time. **TAGS:** Subnational debt; Contingent Liabilities; Debt sustainability

**Financial Analysis**

**Endogenous market development for government securities in lower-income economies (2021)**
Tadashi Endo - Nagoya University

Many lower-income economies have difficulty developing government securities markets (GSMs). A “Two-Dimensional Policy Framework for GSM Development” offers a solution to improve upon the twenty-year-old World Bank/IMF’s conventional policy framework. It differentiates GSMs by their development phases and presents endogenously phase-coherent policy sets. This research found that the endogenous variables explained 40% of trading volume growth in the early phase of India’s GSM development and that utilities played a...
dominant role in increasing trade volumes in the early-phase market. The framework is worth test-applying to GSM development in lower-income economies. TAGS: Financial Analysis; Bond market development; Sovereign debt market

Long-Term Debt Sustainability in Emerging Market Economies: A Counterfactual Analysis (2022)
Ugo Panizza - The Graduate Institute Geneva
The 2015 Addis Ababa Action Agenda recognized the need for policies aimed at maintaining long-term debt sustainability. This paper describes a set of commonly used definitions of debt sustainability and shows that none of them focuses on long-term debt sustainability. It then discusses concept and several practical and conceptual difficulties linked to assessing solvency in developing and emerging countries. Next, the paper asks whether countries default because they borrow too much, or because investors think that they will default and this expectation becomes self-fulfilling. To answer this question, the paper uses a sample of 17 emerging market countries over 1970-2020 to build counterfactual debt levels under the assumption that these countries had continuous access to the international capital market without paying any premium over US Treasuries. The exercise shows that most debt crises are not driven by solvency issues. TAGS: Financial Analysis; Debt sustainability; Sovereign defaults; Debt crisis

South Africa: The Financial Sector-Sovereign Nexus (2022)
Heiko Hesse, Ken Miyajima - International Monetary Fund
Globally, financial institutions have increased their holdings of domestic sovereign debt, tightening the linkage between the health of the financial system and the level of sovereign debt, or the “financial sector-sovereign nexus,” during the ongoing COVID-19 pandemic. In South Africa, the nexus is still relatively moderate, albeit rising, and the increased focus of the Prudential Authority on the associated risks provide reassurance. Options to mitigate such risks through the use of regulatory measures can be explored. However, absent the necessary fiscal consolidation and structural reforms, risks from the nexus to both the financial system and the sovereign will increase. TAGS: Financial Analysis; Financial stability; Structural policies; COVID-19

Wei Jiang, Thomas J. Sargent, Neng Wang, Jinqiang Yang - Hong Kong University of Science and Technology, New York University, Columbia University, Shanghai University of Finance and Economics
An optimal tax and government borrowing plan in a setting with tax distortions (Barro,1979) locally pin down the marginal cost of servicing government debt, called marginal p. An option to default determines the government's debt capacity and its optimal state-contingent risk management policies make its debt risk-free. Optimal debt-GDP ratio dynamics are driven not only by three widely discussed forces, 1.) a primary deficit, 2.) interest payments, and 3.) GDP growth, but also by 4.) hedging costs. Hedging fundamentally alters debt transition dynamics and equilibrium debt-capacity, which are at the center of the recent "r-g" and debt sustainability discussions. The authors calibrate our model and make comparative dynamic quantitative statements about the debt-GDP ratio transition dynamics, equilibrium debt capacity, and how long it will take the US to attain debt capacity. TAGS: Financial Analysis; Debt sustainability; Sovereign defaults; Debt and growth

PDM Network Bimonthly Newsletter
For information, contact the PDM Network Secretariat at: Publicdebnet.dt@mef.gov.it
Follow us on Twitter @pdmnet and on our website www.publicdebnet.org
**Sovereign Defaults and Debt Sustainability: The Debt Recovery Channel** (2022)
Diarra Ibrahima, Guillard Michel, Kempf, Hubert - Université Paris-Saclay, Ecole Normale Supérieure Paris-Saclay

This paper focuses on the debt recovery channel linking the dynamics of public debt to partial sovereign defaults. The authors build a simple model which incorporates sovereign default and a debt recovery rule. It depends on a parameter that allows for partial debt recovery. The authors show that the maximum debt-to-GDP ratio that a country can sustain without defaulting is increasing, nonlinear, and sensitive to the debt-recovery parameter. A higher debt recovery parameter increases the fiscal space but worsens the financial position of a borrowing country after a default episode. The authors show the empirical relevance of this channel for estimating country-specific fiscal spaces.

