Introducing the

Sovereign Risk & Debt Sustainability Framework

for Market Access Countries

Joint Vienna Institute

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Background

The IMF has two frameworks for debt sustainability analysis	• Debt Sustainability Framework for Low-Income-Countries (LIC-DSF, joint with the World Bank) • Debt Sustainability Framework for Market Access Countries (MAC DSA)
The frameworks are regularly reviewed	• The LIC-DSF was last reviewed in 2017-18 and is currently in effect • A review of the MAC DSA in 2011-13 resulted in the framework that is currently in use
A major reform has been approved to the framework for market access countries	• In January 2021, the IMF's Executive Board concluded a new review of the MAC DSA framework that called for significant improvements • The template and guidance note (instructions) are currently being developed for a successor framework that is expected go live by 2022:Q1

The SRDSF introduces several key reforms

Horizon-based approach & long-horizon analysis

Greater focus on the timing of risks and more attention to longer-term issues provides for a richer and more nuanced assessment

Emphasis on debt transparency

Improved debt disclosures and reporting aims to avoid debt surprises and support more evenhandedness in DSAs

Improved techniques and predictive power

Strengthened methodologies support better overall capacity of the framework to detect sovereign debt risks

Clearer bottom-line results

Clear communication supported by mechanical signals, three-way assessments at each horizon, and an overall judgment-based sovereign risk assessment

One framework, two aims

To provide a framework that can be used to assess the **risk of sovereign stress** AND **debt sustainability** in market-access countries

Sovereign Risk Assessment

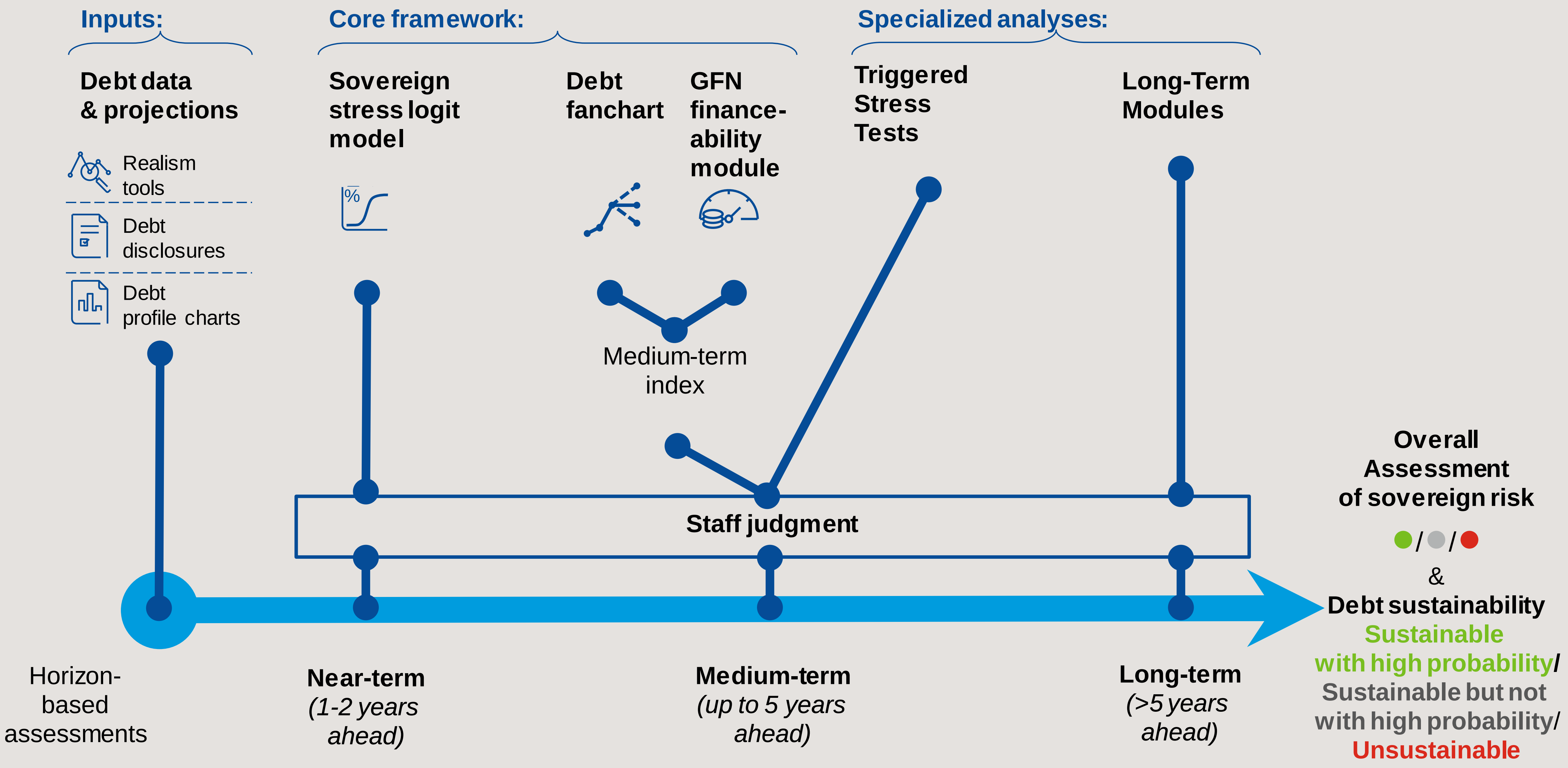
Critical for IMF's **surveillance** function: ("Early Warning System" for alerting sovereigns to the risk of falling into debt-related **stress")**.

