Considerations regarding a multilateral sovereign-debt resolution mechanism

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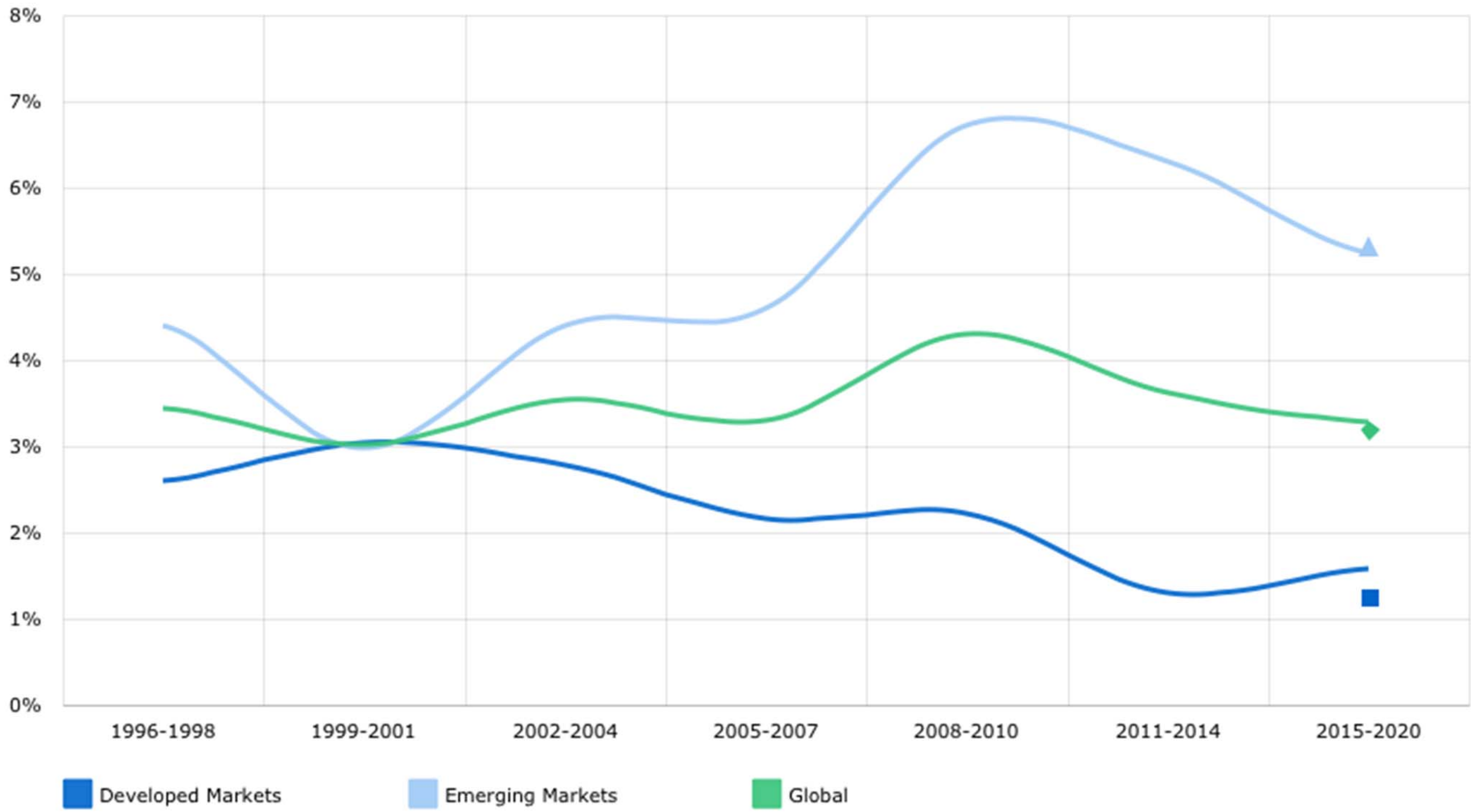
1. Global macro environment: medium-term prospects
2. Past and future of debt, sovereign debt, and sovereign-debt crises for developing countries
3. Implications of innovations in global banking, lending markets
4. Considerations on a multilateral sovereign-debt resolution mechanism

1. Global macro environment: medium-term prospects

Potential Output Growth Headed Lower, Especially in Emerging Markets; Developed Markets Subdued



Source: IMF, Morgan Stanley Research forecasts

Taken from "Global Macro: Pros and Cons of Getting Stuck in the Middle," Morgan Stanley Research, September 11, 2015; section entitled "Emerging-Market Drag."

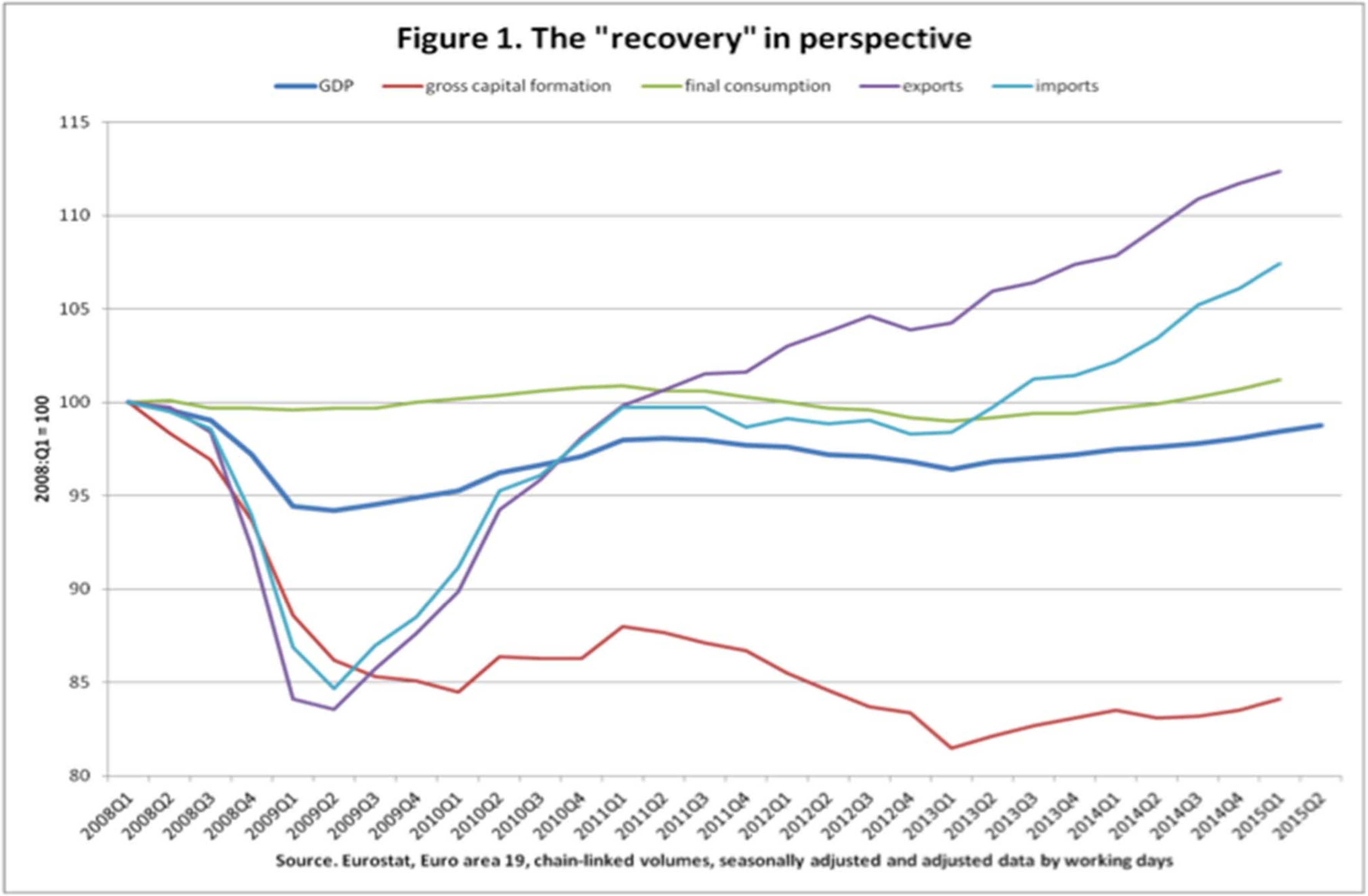
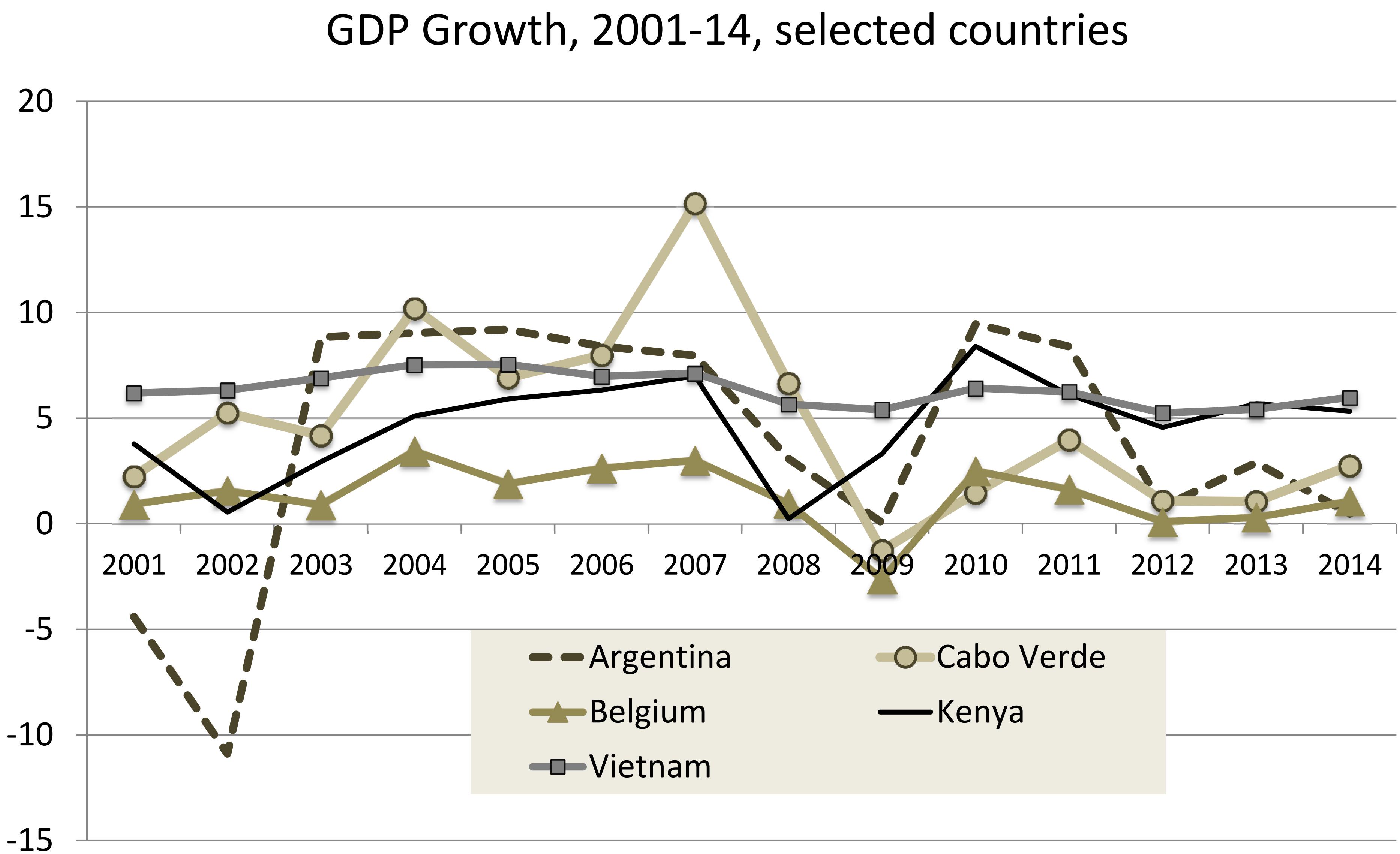


