



Sovereign Debt Management Newsletter

Storkey & Co Limited
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What's New

In our consulting assignments, we have found that government on-lending is poorly managed. We have identified some of the issues in the feature article on page 2.

Also in this Newsletter, there are articles covering:

- The French Government 50-year OAT launched on 25 April 2005.
- An article published by the European Central Bank on "Government Debt Management in the Euro Area".
- The UNCTAD-DMFAS Debt Management Conference and Meetings to be held in Geneva from 20-24 June 2005.

Storkey & Co Update

Over the past 3 months, we have:

- continued to assist with the Debt Management and SOE Fiscal Risk component of the Public Financial Management Reform Project for the Ministry of Finance in Vietnam.
- Assisted PwC with the ADB West Bengal Development Finance project in India which commenced on 30 January.

There have been a number of annual reviews and reports issued by debt offices over the past three months (refer page 4). We find these very useful in our research as they set out current practices and signal issues for review. For example, some debt offices are reviewing the issuance of very-long dated bonds (i.e., 50-years) to meet increasing investor demand. France has been the first to issue (refer page 2). However, others such as Sweden are not considering such bonds due to their duration and cost/risk considerations.

We will watch and report developments with this and other important issues in future newsletters.

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Special points of interest:

- *The 4th Annual Public Sector Finance & Treasury Management Conference "Good Government Incorporating Risk Management Disciplines into Public Finance" was held in Melbourne from 26-27 April.*
- *The 38th Annual Meeting of the Asian Development Bank will be held in Istanbul, Turkey from 4-6 May.*

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Risks of Government On-lending

In many of our developing country consulting assignments, we have found that government on-lending is poorly managed and that there is a lack of understanding of the risks associated with on-lending activities. We have identified a number of causes.

First, the management of on-lending is separated from the underlying debt, often across different government agencies.

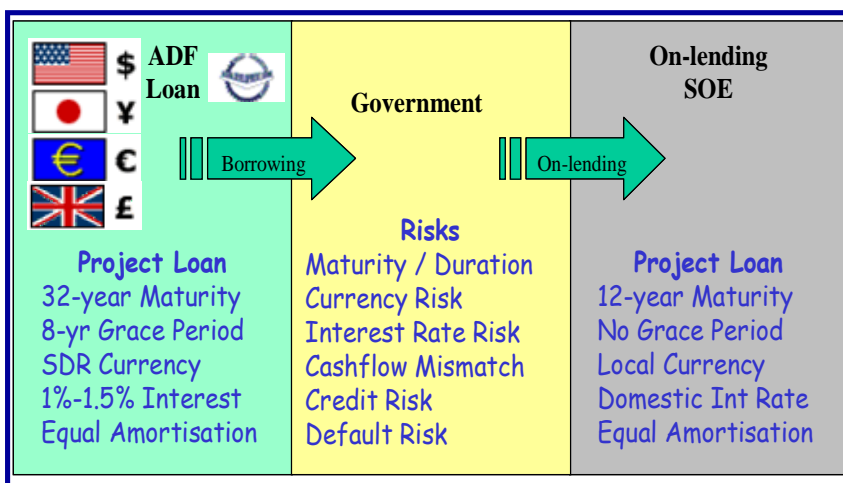
Second, many countries borrow from international agencies with long-maturity foreign currency loans but on-lend in short-maturity local currency loans. An example

of an ADB ADF project loan is shown in the diagram below. The example presents a significant mismatch in terms of currency, interest rate, duration and cash-flows.

Third, an SOE or agency that has been provided with on-lent loans may not meet their payment obligations because of a perceived lack of budgetary funds to meet their debt service obligations. This means that on-lent loans are often in arrears and in some cases no repayments of these loans have been made at all. On-lending agreements are often inadequate or non-existent.

Fourth, on-lending can be a way of getting around budgetary limitations by treating these activities as "off-budget." Some governments have set up funds to manage the on-lending payments and to use these funds for budgetary purposes rather than to hedge the underlying risks.

We have concluded there is an urgent need to develop an understanding and build capacity in government to ensure that debt and on-lending are managed within an asset-liability management framework with the associated risks clearly identified and managed.



"We have found that government on-lending is poorly managed and that there is a lack of understanding of the risks associated with on-lending activities."

French Government 50-Year OAT

Agency France Trésor launched the longest maturity bond on the euro yield curve on 25 April 2005 with a 50-year maturity due 2055.

The €6bn syndicated bond has a 4% annual coupon and was priced with a yield of 4.21%, which was 3 basis points over the benchmark 30-year OAT. The 21 primary dealers (SVT) were members of the syndicate.

The issue followed a world-wide survey of 550 investors carried out by a number of primary dealers.

The launching of the new OAT marked the creation of a new liquid segment on the euro yield curve and a new step in the development of the Euro fixed-income market. Demand for the OAT reached €19.5bn with broad geographical distribution.

There is clearly demand for ultra-long dated bonds due to the ageing population and the need to address potential asset/liability mismatches of pension funds and insurance companies.

