European Stability Mechanism

Lost and Found:
Market Access and Public Debt Dynamics

Discussion by Aitor Erce (European Stability Mechanism)

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Very timely and relevant issue

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[Fact] Since the 2008 bust, sovereign debt distress is back with force:

- Argentina, Ukraine, Jamaica, Greece, Cyprus, Belize… have restructured their sovereign claims.
- Double-digits of other countries have been forced to request financial support from the official sector.

[Fact] Sustainability assessments are as much art as science:

- Country and case specific debt stock triggers used to be the core result of debt sustainability analyses (DSAs).

[Fact] Better understanding of debt-stocks' flow-feats needed

  – Renewed debate: Stock versus Flows

[Policy need] How can we enrich DSA analyses with flow measures?

  – Debt dynamics matter…they matter a lot!

Debt sustainability: Stock versus Flows

Efforts to resolve the debt crisis have significantly altered Greece's debt profile, rendering sustainability analyses not factoring-in these very different flow features, powerless (Corsetti et al., 2016).

A consensus is emerging that debt sustainability relates to both:

– Dynamics of debt (a decreasing path)

– Gross financing needs (GFN) (must be below a manageable level).

GFN= Primary balance (deficit(+)/surplus(-)) + Interest payments + Amortisations

- In Gabriele et al. (2016) we show that GFN is fundamental to understand forthcoming DD.

Why not considering both simultaneously?

– GFN as one component of the change in debt: Debt Change=GFN-Revenues

On the data: DD & LMA

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The LMA dataset is very interesting but…

- Why not using a higher frequency?
- Dates for Ireland and Portugal?

The DD dataset is also interesting but…

- Why not including countries under official support as DD events?
- Why excluding AEs? They also suffer fiscal stress

On the econometric analysis

Not easy to follow what data-points remain in-sample at each stage

- Is removing observations the most efficient way to handle your concerns (why not using a post-event dummy?)

LPM and Probit are well accepted and easy to interpret/implement modelling approaches but:

- They can not tell apart supply and demand…and so?
    - Countries under official funding need not tap the markets
- When modelling market access recovery…sample selection?
    - A two-step approach? First, model market access. Then, re-access.

Other low-hanging fruits?

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- Are the effects described in the paper asymmetric?

    Are debt consolidations (falling debt) more or less strongly linked to stress/market access indicators that debt expansions (increasing debt)?

- Can we learn something about the length of the loss-of-market-access spell from the new paradigm presented on this paper?

    Do faster debt reductions lead to earlier market re-openings?

- Do the mechanism at play in this paper interact with other macroeconomic features?

    Is the effect of the debt dynamics larger or smaller during periods of global turbulences?

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Something else missing?

Well…I work for the ESM…

In on-going work with G. Corsetti and T. Uy, we study the endogenous relation between the terms of official support (OS) and sustainability/market access:

- Creditor composition matter for understanding sustainability
- OS can facilitate market access

Wrap up…

Very nice paper: relevant, clear and to the point

– DSAs need to better consider debt dynamics

– Debt dynamics go a long way into explaining market re-access

Some (potential) interesting ways forward:

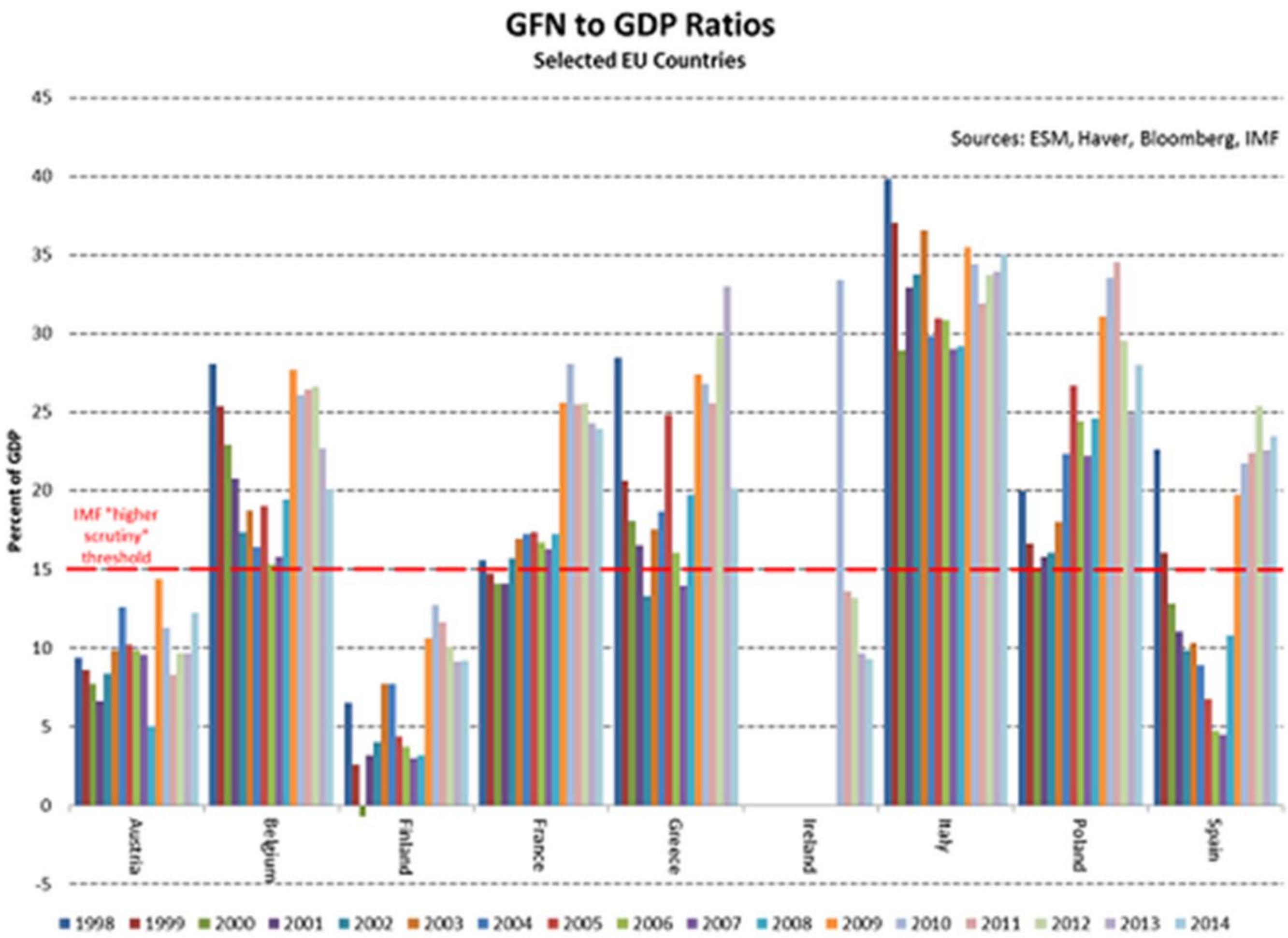
- More involved econometrics

- Additional scenarios: other controls

Thanks for your attention

Stock versus Flows: Greek Lessons

Gross Financing Needs



Gabriele et al. (2016)

	Stress definitions					
Average GFN in t-1 when:	250 bps	300 bps	350 bps	400 bps	500 bps	550 bps
Stress at time t occurs	21.5	22.9	23.9	25.1	27.1	27.1
Stress at time t does not occur	14.4	14.9	15.0	15.0	15.1	15.1
Number of events	65	42	36	30	24	24

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Fixed-effects (within) regression               Number of obs      =       136
Group variable: id                              Number of groups   =         8