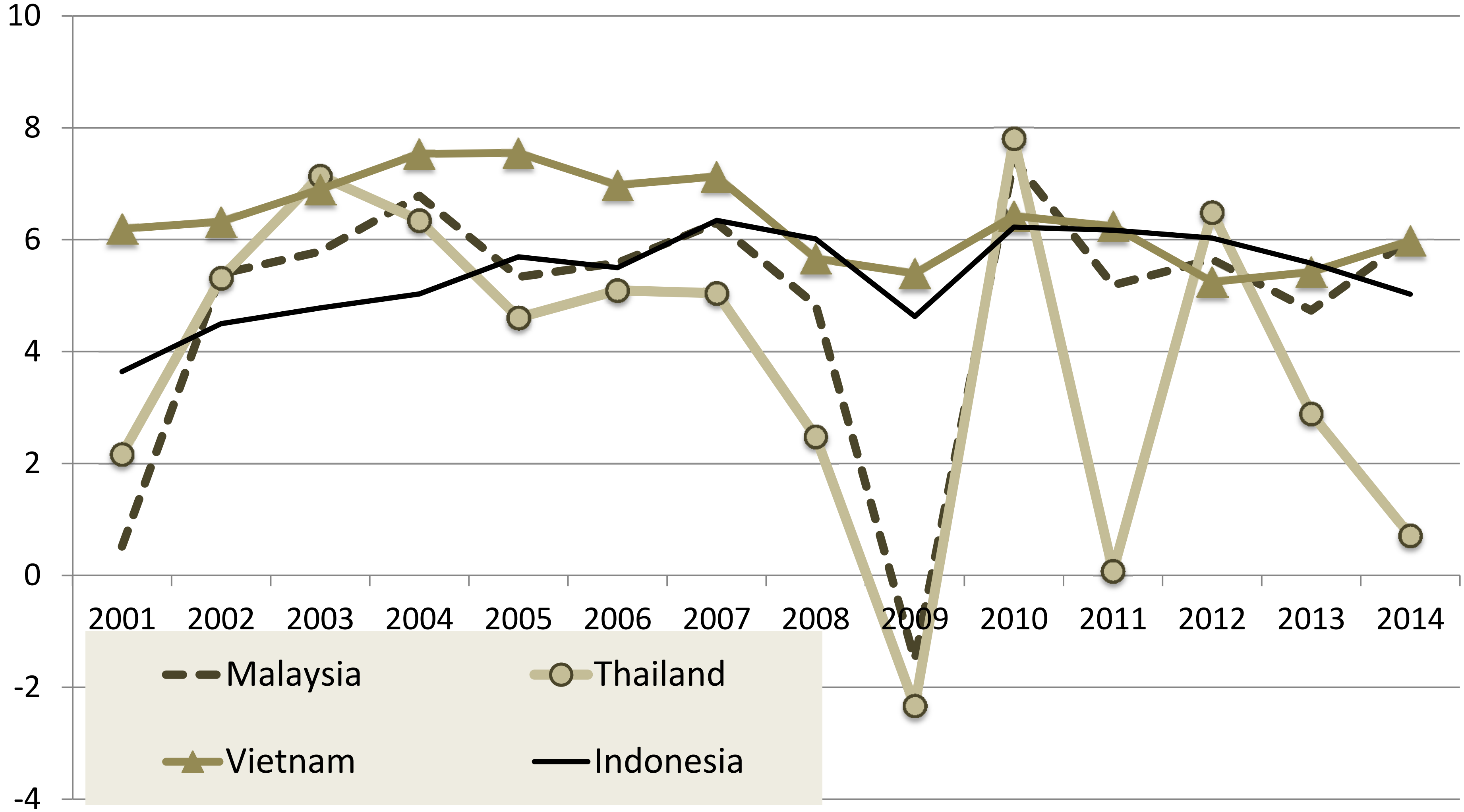
Figure 1. The "recovery" in perspective

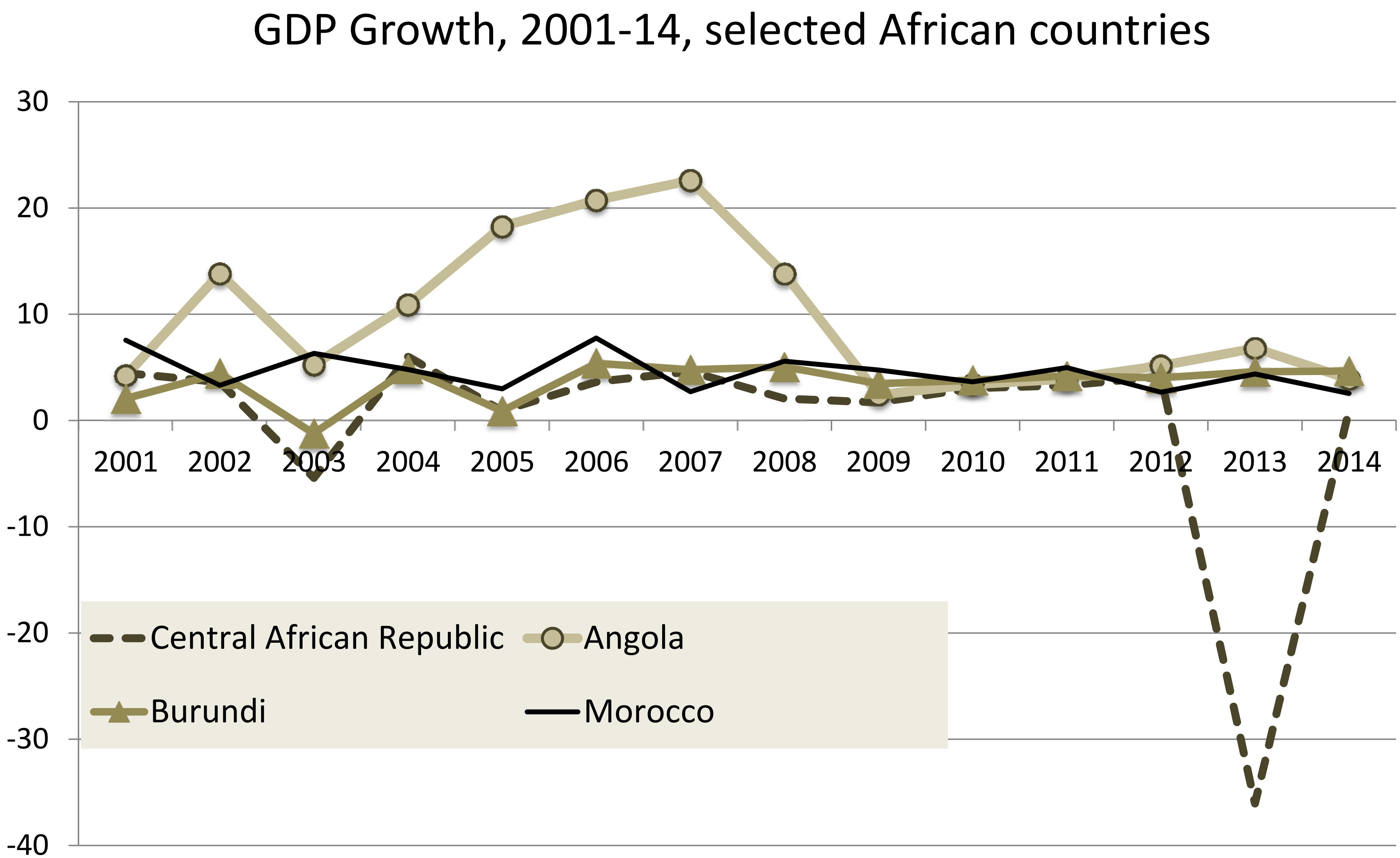
From: **Euroland Has No Plan B: It Needs An Urgent Recovery Plan**
by Jörg Bibow on 7 September 2015, *Social Europe.*

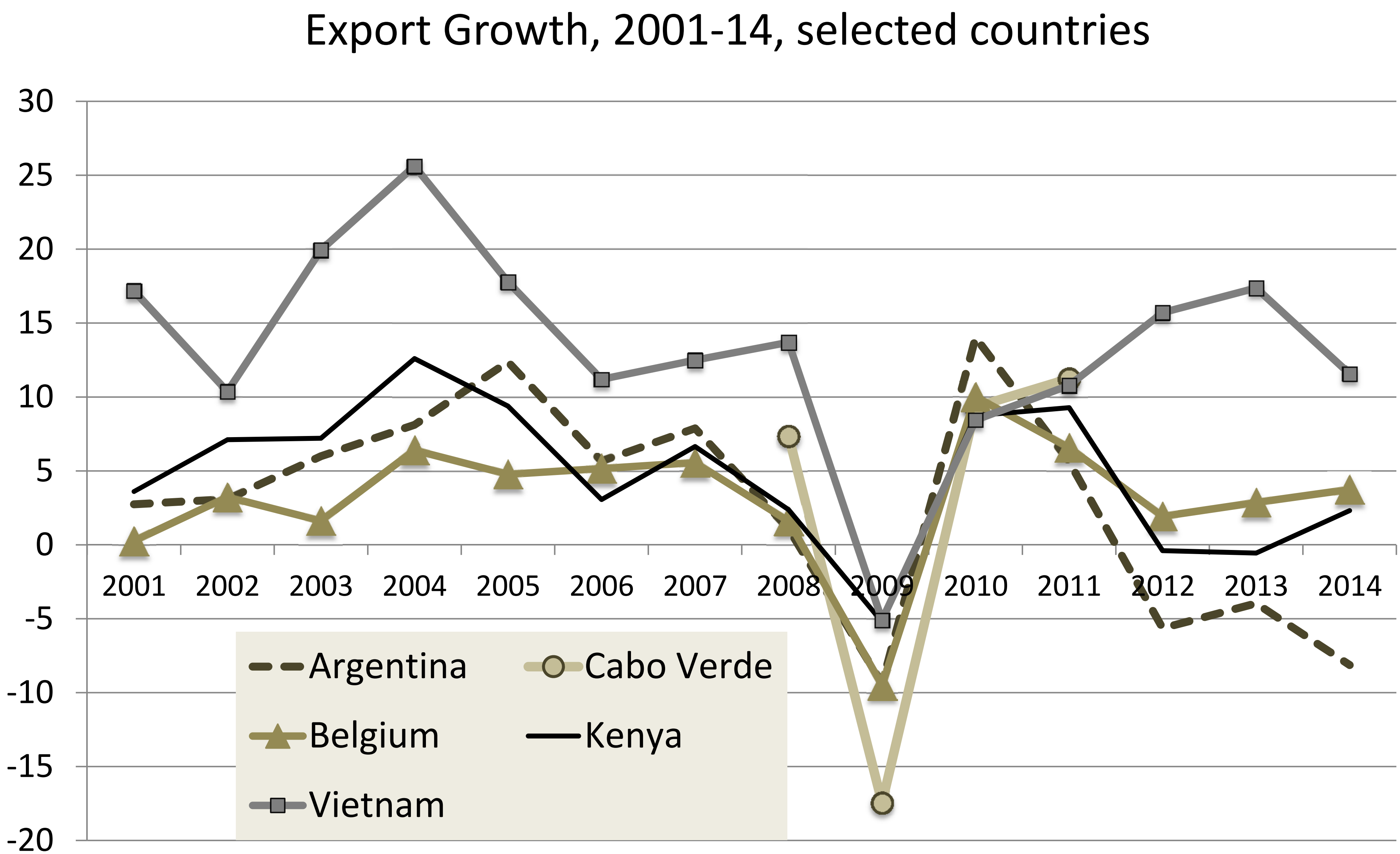


GDP Growth, 2001-14, selected countries
20
15
10
5
0
-5
-10
-15
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
Argentina
Cabo Verde
Belgium
Kenya
Vietnam