**TAGS:** Financial Analysis; Sovereign defaults; Debt sustainability

---

**Default or depreciate** (2021)
Yasin Kürsat, Önder Enes Sunel - Ghent University

The authors propose a theory of domestic and foreign currency debt and limited commitment to exchange-rate and debt repayment policies. Exchange-rate depreciation is costly, but reduces the real value of domestic-currency debt and helps smooth consumption without the full punishment of default. However, during a global liquidity shock, government debt balances endogenously tilt towards hard-currency as in the data, although issuing local-currency debt to foreigners is needed the most to transfer the currency risk. This is because foreign lenders become more risk averse to holding nominal sovereign debt during stress episodes. The authors show that a modest depreciation of currency following adverse shocks precludes a sovereign default by inflating away outstanding local-currency debt burdens in contrast to a counterfactual economy with fully dollarized sovereign debt. The quantitative application of our theory accounts for the business cycle properties and the currency composition of sovereign debt in Mexico.

**TAGS:** Financial Analysis; Sovereign defaults; Debt and fiscal/monetary policies; Financial stability; Cost and Risk; Debt sustainability

---

**Sovereign Credit Ratings analysis using the Logistic Regression Model** (2022)
Oliver Takawira, John W. Muteba Mwamba - University of Johannesburg, South Africa

This study is an empirical analysis of sovereign credit ratings (SCR) in South Africa (SA) using Logistic Regression (LR) to identify their determinants and forecast SCRs. Data of macroeconomic indicators including SCRs from 1999 to 2020 in quarterly format were classified and analyzed to identify indicators utilized by Credit Rating Agencies (CRAs) and then predict future ratings CRAs take various information from political, infrastructure, financial, economic, regional, local, and other factors pertaining to a country and assess the ability of that country to pay its debt. This information is then presented through a grading scale termed rating, with the highest rating country being highly creditworthy and lowest rating likely to default. There are three major CRAs, namely, Fitch, Moody’s and Standard and Poors. The study identified the use of different macroeconomic indicators by CRAs as well as different techniques in assessing and assigning sovereign credit ratings. The study points out that Household Debt to Disposable Income Ratio (HDDIR) was the most influential variable on SCRs. HDDIR, exchange rates and the inflation rate were the most crucial variables for guessing credit ratings. Policymakers should aim to reduce household debt in relation to disposable income, implement policies that strengthen the local currency and stabilize as well as...
lower inflation. Investors should watch out on nations that have high household debt levels as this may spill over into credit risk. **TAGS:** Sovereign Credit Ratings; Financial Analysis

### Debt Crisis

**Sovereign Credit and Geopolitical Risks During and After the EMU Crisis (2022)**

Theodore D. Bratis, Georgios P. Kouretas, Nikiforos Laopodis, Prodromos Vlamis - Athens University of Economics and Business, American College of Greece, University of Piraeus

This paper focuses on the sovereign crisis of the Euro debt crisis era, and the authors address the existence of the relationship of CDS and bond markets sovereign credit risk pricing for selected core and periphery EMU countries, during and after the 2009 EMU crisis. The authors study this relationship in conjunction to geopolitical risk as a measure of macroeconomic uncertainty. The authors use daily observations for several bond maturities and CDS premium with reference to the core (France and Germany) vs. periphery EMU countries (Portugal, Italy, Ireland Spain, and Greece) for the period 2009 to 2014. To measure global geopolitical risk, the authors employ the Caldara and Iacoviello (2018) global geopolitics index (GPR). Using alternative econometric approaches, the authors find adequate evidence of volatility spillovers between the geopolitical risk index and sovereign risk markets mainly during the crisis period (2009-2012) and weaker during the easing of the eurozone debt crisis period (2012-2014). Moreover, based on Granger causality the estimation of the short-term dynamics reveals a significant linkage during the post-crisis period rather than during crisis. **TAGS:** Debt crisis; Sovereign CDS; Secondary Markets

### Creating a Safe Asset without Debt Mutualization: The Opportunity of a European Debt Agency (2022)

Massimo Amato, Everardo Belloni, Carlo A. Favero, Lucio Gobbi - Bocconi University, Politecnico di Milano, University of Trento

This paper analyses the potential of a European Debt Agency (EDA) as an efficient debt management institution for the Euro area. The simulation of prices and quantities that would have been observed in a scenario with an operational EDA illustrates that there have been fluctuations in bond prices that EDA would have been able to prevent. Moreover, due to the less volatile price dynamics, EDA would have been capable to absorb the entire eurozone debt while reducing its size. This evidence speaks in favour of EDA as an institutional debt management tool for hedging Member States financing from market sentiment vagaries; creating a European Safe Asset; unburdening ECB from debt management and managing efficiently the implementation of fiscal rules. **TAGS:** Debt sustainability; Debt and fiscal/monetary policies

### Debt Restructuring

**On the benefits of repaying (2021)**

Francesca G. Caselli, Matilde Faralli, Paolo Manasse, Ugo Panizza - IMF, Imperial College, University of Bologna, Graduate Institute Geneva

