

BENEFITS FOR ISSUING COUNTRIES, INVESTORS AND INTERNATIONAL FINANCIAL STABILITY

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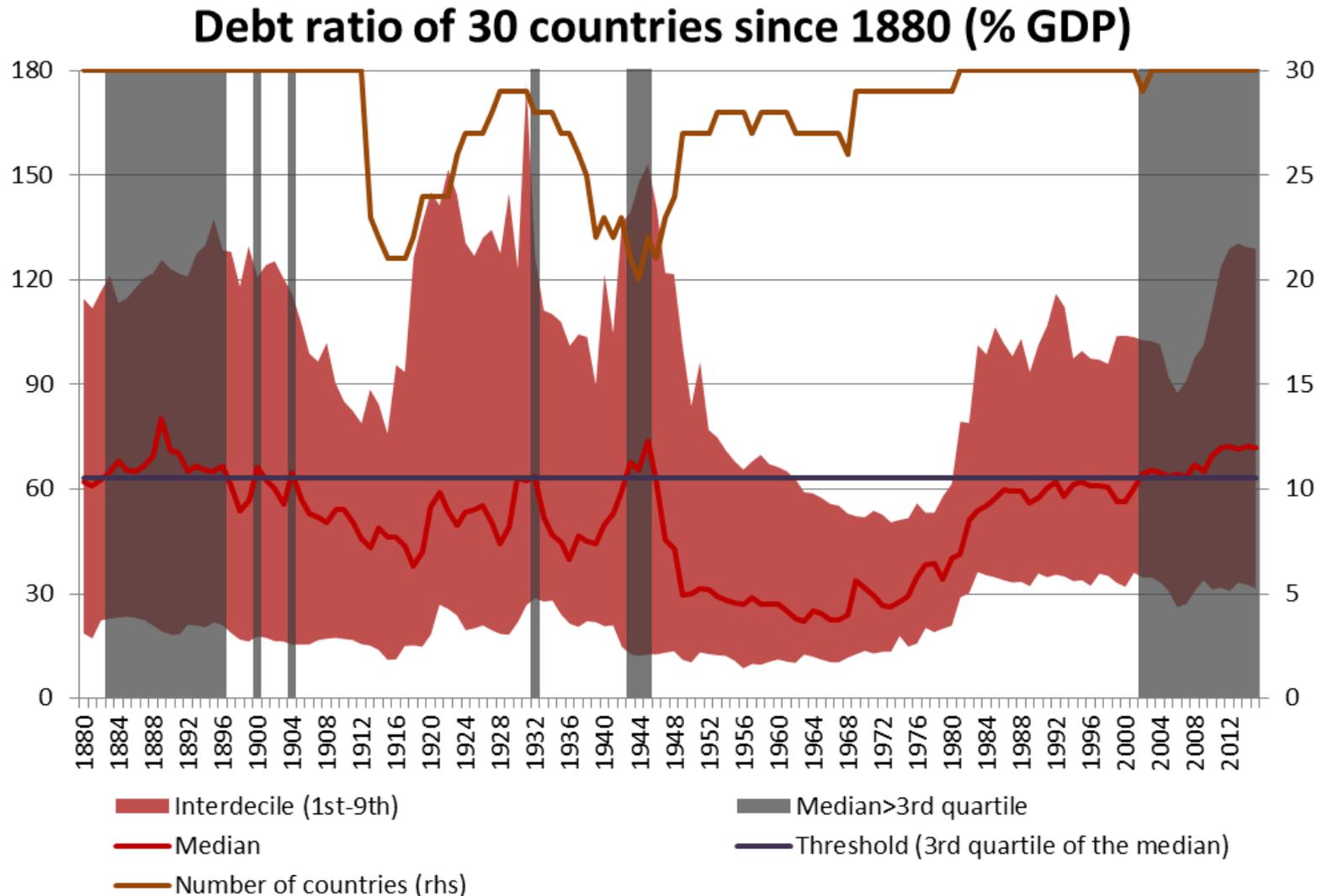
BANQUE DE FRANCE

