

Debt Sustainability Assessments —Current Efforts at the International Monetary Fund

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DSA at the Fund

- Concerns about medium-term balance of payments and fiscal sustainability has traditionally been at the core of Fund work
 - More recently, the focus has been increasingly on stocks—and its dynamics—in addition to flows
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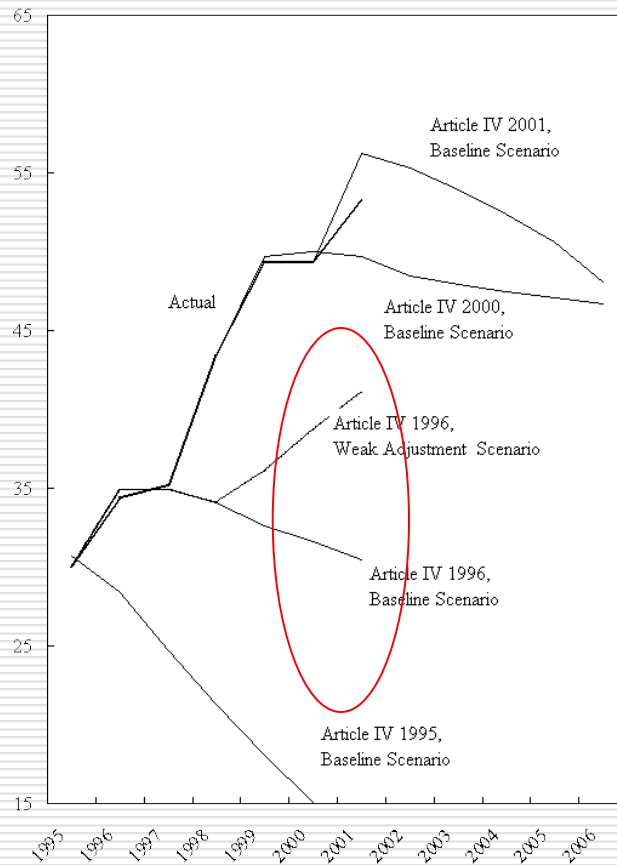
Sustainability assessments are important in Fund staff work

- Exchange rate and current account assessments
 - Fiscal policy advice
 - Use of Fund Resources: inform decisions on capacity to repay the Fund, access levels
 - Surveillance: crisis prediction, prevention → anticipate problems several years ahead to recommend policies to prevent crisis
 - Distinction between insolvency and liquidity crisis → affects policy prescription
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Objectives of the Framework

- Ensure that surveillance adequately focuses on risks to debt dynamics
 - Promote consistency and discipline/realism in sustainability analyses
 - Provide basis for better judgments on:
 - Vulnerabilities
 - Plausibility of debt dynamics articulated in programs
 - Required degree of restructuring (countries that have defaulted)
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Public debt projection: Brazil



Two different DSA frameworks

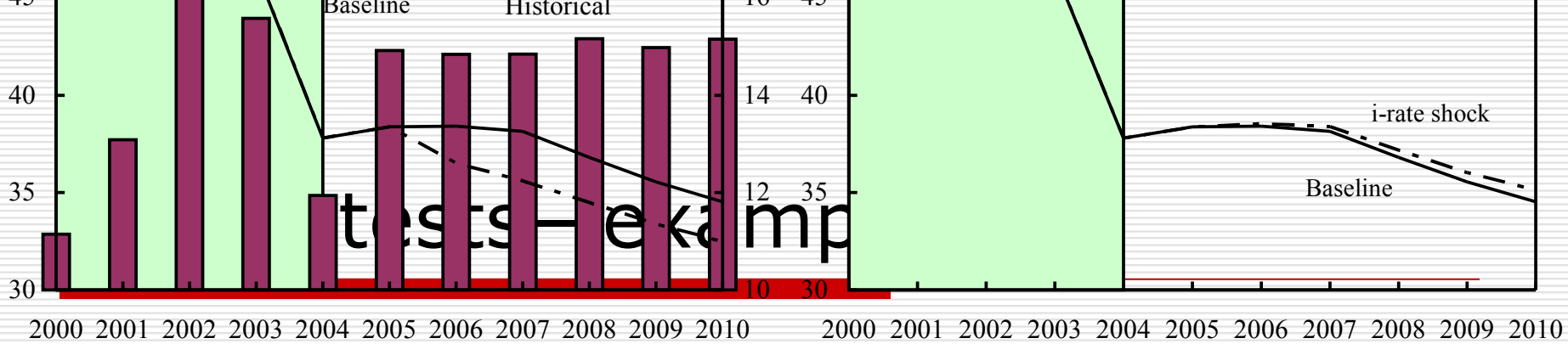
- Countries with market access: advanced and middle-income countries
 - Countries relying on official financing (low-income countries)
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Template for public and external DSA for countries with market access

