UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

Eighth UNCTAD Debt Management Conference

Geneva, 14 - 16 November 2011

Debt Management Offices: New Developments and Challenges

by

Ms. Miriam Tamene

Adviser, Debt Management Section

Commonwealth Secretariat

DEBT MANAGEMENT OFFICES: NEW DEVELOPMENTS AND CHALLENGES

UNCTAD

DEBT MANAGEMENT CONFERENCE

NOVEMBER 2011

CONTENTS

- **INTRODUCTION**
  - Public debt management brief overview
  - DMOs' core responsibilities
- **RECENT DEVELOPMENTS**
  - Macroeconomic conditions
  - Influences from markets
  - Contingent liabilities
- **CHALLENGES FOR THE DMOS**
- **CONCLUSION**

PUBLIC DEBT MANAGEMENT: AN OVERVIEW (1)

GOVERNANCE FRAMEWORK

GOVERNANCE COMPONENTS

- Legal framework
- Institutional arrangement
- Delegation and accountability (auditing arrangement)
- Decision making (policy, strategy)
- Reporting

PUBLIC DEBT MANAGEMENT: AN OVERVIEW (2)

ACCOUNTABLE REPORTING

PARLIAMENT
MINISTERS
AUDITORS

CONSULTATION , COMMUNICATION

INVESTORS, CREDITORS
RATING AGENCIES
MARKET INTERMEDIARIES
MARKET INFRASTRUCTURES
PUBLIC
WORLD BANK, IMF, REGIONAL DEVELOPMENT BANKS

DMU

COORDINATION , MONITORING

CENTRAL BANK (MONETARY POLICY)
MINISTRY OF FINANCE (BUDGET, FISCAL,)
PUBLIC DEPARTMENTS (BORROWERS)
CASH MANAGEMENT (REVENUE AND CUSTOMS)

CONTRACTURAL AGREEMENT

ISSUING AGENCIES (E.G. CENTRAL BANK)
PRIMARY DEALERS, SYNDICATORS
MARKET MAKERS
SETTLEMENT INFRASTRUCTURES
CENTRAL DEPOSITORY SYSTEM