This paper studies whether countries benefit from servicing their debts during times of widespread sovereign defaults. Colombia is typically regarded as the only large Latin American country that did not default in the 1980s. Using archival research and formal econometric estimates of Colombia's probability of default, the authors show that
in the early 1980s Colombia’s fundamentals were not significantly different from those of the Latin American countries that defaulted on their debts. The authors also document that the different path chosen by Colombia was due to the authorities’ belief that maintaining a good reputation in the international capital market would have substantial long-term payoffs. The authors show that the case of Colombia is more complex than what is commonly assumed. Although Colombia had to re-profile its debts, high-level political support from the US allowed Colombia to do so outside the standard framework of an IMF program. Our counterfactual analysis shows that in the short to medium run, Colombia benefitted from avoiding an explicit default. Specifically, the authors find that GDP growth in the 1980s was higher than that of a counterfactual in which Colombia behaved like its neighboring countries. The authors also test whether Colombia’s behavior in the 1980s led to long-term reputational benefits. Using an event study based on a large sudden stop, the authors find no evidence for such long-lasting reputational gains. TAGS: Debt Restructuring; Sovereign defaults; Multilateral financing

Macroeconomic Analysis

Public Debt and Real GDP: Revisiting the Impact (2022)
Constance de Soyres, Reina Kawai, Mengxue Wang - IMF, University of Washington
This paper provides new empirical evidence of the impact of an unanticipated change in public debt on real GDP. Using public debt forecast errors, the authors identify exogenous changes in public debt to assess the impact of a change in the debt to GDP ratio on real GDP. By analyzing data on gross public debt for 178 countries over 1995-2020, the authors find that the impact of an unanticipated increase in public debt on the real GDP level is generally negative and varies depending on other fundamental characteristics. Specifically, an unanticipated increase in the public debt to GDP ratio hurts real GDP level for countries that have (i) a high initial debt level or (ii) a rising debt trajectory over the five preceding years. On the contrary, an unanticipated increase in public debt boosts real GDP for countries that have (iii) a low-income level or (iv) completed the HIPC debt relief initiative. TAGS: Debt and growth; Debt Forecasts; Debt sustainability; Financial Analysis
Assessing Debt Stationarity and Sustainability in the Longer Run with Fourier DF Unit Root Tests and Time-Varying Fiscal Reaction Functions (2022)
Jamel Saadaoui, Chi Keung Marco Lau, Yifei Cai - University of Strasbourg, Chi Keung Marco Lau, The University of Western Australia

Thanks to various Fourier DF unit root tests, time-varying fiscal reaction functions and threshold regressions, this study examines the stationarity and the sustainability of public finance for six industrial countries over the period spanning from 1870 to 2017. Longer-run debt sustainability is not rejected for the UK, Sweden, and for the US. The evidence is more mixed for Canada, Italy and Portugal.

TAGS: Debt sustainability; Debt and growth

Calamities, Debt, and Growth in Developing Countries (2022)
Rachel Yuting Fan, Daniel Lederman, Ha Nguyen, Claudio J. Rojas - World Bank

Public debt in developing economies rose at a fast clip during 2020–21, at least partly due to the onset of the global Covid-19 pandemic. Nobel laureate Paul Krugman opined in early 2021 that “fighting covid is like fighting a war.” This paper argues that the Covid-19 pandemic shares many traits with natural disasters, except for the global nature of the pandemic shock. This paper empirically examines trends in debt and economic growth around the onset of three types of calamities, namely natural disasters, armed conflicts, and external-debt distress in developing countries. The estimations provide quantitative estimates of differences in growth and debt trends in economies suffering episodes of calamities relative to the trends observed in economies not experiencing calamities. The paper finds that debt and growth evolve quite differently depending on the type of calamity. The evidence indicates that public debt and output growth tend to rise faster after natural disasters than in the counterfactual scenario without disasters, thus illustrating how debt-financed fiscal expansions can help economic reconstruction. The findings are different for episodes of debt distress defined as periods of debt restructuring, however. Economies experiencing debt distress are associated with growth trends that are on average below the growth rates of unaffected economies prior to and after the beginning of an episode of debt restructuring.

TAGS: Debt and fiscal/monetary policies; COVID-19

Economic Policies

Sovereign Defaults in a World of Climatic Disasters (2022)
Ibrahima Diarra - Université Paris-Saclay

This paper analyzes the implications of a gradual increase in the frequency of climatic disasters for public debt sustainability and sovereign default risk. I develop a simple stochastic model of sovereign default that allows for time-varying probability of climatic disasters. I show that the default ratio—the maximum debt-to-GDP ratio that a country can sustain without defaulting—is decreasing and highly nonlinear in the probability of disaster. The model emphasizes the crucial role of the perception of disaster risk, independently from the realizations of disasters. Different perceptions of disaster risk may have very different implications for sovereign default risk. A perception of disaster risk based on a constant disaster probability leads to a constant default ratio. On the other hand, a naive perception of disaster risk—creditors revising the disaster probability in each period while disregarding any future changes—leads to a time dependent default ratio, but it relatively underestimates default risk compared to a fully forward looking perception of disaster risk.

