

# **Monitoring External Debt and Debt Vulnerabilities**

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# Increased volatility of global capital ...

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## Implications for stability

- ▶ undermining exchange rate arrangements
- ▶ weakening firms' balance sheet
- ▶ financial sector crises
- ▶ uneven social costs
- ▶ major stress on public finances

## ... requires a stronger public policy response

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### **Recognize potential problems at an early stage**

- ▶ develop effective responses for preventing or minimizing the cost of systemic crises
- ▶ traditional stock and flow indicators -- debt/GDP, ST debt/debt, debt service/exports, etc -- are of limited value
- ▶ newer indicators with a balance sheet approach
  - domestic and external indebtedness
  - liquidity ratios
  - contingent liabilities
  - open positions in forward markets

# Better monitoring

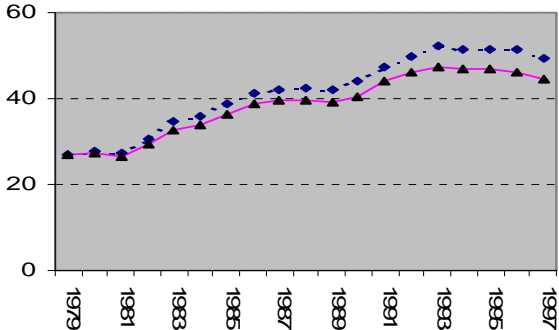
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## Role for stronger risk management

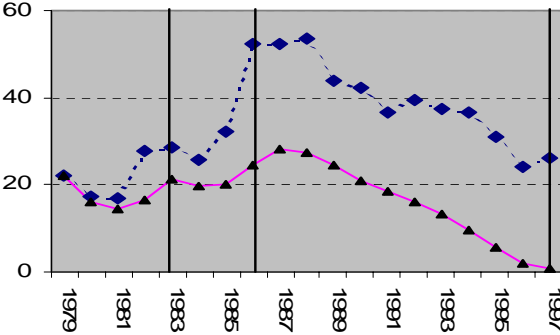
- ▶ monitor broader array of data including contingent liabilities (guarantees) short-term debt, and open position in forward markets, as well as key domestic variables
- ▶ simulate evolving risks to macro stability from capital flows, buildup of indebtedness, contingent liabilities, fiscal balances
- ▶ understand the linkages in the macroeconomy
  - indebtedness of firms
  - strength of financial systems

# There is a wide divergence between stock of debt and accumulated past budget deficits ...

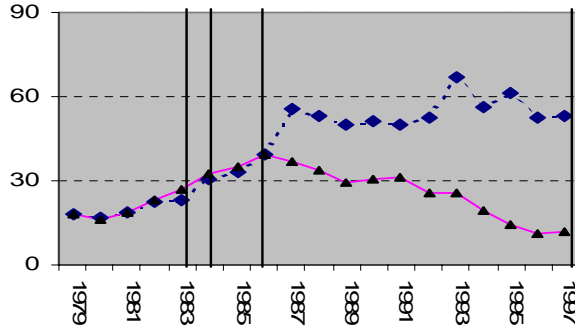
**USA**



**Indonesia**



**Philippines**

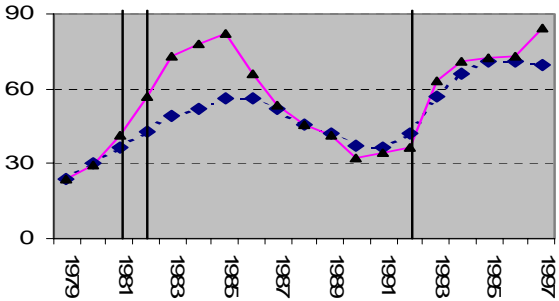


---◆--- Actual debt-output ratio  
—▲— Implied debt-output ratio from past deficits

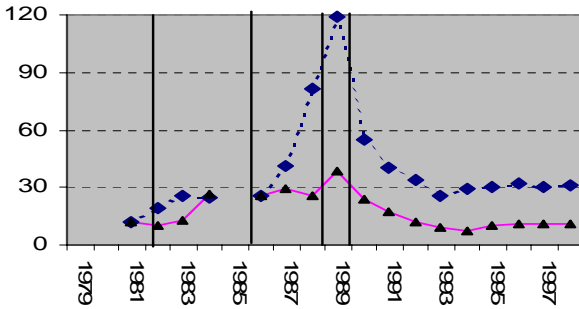
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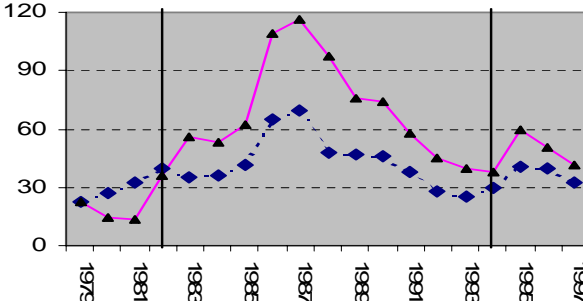
**Sweden**



**Argentina**



**Mexico**



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# What explains the divergence? ... the concept of hidden deficits

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## Accounting practices for debt services

- ▶ divergence between when the expenditure is actually made versus when it is accounted in the budget

## Extra-budgetary activities

- ▶ non cash expenditures, loan and bond transfers
- ▶ bailing out of financial institutions and corporations (Indonesia's bank bailout in 1994 - cost 2% of GDP)
- ▶ quasi-fiscal costs like, sterilization of capital inflows

## Contingent liabilities

- ▶ realization of state guarantees

## Asset Transactions/ Capital gains and losses

- ▶ real exchange rate, domestic inflation
- ▶ changes in cross currency rates (1/3 rd increase in Indonesia's external debt between 93 & 95)

# Conclusion

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**Key: transparency in fiscal accounting**

**What's missing: proper accounting of bank assistance and realized contingent liabilities**

**Important policy message: debt management is crucial**

**More academic message: premature to discard the first generation currency crisis models**