GDP Growth, 2001-14, selected SE Asian countries




GDP Growth, 2001-14, selected African countries
30
20
10
0
-10
-20
-30
-40
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
Central African Republic
Angola
Burundi
Morocco


Export Growth, 2001-14, selected countries
30
25
20
15
10
5
0
-5
-10
-15
-20
2001
2002
2003
2004
2005
2006
2007
2008
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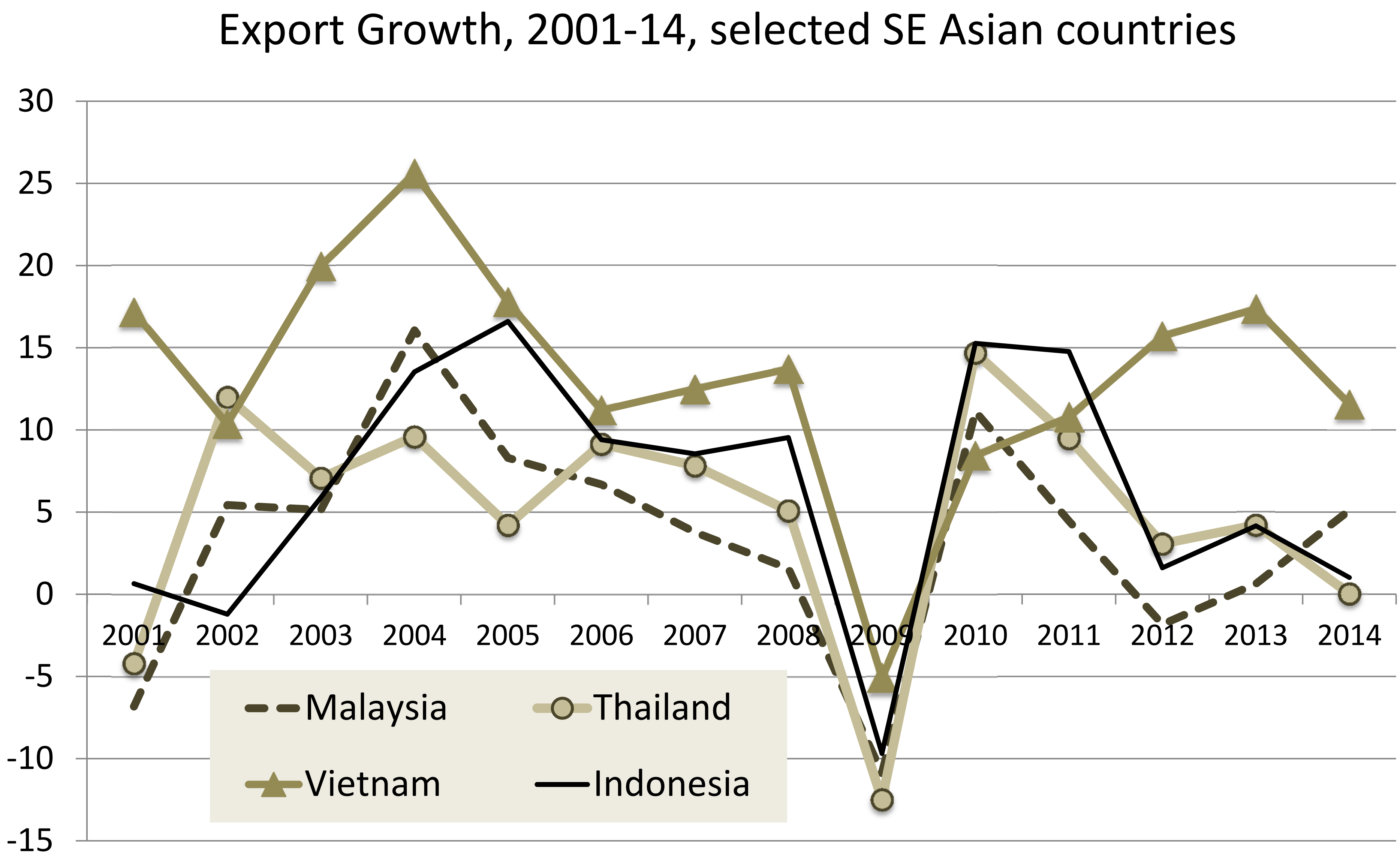
Cabo Verde
Belgium
Kenya
Vietnam


