TRENDS IN SOVEREIGN DEBT MANAGEMENT IN IBRD COUNTRIES OVER THE PAST TWO YEARS

The speaker presents some of the key results from the questionnaire responses from 48 IBRD countries in 1997 and 1999 and analyzes the trends in sovereign debt management, focusing on debt management objectives, the management of financial costs and risks, the use of strategic benchmarks, analytical techniques for measuring the costs and risks of debt, constraints to debt management and institutional arrangements, and capacity building.

Fred Jensen, *Chief Officer, Sovereign Debt Management Advisory Group, Financial Products and Services Department, The World Bank*

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Good morning ladies and gentlemen. My name is Fred Jensen. I am the head of a group in the Financial Products and Services Department which gives technical assistance in the area of debt management, and I am part of the team that's hosting the Forum today. I would like to welcome you all and tell you how much we appreciate the heavy turnout and the excellent participation we have received in this Forum.

As you know, this is the second Debt Management Forum that we have held. The first one was two years ago in October 1997. This year we have 56 IBRD borrowing countries participating, which compares to 50 participating countries in the Forum we held two years ago. I'm referring to the countries that are here in Washington and around the tables. We also have three countries who are participating long distance. You can see the cameras around the room. The Forum is being broadcast to these countries and they will be taking part as well.

As we did two years ago, we asked the participating countries to answer a fairly detailed questionnaire about practices, objectives and concerns in the area of debt management as well as their preferences about the topics to be covered in this Forum. I'm glad to say that nearly all the participating countries did send in this form and I would like to thank you very much for the obvious care and interest you put into your answers. The answers were extremely high quality and of course, they were key to guiding the structure of the agenda for the next three days. I think you will all find the responses of your fellow participants very interesting when you look at the summary of this questionnaire. Because we can compare a number of the questions to those we asked two years ago, we think this survey provides a good picture of the progress that a number of countries have made over the past two years in building capacity in the area of sovereign debt management, together with a fairly clear picture of the main challenges that remain. In this session, I would like to highlight some of the key points that were made in the survey. My comments refer to a shortened version of the summary of survey responses. You will find the complete summary in a handout that should be in your folder.[1]

I have been asked to talk about trends over the past two years and, of course, that corresponds to the time period since the October 1997 Forum, but it also corresponds to the timeframe of the debt crisis that had begun just prior to the October conference. I think you will see that this crisis has had a strong effect on the nature of the responses to the survey as some of the key concerns arising from the crisis are reflected in answers to many of the topics that we surveyed.

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[1] The complete summary of the survey responses is contained in the Annex of this document.

Before I turn to the survey, by way of background, the first table shows a comparison of credit ratings. This is for the 56 countries that are participating here in Washington. It shows changes in the credit ratings from Moody's and Standard & Poor's over that two year time period. During the past two years, six additional countries have received ratings, but the clearest trend, of course, is the number of countries that have been downgraded. Nineteen countries were downgraded, but also nine countries were upgraded. As you can see at the bottom of the table, the range of ratings for the participating countries has shifted downward at the high end and at the low end. At the high end, ratings have gone from A1 to A3, or AA minus to A, and there have been comparable declines to ratings at the low end. On the other hand, both the mean and the mode of the distribution of these ratings show virtually no change. Of course that reflects the number of countries that were upgraded as well as some of the newer ratings that have been assigned, but also a great deal of stability of the ratings of the countries in the middle: something that a lot of commentators sometimes forget is that the impact of the debt crisis clearly has not been uniform across all countries that are active in the international bond markets. Nonetheless, it has had an effect on how countries view debt management and, I think, on all of their concerns and priorities.

It has had an effect, of course, on issuance of bonds in the international markets. The second table shows a comparison between the numbers of countries that were active issuers in the bond markets at the time of the October 1997 survey and now. Here we are comparing a bit apples and oranges: the 49 countries shown in this survey for October 1997 were those countries who had participated in the survey at that time. Of those 49, 30 were active issuers during the period prior to October 1997--about sixty percent-- while in October 1999, of the 56 participating countries, fewer than half have issued bonds since the last conference. So there has been something of a decline, as you all know, in bond issuance although there are still quite a number of countries who are active issuers.

Let me turn to the summary of the responses to the questionnaire. The third slide corresponds to the first table in the complete summary of the survey responses, and aggregates these responses by the principal objectives. We asked a similar question in 1997 so we have a comparison. I have shown here the aggregate figures for the six main categories that you will find there. The first category, funding management, covers a variety of objectives. The main one being to meet the government's funding requirements, but also refers to strategies for diversifying the investor base and maintaining access to various markets, etc. In that first category we find roughly the same number of responses in the two surveys.