R-sq:                                           Obs per group:
     within  = 0.7582                                         min =         17
     between = 0.4435                                         avg =       17.0
     overall = 0.6641                                         max =         17

                                                F(20,108)          =     16.94
corr(u_i, Xb)  = -0.2827                        Prob > F           =    0.0000

------------------------------------------------------------------------------
      spread |      Coef.   Std. Err.      t    P>|t|     [95% Conf. Interval]
-------------+----------------------------------------------------------------
 debt_to_gdp |  -1.601385   1.995827    -0.80   0.424    -5.557461     2.35469
 gdp_real_gr |  -48.72127    7.86657    -6.19   0.000    -64.31418   -33.12837
  gfn_to_gdp |  -26.99017   5.755461    -4.69   0.000    -38.39849   -15.58185
       inter |   .3120438   .0612606     5.09   0.000     .1906146     .433473
          y1 |    207.235   77.22429     2.68   0.008     54.16308    360.3069
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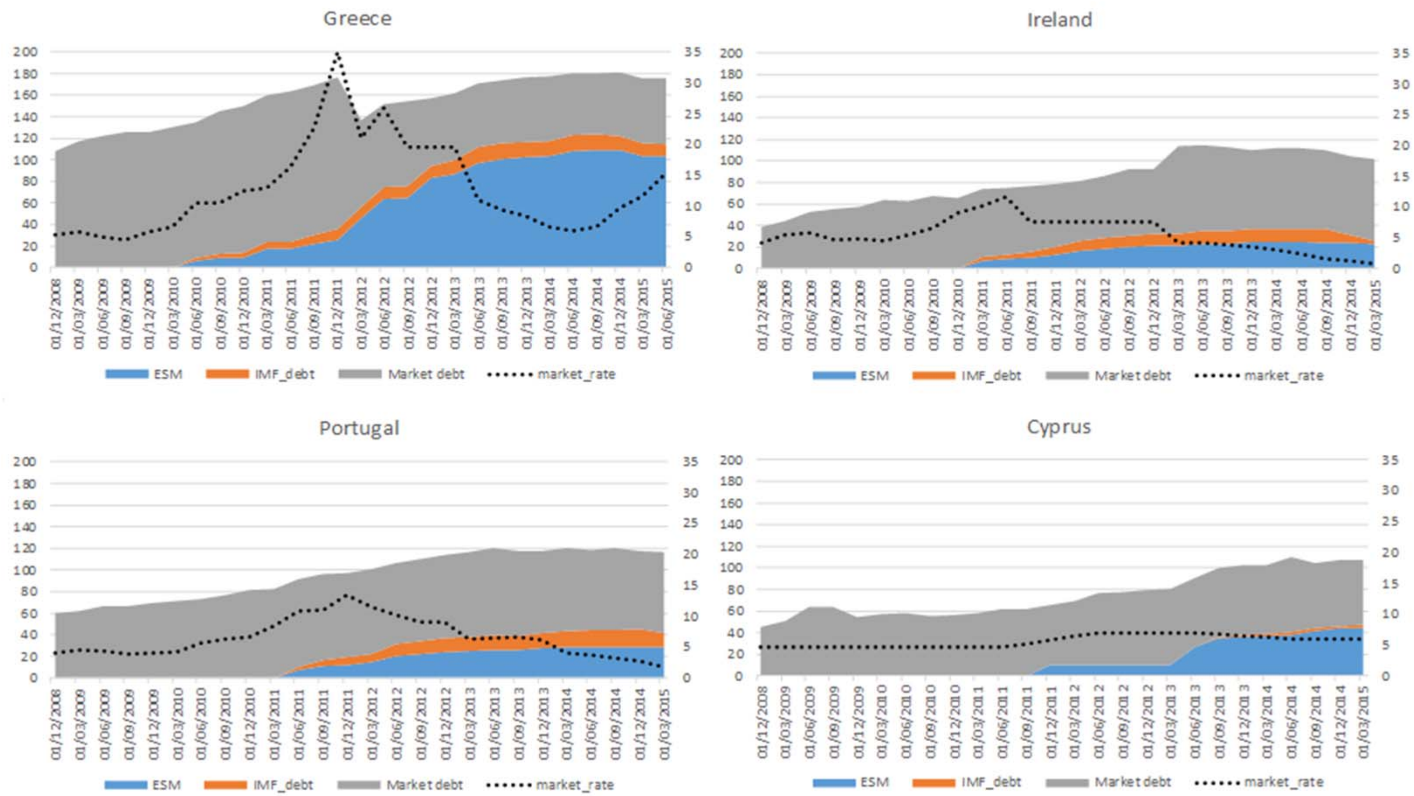
Debt Sustainability and the Terms of Official Support