Export Growth, 2001-14, selected SE Asian countries
30
25
20
15
10
5
0
-5
-10
-15
2001
2002
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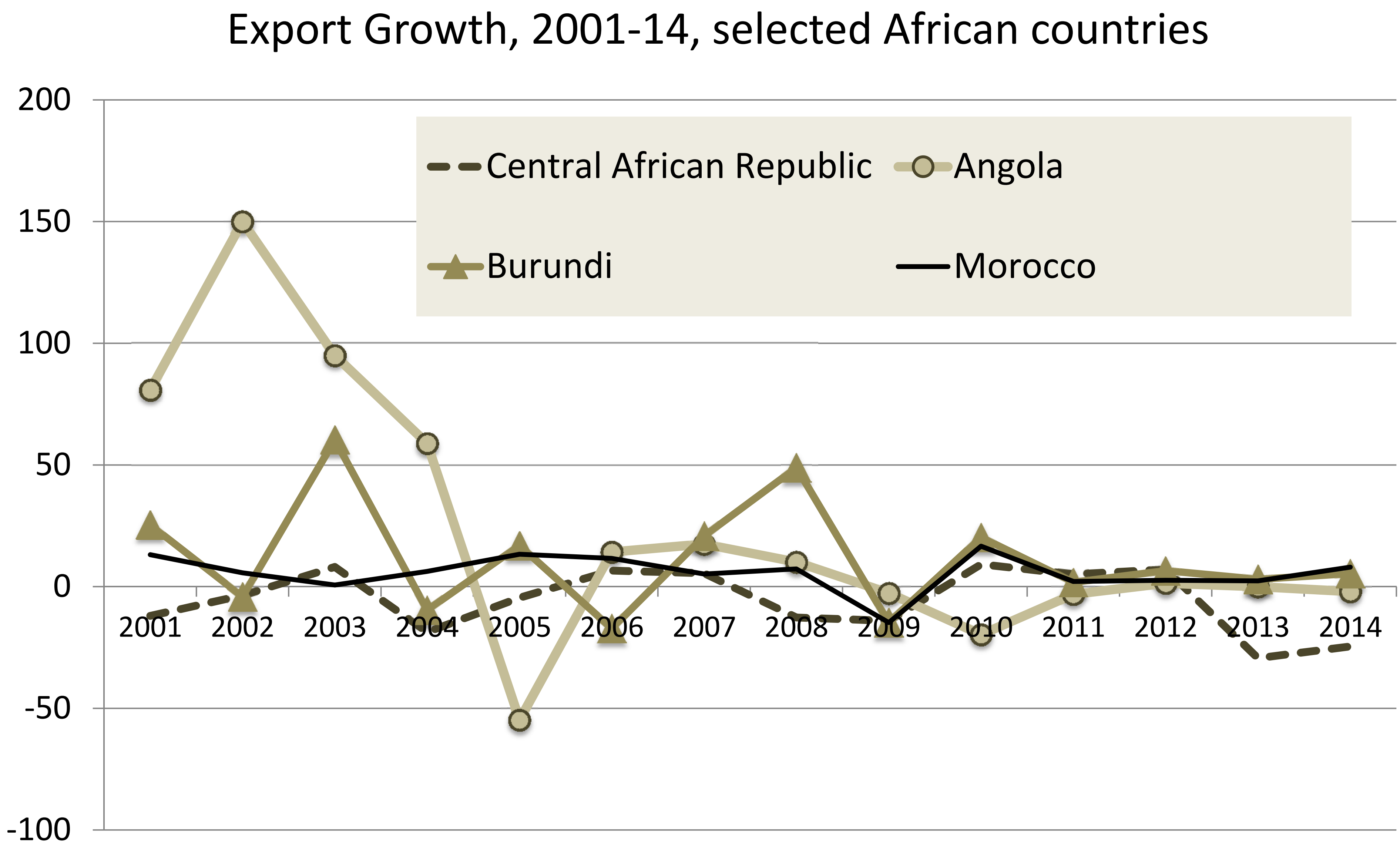
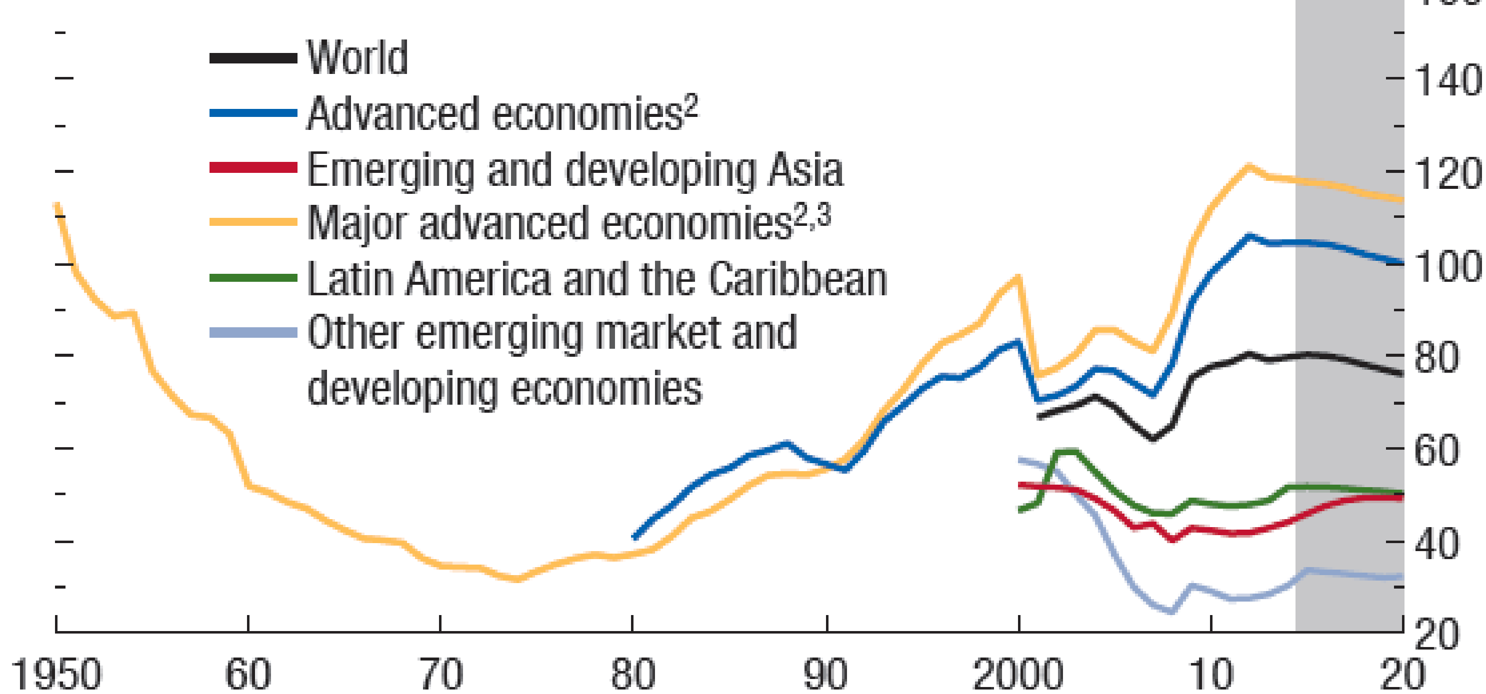
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
Malaysia
Thailand
Vietnam
Indonesia


Export Growth, 2001-14, selected African countries
200
150
100
50
0
-50
-100
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
Central African Republic
Angola
Burundi
Morocco

3. Gross Public Debt



Source: IMF staff estimates.
[1]Euro area countries (Greece, Ireland, Italy, Portugal, Spain) with high borrowing spreads during the 2010–11 sovereign debt crisis.
[2]Data up to 2000 exclude the United States.
[3]Canada, France, Germany, Italy, Japan, United Kingdom, United States.

