



Eighth UNCTAD Debt Management Conference

Geneva, 14 - 16 November 2011

Interactions between Government Domestic Borrowing Needs and the Corporate Sector

by

Mr. Michele Manna

Head, Public Debt Division, Operation Department, Central
Bank of Italy

The views expressed are those of the author and do not necessarily reflect the views of UNCTAD



BANCA D'ITALIA
EUROSISTEMA



INTERACTION BETWEEN GOVERNMENT DOMESTIC BORROWING NEEDS AND THE CORPORATE SECTOR

Geneva, November 15th, 2011

Michele Manna

Bank of Italy

Central Bank Operations, Department



BANCA D'ITALIA
EUROSISTEMA



-
- Some key data on the Italian public debt ...**

 - and on the issuance of corporates in the country**

 - One settled fact and two not entirely so on the relationship between sovereigns and corporates**



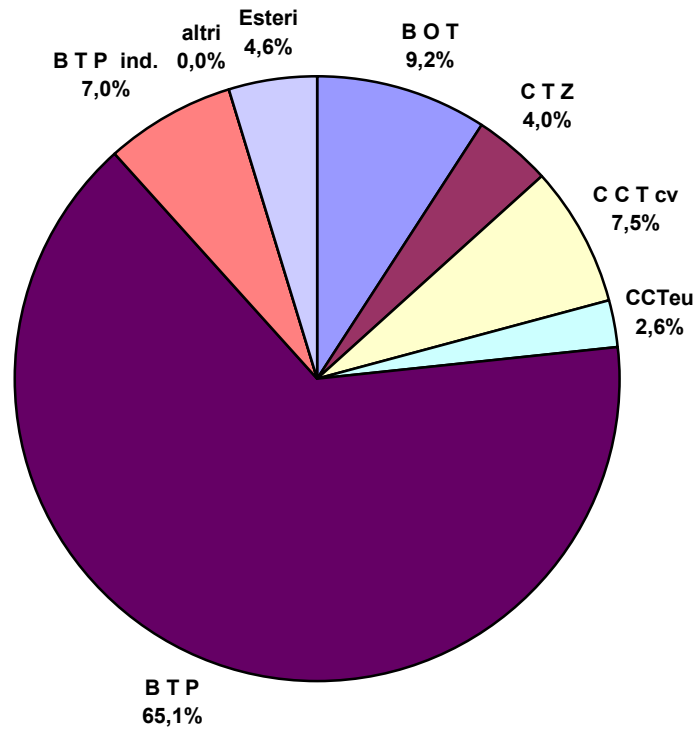
BANCA D'ITALIA
EUROSISTEMA



Part I. Some key data



A breakdown of Italy's outstanding public debt *(in %, 100 = securities issued as of end-September 2011)*