Details of the OAT are set out on the Agency France Trésor website at:

www.aft.gouv.fr



Government Debt Management in the Euro Area

The European Central Bank (ECB) has published an article by Guido Wolswijk and Jakob de Haan "Government Debt Management in the Euro Area—Recent Theoretical Development and Changes in Practices."

The paper reviews recent developments in the management of government debt in the euro area, covering both theoretical and practical aspects. In particular, it focuses on key aspects of debt management:

- objectives of debt management
- its organisation
- maturity of debt
- inflation-indexed debt
- currency denomination of debt
- ownership of debt
- debt issuing and trading practices

The paper concludes that "there is a tendency towards convergence on key aspects of debt management. Rather than repre-

senting a break with the past, the introduction of the euro has supported and strengthened trends already underway."

It is a useful addition to the debt management literature and provides a good summary of current practices and recent developments by the debt managers in the 12 initial EU countries. The Occasional Paper Series No. 25/ March 2005 can be downloaded from the ECB's website:

www.ecb.int

Debt Management Conference in Geneva

UNCTAD will hold the Fifth Inter-regional Debt Management Conference in Geneva during the week of 20 to 24 June 2005. It will be held back-to-back with the fifth meeting of the DMFAS Advisory Group and with the fourth General Assembly of the World Association of Debt Management Offices (WADMO).

The Conference is organised by UNCTAD's Debt Management-DMFAS Programme, in the aim of helping Governments build their

capacity in managing debt—both external and domestic. The Conference will address such issues as:

- Changing role of the debt manager
- Case for a separate debt management office
- Importance of information and transparency
- Debt surveillance and rating
- Debt arbitration and mediation

The Conference and Multi-stakeholder meetings will take place from 20 to 22 June, the

"The last Conference, held in November 2003, brought together some 300 participants from more than 90 countries, as well as senior representatives of international and regional institutions."

DMFAS Advisory Group meeting on 23 June, and WADMO meeting on 24 June.

For more information, refer to the UNCTAD-DMFAS website:

www.unctad.org/dmfas

Recent Developments or Announcements

In the OECD Financial Market Trends publication (No.88, March 2005), there is an article from Hans Blommestein "Overview of Advances in Risk Management of Government Debt." There is a publication by the same author on this topic forthcoming.

Two publications released recently by the ADB Economic and Research Department are:

- "Developing the Market for Local Currency Bonds by Foreign Issuers: Lessons from Asia" ERD Working Paper Series No.63, February 2005
- "Empirical Evidence of Sustainability and Feasibility of Government Debt: The Philippines Case" ERD Working Paper Series No.64, February 2005

The Danish Government Borrowing and Debt Report 2004 has two articles in the Special Topic Section worth reading. These are:

- Issuance of Government Bonds
- Loan Guarantees and Re-Lending

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Storkey & Co Limited is an international management consultancy providing independent specialist advice on debt and risk management to central, state/regional & local governments, government enterprises, & corporate treasuries.

The company employs or works in partnership with recognised experts who have considerable international experience in the finance markets and in public sector debt management. With their extensive project and change management expertise, they have developed an international reputation for delivering the highest quality practical solutions.

These experts have gained practical experience from working in a government debt office and on ADB, AusAID, DFID, IMF, UNDP and World Bank technical assistance projects internationally.

Since the company was established in early 2001, assignments have been undertaken in Australia, Canada, Fiji, India, Indonesia, Lithuania, Mauritius, New Zealand, Papua New Guinea, Philippines, Solomon Islands, Thailand, and Vietnam.

Debt Management Unit Publications & Websites

There are no new debt management office or agency websites to report. Key publications released by DMUs over the past 3 months:

- **Brazil** Public Debt: Annual Borrowing Plan 2005
- **Canada** Debt Management Strategy 2005-2006
- **Colombia** Economic and Fiscal Sustainability: Of Facts, Myths and In-Betweens
- **Denmark** Danish Government Borrowing and Debt 2004
- **Germany** Newsletter April 2005
- **Greece** Public Debt Bulletin Dec 2004
- **Ireland** Information Memorandum 2005
- **Jordan** Quarterly Bulletin Dec 2004
- **Latvia** Report on the Implementation of Latvian Government Debt Management Strategy in 2004
- **Netherlands** Dutch Government Securities 2005
- **New Zealand** Economic and Financial Overview 2005
- **Poland** Debt Management Strategy 2005-2007
- **Slovakia** Strategy for State Debt and Liquidity Management 2004 to 2006
- **Slovenia** Bulletin of Government Finance February 2005
- **Sweden** Central Government Borrowing 2005:1
- **Sweden** Annual Report 2004
- **United Kingdom** DMO Business Plan 2005-2006

Also released:

- **DRI** Strategies for Financing Development #22
- **MEFMI** Update Feb-Mar 2005

The full list of DMO/DMU websites is on our website at:

www.storkeyandco.com/Library/Links/links.html