Debt Sustainability Assessment

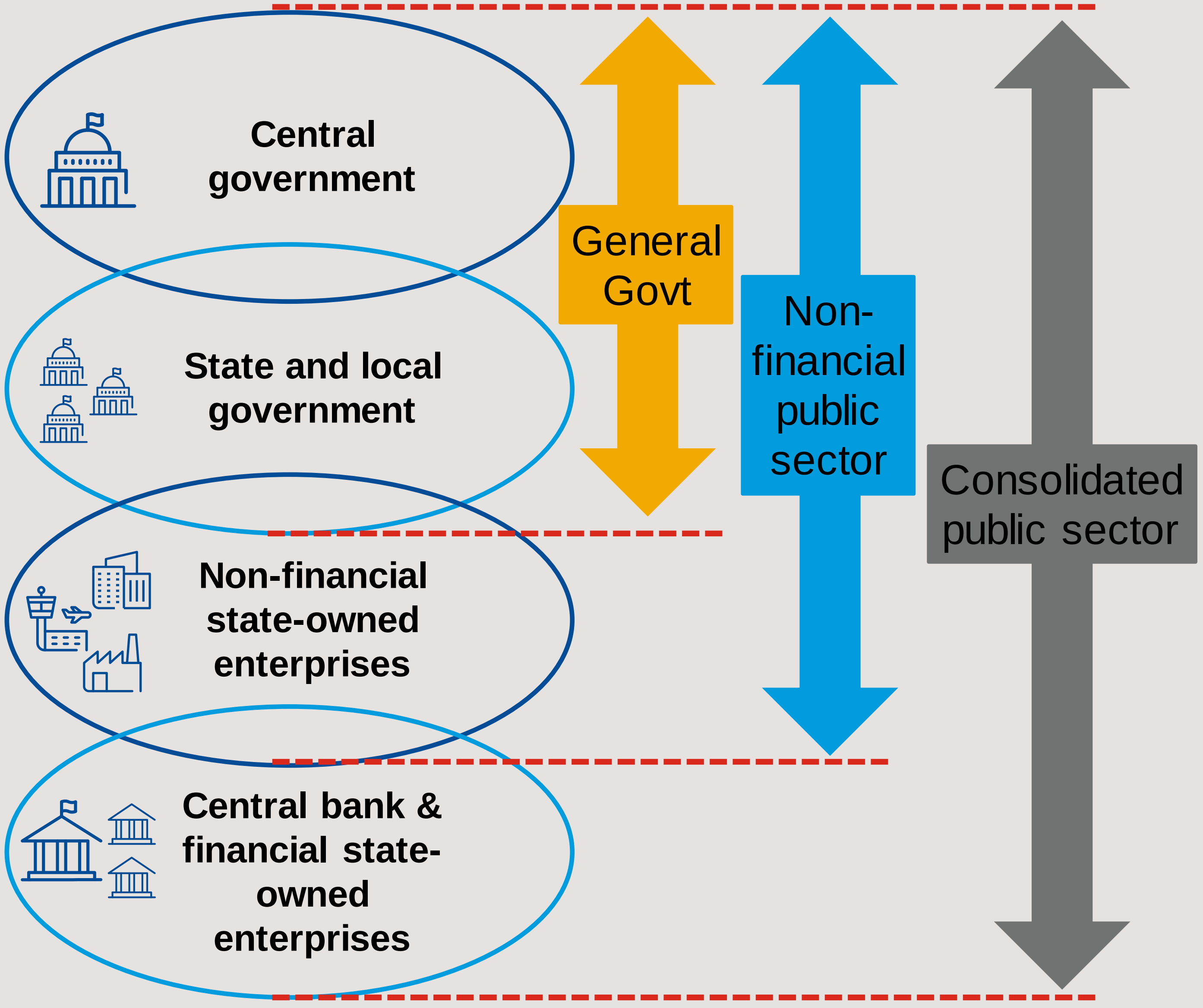
Critical to support IMF **lending** decisions: Underpin the Fund's judgments on whether debt is sustainable (or sustainable with high probability, in exceptional access cases)