The second category refers to objectives having to do with strategies for developing markets, primarily domestic securities markets and bond markets. It includes strategies for maintaining liquidity in the government bond markets for establishing pricing benchmarks around government issues for building or extending the government security yield curve, things of this nature. There is quite a jump in the number of countries that mentioned this as one of their principal objectives.

The third category, management of financial costs and risks, is the largest category in terms of responses and I'll come back to that one in a moment. If you combine the two categories of strategies for developing markets with strategies for managing costs and risks, these are the responses dealing with the strategic elements of debt management, and we see that putting the two together, roughly half the responses we received were in that category. On that point, let me make a note that the percentage shares that you see here are shown as shares of total responses, but there are roughly the same number of countries responding to both surveys. In 1997, there were 49 countries that we tabulated and for this Forum, there are 48 questionnaires. So roughly the same number of countries responded but they listed more objectives, and gave more detail on the objectives. If these responses were tallied in terms of the number of countries, then nearly two-thirds of the countries listed these types of strategic objectives as being among their main priorities.

Just finishing off the list, we have a number of objectives that have to do with debt management operations such as ensuring timely payment of debt service, improving the management information systems, etc.

The fifth category, which is also a large one, has to do with objectives that refer more to managing the levels of debt than to the structure of debt. These include things such as reducing the volume of external debt, ensuring that debt burdens are not so high as to create vulnerability, maintaining sustainability of debt service, etc.

So let me come back to the largest category-management of financial costs and risks. The fourth slide provides added detail. Comparing 1997 with 1999, there was a sharp increase of responses in this category from 30 to 53 (with roughly the same number of countries responding). We get a fairly clear picture of the increased importance that countries have placed on these types of objectives. The first category refers to various objectives expressed in terms of reducing costs, or reducing risk, or minimizing cost and minimizing risk. The second one is a very similar one, but it's expressed more in terms of managing the tradeoff between cost and risk, so the objective might be to reduce the cost of debt while taking into account or limiting the risk of the portfolio or reducing the risk, taking into account the cost of reducing the risk. That showed quite an increase in the number of countries that expressed this type of objective in that way, nearly doubling. The third category, managing rollover or liquidity risk, showed the largest increase in terms of objectives of any of the responses in the survey, which I think is no surprise. There is a clear impact of the debt crisis, which resulted in some countries being unable to roll over debt, or being able to roll over only at high cost, and the number of countries listing this as among their top priorities has doubled. Then we have such things as the strategies of matching assets and liabilities, using hedges to do that, and monitoring or controlling private sector debt and contingent liabilities.

This increased interest in developing strategies for risk management is reflected in the fairly substantial increase in the number of countries that are using strategic benchmarks. We asked a question about how many countries are using these benchmarks and then some detail on what the benchmarks were. The detailed responses are summarized in a couple of the tables in your handout. The countries responding that they have a benchmark list specific targets for currency mix, the share of fixed rate versus floating rate debt or duration, or perhaps the share of foreign exchange debt versus local currency debt, as well as some of the specific targets for amortization and maturity profiles of the debt. The fifth slide shows the number of countries using strategic benchmarks for external debt. There has been a fairly substantial jump since 1997, although the numbers are still relatively small. Two countries mentioned the use of a strategic benchmark in 1997 and now two years later there are ten countries. So, roughly 20% or so of participate countries are now using benchmarks while the remainder are not.

In addition to this question we asked participants, if they were not using benchmarks, do they have a set of risk guidelines for managing debt. An additional ten countries responded that although they are not using benchmarks, they do have guidelines expressed in terms of limits, for example, on the share of floating rate debt or foreign exchange debt, things of this nature. The difference being that the majority of the countries responding that they use strategic benchmarks are using those benchmarks as well for performance measurement of the debt managers. So although the two look very similar, the benchmarks are a bit more of a formal practice. Taken together, roughly 40% or so of the participating countries now have explicit benchmarks or guidelines for managing debt in terms of risk or their overall government strategies.

Roughly the same group of countries that use benchmarks or risk guidelines reported that they are using a variety of analytical techniques for analyzing the costs or the risks of debt. The next slide summarizes the types of techniques that the respondents indicated they were using, including such things as the use of debt sustainability indicators, sensitivity testing using scenario analysis, or in a number of cases, value at risk or cost at risk measures to test the sensitivity of the cost of debt. A couple of other countries mentioned they were in the process of developing these types of techniques or models. It's still the case that, despite the sharp increase in interest that countries have expressed in these types of issues of cost and risk and developing strategies for managing debt, the majority of countries indicated they were not at this time using any particular type of analytical technique to develop these strategies.

