



FINANCIAL SYSTEM AND THE SOVEREIGN: TIES THAT BIND



Debt Management in Developing Countries: New Frontiers and Ongoing Challenges

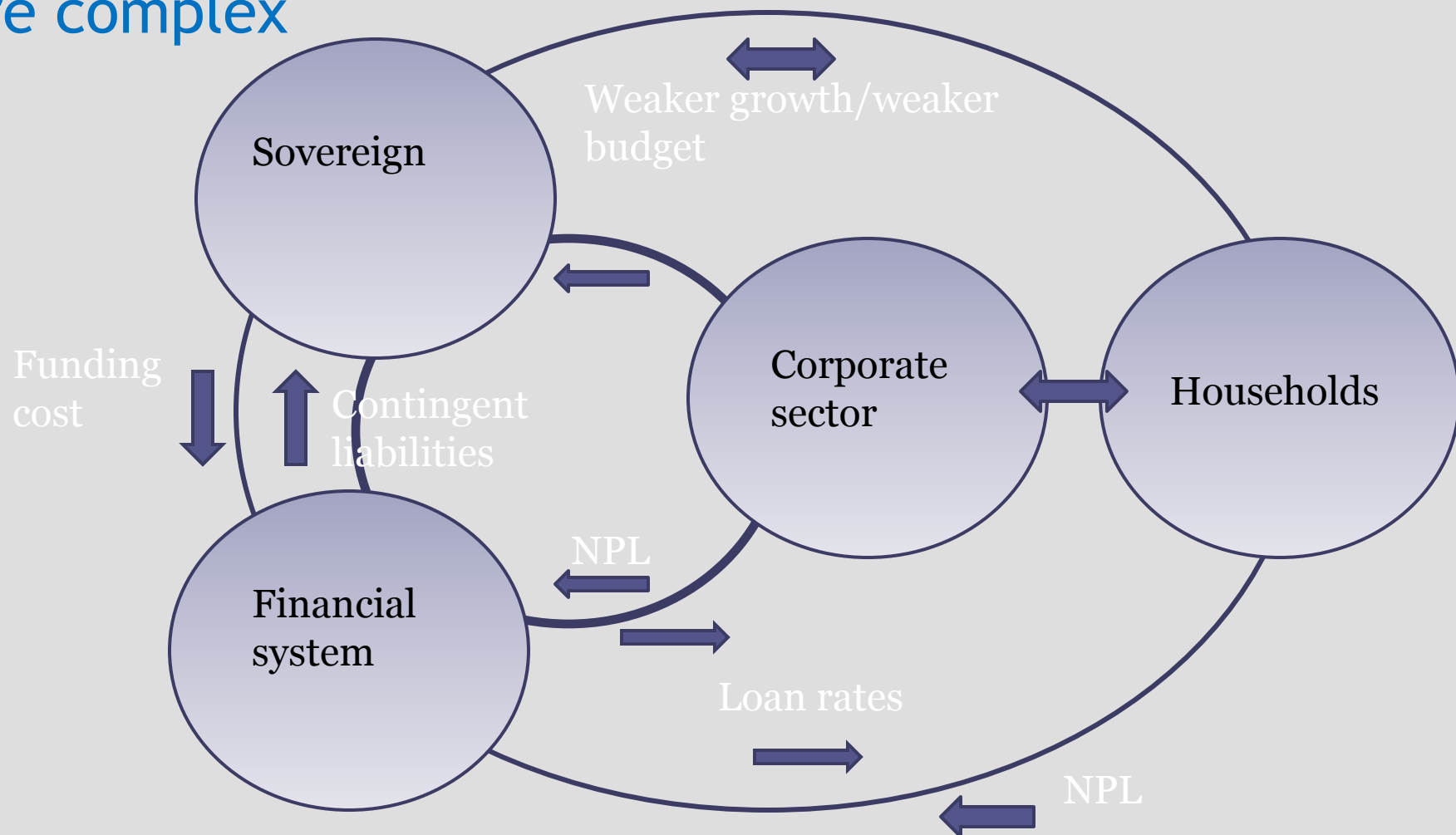
Debt DMF Stakeholders' Forum

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Links between the financial system and the sovereign are several:

- Sovereign debt is a benchmark asset
- Sovereign debt is used to manage bank balance sheets: collateral, liquidity, profitability over the business cycle, and solvency
- Sovereign debt is an asset for non-bank financial institutions
- Sovereign debt and sovereign guarantees may be needed to backstop the financial system