BASED ON A PAPER CO-AUTHORED BY JEAN-BAPTISTE GOSSÉ AND
LUDOVIC GAUVIN

17 January 2018

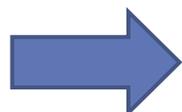
Brussels

The right time for a follow-up conversation on contingent debt



Design of the GIBs and debt dynamics

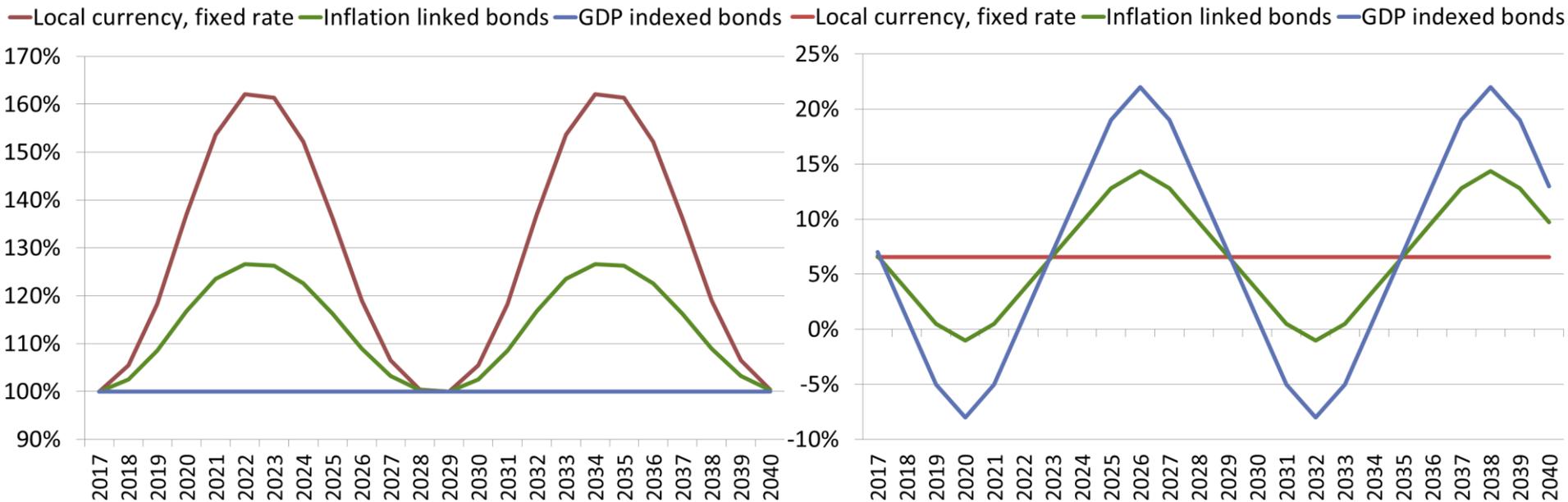
- Bonds denominated in national currency
- Principal indexed on nominal GDP
- Fixed coupon rate (not indexed on nominal GDP)
- Coupon varies with nominal GDP through the indexation of the principal

 Reduce procyclicality of debt/GDP ratio, contracyclical debt service ratio

Reducing default risk by stabilizing debt ratios in the cycle and contracyclical debt service ratio