Two arguments for austerity macro policy in the developed economies

1. Is there a 90% threshold for sovereign debt/income?

Barry Eichengreen, *Hall of Mirrors* (2015), p. 10:

- No. Especially when borrowing is cheap and there are underemployed resources.

2. Is there evidence that austerity has expansionary macro effects?

Eichengreen, 2015, p. 10:

- No. The cases referred to in academic work are special cases, whose conditions are not now replicated.

New arguments for expansionary fiscal policy in the developed economies

1. Does expansionary fiscal policy have a multiplier greater than 1?

IMF (Cottarrelli, Gerson, Sanhadji, *Post-Crisis Fiscal Policy*, 2015)

- Under two conditions: (a) a very deep recession, such as the US or UK experienced in 2008-09; (b) in a mild recession or under stagnation, only if there is coordinated multilateral expansionary policy.

2. *Can monetary policy do it all (stimulate growth, avoid inflationary pressure)?*

Claudio Borio (BIS), Richard Fisher (Federal Reserve)

- No.

Developing-economy futures under developed-country austerity policies?

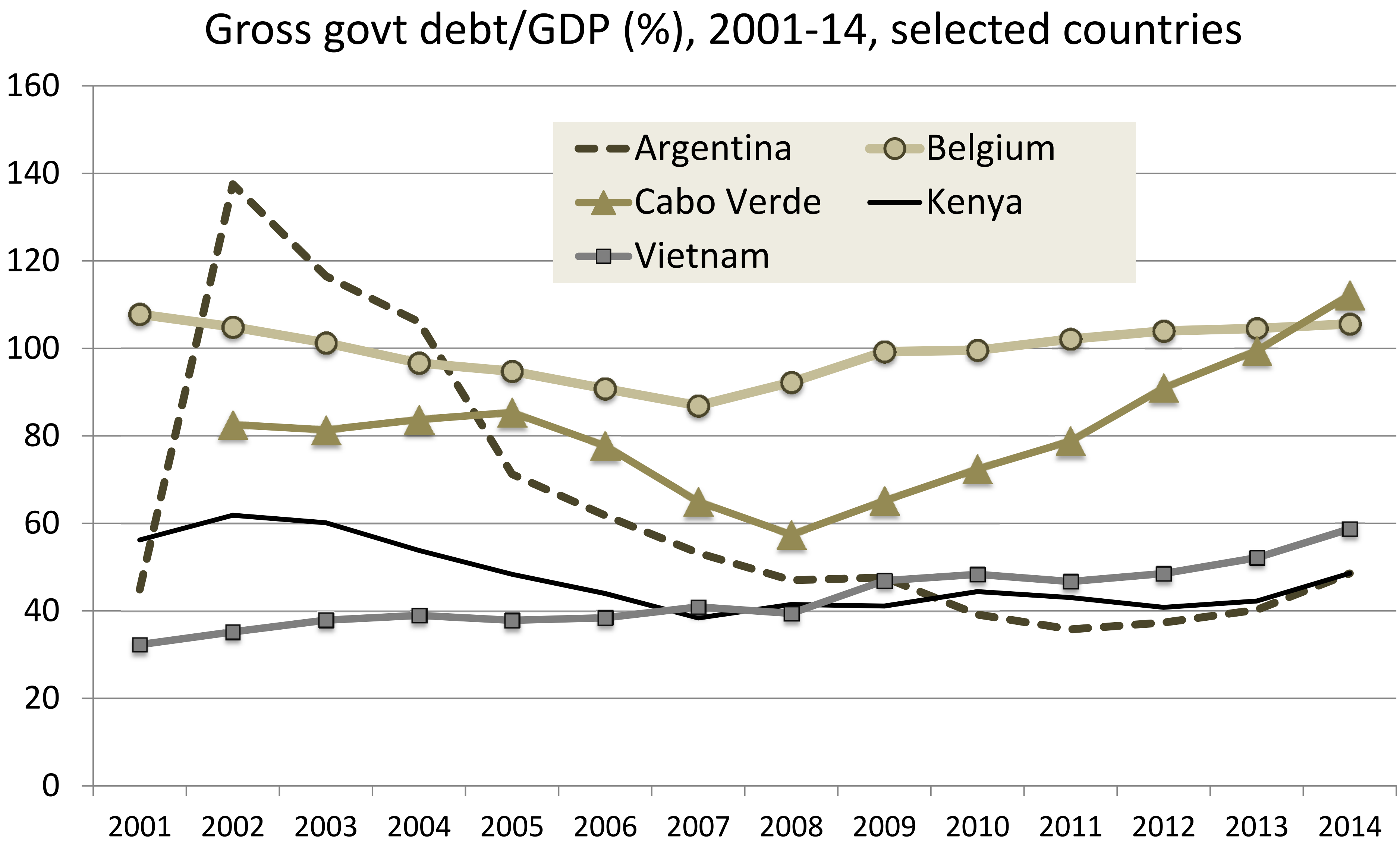
1. QE continues, US/UK interest rates stay low:

- Bubble-led growth, financial markets searching for zero-sum speculative gain
- Financial boom-bust in developies economies

2. QE ends, interest rates raised in US, UK:

- Financial bust in developing economies

2. Past and future of debt, sovereign debt, and sovereign-debt crises for developing countries


Gross govt debt/GDP (%), 2001-14, selected countries
160
140
120
100
80
60
40
20
0
2001
2002
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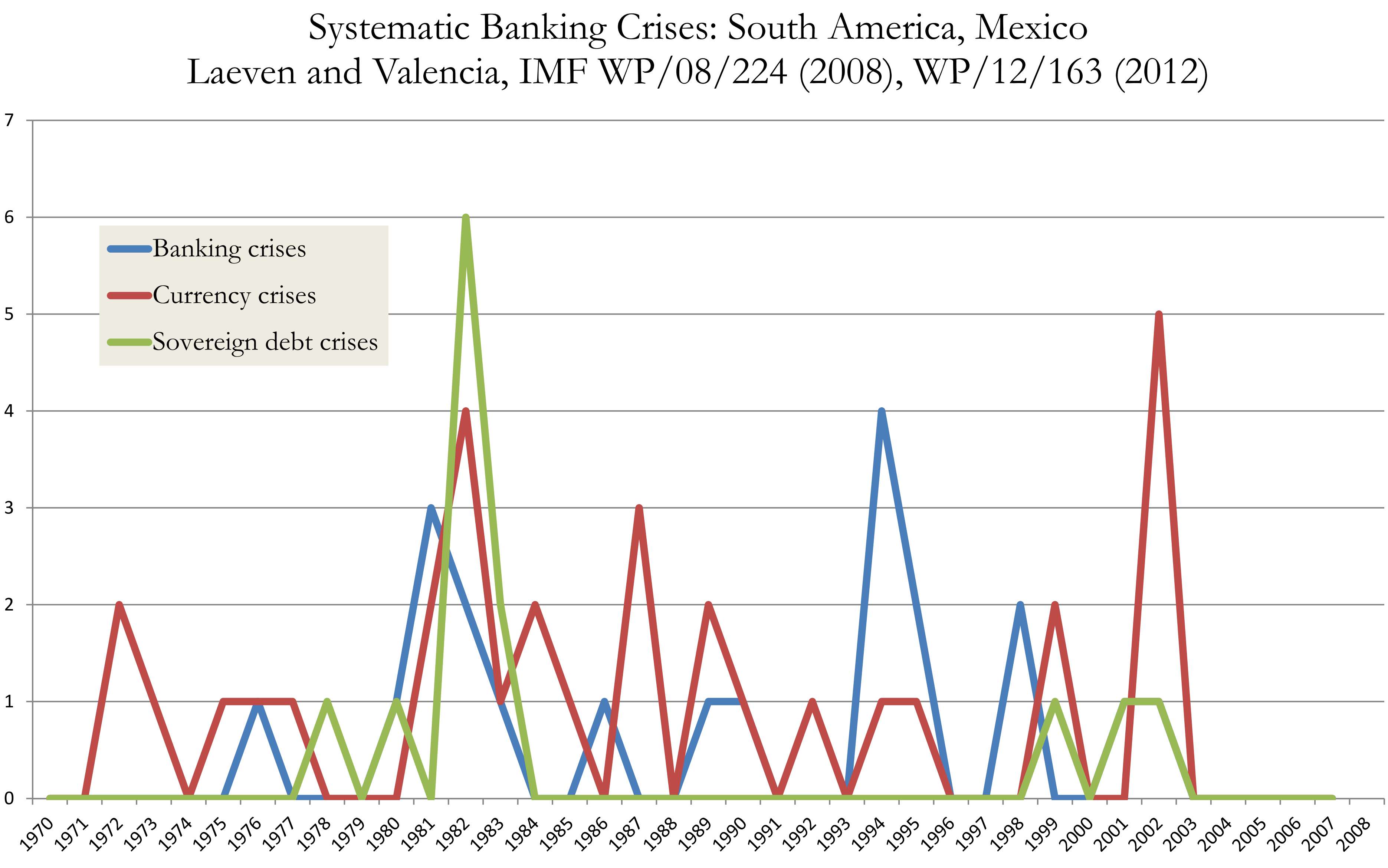
Argentina
Belgium
Cabo Verde
Kenya
Vietnam