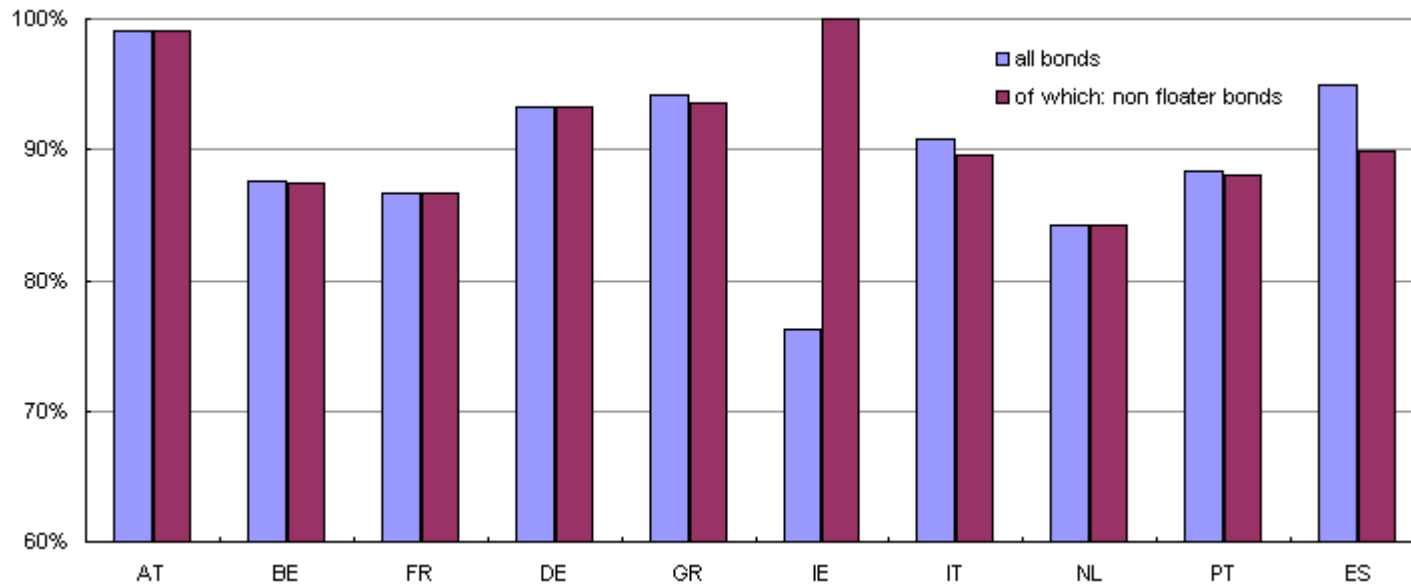


Source: Bank of Italy



Medium-long term bonds, selected European countries

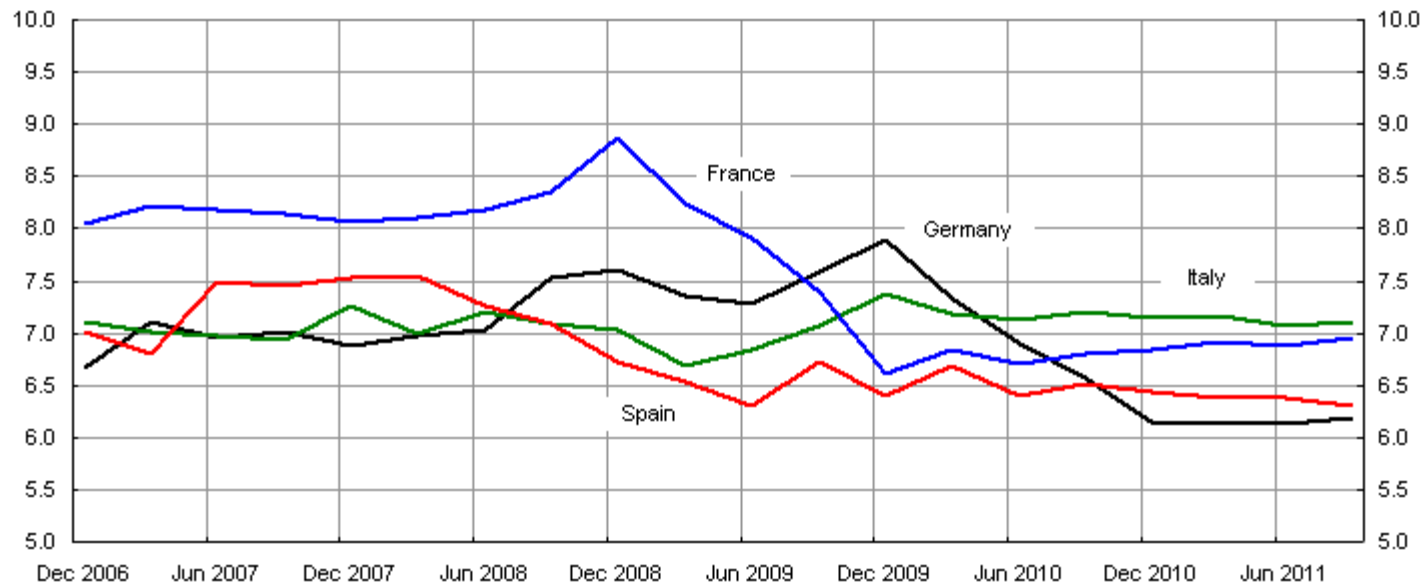
(in % of outstanding stock, as of end-September 2011)