Public debt-to-GDP ratio

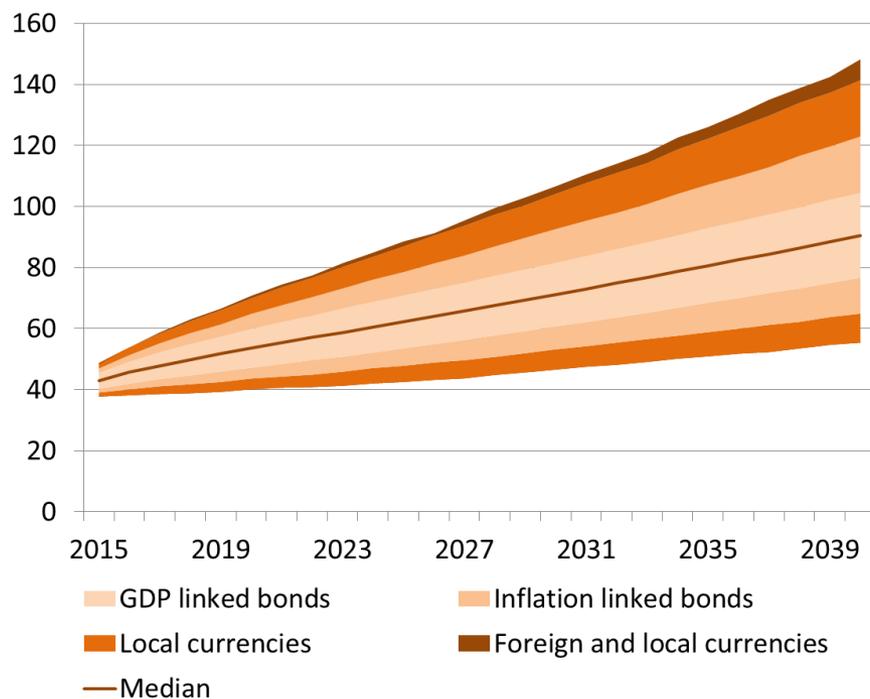
Debt service (% of debt)



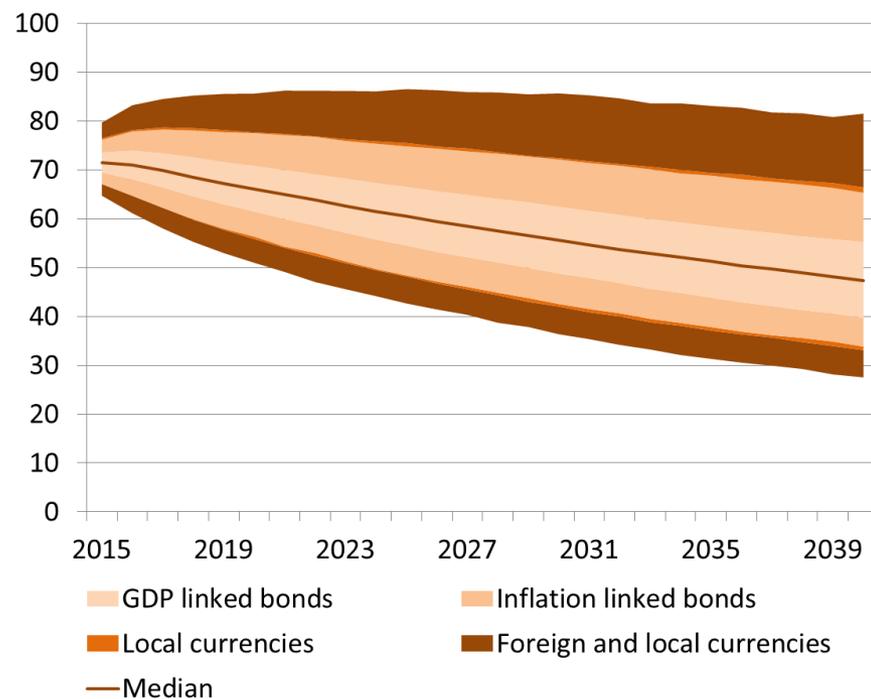
$$d_t^i = \frac{(1+c_{t-1}^i)(1+x_t^i)}{(1+g_t)} d_{t-1}^i - s_t = (1 + c_{t-1}^i) d_{t-1}^i - s_t$$