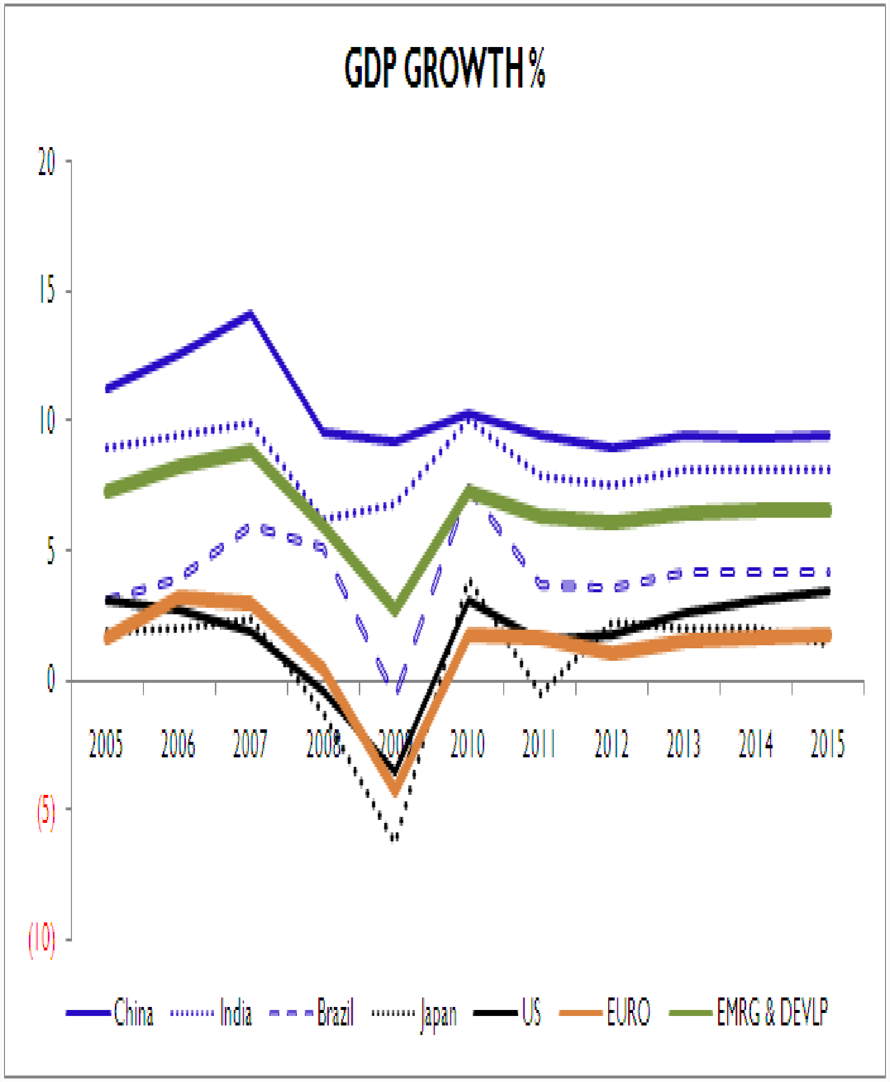
DMOS RESPONSIBILITIES

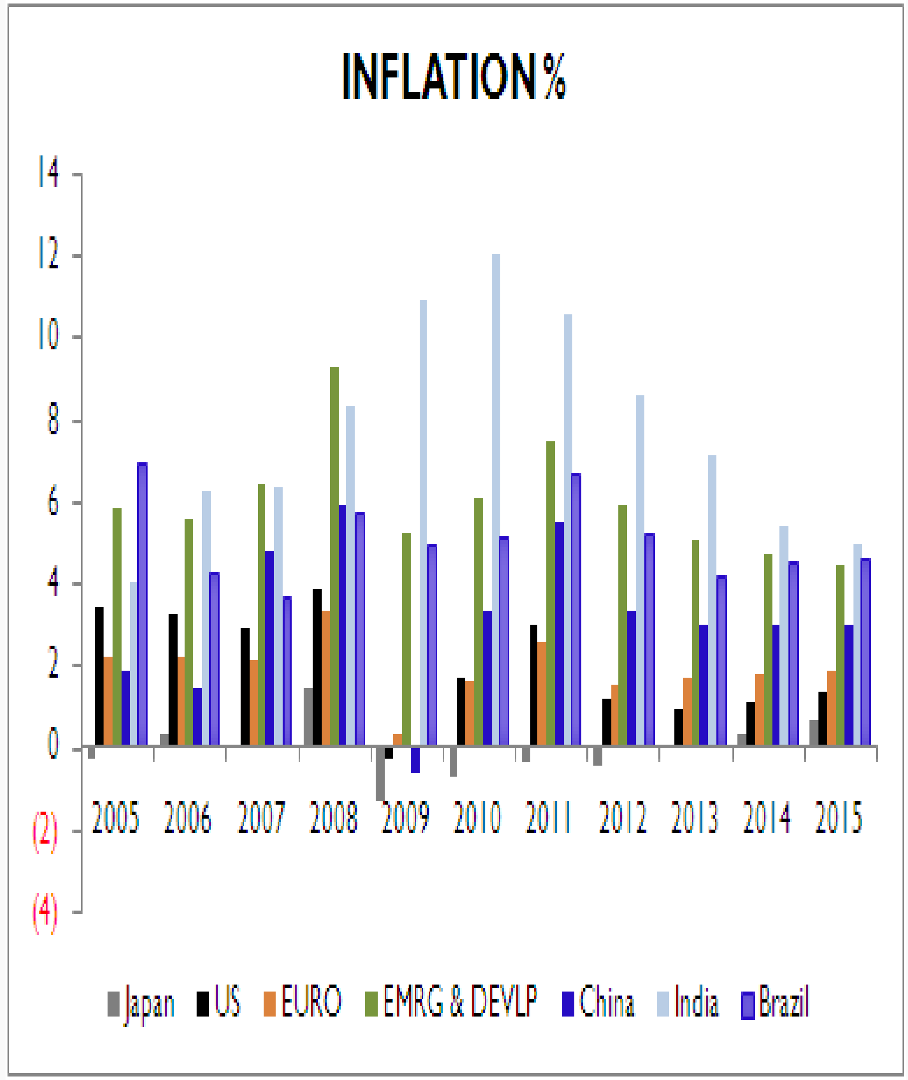
CORE DMO RESPONSIBILITIES			
Front Office	**Middle Office**	**Back Office**	**Client Servicing**
Loan negotiations	Debt policies	Payment validation & confirmation	Project administration
Transactions pricing	Debt strategies	Payment Orders	On lending to and investments for: • SoEs • Sub-nationals
Debt issuance • Domestic • External	Risk analysis	Disbursements	Loan guarantees
Debt portfolio management	Debt portfolio monitoring	Debt records	Parastatals control
Market development	Support debt sustainability analysis	Debt recording systems	Public Private Partnership (PPP)
Project financing	Reporting and publications	Debt accounting	
Cash flow management	Limit monitoring	Debt reports	
Investor relations	On-lending and guarantee policies	Forecasts	
Investment management	Relationship with rating agencies		
	Legal agreements		
	IT and IMS (controls)		