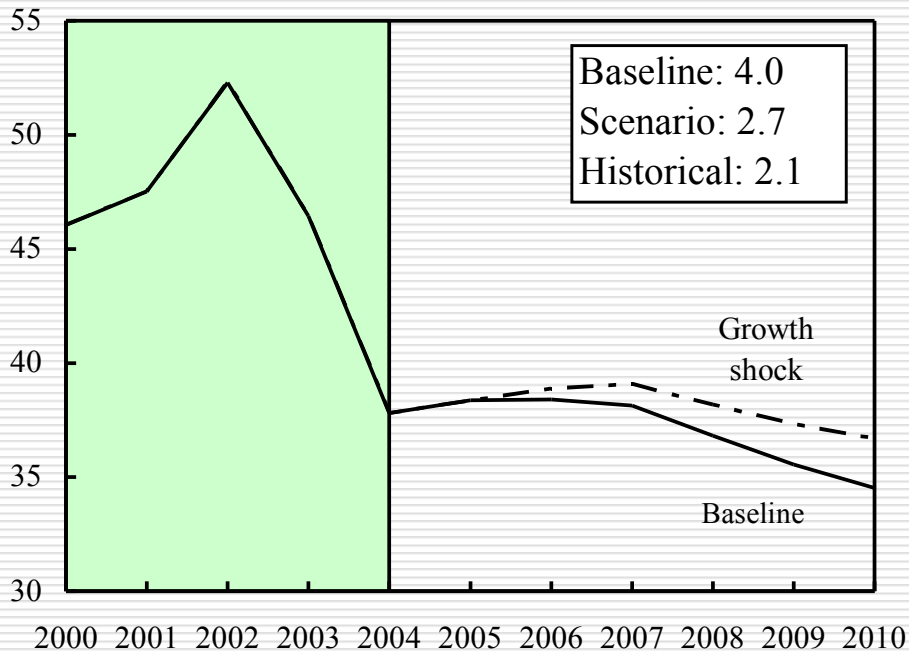
- Baseline (program) projections for debt dynamics and gross financing needs over 5-year period
 - Underlying macroeconomic assumptions
 - Stress tests for debt ratios
 - Historical scenario (historical parameter averages)
 - Possible country-specific alternative scenario
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Stress tests to check realism of projections...