Hence, new title: "Sovereign Risk and Debt Sustainability Framework for Market Access Countries"(MAC-SRDSF)

SRDSF overview



Improved debt coverage and disclosure



Closer attention to risks stemming from narrow coverage

- General government is the default institutional coverage
- Broader coverage is possible when an economic case exists
- When coverage is narrow (central government only), a contingent liability stress will track risks
- Guidance will explain how to treat specific central bank liabilities (e.g. liquidity paper and FX swaps)
- Enhanced disclosure of coverage, instruments, and debtholders will support risk analysis and evenhandedness

The near-term assessment is based on a logit model

- A multivariate logit model to act as an Early Warning System featuring key stress drivers across a variety of categories:
- This module is applicable only to countries not currently in stress (it is not run for non-precautionary program countries)
- All inputs to the model are historical observations, eliminating optimism as a risk in this module
- The key metric is the fitted probability from the logit model, which indicates probability of sovereign stress in the next 1-2 years

Structural characteristics

- Institutional quality index
- Stress History

Cyclical position

- Current account balance
- Change in REER (3-yr)
- Credit gap (if > 0)

Debt burden and buffers

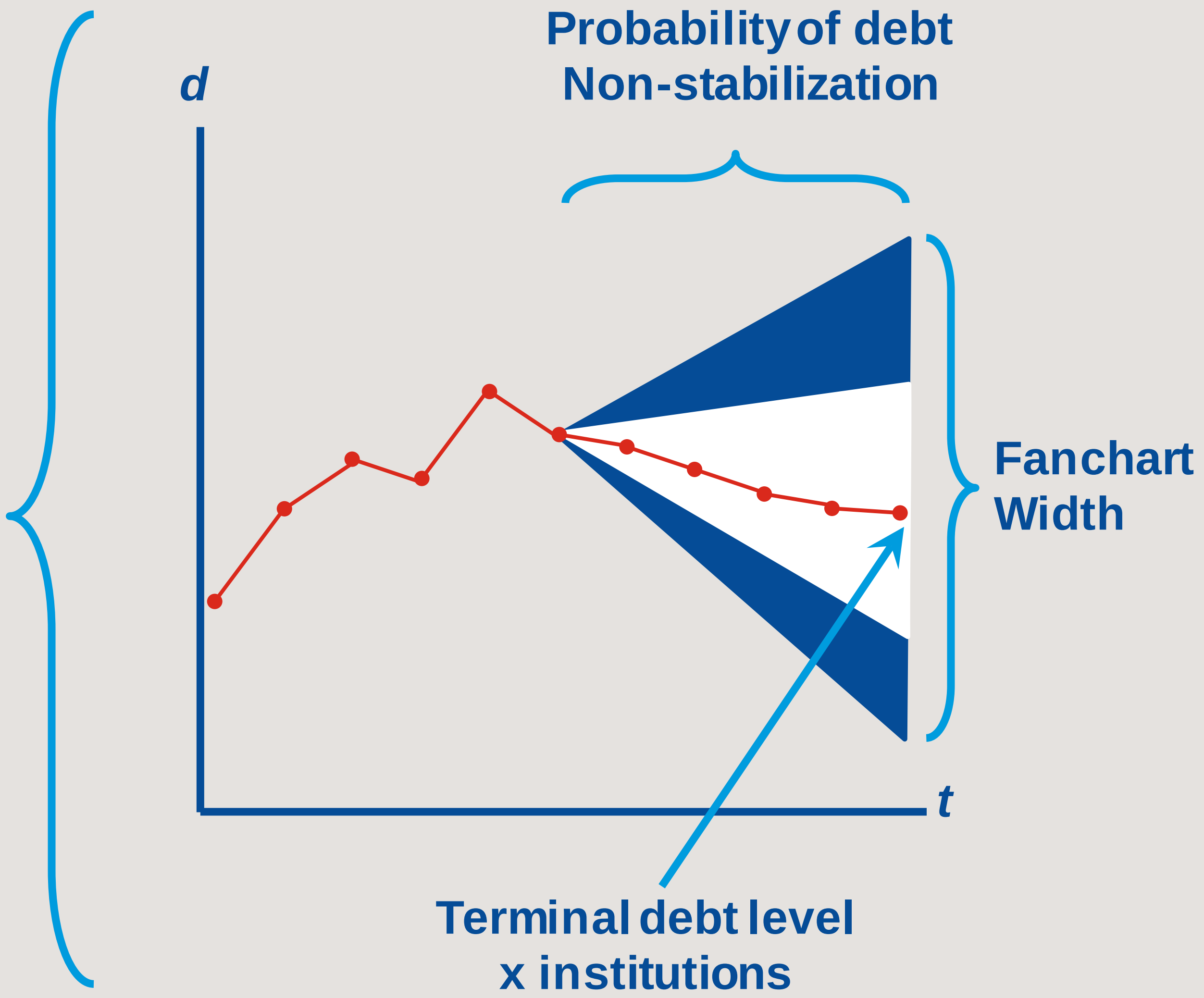
- Δ public debt-to-GDP
- Public debt-to-revenue
- FX public debt-to-GDP
- Intl. reserves-to-GDP

Global conditions

- Change in VIX
- Option: share of currency union MACs in stress

Upgraded debt fancharts will receive greater emphasis

- ***The SRDSF's debt fanchart includes important innovations***:
    - Better integration with output
    - Protections against forecast optimism
    - Improved methodology