TAGS: Financial Analysis; Debt sustainability; Sovereign defaults
Post-COVID fiscal rules: a central bank perspective (2022)
Sebastian Hauptmeier, Nadine Leiner-Killinger, Philip Muggenthaler, Stephan Haroutunian - European Central Bank

Regarding a prospective reform of the European Stability and Growth Pact (SGP) it seems rather consensual that a simplified framework should take account of the prevailing macroeconomic context and enhance the balancing of sustainability and stabilisation considerations. This paper provides simulation analysis for the euro area and individual countries with a view to assessing the short- and longer-term budgetary and macroeconomic implications of a move to a two-tier system with an expenditure growth rule as single operational indicator linked to a debt anchor. Compared to the status quo, our analysis suggests that expenditure growth targets which take account of the ECB’s symmetric 2% inflation target can improve the cyclical properties of the framework. In particular, providing additional fiscal accommodation in a low inflation environment would enable monetary policy to operate more effectively, especially in the vicinity of the effective lower bound, thereby improving the synchronisation of fiscal and monetary policies. The link to a longer-term debt anchor at the same time ensures a transition towards the Treaty’s debt reference level. TAGS: Debt and fiscal/monetary policies; Debt sustainability

On the Relationship Between Interest Rate Policy & Debt Sustainability (2022)
Yuta Takahashi, Naoki Takayama - Hitotsubashi University

A situation where interest rates are lower than the economic growth rate, r < g, has begun to emerge in many developed countries, as in Japan. Recent studies and policymakers have begun to consider the possibility that this r < g economic phenomenon may make it unnecessary for governments to maintain fiscal discipline. The authors re-examine various monetary policies by a central bank including negative interest rate policy in the context of the fiscal sustainability. The authors identify a situation where the BOJ’s bond purchasing policy can be justified: the policy lowers nominal interest rate and even make it possibly negative and ease the fiscal burden. The authors also confirm that the conventional concern is applied: the BOJ is forced to help the fiscal authority, resulting in a huge inflation. The

A Balance-Sheet Model of Fiscal Policy in Namibia (2022)
Federico Sturzenegger, Nicolás Der Meguerditchian - Universidad de San Andrés

The issue of debt sustainability has been the focus of continued theoretical and practical interest over the years. In emerging markets, much of the debate has focused on explicit government liabilities, which, while relevant, only represents a small share of government’s liabilities. In contrast the balance-sheet approach estimates all government assets (the most important being the net present value of taxes) and liabilities (the most important being the net present value of expenditures) to compute the government’s net worth. In this paper the authors apply this methodology to study fiscal sustainability in Namibia. The authors find that, currently, the Namibian government’s net worth is tilted sharply to the left. The authors simulate the impact of two types of shocks, a depreciation of the real exchange rate and an additional GDP growth and find that both produce a further deterioration of the government's balance sheet. Finally, the authors ask about what type of policies would allow the government to recover the fiscal sustainability and show that, for example, a partial freeze in public salaries allows to recover fiscal sustainability very quickly. TAGS: Debt and fiscal/monetary policies; Debt sustainability
authors proceed by exploring these theoretical possibilities empirically. In particular, the authors thoroughly examine a recent study by Mian et al. (2022) which argues that Japan can significantly expand its fiscal stimulus without increasing taxes. The authors find that their results sensitively depend on their choices of various parameters. So, their policy recommendation needs to be taken with a grain of salt. **TAGS: Debt and fiscal/monetary policies; Debt sustainability**

**Monetary Policy Transmission and Policy Coordination in China** (2022)  
Sonali Das, Wenting Song - International Monetary Fund, Bank of Canada  
The authors study the transmission of conventional monetary policy in China, focusing on the interaction between monetary and fiscal policy given the unique institutional set-up for macroeconomic policy making. Our results suggest some progress but also continued difficulties in the transmission of monetary policy. Similar to recent studies, the authors find evidence of monetary policy pass-through to interest rates. However, the impact of monetary policy measures that are not coordinated with fiscal policy is significantly weaker than that of coordinated measures. This suggests the need for further improvements to the interest-rate based framework. **TAGS: Debt and fiscal/monetary policies; Sovereign bonds yields**

**Fiscal support and monetary vigilance: Economic policy implications of the Russia-Ukraine war for the European Union** (2022)  
Olivier J. Blanchard, Jean Pisani-Ferry - Peterson Institute for International Economics  
Nobody can predict with much confidence how the war in Ukraine will evolve and what its geopolitical consequences will be over the next few months, let alone the next few years. Nevertheless, policymakers must think about the implications of the war and the appropriate responses, realizing that they will need to be adapted as circumstances evolve. Moreover, they must think coherently about the joint implications of their actions, from sanctions on Russia to subsidies and transfers to their own citizens and avoid taking measures that contradict each other. This is what the authors try to do in this Policy Brief, focusing on the macroeconomic aspects of relevance for Europe. **TAGS: Debt and fiscal/monetary policies; Debt sustainability**