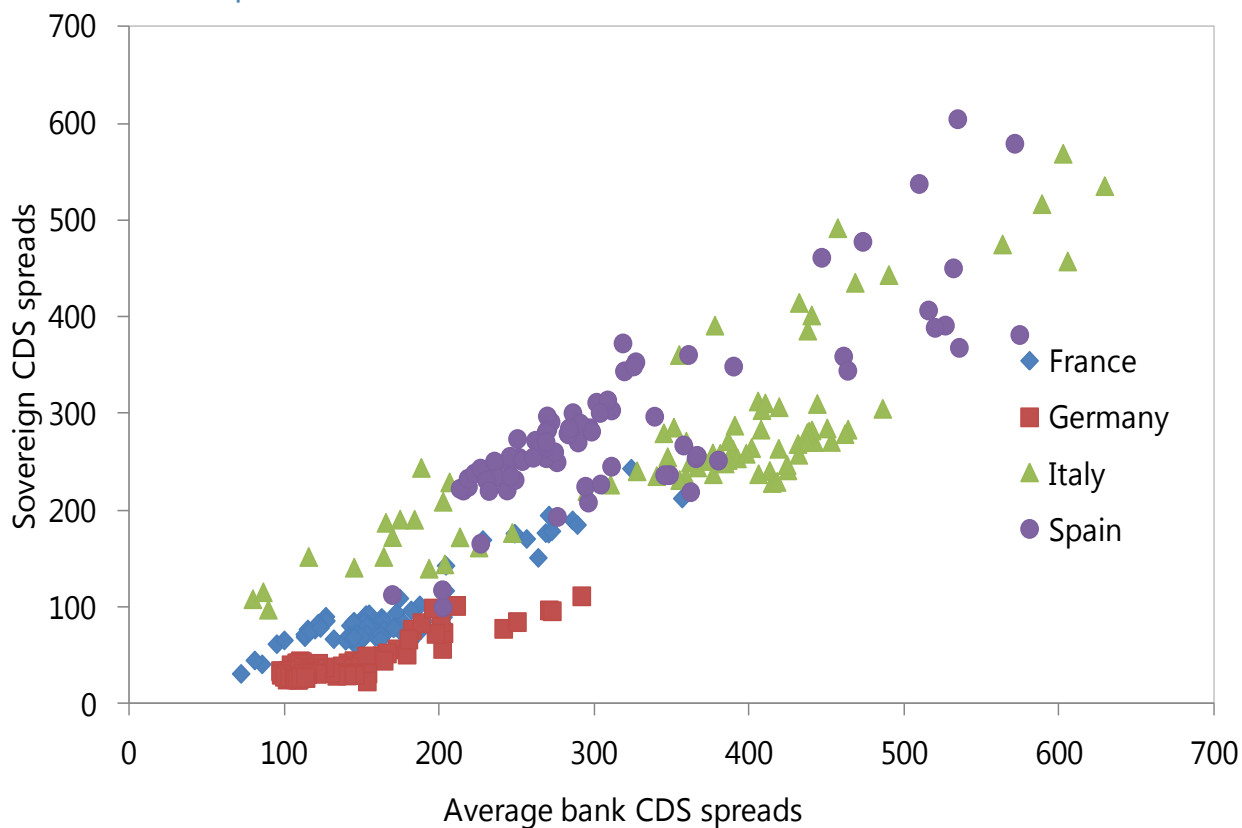
Loops between the financial system and the sovereign are complex