Systematic Banking Crises: South America, Mexico
Laeven and Valencia, IMF WP/08/224 (2008), WP/12/163 (2012)
Banking crises
Currency crises
Sovereign debt crises
0
1
2
3
4
5
6
7
1970
1971
1972
1973
1974
1975
1976
1977
1978
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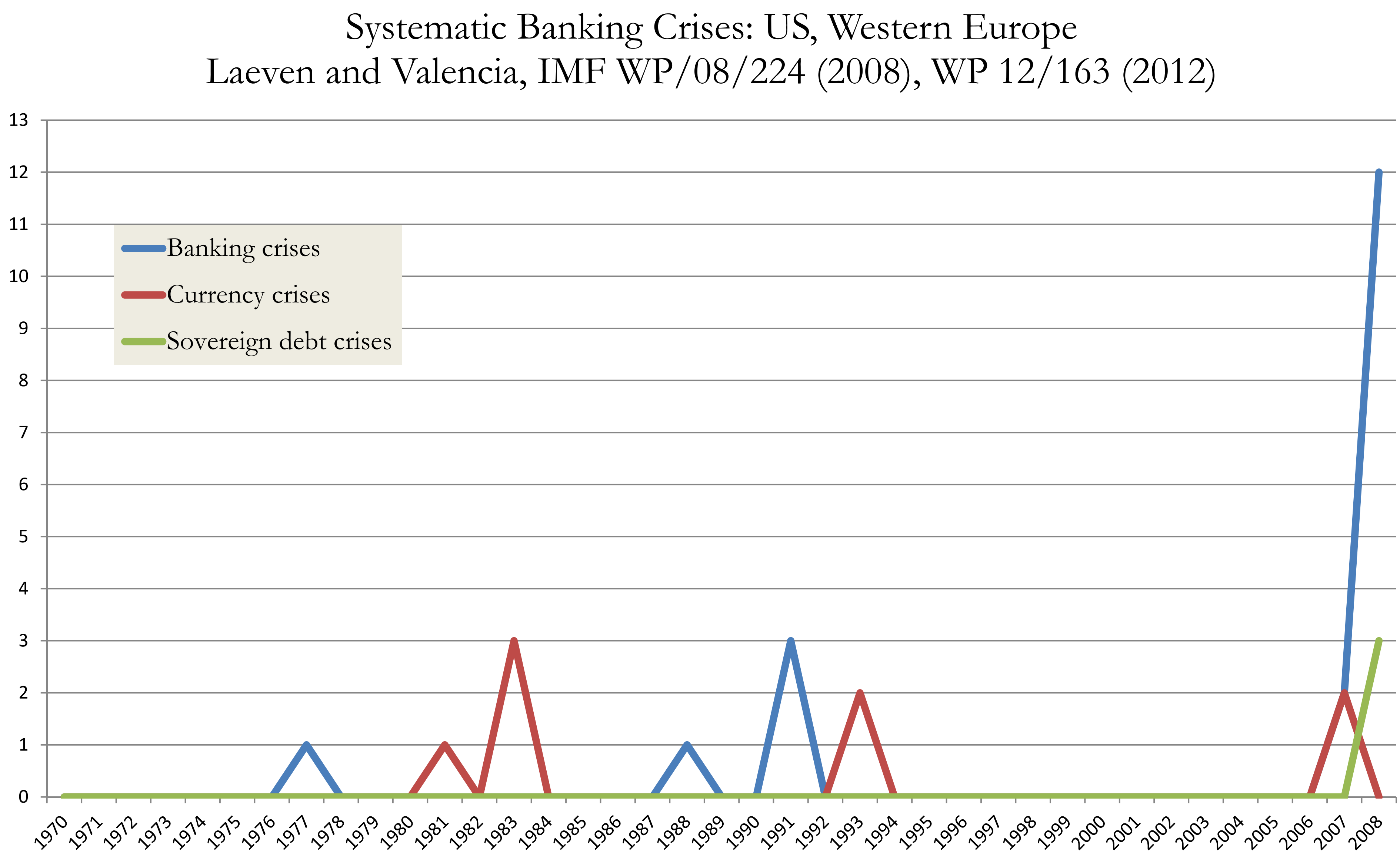

Systematic Banking Crises: US, Western Europe
Laeven and Valencia, IMF WP/08/224 (2008), WP 12/163 (2012)
Banking crises
Currency crises
Sovereign debt crises
0
1
2
3
4
5
6
7
8
9
10
11
12
13
1970
1971
1972
1973
1974
1975
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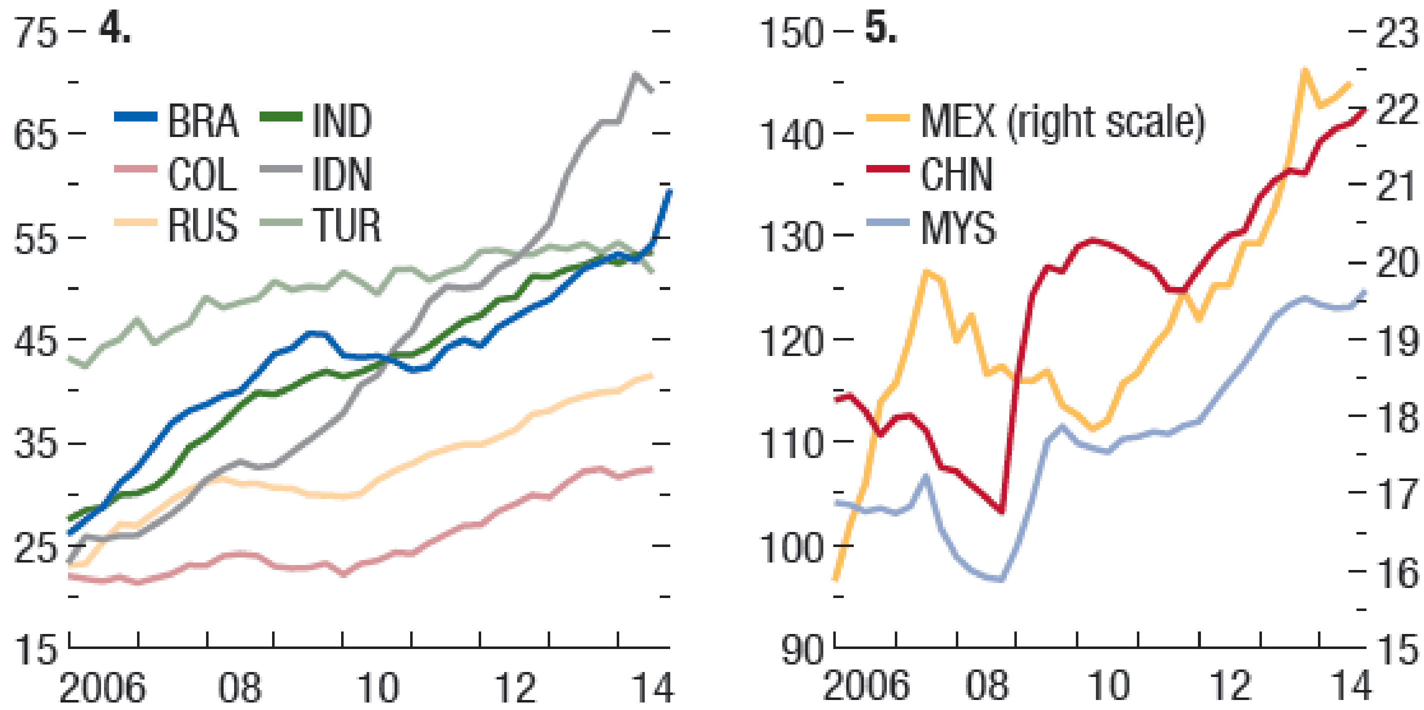
2008

Credit-to-GDP Ratio[2]
(Percent)



Sources: Haver Analytics; IMF, International Financial Statistics (IFS) database; and IMF staff calculations.
Note: Data labels in the figure use International Organization for Standardization (ISO) country codes.
[1]Deflated by two-year-ahead WEO inflation projections.
[2]Credit is other depository corporations' claims on the private sector (from IFS), except in the case of Brazil, for which private sector credit is from the Monetary Policy and Financial System Credit Operations published by Banco Central do Brasil.

