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Burgeoning Global Debt Impact on Developing Countries

by

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Background

- Globalisation
  - Access to large savings in e.g. Asia
  - Access to supply of large labour force
- Globalisation contributed to low inflation and low real interest rates and hence low nominal rates
- Global liquidity, easy to borrow and leverage investments
- Burst of bubble, scaling down of balance sheets and leverage – falling assets prices

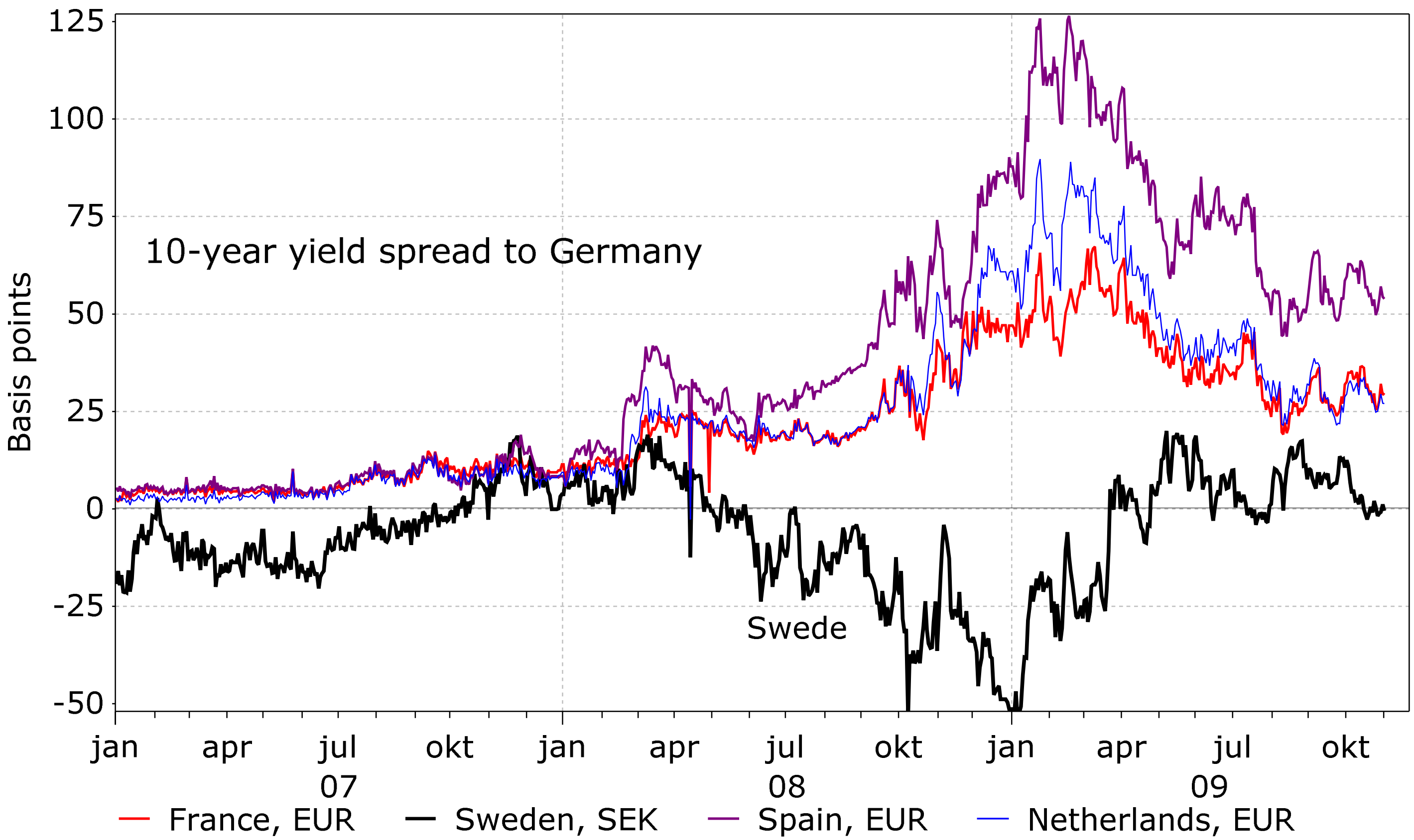
Consequences of financial crises

- Started as liquiditity crises
  - Assets became illiquid. Liquidity premium increased. Uncertainty about counter-party risks
- Difficulties in general to borrow. Credit spreads widened
- Excess demand for liquid securities with strong credit
- Burgeoning government debts as business cycle deteriorated and capital injections and bank support was needed
- Financial investments were closed creating a lack of funding

Consequences of financial crises

- Some countries have borrowed enormous amounts without greater difficulties: UK, US, Germany
- Borrowing in reserve currencies, with benchmark status and with strong liquidity proved advantageously with low liquidity premiums
- In the Euro zone Germany was favoured by markets with low liquidity premiums
- Other Euro zone countries had to pay large liquidity premiums

Yield spreads to Germany



Source: Reuters EcoWin

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Swedish experiences

- Sweden is a benchmark issuer in Swedish kronor
  - The Krona is a floating currency but not a reserve currency
  - Swedish government bond and T-bills are the most liquid security with strong credit implying strong demand
  - The Swedish borrowing requirement has been limited during the crisis
- Diversification of funding
  - By concentrating borrowing to nominal bonds during periods of budget surplus, and subsequently diversifying and using inflation-linked bonds, T-bills and bonds denominated in foreign currencies when borrowing requirement increases - we can avoid sharp increases and swings of nominal bonds issuances.

Swedish experiences

- We have issued guarantees for bank loans as part of the bank support
- Loans issued under guaranteed programs are substitutes for government bonds and bills, hende increasing competition for government borrowing
- Increased home-bias, tendencies to protectionism, the dissappearance of hedge-funds and other investors have reduced the investor base

Crowding Out effects

- Typical crowding out effects are channelled by rate increases due to large government borrowing requirement
- Of course, the large government borrowing requiremnt has crowded out other borrowers
  - around € 1,000 bn has been issued by central government in the Euro zone last four quarters
  - around $ 15,000 bn is planned to be issued by central governments in the OECD area in 2010 - most of i beeing G7 countries

Crowding Out effects

- In spite of the enormous amounts issued the OECD countries in general have managed surprisingly well
  - The largest borrowers like US, UK and Germany have perhaps managed best
- Smaller non-benchmark countries have managed less well
  - For non-AAA countries the situation has been difficult, some have not had access at all
- Crowding out effects through liquidity preferences, credit ratings/spreads
- Liquidity support from central banks has played a crucial role

Looking forward

- Financial markets are ”normalising”
    - Liquidity is not back to normal and some market players are not back
- Exit strategies and timing important for rates and access to savings/lending
- Consolidation of debt/budget situation necessary
- Increased competition from other borrowers when the economy picks up