Sovereign and banks are conjoined in health and stress

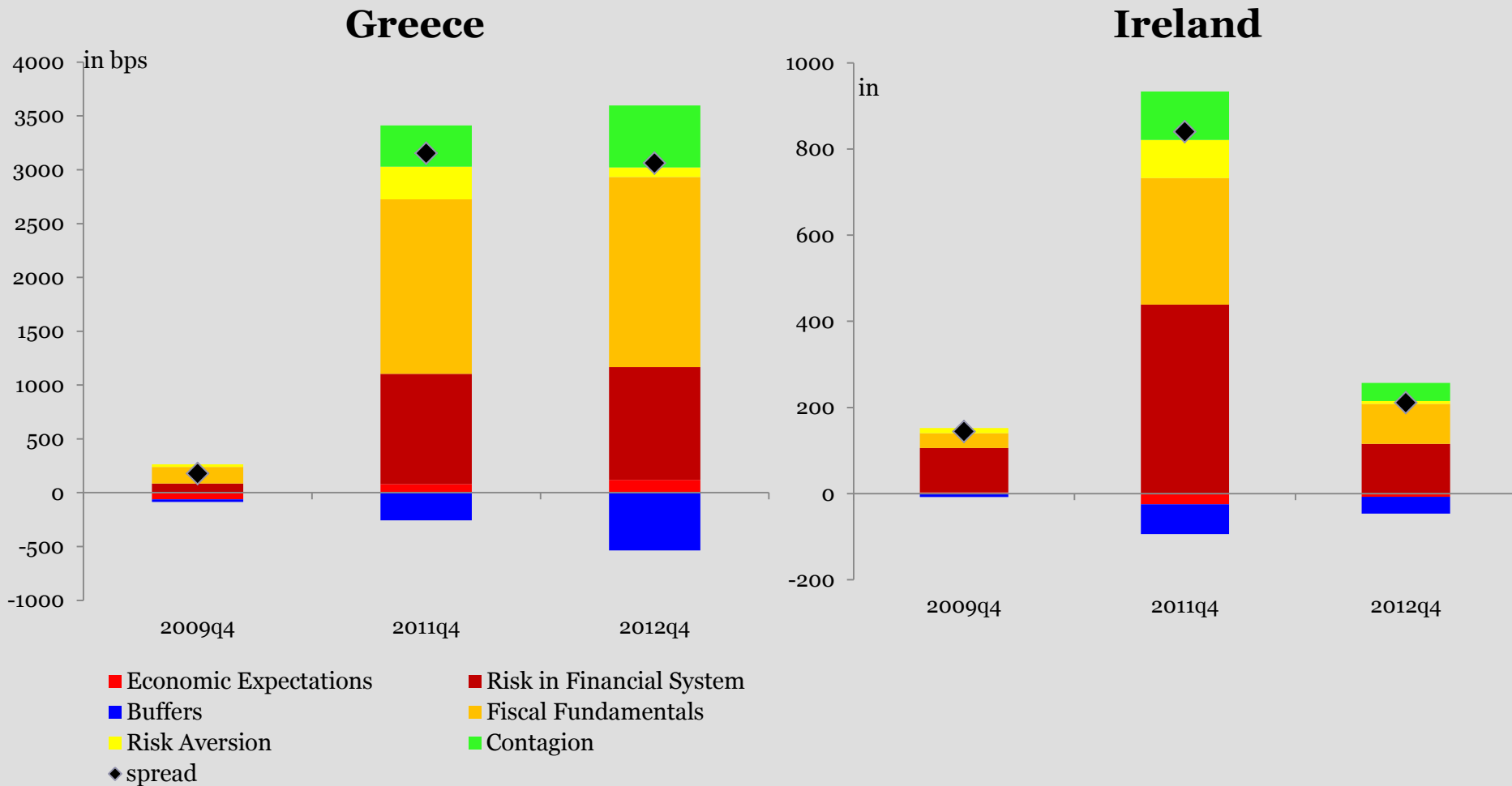
Average Monthly Bank and Sovereign Stress

(Basis points, 01/2010 to 9/2013)