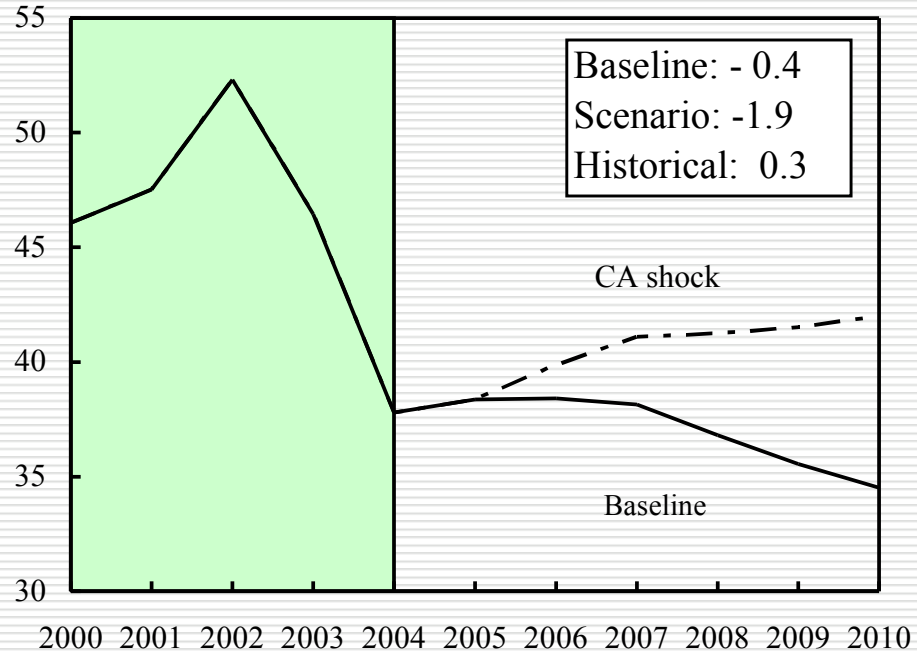
- Use of small but persistent shocks
 - Shocks applied to the baseline
 - Shocks applied to interest rate, growth rate, current account (external), primary balance (public), real depreciation, contingent liabilities (public). Also combined shock.
 - Graphical presentation
 - Lists baseline assumption, historical average, and bound test assumption
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Growth shock