**Measuring U.S. Fiscal Capacity using Discounted Cash Flow Analysis** (2022)  
Zhengyang Jiang, Hanno N. Lustig, Stijn Van Nieuwerburgh, Mindy Z. Xiaolan - Kellogg School of Management, Stanford Graduate School of Business, Stanford Graduate School of Business, University of Texas  
The authors use discounted cash flow analysis to measure a country's fiscal capacity. Crucially, the discount rate applied to projected cash flows includes a GDP risk premium. The authors apply our valuation method to the CBO's projections for the U.S. federal government's deficit between 2022 and 2051 and debt in 2051. In spite of low rates, our current measure of U.S. fiscal capacity is lower than the debt/GDP ratio. Because of the backloading of projected surpluses, the duration of the surplus claim far exceeds the duration of the outstanding Treasury portfolio. This duration mismatch exposes the government to the risk of rising rates, which would trigger the need for higher tax revenue or lower spending. Reducing this risk by front-loading the surpluses also requires major fiscal adjustment. **TAGS: Debt and fiscal/monetary policies; Debt sustainability; Sovereign bonds yields; Cost and Risk**
On the Sustainability of Fiscal Policy in Sierra Leone (2022)
Samuel Bonzu - Sierra Leone Mof
The aim of this paper is to empirically investigates whether Sierra Leone fiscal policy is sustainable. In this regard, I employ different econometric methodologies used in the empirical literature to investigates the sustainability of fiscal policy. The empirical findings that emerged from this study are useful on one hand to creditors, serving as a guide for lending to the government, and, on the other hand to the government, cautioning policymakers to avoid public debt from exploding that could possibly lead to fiscal insolvency and/or debt distress. I start by testing for the stationarity properties of the primary balance, the necessary condition for a sustainable fiscal policy. The findings indicated that Sierra Leone fiscal policy is sustainable under the review period. Next, I test for cointegration relationship between government revenue and government expenditure, the alternative approach to test for a sustainable fiscal policy. On this note, I employ both the Dynamic Ordinary Least Square (DOLS) and the Johansen cointegration techniques. Both approaches confirmed the existence of a cointegration relationship between government revenue and government expenditure. The estimated cointegration coefficients show that fiscal policy during the review period is weakly sustainable and the cointegration between government spending and revenue is positive (but less than one) and statistically significant. This implies that for each percentage point of GDP increase in government expenditure, government revenues increase by less than one percentage point of GDP. Additionally, I proceeded to endogenously account for structural breaks in the cointegration relationship, which is relevant for Sierra Leone, a country that has witnessed significant changes over the years, including the Structural Adjustments Programme (SAP) in the 1980s, tax reforms in the 1990s and 2000s, etc. I found evidence of a significant structural break occurring in 1984. There also exists uni-directional causality running from government revenue to government expenditure. This causality result is in line with the tax-and-spend hypothesis as proposed by Friedman (1978). Finally, I estimate an error correction model and the error correction term shows that the speed of adjustment from the expenditure side works faster than that of the revenue side to correct the fiscal disequilibrium. TAGS: Debt sustainability; Debt and fiscal/monetary policies; Debt and growth

The economic impact of Next Generation EU: a euro area perspective (2022)
Krzysztof Bańkowski, Othman Bouabdallah, João Domingues Semeano, Ettore Dorrucci, Maximilian Freier, Pascal Jacquinoit, Wolfgang Modery, Marta Rodríguez-Vives, Vilém Valetal, Nico Zorell - European Central Bank
This paper assesses the potential economic impact of Next Generation EU (NGEU), focusing on the euro area. Its findings suggest that the envisaged national investment and reform plans present a coherent package to support both recovery from the pandemic-induced crisis and longer-term modernisation of the euro area economy through their digital and green transitions. NGEU, however, can only unfold its full potential if all plans are implemented in a timely and effective way. The authors estimate the impact of the national plans on output, inflation and public debt using ECB staff economic models under the assumption of successful implementation. Specifically, NGEU is expected to take effect through three channels: structural reform, fiscal stimulus and risk premium. Overall, NGEU may increase gross domestic product (GDP) in the euro area by up to 1.5% by 2026, with the impact expected to be significantly larger in the main beneficiary countries. In Italy and Spain, two of the main beneficiaries, the public debt-to-GDP ratio may be more
than 10 percentage points lower by 2031. At the same time, all euro area countries are expected to benefit from NGEU through positive spillovers, greater economic resilience and convergence across countries. Finally, the effect of NGEU on euro area inflation over the medium term is deemed to be contained to the extent that the inflationary effect of additional public expenditure is offset, at least to some degree, by the disinflationary effect of greater productive capacity resulting from the planned structural reform and investment measures. TAGS: Debt and fiscal/monetary policies; Debt sustainability; Structural policies