Source: Bloomberg

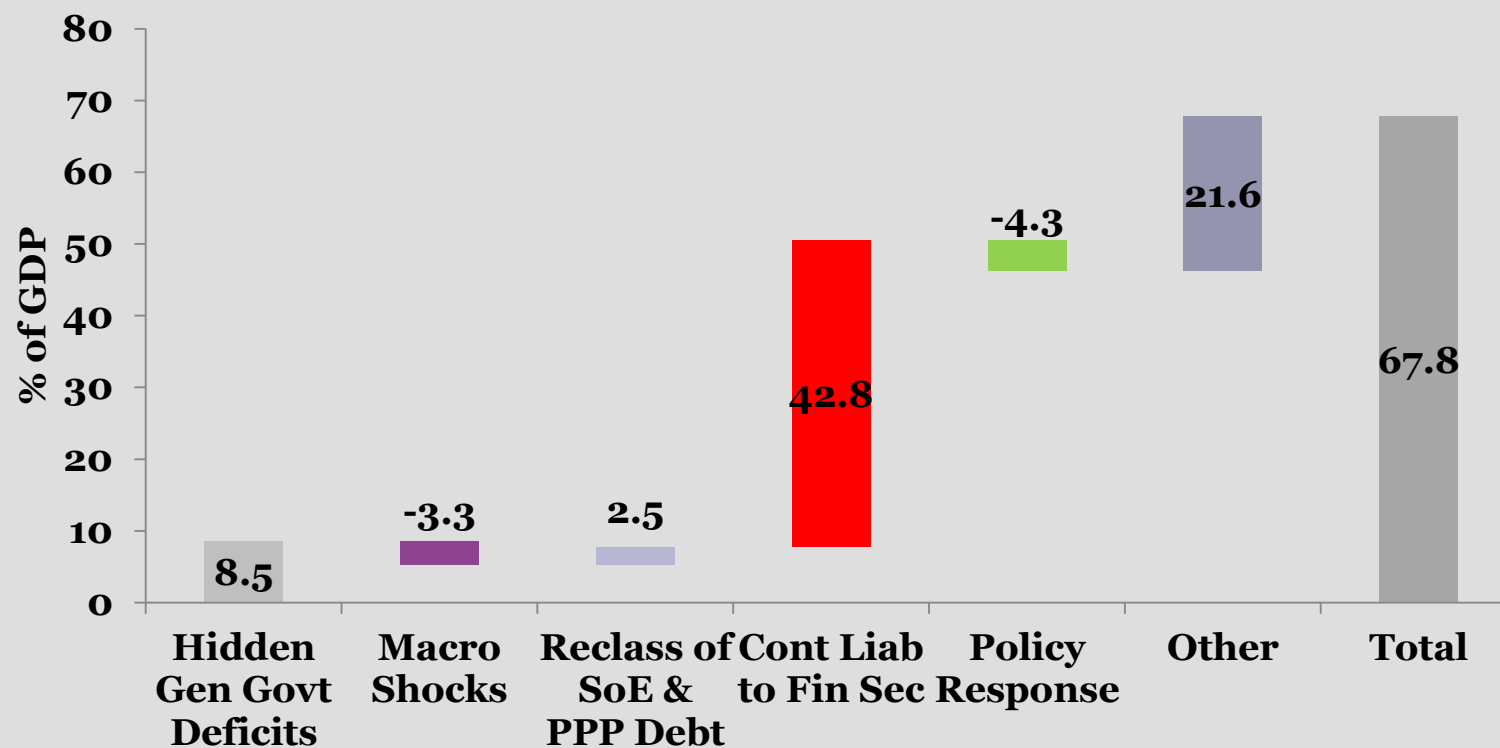
Financial stress contributes to sovereign spreads



Source: Bloomberg and IMF staff calculations

Financial sector support can hit the sovereign hard

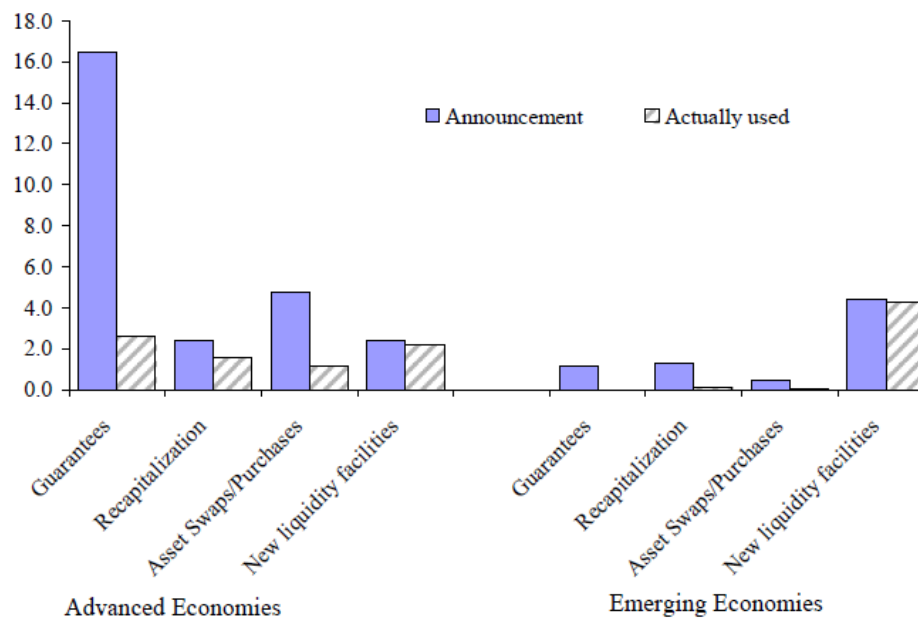
Iceland: sources of unexpected increase in government debt