So what are some of the difficulties or constraints that countries have mentioned in developing these techniques or setting up benchmarks? The following slide summarizes the difficulties or constraints that were mentioned by countries in establishing strategic benchmarks. The two main ones being the lack of a specific policy guiding debt management, and a lack of expertise in debt management. There are some significant additional constraints that have been mentioned: a lack of systems or software, a lack of development of domestic markets (which would certainly inhibit a lot of the types of strategies that countries might prefer to follow), and a difficult economic environment.

A related area of risk that has been receiving a great deal of attention among analysts, and also among the countries around these tables, is risks that arise from contingent liabilities, either through government guarantees, other explicit types of contingent liabilities, or implicit liabilities. As you are well aware, losses on contingent liabilities had a lot to do with the debt crisis that we experienced over the last couple of years. Reflecting this, well over half of the participating countries indicated that the debt management office had at least some responsibility for monitoring or managing risks of government guarantees or other contingent liabilities. As shown in the next slide, 33 of the 48 respondents indicated that the debt offices had responsibilities in this area, including eight that indicated that they had total responsibility for managing the risks of government guarantees. Other respondents reported responsibility for analyzing and recommending policies for managing contingent liabilities, recording or monitoring guarantees and other types of contingent liabilities, etc. We didn't ask this question in 1997, but my sense would be that this would represent a sharp increase in the level of responsibility among debt managers in the participating countries.

Let me turn now to institutional arrangements. In various portions of the survey, we found that a number of countries were expressing a good deal of concern about not having an appropriate institutional framework for carrying out their responsibilities in debt management. The next slide summarizes one of the questions relating to institutional responsibilities for managing the central government's foreign currency debt. There is another one for domestic debt, etc. We see that in 1997 and 1999, roughly half the respondents indicated that the sole responsibility for debt management was in the Ministry of Finance. Approximately one-third of respondents indicated a shared responsibility between the Ministry of Finance and the Central Bank, virtually unchanged since 1997. A small number have sole responsibility in the Central Bank and then a variety of other responses. So, despite the concern over appropriate institutional arrangements, you will see in these and other responses in the survey that there has been very little change in institutional responsibilities over the last two years. What this may indicate is that changes in these types of institutional arrangements are something that take quite a long time. Another possibility is that the general concern over institutional arrangements extend to arrangements within the debt office, and the capacity of the debt office to carry out it's responsibilities.

Referring to institutional arrangements, about a third of the participants indicated that they have established so-called middle office units. As shown in the next slide, only one country reported a centralized middle office unit that is responsible for all of the analytical obligations of the debt office for all sovereign debt. Thirteen countries indicated that, while there might not be a centralized unit responsible for all debt, they had established distinct units that were responsible for analytical activities or monitoring and control activities for at least a portion of the debt. A couple of others indicated they were in the process of consolidating these responsibilities in a middle office. But still, two-thirds of the respondents indicated either they have no middle office unit with capacity for carrying out analysis of alternative strategies for debt management, or did not respond to the question, despite the importance so many respondents gave to this.

Let me finish with a summary of the last two slides that are in your handout. The first one summarizes what countries mentioned as their most important accomplishments in the area of sovereign debt management during the last two years. What we see here is very consistent with the list of objectives and priorities that we saw in the first table from the summary. The more significant developments include progress in developing local currency debt markets and tapping new markets using new financing mechanisms. In addition, half of the respondents list improved institutional capacity as one of their main accomplishments over the previous two years. There are a number of other responses with smaller categories.

The last table lists what countries mentioned as the main constraints, obstacles and concerns that they face in the area of debt management. Despite the progress just mentioned, concern over institutional capacity shows up as the largest item, with about one-half of the responses falling in this category. Risk management which shows up as the second largest item, also relates to institutional capacity.

That was a summary of the survey. As I mentioned, we depended on the survey responses as well as the questionnaire that we distributed asking specifically about interest in different topics in designing the agenda for the Forum. We will be discussing a number of these main themes and topics over the next three days and we will hear from a large number of the world's leading experts in debt management both from developed countries as well as emerging market countries. We also have a number of speakers from public as well as private organizations which work closely with debt managers around the world. I am looking forward to learning from this fine audience over the next three days as I am sure we all are and I wish you all great success in this conference. Thank you very much.