



SOVEREIGN DEBT MANAGEMENT STRATEGY

ASSET-LIABILITY MANAGEMENT or PORTFOLIO MANAGEMENT ?

Louis de Montpellier
Director Strategy & Risk Management
Debt Agency, Treasury of the Kingdom of Belgium

Tel. +32.2.233 72 79 / Fax +32.2.233 71 14

E-mail : Louis.deMontpellier@tf.minfin.be

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CONTENT

- **Objective and risks**
- **Asset-liability Management or Portfolio Management**
- **Economic policy constraints and European Monetary Union**
- **Institutional implications**



I . OBJECTIVE and RISKS

- **Objective : « Minimise the financial cost of the public debt ... while maintaining risk at an acceptable level. »**
- **Financial, long term cost; not only budgetary cost**
- **Risks :**
 - ❑ **Financial risks : as all market participants**
 - ◆ **market risks (interest rates, currency, liquidity)**
 - ◆ **operational risks (credit, technical, ...)**
 - ❑ **« macro-economic » risks - specific to a Sovereign State**
 - ◆ **endangering policy objectives**
 - ◆ **budgetary and monetary policies**
 - ❑ **Several quantifiable risk types => several risk measures**



II . ASSET-LIABILITY MANAGEMENT

- **Assumption : country with a diversified, open and mainly private economy**

- **Assets**
 - Domestic assets : mainly real assets**
 - Domestic revenues : mainly fiscal cash-flows**
 - External assets : foreign exchange reserves**
 - External revenues : form reserves investment**

- **most domestic asset value and domestic revenues are not directly sensitive to financial variables (interest rates and exchange rates)**



II . ASSET-LIABILITY MANAGEMENT

- **Liabilities**
 - ❑ **Domestic debt**
 - ❑ **Foreign debt**

- **all liability value and payments are directly sensitive to financial variables**

- ⇒ ➤ **assets (economic risks) and liabilities (financial risks) cannot hedge each other**

- ⇒ ➤ **no « zero-risk » position**



II . ASSET-LIABILITY MANAGEMENT

- **Asset-liability approach gives insight**
 - ❑ **assets mainly denominated in local currency**
 - **favor public debt in local currency**
 - **... with the exception of foreign exchange reserves**

 - ❑ **assets have a long duration**
 - **favor long term debt**

 - ❑ **lots of real assets**
 - **favor index-linked debt**



II . PORTFOLIO MANAGEMENT

- **Cost optimisation under risk constraint**
- **Risk aversion :**
 - ❑ **in general : no financial portfolio without financial risks**
 - ❑ **the case of a sovereign State**
 - ◆ **aversion for financial risks**
 - ◆ **aversion for macro-economic risks**
- **“macro-economic” risks = policy constraints**
 - ❑ **Monetary policy**
 - ❑ **Budgetary policy**

III . POLICY CONSTRAINTS :

MONETARY POLICY

THE CASE OF BELGIUM



- **Monetary policy objective :**
 - ☐ **external :**
 - ◆ **before EMU : stable parity with the EMS strongest currencies**
 - ◆ **in EMU : no external objective**
 - ☐ **domestic : stable value, low inflation**
- **Impact on public debt management**
 - ☐ **Interest rate risk management : proportion of domestic floating rate debt**
 - ☐ **Foreign exchange risk management : level and composition of foreign debt**
- **Constraints are arduous to quantify**
- **Constraints modified in EMU context**



III . POLICY CONSTRAINTS : BUDGETARY POLICY THE CASE OF BELGIUM

- **Budgetary policy objective**
 - ❑ **maximum deficit in GDP %**
 - = maximum annual public debt cost**
 - ❑ **annual reduction ratio debt/GDP**

- **Impact on public debt management**
 - ❑ **Interest rate risk management :**
 - ◆ **average duration**
 - ◆ **fix/floating**
 - ❑ **Financing risk management**
 - ◆ **refunding profile**
 - ❑ **Foreign exchange risk management**
 - ◆ **volatility in domestic currency of the value of the foreign currency debt**

- **Quantifiable constraints : new risks measures**



IV . INSTITUTIONAL IMPLICATIONS

- **Clarification of objectives and risks**
 - ❑ **Clarification of responsibilities**

- **Annual process**
 - ❑ **the budget law defines the broad objectives and empowers the Minister of Finance, the Treasury and the Debt Agency**

 - ❑ **the Debt Agency proposes the strategy under the form of annual strategic guideline; the Minister of Finance approves**

 - ❑ **the Debt Agency optimises the financial management of the budget law and the strategic guidelines**

 - ❑ **many contacts between the political authorities, the Central Bank and the Debt Agency (a department of the Treasury)**
 - ◆ **on the preparation of the guidelines**
 - ◆ **on other aspects of public debt management**



INSTITUTIONAL IMPLICATIONS

- **Transparent control on public debt management**
 - ❑ **risk measures**
 - ❑ **performance measures**

- **Market credibility**
 - ❑ **improved transparency of general objectives**
 - ❑ **improved flexibility of individual operations**
 - ❑ **fewer anticipation effects**
 - ◆ **market**
 - ◆ **economic policy**