Source: IMF staff calculations

Commitments need to be large even if actual use turns out small

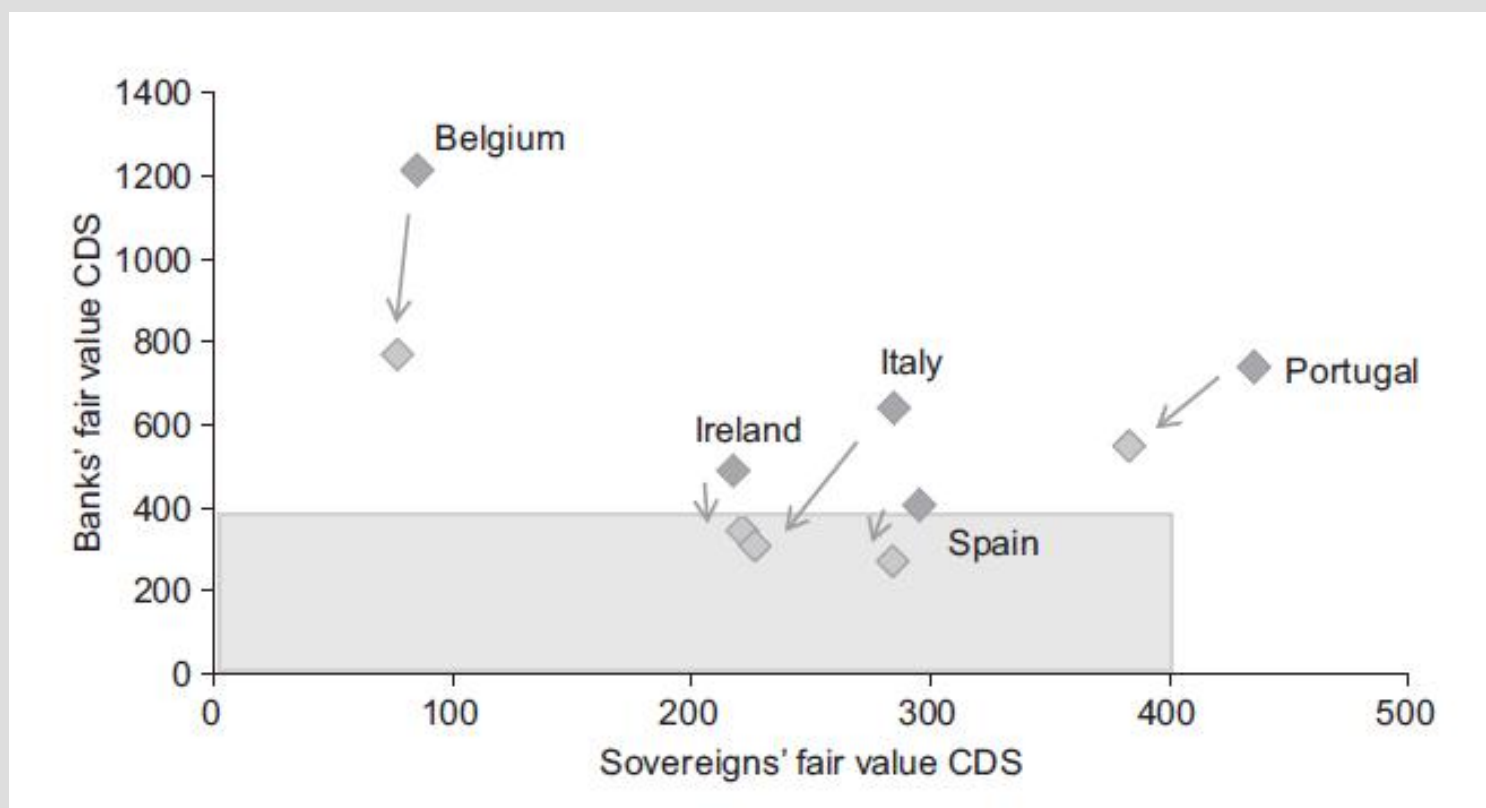
Figure 1. Financial System Support: Announcements and Actual Use
(In percent of 2008 GDP)



Sources: *World Economic Outlook*; *International Financial Statistics*; IMF staff estimates based on announcements by official agencies.

Note: Based on announcements made during January 2008–June 2009; and the latest information on the actual use as of May or June 2009. Medians of sample countries in Table 3. See Appendix I for details.

Banks and Sovereigns need to be “jointly” safe



Source: IMF staff calculations

What can Debt Managers Do?

- Take into account role of sovereign debt in financial system: safe and predictable
- Facilitate use of sovereign debt for collateral, liquidity, and business cycle management: safe and liquid, but mind exposure to sovereign
- Identify contingent liabilities: debt manager has role as risk manager to conduct investor base, contingent claims, and contagion type analysis and provide input to broader policy making
- Anticipate guarantees and debt issues to deal with realization of contingent liabilities: buffers, contingent debt



THANKS