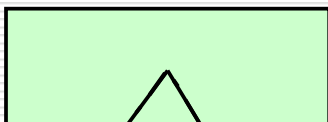


Current account shock



Combined shock 2/

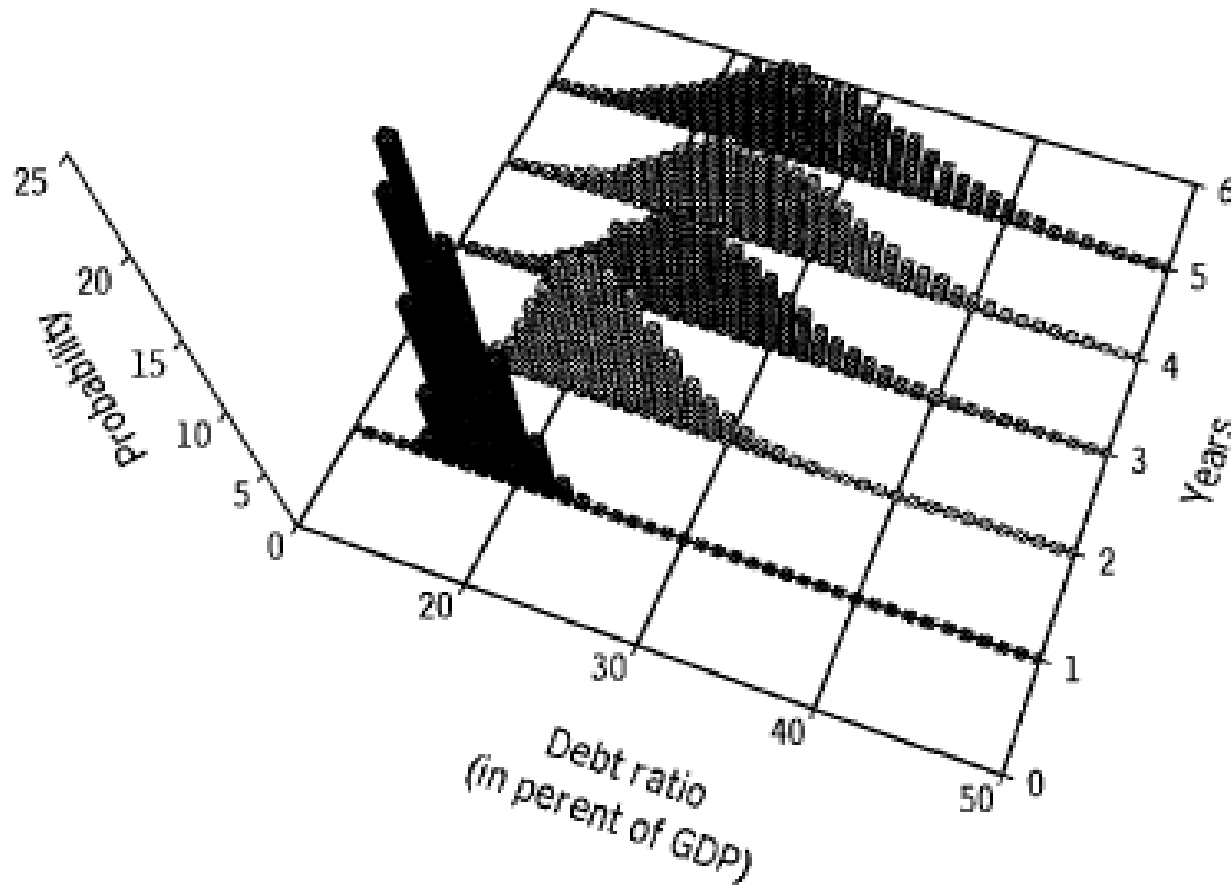
Real depreciation shock 3/



How are sizes of shocks chosen?