Source: Bank of Italy



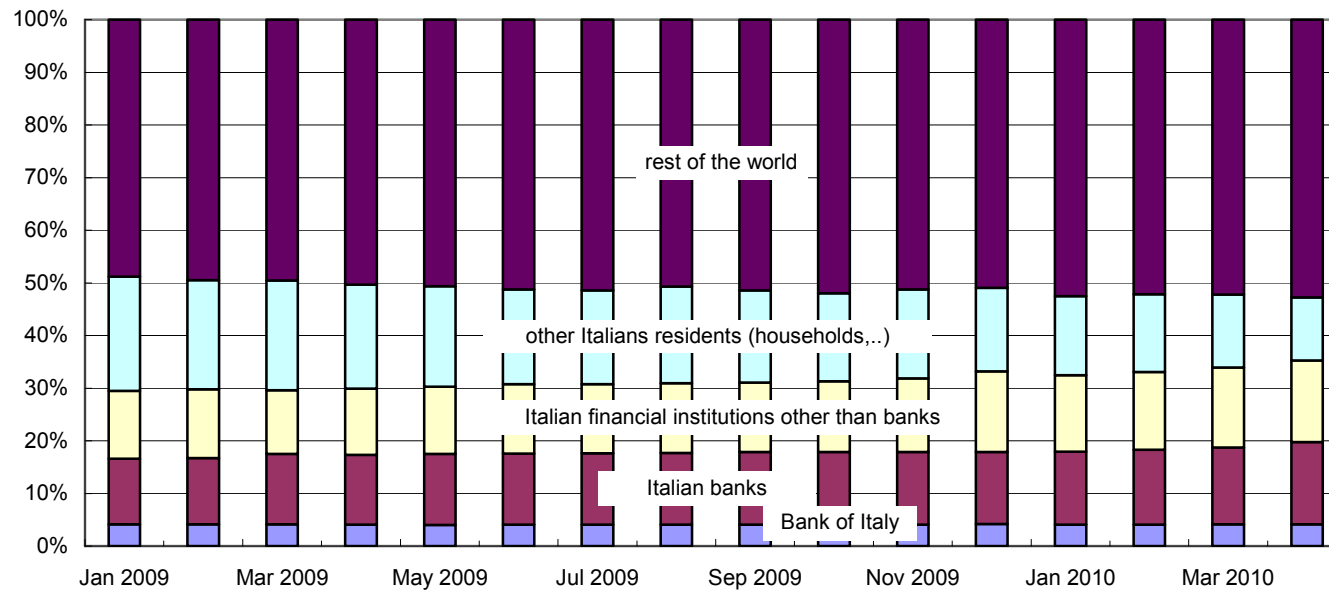
Maturity of outstanding domestic debt (number of years; weighted average)



Source: Based on data from Bloomberg and Bank of Italy



The holders of Italian domestic government bonds



Source: Bank of Italy



Issuers and holders of Italian debt securities and listed stocks
(in % based on stocks at March 2011)

Issuing sector Holding sector	Debt securities				Quoted shares	sum
	Central gov't	Other entities of public sector	Banks	Firms and other financial intermediaries		
Bank of Italy	2.1%	0	≅ 0	0	< 2 %	2.4 %
Banks	6.0%	< 2 %	5.5 %	4.8%	< 2 %	17.9 %
Investment funds	2.0%	0	< 2 %	< 2 %	< 2 %	2.4 %
Other residents	13.2%	< 2 %	15.1 %	< 2 %	10.4%	39.9%
Rest of the world	24.8%	< 2 %	5.3 %	4.4 %	2.5%	37.5%
sum	48.1%	< 2 %	26.1 %	10.1 %	14.4%	100 %

Source: Bank of Italy



Access by Italian firms to international financial markets

- Italian firms do not rely much on the issuance of securities: at end-2009, securities amounted to 7% of their financial debt, against 9% in Germany, 19% in France and 40% in the United States
- In turn, this would owe mainly to the fact that few firms are quoted in Italy.
- Possibly, an additional factor is the limited number of financial intermediaries specialised in the placement business
- Compared with the years before the crisis, the increased risk aversion of investors continues to affect the characteristics of the securities issued: in 2009 the spreads over the reference rate stayed above 200 basis points, compared with an average of around 100 points in 2003-07



BANCA D'ITALIA
EUROSISTEMA



Part II. One settled fact and two not entirely so on the relationship between sovereigns and corporates

- Sovereign credit risk and bank funding conditions
- Modelling the corporate spread
- The real effects of debt



BANCA D'ITALIA
EUROSISTEMA



Sovereign risk and the cost and composition of bank funding

“.. Higher sovereign risk since late 2009 has pushed up the cost and adversely affected the composition of some euro area banks’ funding ..