Fiscal Policy for inclusive growth in Asia (2022)
Benedict Clements, Sanjeev Gupta, João Tovar Jalles – Universidad de Las Américas, Center for Global Development, University of Lisbon
This paper discusses how fiscal policy can help foster more inclusive growth in developing Asia. On average, government expenditures in developing Asia are higher, as a share of gross domestic product, than those in Latin America and the Caribbean. Relative to Latin America, developing Asia spends more on social benefits, but less on education and health. While general government revenues have risen since 2000, they are still not sufficient to fully fund targeted transfer programs and provide adequate in-kind benefits to the population. Against this background, this paper discusses priorities for policy reforms as countries in the region seek more inclusiveness and confront the effects of the coronavirus disease (COVID-19). The paper finds that eliminating inefficiencies in health, education, and public investment, for example, would generate the equivalent of 3 percent of gross domestic product. Savings from curtailing subsidies for fossil fuels would also generate resources for expanding redistributive spending. Reallocation spending toward primary care, and education spending toward primary and secondary education, would help lead to more equitable growth. There is also scope to raise spending on social benefits and better target them to the poor. TAGS: Debt and fiscal/monetary policies; Debt and growth; Structural policies COVID-19

When could Macroprudential and Monetary Policies be in conflict? (2022)
Bank of France
This paper aims to provide a comprehensive analysis of the potential conflicts between macroprudential and monetary policies within a DGSE model with financial frictions. The identification of conflicts is conditional on different types of shocks, policy instruments, and policy objectives. The authors find that conflicts are not systematic but are fairly frequent, especially in the case of supply-side and widespread shocks such as investment efficiency and bank capital shocks. Second, monetary policy and countercyclical capital requirements generate conflicts in many circumstances. By affecting interest rates, they both “get in all the cracks”, albeit with their respective targets generally moving in opposite directions. Nonetheless, monetary policy could reduce its adverse financial side effects by responding strongly to the output gap. Third, countercyclical loan-to-value caps, as sector-specific instruments, cause fewer conflicts. Thus, they can be more easily implemented without concerns about generating spillovers, whereas smooth coordination is required between state-contingent capital requirements and monetary policy. TAGS: Debt and fiscal/monetary policies; Financial stability
Fiscal Sustainability Report 2021
European Commission
The Fiscal Sustainability Report 2021 provides an overview of fiscal sustainability challenges faced by EU Member States over the short, medium and long term. The Commission Fiscal Sustainability Report (FSR) 2021, the sixth edition of this report introduced in 2006, provides an update of fiscal sustainability challenges faced by the Member States. Government debt has significantly increased as a result of the pandemic across the EU. Financing conditions, which have largely improved over the past decades, remain favourable. [...] TAGS: Debt Forecasts; Economic Forecasts; Debt sustainability; Debt and fiscal/monetary policies

Russian sanctions and Market Impacts InfoHub
ISDA
This page will be updated on a regular basis as relevant information becomes available globally and will serve as the central depository for information from ISDA relating to the impact of Russian sanctions on derivatives markets. TAGS: Derivatives; Financial stability

Building a robust and diversified clearing ecosystem
Fabio Panetta – ECB
Speech by Mr Fabio Panetta, Member of the Executive Board of the European Central Bank, at the Fourth Annual Joint Conference of the Deutsche Bundesbank, European Central Bank and Federal Reserve Bank of Chicago on CCP Risk Management, Frankfurt am Main, 22 March 2022. TAGS: Derivatives; Financial stability; Trading platforms

High-frequency macroeconomic risk measures in the wake of the war in Ukraine
Laurent Ferrara, Matteo Mogliani, Jean-Guillaume Sahuc - SKEMA Business School, Banque de France
Following the Russian invasion of Ukraine on 24 February 2022, financial stress indicators suddenly increased. Using this high-frequency daily information conveyed by financial markets, this column presents a newly developed mixed-frequency quantile regression model in order to quantify macro risks in the euro area for the first quarter of 2022. The authors show that macro downside risks perceived by financial markets in the euro area are about three times higher than those for the US economy. TAGS: Economic Forecasts; Cost and Risk

Traction lost: Monetary policy at very low rates
Rashad Ahmed, Claudio Borio, Piti Disyatat, Boris Hofmann - U.S. Treasury Department, BIS, Bank of Thailand
Nominal interest rates in many advanced economies have been low for more than a decade. This column presents evidence that monetary transmission to economic activity is substantially weaker when nominal interest rates fall to very low levels, and that the strength of transmission tends to wane the longer interest rates stay low. This suggests that the observed flattening of the Phillips curve has gone hand in hand with a corresponding steepening of the IS curve. If so, monetary policy trade-offs have become more challenging. TAGS: Debt and fiscal/monetary policies; Financial stability; Debt sustainability
News

What’s new area of the PDM Network site proposes a daily selection of news on public debt management from online newspapers and info providers, as well as the most recent documents and reports uploaded on the website. Subscribers also receive the weekly newsletter Emerging Sovereign Debt Markets News drafted by the PDM Secretariat and based on Thomson Reuters © information services.

