Sovereign Debt and Asia: International Lessons and Emerging Issues

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Debt Lessons 1

• Latin America 1980s:
  - Avoid excessive external debt leverage
  - Fiscal sustainability
  - Cooperative approach (LLR for liquidity problem: Colombia, Chile; structural change and market-based debt reduction – Brady plan for Argentina, Brazil, Mexico, others with moderate haircut)
  - Realistic exchange rate & interest rate to avoid capital flight
  - Politics as important as economics (Chile vs Venezuela)
Debt Lessons -2

- East Asian Crisis 1997-98
  - Avoid high leverage of short-term external debt relative to external reserves
  - Successful management of liquidity problem without haircut
  - Again cooperative approach crucial; 3-year stretchout in Korea
  - Shift toward domestic markets to reduce asset-liability mismatch
  - Issue: lesson of reserves cushion → excessive mercantilism?
  - IMF as villain: the wrong lesson
• Euro area crisis
  - Rich countries can have sovereign debt crises (!)
  - Risks of single currency
  - Credible backstop of central bank paramount (OMT)
  - Meaningful progress toward fiscal consolidation, privatization key to underpin expectations (Italy, Spain, Portugal)
  - Avoid massive socialization of banking sector debt (Ireland)
  - Politics again (Grexit-risk destabilizations)
  - Need balance in PSI; importance of pari passu in OMT
Asia Reduces Sudden Stop Risk...

Short-term external debt/reserves (%)


...Partly by Insuring Itself

External reserves/imports of goods and services (%)


Indonesia, Korea, Malaysia, Philippines, Thailand
External Debt Burdens Are Now Moderate (or Negative)

Net external debt/exports of goods and services (%)
Government Debt is at Maastricht Levels or Lower

Government debt/GDP, Latin America and Asia (%)

- Argentina
- Brazil
- Chile
- Colombia
- Mexico
- Peru
- Uruguay
- Venezuela
- China
- India
- Indonesia
- Korea
- Malaysia
- Philippines
- Thailand
- Vietnam

Graph showing government debt/GDP for various Latin American and Asian countries from 2001 to 2012.
But Not in the Euro Area Periphery

Government debt /GDP (%)

Source: IMF (2013a)
Debt Sustainability Equation

\[ \pi \geq \lambda \times (r - g) \]

\( \pi \): primary surplus (fraction of GDP)

\( \lambda \): debt ratio (public debt / GDP)

\( r \): interest rate on debt (nominal)

\( g \): growth rate (nominal)
### Most EMEs Meet the Debt Sustainability Equation

**2013-18 averages, percent**

<table>
<thead>
<tr>
<th>Country</th>
<th>Growth</th>
<th>Inflationᵃ</th>
<th>Interest rate</th>
<th>2012 Debt/GDP</th>
<th>Primary surplus</th>
<th>DSPSᵇ</th>
<th>D-S fiscal gapᶜ</th>
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</thead>
<tbody>
<tr>
<td>Argentina</td>
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</table>

ᵃ GDP deflator; b. DSPS: Debt ratio stabilizing primary surplus; c. Gap to reach DSPS
But Spain and Japan do not

2013-18 averages, percent

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<th>DSPS b</th>
<th>D-S fiscal gap c</th>
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</tr>
</tbody>
</table>

a. GDP deflator; b. DSPS: Debt ratio stabilizing primary surplus; c. Gap to reach DSPS;

Sources: IMF (2013a, 2013c)
Original Sin Forgiven
Domestic Debt as Percent of Total Government Debt

Brazil
Chile
Colombia
Mexico
Peru
Venezuela

China
India
Indonesia
Korea
Malaysia
Philippines
Thailand

0%
20%
40%
60%
80%
100%

2000
2010

2000
2010
Paying a Premium for Sudden Stop Insurance

Domestic versus foreign borrowing cost: Korea, Mexico, South Africa, and Thailand

Note: D is the interest rate for domestic long-term government bonds. EF is the “expected foreign” rate and is constructed as follows: It equals a risk-free base for the 10-year US Treasury bond (EF1), plus the inflation differential between the country and the United States (EF2), plus the country-risk spread (EF3). SSP is the sudden-stop social risk premium.

Sources: Datastream; IMF (2013a, 2013b).
The Optical Illusion of The Lost Decade

Real GDP per labor force: Germany, Japan, and United States

Index (1995-2000 = 100)

Sources: IMF (2013b); BLS (2005).
Sum: Asian EMEs have learned debt lessons well; Japan perhaps not

- Avoided high external debt / exports
- Sharply reduced short term ext. debt/reserves
- Avoided debt restructurings with haircuts
- Kept public debt ratios at reasonable levels
- Meeting debt sustainability primary surplus
- Even India; inflation boosts nominal growth
- Relying more on domestic borrowing
- Japan’s 240% ratio a concern post-Greece