RECENT DEVELOPMENTS: MACROECONOMIC CONDITIONS (1)

- Fiscal vulnerabilities
  - dichotomy between advanced and emerging/developing markets
  - risks straddle between:
    - global recession led by another downturn in advanced economies
    - high inflation led by demand by emerging markets
- Macroeconomic policies
  - Fiscal consolidation plans threatened by lack of growth
    - Low tax receipts → higher level of debt → unsustainable debt
  - Low growth in the US & EU →⬇ emerging markets (despite ↑ in South to South trade which is concentrated on intermediate products)
  - Monetary easing becomes inflationary in the advanced economies
  - Monetary tightening not sufficient and timely to curb inflation in emerging economies

RECENT DEVELOPMENTS: MACROECONOMIC CONDITIONS (2)





RECENT DEVELOPMENTS: MARKETS (I)

RISKS	OUTLOOK	IMPACT
Interest rate	↑ to curb inflation	• Floating rate notes • New debt • Rise in debt servicing costs

Exchange rate	• Emerging market currencies ↑
	• Medium to long-term US$, €, £ ↑
		• Rise in debt servicing costs of loans or bonds denominated in
		  • Yuan and other emerging market currencies in the short to medium term
		  • $, €, £ in the medium to long-term

Inflation	commodity price ↑	• Inflation indexed bonds
Refinancing risk	↑ sovereign risk	• Funds repatriation to domestic market (↓external source of funding) • Sovereign balance sheet contraction in advanced economies → less external funding for developing countries

RECENT DEVELOPMENTS: MARKETS (2)

RISKS	OUTLOOK	IMPACT
Liquidity	↑ flight to safe haven (liquid assets) in the immediate term	• In developed markets increasingly becoming difficult to gauge liquidity • Difficult environment for nascent domestic debt markets (particularly serious for those countries dependent on external financing as they try to switch to domestic market) • DMOs with active cash management may encounter dysfunctional money market →↑ liquidity risk
Execution	↑ due to the precarious financial health of the banking sector ↑ for developing countries dependent on aid and official bilateral loan	• Risk is acute for countries dependent on securities market as the debt market requires stable banking sector (financial intermediaries) • With contracting balance sheet advanced economies risk failing to meet their aid or loan commitment

RECENT DEVELOPMENTS: MARKETS (3)

RISKS	OUTLOOK	IMPACT
Banking regulation	• Liquidity regulation • Move from OTC to exchange settlement or central counterparties	• Banks adjusting their asset portfolio towards highly liquid and creditworthy bonds that match their liability→🡡 demand for sovereign bonds • Settlement via central counterparties →🡡 demand for sovereign bonds
QE (unwind)	• Medium to long term risk	• Coordination between central banks and MoF selling government securities • Abundance of liquidity assets (ie Treasuries) might influence end investors in readjusting their asset portfolio (ie shifting towards Treasuries)