    - Clearer interpretation of results
- ***The overall result is summarized in the debt fanchart index***:
- ***The fanchart supports:***
    - Richer analysis of debt carrying capacity
    - Closer linkages to sustainability definition
    - More probabilistic DSA assessments



The GFN financeability module analyzes liquidity risks

- ***The GFN module analyzes liquidity risks along several dimensions***:
- ***The overall result is summarized in the GFN financeability index (GFI)***:
  - Average GFN-to-GDP in the baseline
  - Banks' current exposures to government
  - Change in bank claims on the government in a stress scenario with macro-fiscal and debt holder shocks
- ***Ability to analyze special subjects:***
  - Unconventional monetary policies/QE
  - Government liquid asset buffers

Magnitude of financing needs	• Size of GFNs remain a critical indicator of potential vulnerability.
Debt holders	• Domestic creditors: central bank, commercial banks, others • External creditors: official and private
Domestic financial institutions	• Bank's government exposures indicate space for financing • Small financial systems limit room for maneuver
Observed volatility	• Stress scenario with shocks based on country history • Holder shock magnifies severity if creditor structure is risky

Tools for specialized analyses are being developed

Stress tests for medium-term risks not fully captured by the core tools:

Banking Crisis

Financial sector bailout if signs of overheating

ER Shock

Devaluation if misalignment not eliminated in MT

Commodity Prices

Extra scrutiny for exporters (revenue) & importers (subsidy)

Natural Disasters

Rebuilding costs when frequent events occur

Contingent Liabilities

Risks from narrow (less than GG) coverage

Long-term modules for risks beyond the standard 5-year horizon:

