Debt Management and Monetary Policy Objectives

What do we need to know?

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DEBT MANAGEMENT FACILITY

Central Banks and Finance Ministries: Managing the "Potential Conflict"

- Different policy objectives and operational requirements
  - Strains between fiscal/debt policies and monetary policies
  - Inconsistent objectives for different parts of government balance sheet
  - Operational conflicts or clashes – including central bank reluctance to see MoF taking a bigger role
- Requires

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- Common interests
  - Efficient debt, cash and monetary policy operations
  - Development of the financial market, especially money market
  - Avoiding market disruption or confusion

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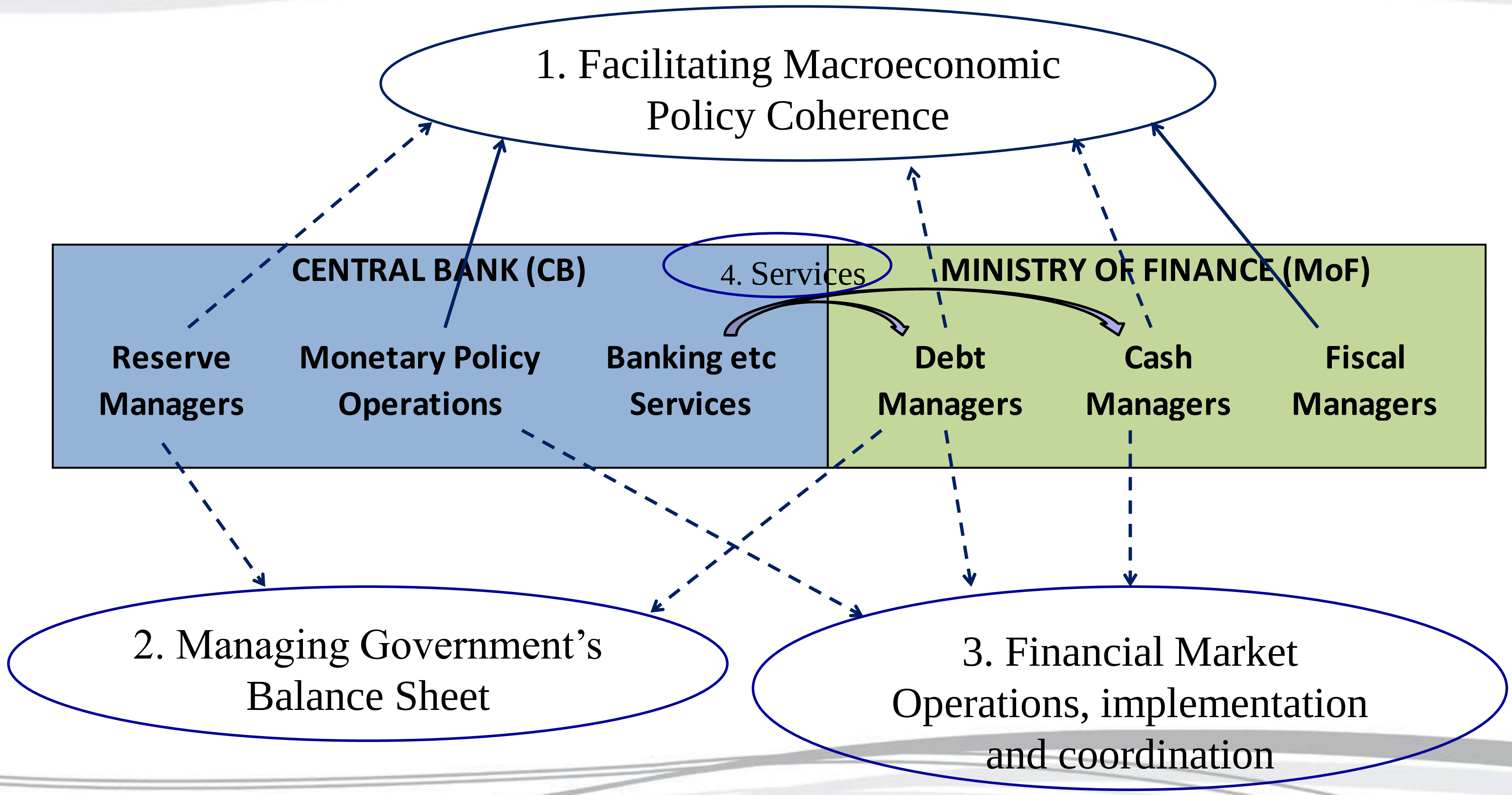
- Clarity and understandings about responsibilities, objectives & interactions
- Backed by effective governance and coordination arrangements