Figure 1. Creditor composition and sovereign default risk

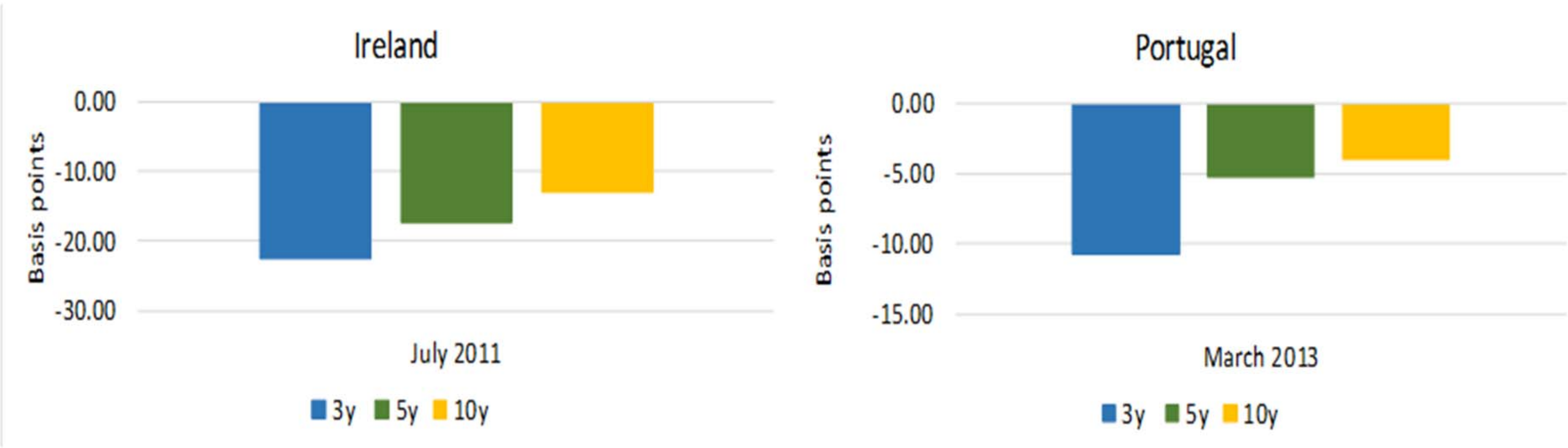


Sources: European Commission, European Stability Mechanism, various countries Central Banks and Bloomberg. Debt is measured as percentage of GDP. The market rate, measured on the right hand side axis refers to the spread on the benchmark 10 year sovereign bond

Sustainability depends on the official loan terms. Irish and Portuguese rates shifted down as cheaper and longer-lasting official loans became prevalent (Corsetti et al., 2016).

Market Access and the Terms of Official Support

Changes in bid-ask spreads following the loan amendments



Source: Official sector Lending Strategies (Corsetti et al., 2016).

By affecting refinancing costs and patterns, OS loans can create room for market financing. Following the changes to the Irish and Portuguese official, their sovereign bid-ask spreads narrowed at all maturities. Lower bid-ask spreads signal receded uncertainty.