Figure 8. Costliest Banking Crises Since 1970

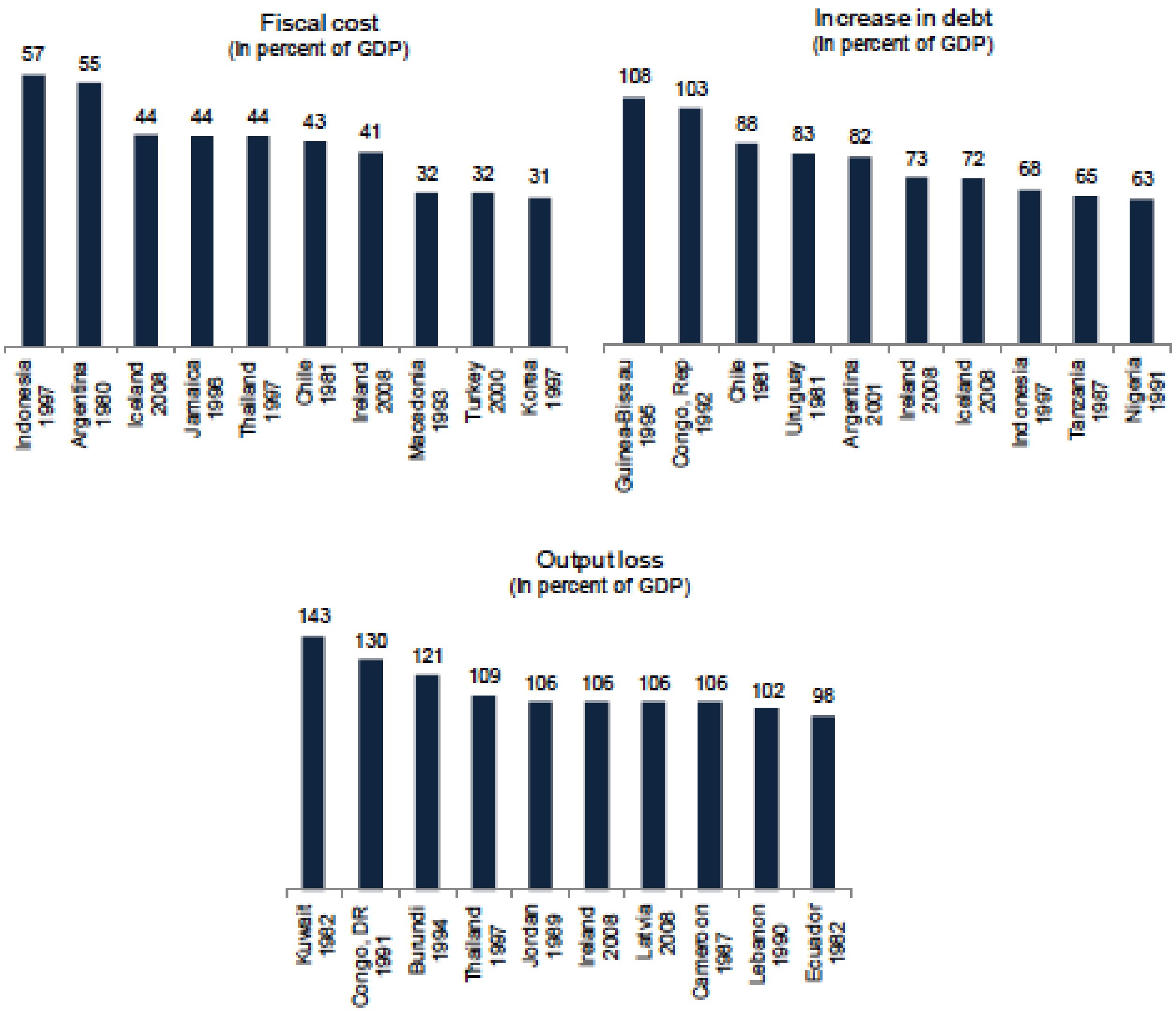
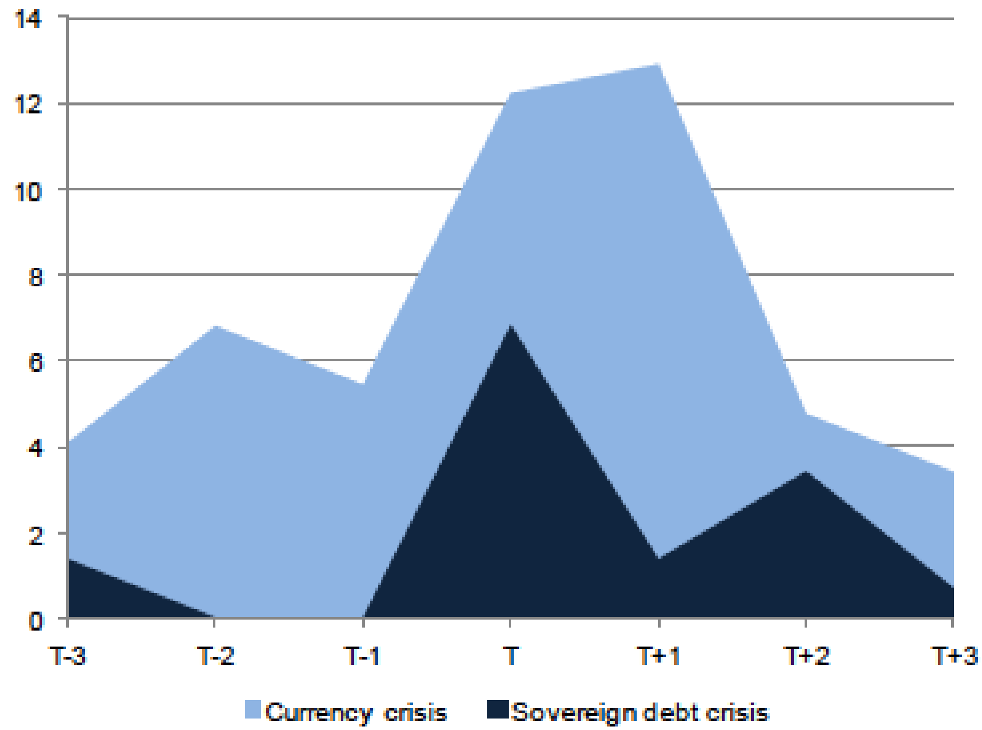


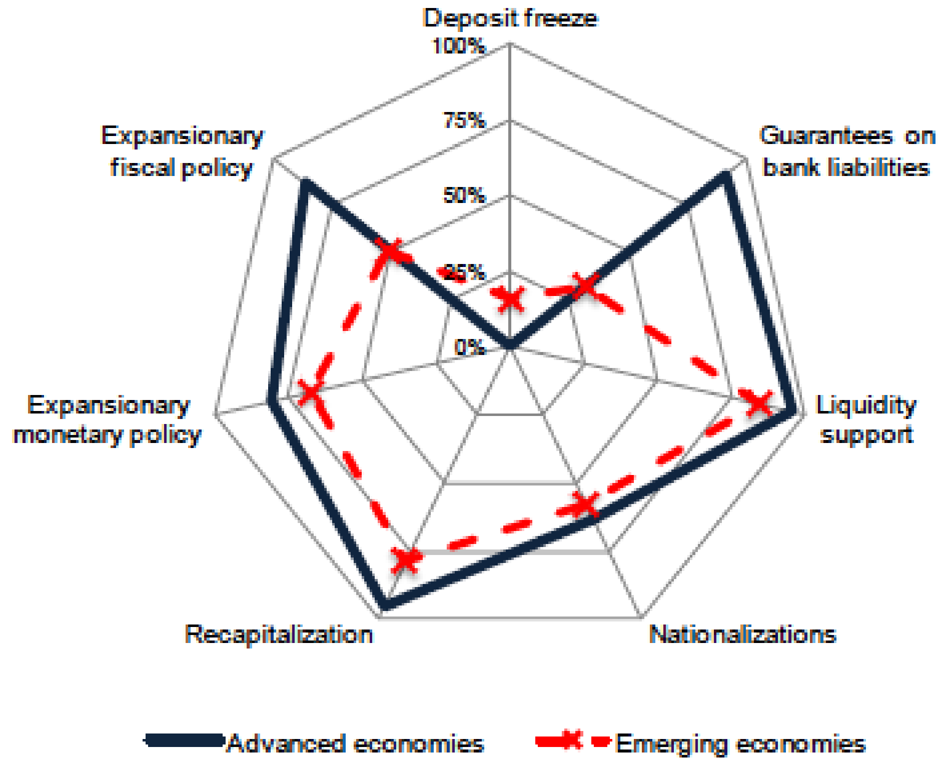
Figure 5. Timing of Currency and Sovereign Debt Crises Relative to Banking Crises