An Overview – Policy and Operational Interaction



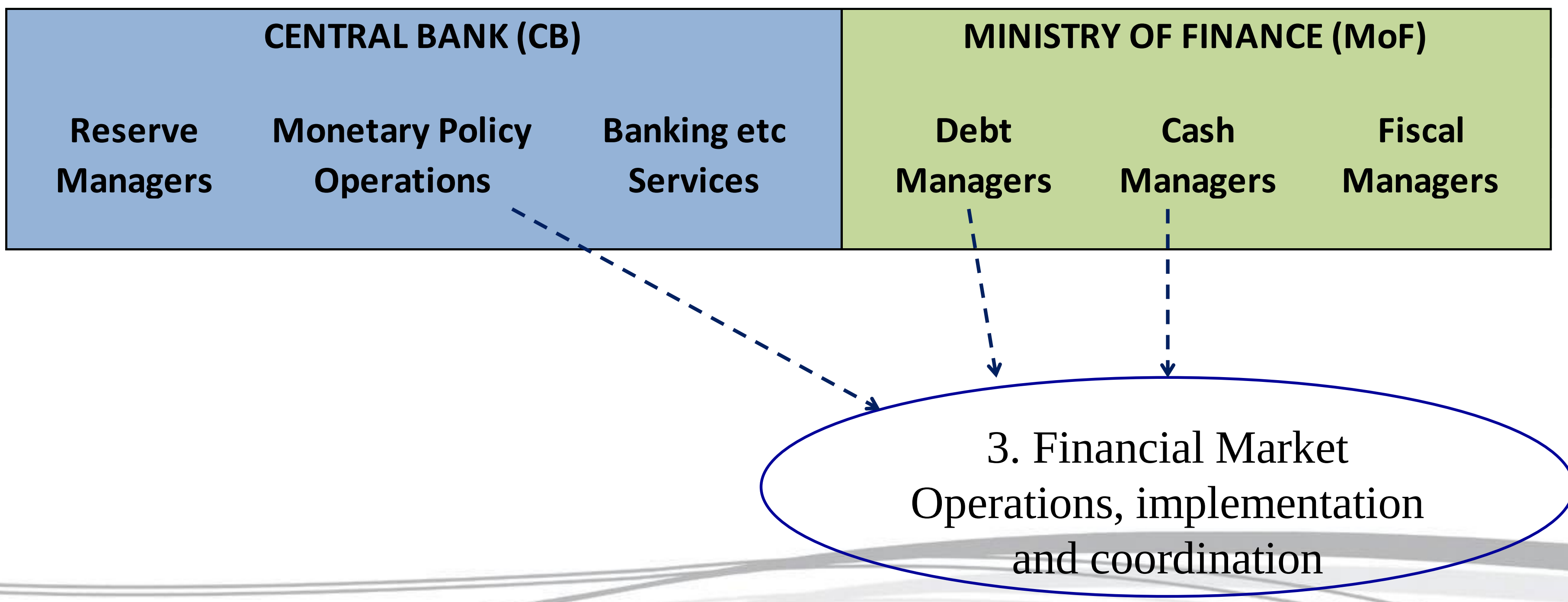
Macroeconomic Policy Roles

- Policy separation: monetary policy v fiscal, debt, cash management policies
  - Different instruments for different objectives facilitates greater transparency, predictability, credibility, and accountability
- Protecting "independence" of CB still requires high level policy coherence
  - Debt & cash operations may affect monetary policy operations & revers versa
    - Particularly in less liquid markets
    - Even in developed markets, model under strain recently from QE - affects shape of yield curve, may affect debt management operations
- Policy separation therefore still requires mechanisms to facilitate high-level policy coherence. Variety of mechanisms:
  - Eurozone stability and growth pact, Fiscal Responsibility Laws, MoF observers on Monetary Policy Committee…..
  - Many under strain during financial crisis – and since
- In middle income countries (less so in OECD) potential use of Public Debt Committee (PDC) or similar to facilitate coordination – see later

