Debt management and its goals

Q 7-01. What is the government's purpose in issuing debt securities?

The primary reason for the initial issuance of debt by a sovereign is to finance a budgetary deficit or to improve the government's cash position. The former may be done effectively with notes or bonds of longer term while the latter may be better accomplished with treasury bills.

Governments that are required to maintain a balanced budget will often issue debt as a means of financing infrastructure and capital improvements. Maintaining a separate capital budget and issuing debt through the capital account eases the challenge of meeting a balanced operating budget.

Q 7-01.01. Are there non-fiscal reasons for debt issuance?

Once a portfolio of debt securities has been distributed, other reasons for debt issuance may arise. It may be desirable to refinance outstanding debt by issuing new securities that match better the timing of maturities to expected funds or that can be sold at a lower interest rate to reduce financing costs.

Additional debt issuance may be used also to improve the market for outstanding issues. In these cases, outstanding debt will influence the terms under which new securities are issued.

- Debt issuance may be targeted to maintain the liquidity of an outstanding security. If the sovereign brings a sufficient quantity of a single issue to market, investors may find that their individual transactions do not have the impact on market price that would impede their movement in or out of a security. Such action improves the secondary market for sovereign debt.

- Debt issuance may be targeted to maintain a benchmark bond for the benefit of the entire debt market. If sovereign debt is issued repeatedly at a given tenor or maturity, the market price of this issue provides a reference point for the market yield curve and the price of debt of lesser quality. This improves the mechanics of the sovereign and other debt markets.

Q 7-01.02. What is the impact of debt issuance on market development?

The existence of sovereign debt securities in a country's financial markets can have important impacts on those markets. Sovereign debt issuance can help foster the development of viable, transparent domestic money and capital markets. Sovereign debt does this by providing a benchmark yield curve and instruments for trading. It should also set a standard for market operations. The stage of development of the capital market, however, may constrain the impact of debt in this regard.

Q 7-01.03. How do market impacts constrain debt management?

Because sovereign debt can play so large a role in the development of an economy, the management of that debt should subject itself to certain constraints and should consider other parties. For example, since government securities are a vehicle for open market operations conducted to implement monetary policy, the central bank will be affected by how debt is managed.

Other interests and agencies of government also are stakeholders in the health of financial markets and their views and concerns may impose a requirement that debt management be tempered by consensus building. For example, a desire to develop a long-term home mortgage market or longer-term corporate finance markets also might be represented in establishing the constraints for sovereign debt management by encouraging the government to extend the yield curve or by suggesting issuance in benchmarks that support liquidity at specific maturities along the yield curve.

Q. 7.01.04. What are the goals of sovereign debt management?

The primary purpose of issuing sovereign debt is to allow the state to meet its fiscal requirements without distorting markets or damaging the nation's economy. The sovereign debt portfolio should be managed to fulfill that purpose while promoting economy, efficiency, and prudence. These terms are interpreted as financing the debt at a sustainable cost, distributing debt instruments at an acceptable cost, and structuring the issuance in a way that keeps the risk of fiscal loss acceptably low respectively.

To meet the goal of economy, the focus will be on the real cost of debt. Efficiency is often addressed through attention to the means of debt distribution. Prudence is usually addressed by debt managers through decisions regarding the timing and volume of debt issue, the profile of maturing debt and rollover, the selection of tenors, and other risk reduction strategies.

To meet these goals, governments should set clear objectives for sovereign debt management. The objectives should be publicly disclosed and include the objective of managing the cost and risk of the state's debt portfolio and to promote the development of the domestic debt market. Governments should develop specific strategies to achieve these objectives.