(In percent of the number of banking crises)



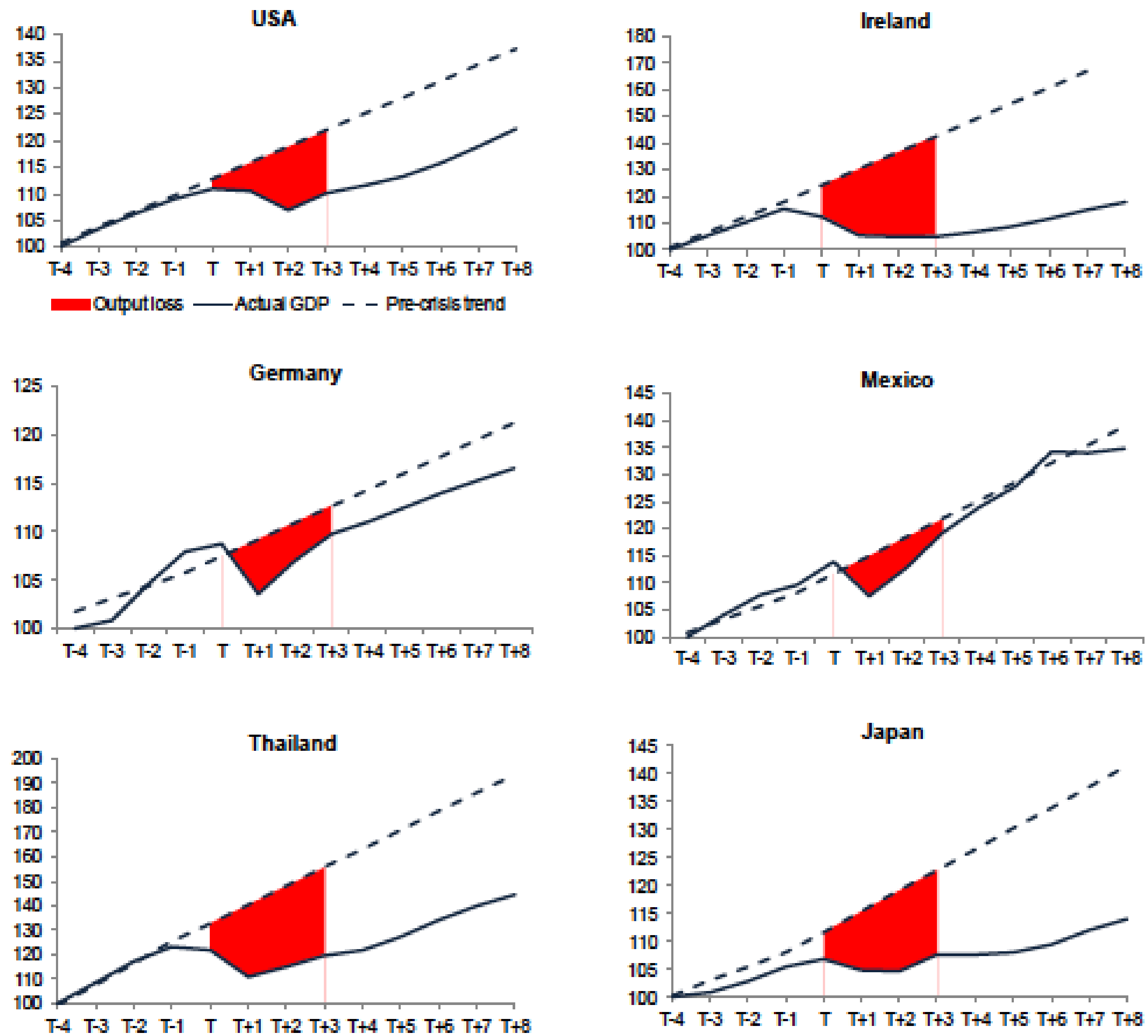
Source: Authors' calculations.
Note: T denotes the starting year of the banking crisis.

Figure 6. Differences in the Mix of Crisis Policies



Source: Authors' calculations.

Figure 7. Output Losses for Selected Crises Episodes 1/

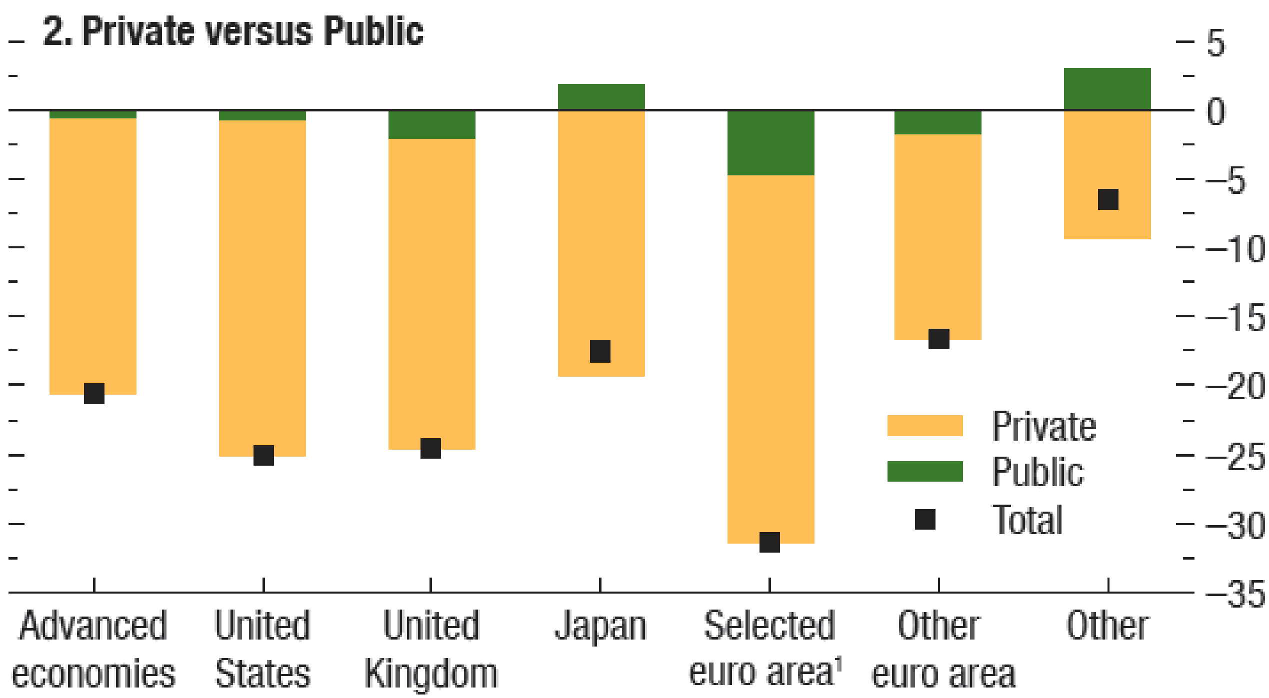


Sources: World Economic Outlook and authors' calculations.

1/Year T equals 2007 for USA, 2008 for Ireland and Germany, 1994 for Mexico, 1997 for Thailand and Japan. GDP in T-4 is set equal to 100.

Figure 4.4. Decomposition of the Investment Slump, 2008–14

(Average percent deviation from spring 2007 forecasts)



Sources: Consensus Economics; Haver Analytics; IMF, Fiscal Monitor database; national authorities; and IMF staff estimates.

Note: The figure presents data for 28 advanced economies: Australia, Austria, Canada, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Israel, Italy, Japan, Korea, Latvia, Luxembourg, Malta, Netherlands, New Zealand, Norway, Portugal, Singapore, Slovak Republic, Slovenia, Spain, Sweden, United Kingdom, United States.

[1]Euro area economies (Greece, Ireland, Italy, Portugal, Spain) with high borrowing spreads during the 2010–11 sovereign debt crisis.

3. Implications of innovations in global banking, lending markets

- Securitization (“originate to distribute” model) replacing lending (“buy to hold” model)
- Consequence: two contracts on one cash-flow as a normal state of affairs
- Result: Conflict of laws, resolved by the home country of the ultimate claim-holder
  - Brady Bonds
  - Subprime loans
  - Sovereign debt (Argentina case)

4. Considerations on a multilateral sovereign-debt resolution mechanism

- Austerity fiscal policy in developed countries will likely continue – cutting off sources of growth in developing economies
  - Commodities bust, China slowdown also factors
- Private debt levels are rising, and when trouble comes, private debt becomes public debt
- Costs of forced adjustment to meet inflexible payment requirements are high (eg, Greece)
- New legal structure of lending sets up conflict-of-laws problems that are unresolvable at the national level.