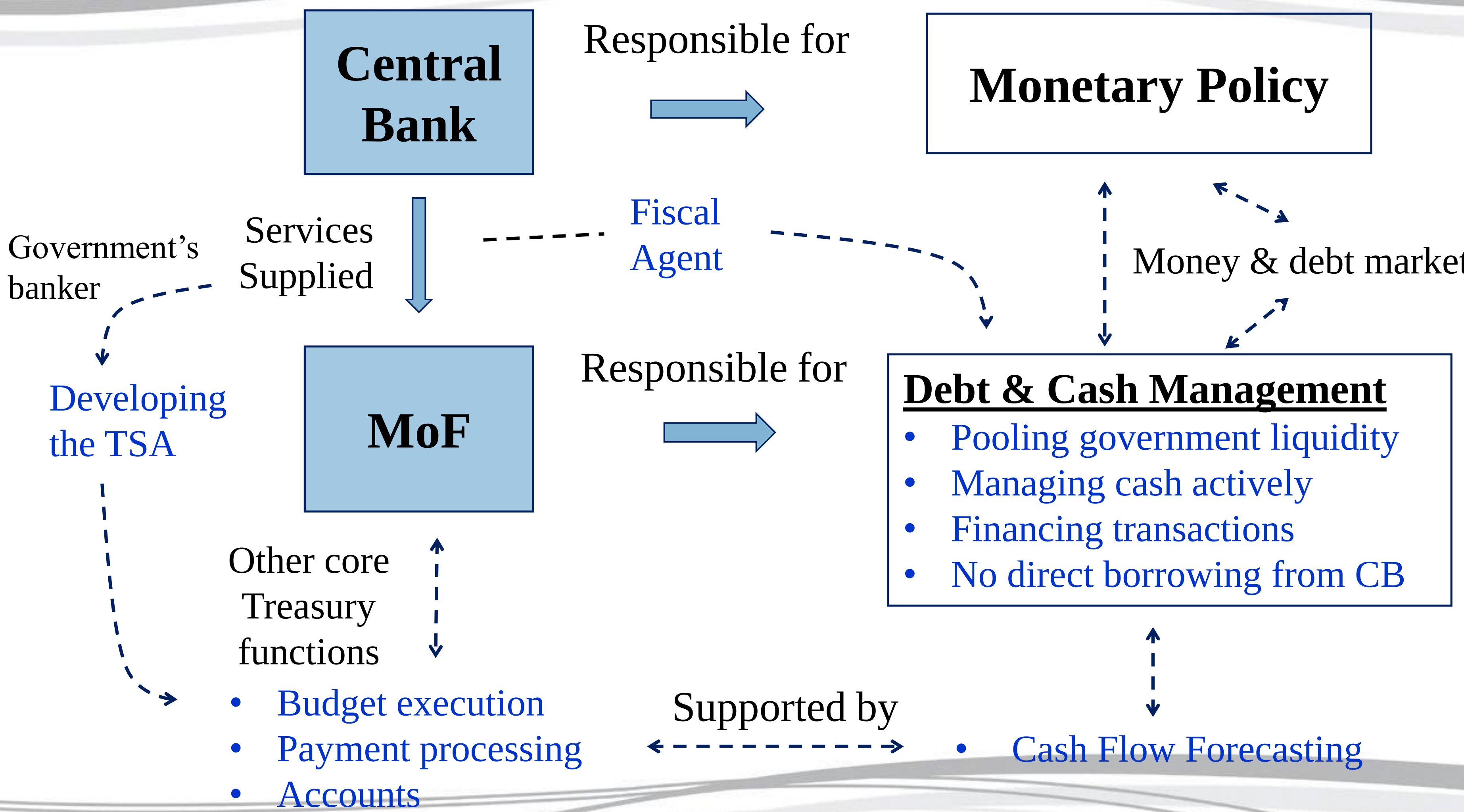
Debt Management Strategy (DMS)

- Development of the Debt Management Strategy
  - All countries increasingly taking account of structure of assets as well as liabilities
  - Risk minimized when characteristics of assets and liabilities match
- Important analytically; but can be problematical
  - Substantial assets (FX reserves) under control of CB not MoF
- CB should be consulted in preparation of DMS
  - Identify conflicts with monetary policy, comment on financial market realism
  - But often reluctant to bring FX assets into purview - a governance challenge
- Annual borrowing plan (ABP) prepared by MoF
  - MoF also prepares more detailed quarterly calendar, and should lead on consultation with market and relationship with primary dealers
  - ABP in consultation with central bank; but may be reluctant to leave it at that
- Public Debt Committee or similar again has a potential role to facilitate coordination