Population Aging

Debt impact of long-term pension and health costs

Large Amortizations

Financing risks from large LT debt repayments

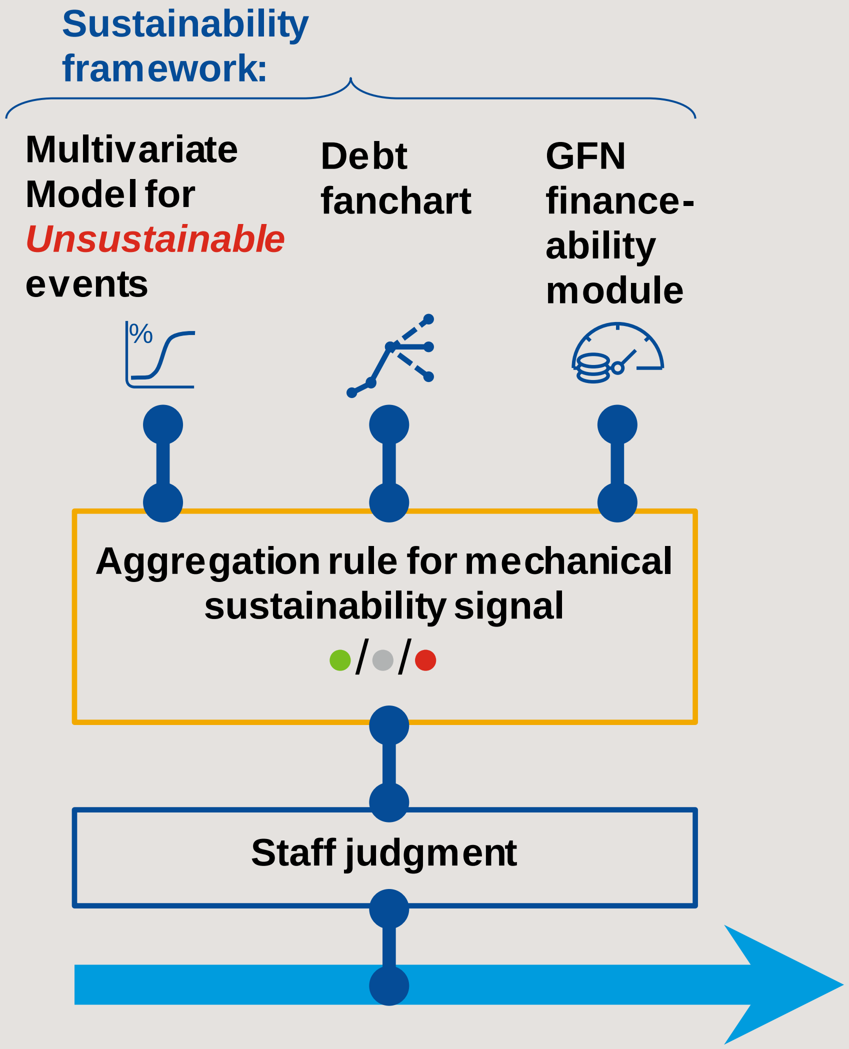
Natural Resource Discovery/Depletion

Implications of the launch or winding up of extraction

Climate Change

Effects of mitigation & adaptation investments on debt

Debt sustainability framework (mandatory only for programs): overall description



The risk tools are amenable for debt sustainability analysis with limited changes

- Focus on near and medium-term tools recalibrated to predict only unsustainable events.
- Aggregation rule combines information from the three mechanical tools to give a sustainability index
- Index can be compared against thresholds for a mechanical three-way sustainability assessment
- Staff judgment complements the mechanical results to yield the final bottom line on sustainability.

Sustainability Assessment:
Sustainable With high probability /
Sustainable but not with high probability /
Unsustainable

The SRDSF will have clearer outputs

The typical SRDSF would include these elements:

- A summary table with the mechanical signals and final assessments of sovereign risk
- In program cases, staff's bottomline assessment of debt sustainability (but not the mechanical signals)
- In surveillance cases, a bottomline debt sustainability assessment (excluding mechanical signals) is optional
- A table on debt disclosures and figures showing debt profile indicators
- Realism tools
- Debt and GFNs by key drivers
- A summary figure for the medium-term tools showing the fanchart, GFN metrics, and medium-term index of **sovereign risk**
- Figures with triggered stress tests and/or long-term modules

Q&A

Thank you