Events and Courses

Please note that the following list contains only events yet to be held at the date of the newsletter, in chronological order. Due to current coronavirus pandemic, many events have been cancelled or postponed, therefore we decided to maintain in the website only confirmed events, according to information contained in their original pages. We have employed maximum care to update this information, but we apologise in advance if some mistakes still remain. We suggest to regularly visit the “Events” section of our website, since the Secretariat adds regularly new events in advance to their dates and deadlines.

MAY

26 - 27 May 2022; OECD – Italian Treasury - World Bank, Rome
2nd OECD - Italian Treasury - World Bank Public Debt Management Conference

26 May 2022; OMFIF, Hybrid
MNB-OMFIF Financial stability conference 2022

26 May 2022; OMFIF, Virtual
Financial relations between Italy and Europe

26 May 2022; CGDEV, Livestreamed
A Conversation with David Malpass & Masood Ahmed

Until 27 May 2022; The Center for Inflation Research at the Federal Reserve Bank of Cleveland and the ECB, Cleveland, Ohio
Call for paper Inflation: Drivers and Dynamics 2022

Until 29 May 2022; Centre for Economic Policy Research, Amsterdam, Netherlands
Call for paper 2nd CEPR Conference Political Economy of Central Banks

31 May - 2 June 2022; Climate Bonds Initiative, Virtual
Climate Bonds' Green Bond Training

JUNE

Until 1 June 2022; NBER, Australia-Japan Research Centre, Center for Advanced Research in Finance, and the Center on Japanese Economy and Business, Tokyo
Call for paper NBER Japan Project Meeting 2022

3 June 2022; Euroframe, Helsinki
18th Euroframe Conference on Economic Policy Issues in Europe

10 May – 6 June 2022; IMF, New Delhi, India
Macro-Fiscal Analysis and Quantitative Methods

6 – 16 June 2022; IMF, Kuwait City, Kuwait
Virtual: Fiscal Frameworks (FF)

8 – 10 June 2022; ICMA, Wien, Austria
ICMA Annual General Meeting and Conference 2022

14 June 2022; Bonds & Loans, Online
Bonds & Loans Mexico 2022

15 – 16 June 2022; Barcelona Graduate School of Economics, Barcelona
The BSE Summer Forum Workshop on A Dynamic Economic and Monetary Union

20 – 24 June 2022; MEMFI, Online
Training in Debt Compilation, Reporting and Monitoring

20 June – 1 July 2022; IMF, Singapore
Virtual: Fiscal Analysis and Forecasting (FAF)

20 June – 1 July 2022; IMF, Singapore
Virtual: Financial Programming and Policies (FPP)

21 – 22 June 2022; EuroMoney, London, UK
The Global Borrowers and Bond Investors Forum 2022

27 – 29 June 2022; ECB, Sintra, Portugal
ECB Forum on Central Banking

27 – 28 June 2022; WASET, Istanbul, Turkey
International Conference on Financial Stability and Regulation – ICFSR

28 – 29 June 2022; Cracow University of Economics, Cracow, Poland
Workshop on Macroeconomic Research 2022

30 June 2022; ICMA, the Association of German Pfandbrief Banks (vdp), The Covered Bond Report, Deutsche Nationalbibliothek, Frankfurt

The Covered Bond Investor Conference 2022

Until 30 June 2022; CEPR and South African Reserve Bank, Pretoria, South Africa
Call for paper Emerging Markets Back in the Spotlight: Risks and Policy Options

Until 30 June 2022; Bank of Finland and CEPR, Helsinki, Finland
Call for paper Monetary Policy in the Post-Pandemic Era

JULY

4 – 29 July 2022; MEMFI, Online
E-Learning course on Development financing options (blended finance)

4 – 7 July 2022; IMF, Mauritius
Financial programming and policies (fpp)

4 – 8 July 2022; IMF, Hanoi, Vietnam
Virtual: Macroeconomic Diagnostics (MDS)

11 – 22 July 2022; IMF, Singapore
Virtual: Macroeconometric Forecasting and Analysis (MFA)

11 – 15 July 2022; IMF, Phnom Penh, Cambodia
Virtual: Macroeconomic Diagnostics (MDS)

Until 15 July 2022; East Asia Research, Singapore
Call for paper 2022 Asia-Pacific Conference on Economics and Finance

18 - 29 July 2022; IMF, Vienna, Austria
Virtual: Vulnerability Diagnostics (VDS)

5 – 25 July 2022; IMF, Ebene, Mauritius
Macroeconomic Diagnostics (MDS)

29 – 31 July 2022; School of Management, Zhejiang University, China
2022 2nd International Conference on Accounting, Auditing and Finance
AUGUST