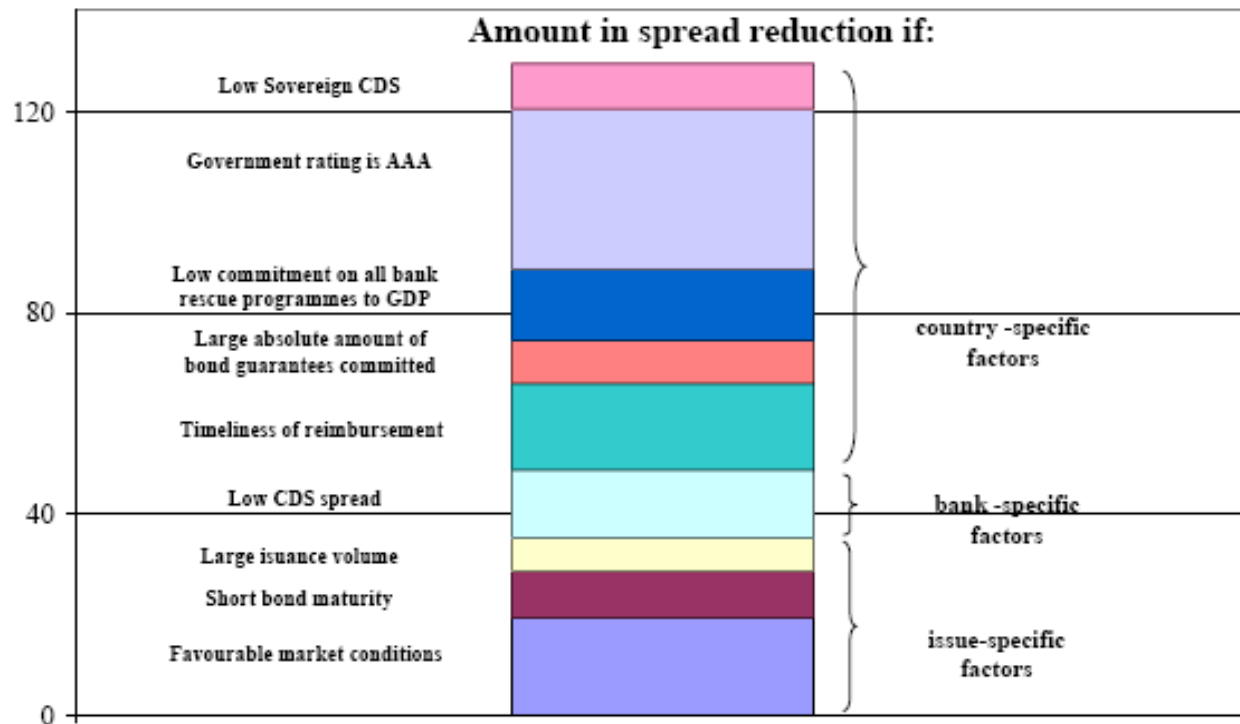
The increase in the cost of wholesale funding has spilled over to banks located in other European countries, although to a much lesser extent ..

Banks in other major advanced economies have experienced only modest changes in their wholesale funding costs ..”



Determinants of the spread between banks and sovereign bonds

(cross-sectional regressions on 512 guaranteed bonds issued from October 2008 to October 2009; countries of issuance: Australia; Austria; France; Germany; Ireland, Netherlands; Portugal; Spain; Sweden; United Kingdom; United States)





Modelling the corporate (credit) spread /1

- The structural framework: the lower the credit quality of the firm, the closer it is to the default boundary, and hence the firm will face a higher probability of default over short maturities
- For longer maturities, if no default occurs, the firm has a higher probability of credit improvement (the term structure is more likely to be humped or downward sloping; for high quality firms, the reverse argument holds)
- The importance of idiosyncratic volatility increases the lower the rating

(Happy families are all alike; every unhappy family is unhappy in its own way; L.N. Tolstoy)

Ample literature: a non-exhaustive and discretionary list includes Black and Scholes, 1973, Merton, 1974, Jarrow and Turnbull, 1995, Bedendo, Cathart and El-Jahel, 2004, Arora, 2055, Yang, 2008



Modelling the corporate (credit) spread /2

- Due to the reliance on diffusion process, the structural approach is believed to deny a sudden drop in firm value ➤ the probability that a firm defaults in the near term is negligible
- The reduced-form approach proposes an exogenous model for the default process and allows for the possibility of default in the immediate future
- Apparently, the quality and quantity of data make a difference: many traded issuers will not be well modelled unless they issue more traded debt



The real effects of debt

- Debt is a two-edged sword. Used wisely and in moderation, it clearly improves welfare. But when it is used imprudently and in excess, the result can be disaster
- Reinhart and Rogoff, 2008: three years after a financial crisis central government debt increases, on average by 86%
- Beyond a certain level, debt is reckoned to be bad for growth. Cecchetti, et al., 2011: for government debt, the number is about 85% of GDP; for corporate debt, the threshold is closer to 90%.



Interactions of sovereign debt management (SDM) with monetary conditions and financial stability

Committee on Global Financial Stability (CGSF), 2011, 'Interactions of sovereign debt management with monetary conditions and financial stability. Lessons and implications for central banks':

- SDM choices do not appear to have constrained central banks' ability to ease monetary conditions via large-scale asset purchases
- How SDM should relate to macroeconomic policy functions depends on their respective objectives and on economic and financial system circumstances. Economies with deep financial markets have tended to emphasise the separation of SDM from other policy functions
- [There is] little evidence that existing arrangements for operational independence of SDM and monetary policy functions have created material problems.
- Modifying these arrangements would be risky. But in the current circumstances, or where financial systems are still developing, there is benefit in debt managers taking a broad view of cost and risk.