Reducing the uncertainty around debt trajectories

Costa Rica



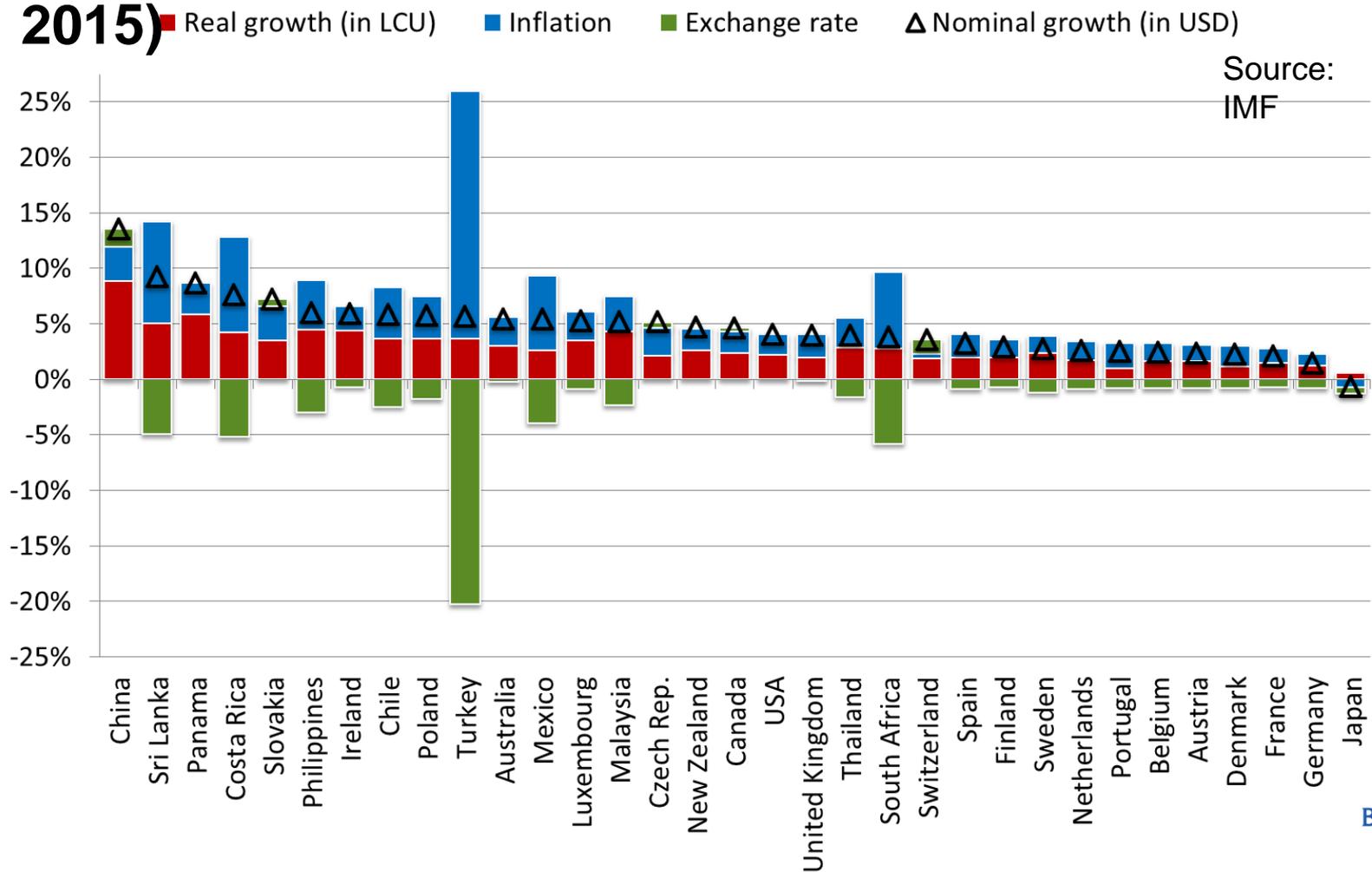
Sri Lanka



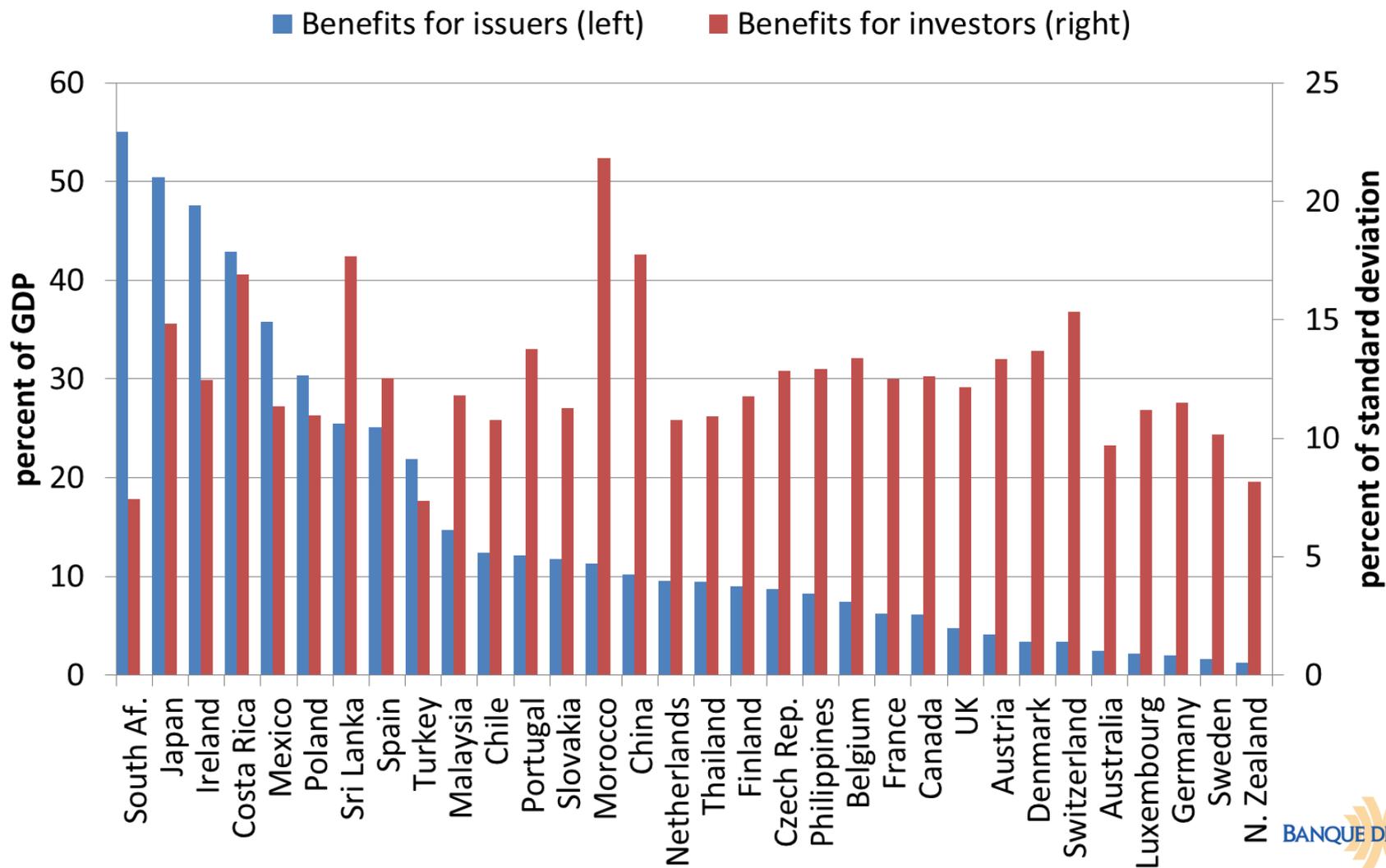
Note. The areas show the gap between the 5th and the 95th percentiles of 10,000 simulations

Significant potential gains for foreign investors in the long term

Average GDP nominal growth breakdown in USD (1996-2015)



Gains for issuing countries (in % of debt over GDP in the 5% worst scenarios) and for investors (in volatility of a benchmark portfolio, compared to equity)



A well suited response when tax compliance is highly sensitive to output fluctuations