1 – 5 August 2022; IMF, Vienna, Austria  
Public Sector Debt Statistics - Fundamental (PDS-F)

8 – 12 August 2022; IMF, Wien, Austria  
Virtual: Institutional Sector Accounts-Introductory Level (ISA-I)

15 – 19 August 2022; MEMFI, Online  
Joint MEFMI/UNCTAD Regional Training on DMFAS for Users and IT Administrators

22 August – 2 September 2022; IMF, Vienna, Austria  
Fiscal Sustainability (FS)

SEPTEMBER

5 September 2022; Crownagents; London, United Kingdom  
Public Debt Management: Issues and Solutions

5 – 9 September 2022; MEFMI, Venue to be confirmed  
Joint MEFMI/World Bank Workshop on Debt Management Performance Assessment (DeMPA)

5 September – 7 October 2022; MEMFI, Virtual  
E-learning course on Risks in Reserves Management

12 – 23 September 2022; Joint Vienna Institute, Wien Austria  
Macroeconomic Diagnostics

16 – 17 September 2022; Bank of Finland and CEPR, Helsinki, Finland  
Monetary Policy in the Post-Pandemic Era

19 – 30 September 2022; Joint Vienna Institute, Joint Vienna Institute, Wien Austria  
Macroeconomic Management in Resource Rich Countries

26 September – 7 October 2022; Joint Vienna Institute, Joint Vienna Institute, Wien Austria  
Monetary and Fiscal Policy analysis with DSGE Models

26 September – 21 October 2022; UNITAR, Web Based  
Global Financial Governance (2022)

29 – 30 September 2022; The Center for Inflation Research at the Federal Reserve Bank of Cleveland and the ECB, Cleveland, Ohio  
Inflation: Drivers and Dynamics 2022

OCTOBER

3 – 7 October 2022; Joint Vienna Institute, Joint Vienna Institute, Wien Austria  
Developing Domestic Debt Markets

6 - 7 October 2022; CEPR, the European Economic Review, European Commission, Brussels  
The COVID-shock and the new macroeconomic landscape: taking stock and looking ahead

24 October – 4 November 2022; Joint Vienna Institute, Joint Vienna Institute  
Financial Markets and Instruments

NOVEMBER

7 – 18 November 2022; Joint Vienna Institute, Joint Vienna Institute, Wien, Austria  
Managing Capital Flows: Macroeconomic Analysis and Policies

12 November 2022; Centre for Economic Policy Research, Amsterdam, Netherlands  
2nd CEPR Conference Political Economy of Central Banks

16 November 2022; Euromoney Conferences and Global Capital, Beijing, China
THE 8TH Annual China Debt Capital Markets Summit

21 – 25 November 2022; Joint Vienna Institute, Joint Vienna Institute, Wien, Austria
Monetary and Financial Statistics Collected and Compiled by the ESCB

21 – 25 November 2022; Joint Vienna Institute, Joint Vienna Institute, Wien, Austria
Public Financial Management and Administrative Reforms

28 November – 9 December 2022; Joint Vienna Institute, Joint Vienna Institute, Wien, Austria
Model-Based Monetary Policy Analysis and Forecasting

28 November – 9 December 2022; Joint Vienna Institute, Joint Vienna Institute, Wien, Austria
Fiscal Policy Analysis

28 – 29 November 2022; CEPR Centre for Economic Policy Research and South African Reserve Bank, Pretoria, South Africa
Emerging Markets Back in the Spotlight: Risks and Policy Options

December

13 – 14 December 2022; NBER, Australia-Japan Research Centre, Center for Advanced Research in Finance, and the Center on Japanese Economy and Business, Tokyo
NBER Japan Project Meeting 2022

15 – 16 December 2022; East Asia Research; Singapore
2022 Asia-Pacific Conference on Economics and Finance

PDM Network in Figures

As of 22nd May 2022, total documents and reports available on the PDM Network website were 8,490. Events and News uploaded on the website since July 2021 were respectively 259 and 13,025. This newsletter is sent to 905 Subscribers from emerging and advanced countries.

Special Thanks

The PDM Secretariat is grateful to Fatos Koc (OECD) for information on new documents and events.

Our Subscribers

Please note that subscription is intended for individuals only and does not entail any support to PDM Network activities by the Institutions the Subscribers work for. Individuals who subscribed to the PDM Network belong to a worldwide range of Institutions, including the following:

University of Tokyo, University of Trieste, University of Tuzla, University of Varna, University of Vienna, University of Viterbo "La Tuscia", University of Zagreb, University of Zimbabwe, University of Zurich, Uruguayan MoF, US Treasury, Versed Professional Services, Vietnamese MoF, Walton College of Business, West African Monetary Union, World Bank Treasury, Wrightson ICAP, Zambia Revenue Authority, Zhongnan University of Economics and Law.