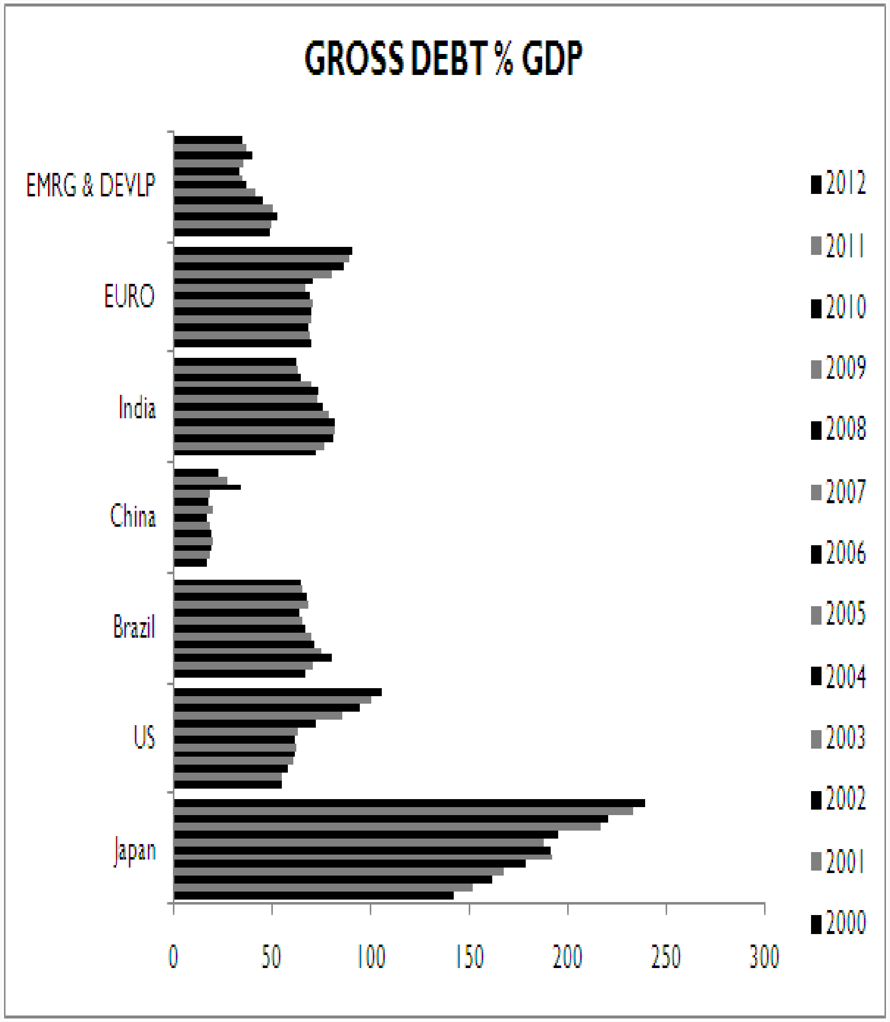
RECENT DEVELOPMENTS: CONTINGENT LIABILITIES

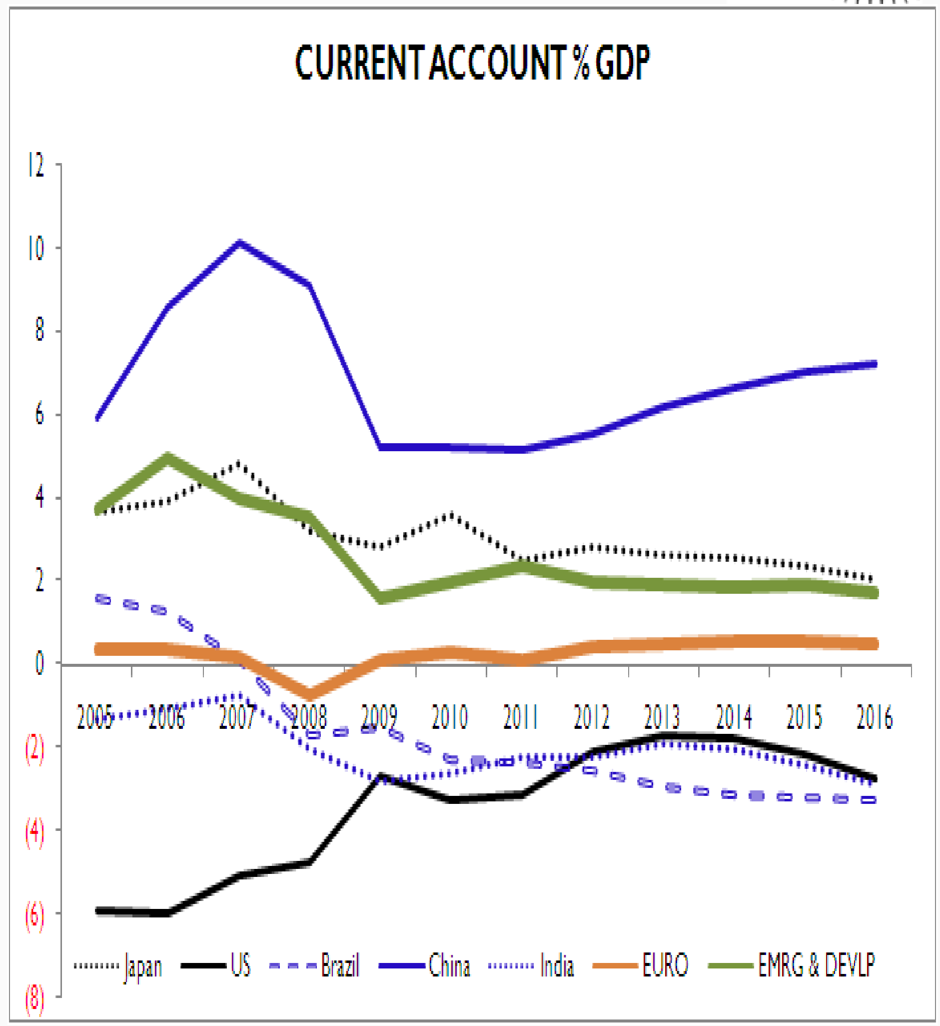
CONTINGENT LIABILITIES	RISKS	OUTLOOK AND IMPACT
Explicit	Public sector → sovereign	• Conditions for securing funding less favourable for public enterprises given weakening b/s of sovereign • Market conditions → adverse effect on the business performance of public enterprises (eg energy companies from ↑ oil price) may crystallise loss • Impact greater from those public enterprises that generate huge revenue for the government (eg tourism sector) • **Exacerbating the burden on the government's b/s**
Implicit	Sovereign ⇆ banking sector, sub-nationals, etc.	• Governments stepped in to the rescue of the banking sector transferring banks' credit/liquidity risk to sovereign • However the risk has reversed in some cases where the banking sector is under pressure from anticipated loss derived from sovereign credit event (directly through their holdings of sovereign bonds or indirectly through weak macroeconomic conditions)