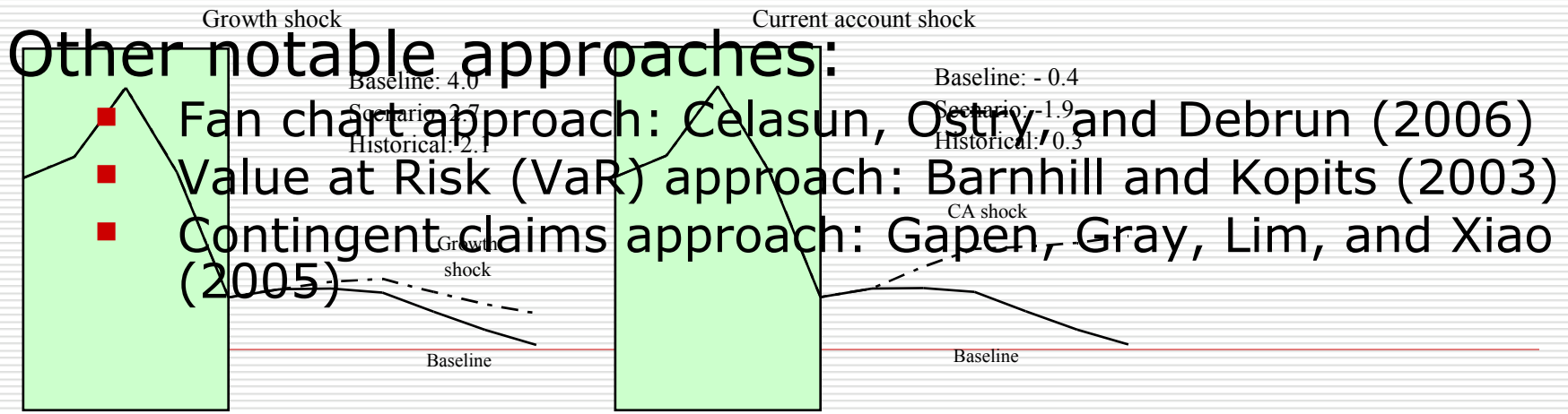
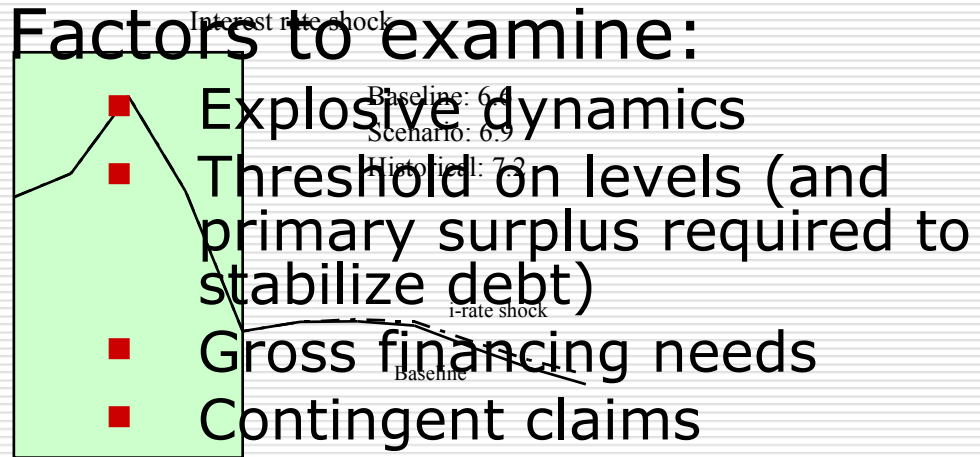
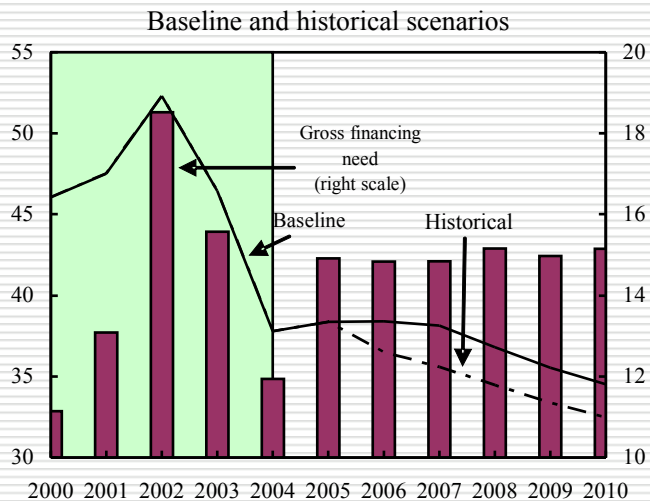
- **Stochastic simulation** used to determine appropriate size of shocks. Key concern:
 - large enough to capture potential risks
 - small enough to have reasonable likelihood of occurrence
 - Historical data from emerging market economies used to simulate distribution of debt
 - Sample: 14 emerging market countries (public debt); 41 middle-income market borrowers (External debt).
 - **1/2 standard deviation** shocks chosen as they reflect realistic p-values (to capture medium term risks)
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Simulated probability distribution



Interpretation of debt ratios

Figure 1. Country External Debt Sustainability: 160 and 165% / (In percent of GDP)



Why different framework for LICs?

- Debt mainly official
 - Different “rollover risk”
 - Different definition of crisis/ “debt distress” (arrears, Paris Club rescheduling, defensive lending)
 - Concessional nature of debt—need to think in present value terms
 - Different purpose—guide official lending in addition to policy advice (hence, jointly with World Bank)
 - Caveat: Heterogeneity—some LICs are near-emerging markets (judgment)
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LICs: Relevant Debt-Burden Indicators

- Numerator
 - NPV of debt (public/external)
 - Debt service

 - Denominator=measure of debt-servicing capacity
 - Total resource base (GDP)
 - Foreign exchange (exports)
 - Administrative capacity (revenues)
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LICs: Basic Elements of Framework

Indicative thresholds for PPG external debt

- Policy dependent (CPIA); supported by empirical analysis
 - Less problematic than in EMs (official debt, no market reaction)
 - Justified to guide official lending decisions
 - Interpret with caution (political choice, distress definition, errors)
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