RECENT DEVELOPMENTS: LEGISLATION PROCESS

- Legislation process
  - takes longer than the time it takes for markets to react
    - US congress
    - EURO zone countries
  - emergency powers even if they are available, may not be desirable
    - Could trigger adverse market reaction

CHALLENGES FOR DMOS: FISCAL VULNERABILITY





CHALLENGES TO THE DEBT MANAGERS

Fiscal

- In absence of rapid fiscal consolidation → high debt level
- Rise in interest rate (and perhaps DX depreciation)→ ↑ debt service cost → further fiscal pressure
- Limited liability management tools (eg swaps and options could become unattractive for investment banks because of regulatory capital requirements)

Securities market

- In an environment of reduced market risk appetite might need to consider other possible options:
  - New instrument targeted or tailored at specific end investors (eg pension funds, insurers)
  - Supplement or introduce new distribution mechanism (auction, syndication,)
- For nascent domestic market debt managers might need to adapt flexible approach
- For emerging and developing economies tapping the international bond markets at the same time as when liquid markets are issuing huge amount might prove expensive

Loans

- Competing limited resources likely to result in reduction of loans from the official sector (multilateral and bilateral)
- Cost of semi-concessional loans likely to rise (reflecting demand pressure on resources)
- Reliance towards project loans but these are expensive and not without risks
- Commercial loans from the banking sector could be a possibility for some countries

CHALLENGES TO DEBT MANAGERS

- Combination of risks ➡ change the characteristics of the debt portfolio
- managing high level of debt, high debt service payments
- redemption profile (shortened)
- % of floating rate, FX
- Monitoring an ever changing risk environment
    - understanding the immediate, medium and long term implications
    - identifying correlated risks, particularly those that would lead to crystallising of implicit contingent liabilities
    - work up options to mitigate risks (within existing debt framework)
    - options beyond the boundaries of agreed framework
    - keep decision makers apprised of situation (noting some options may require legislation)
    - consider seeking approval or conditional approval for a range of alternative measures to enable taking actions when and if the need arise

CHALLENGES TO DEBT MANAGERS

- Implementing changes requires careful handling:
- **INTERNAL STAKEHOLDERS**
    - seeking agreement with other policy makers (fiscal, monetary, etc) within the government – important to have joined up approach
    - briefing senior officials and decision makers extensively
    - seeking approval for bold changes if that is what is required
    - **EXTERNAL STAKEHOLDERS**
    - market participants (consultation might be required depending on the change being contemplated, in particular if there are primary dealers)
    - credit rating agencies
    - large official creditors
- Resources
    - High demand on staff (in particular middle and front offices)
    - Take lessons from others (rather than reinventing the wheel)

CONCLUSION

- **MACROECONOMIC AND MARKET CONDITIONS**
  - current environment likely to persist in the medium term
  - at best conditions set to continue to be unpredictable
  - consequently making the tasks of debt managers difficult
- **NONETHELESS, DEBT MANAGERS NEED TO BE PROACTIVE**
  - examine all options (taking lessons from others thus far)
  - consult (if appropriate) with key stakeholders before introducing new actions or changes
  - prepare decision makers to take informed and evidence based decisions
  - communicate changes clearly (addressing caveats head-on)