Coordination Structures: Operations and Services



The Modern Treasury Framework



Implications for Central Bank

- Bank may remain as fiscal agent
  - Risk of imposing own policy views, market signalling
  - Clarity and predictability important, avoid market perception of conflict of interest
- As cash management develops
  - Movement of liquidity away from the banking system, although Treasury will reduce cash balances, recycle to banks
  - Reduced volatility of cash balances will benefit CB – the counterpart is reduced volatility in banking sector liquidity
- Coordination and cooperation
  - Clarity on responsibilities and information flows
  - Operational interactions – eg auction timings and roles
  - Mutual development of money and debt market

Common Interest in Money and Debt Market Development

MoF

- Efficiency of debt and money market
- UK DMO formal objective "to promote the liquidity, stability and efficiency of the [Government bond and Treasury bill] markets"

Central Bank

- Clear interest in efficiency of money market
- But multiple objectives related to efficiency and security of financial markets

Regulators

- Regulators also often have mixed objectives
- Competition, efficiency, growth, consumer protection, stability…..

- Collective but sometimes competing objectives

- Many countries fail to grapple with the challenges - although may set up a steering committee with e.g. CB chair

Some Specific Sources of Tension

- Choice of instrument
  - Use of index-linked bonds
  - CBs do not always accept case for active cash management
    - Active cash management is demanding and risky; CB concerned about "competence" of government – e.g. in cash flow forecasting, ability to intervene properly, wrongly signalling to market
- Timing and amounts of Government auctions should fit with central bank's monetary policy operations
  - Avoid draining/supplying liquidity simultaneously
  - Government cash flow forecasts support monetary policy
- Central bank bills (CBbills) alongside Tbills risks fragmentation of secondary market liquidity
  - end up costing both institutions more, as liquidity in both is limited

Treasury bills or Central Bank bills?

- Important issue in many countries
  - Build up in domestic liquidly
  - Linked with FX inflows (and unwillingness to let exchange rate float)
  - Central bank issues own bills since lacks other tools to absorb liquidity
- May be possible to mitigate problem by central bank and MoF agreeing to issue paper of different maturity
- MoF can overfund the borrowing requirement, by issuing extra Tbills or Tbonds
- More tailored approach [does require trust between MoF & CB]
  - The MoF sells additional Tbills at the request of the central bank, as an add-on to the normal auction,
  - Sterilize the proceeds by holding them in a separate account at the central bank, remunerated at the discount rate set in the bill auction.
  - Arrangement and amounts involved must be made transparent

Some Other Policy Issues

- Interest on TSA balance and other deposits at CB
  - International experience varies, but best practice to pay a market-related rate:
    - Improves accounting transparency, avoids the implicit cross-subsidy associated with administered rates.
    - Removes the incentive for the MoF to take economically inappropriate decisions, eg placing funds in commercial banks with low credit ratings.
    - Similarly, in the interests of transparency and proper financial incentives the MoF should pay transaction-related fees
- Any use of overdraft must be defined - term, rate, repayment etc
- Structural surpluses – wealth funds, fiscal reserve funds etc – may be managed separately
  - On or off CB's balance sheet [Peru, Trinidad, Botswana]
  - In both cases need transparent governance, agreement on objectives, asset allocation, reporting etc
  - Funds on CB's balance sheet complicate ALM analysis – as above

Coordination

Mechanisms

- Formalize objectives and understandings
  - Legislation, Decrees, Regulations, etc
  - Terms of reference of committees and working groups
  - Memorandums of Understanding (MoU) on operations
  - Service level agreements (SLAs)
- Treasury "ownership" functions logically separate
  - Financial performance of CB, dividend rules capitalization, etc
  - Best managed separately from operational interactions

Structures

- Must cover both policy and operations
- At different levels
  - Minister/Governor
    - Handle high level policy issues, firefighting
    - Identify areas for cooperation
  - Formal committee structures, e.g.
    - Public Debt Committee for high level policy coherence
    - Cash Coordination Committee for daily or weekly operations
  - Technical working groups, day to day cooperation

Role of Public Debt Committee (PDC)

- Main role is approval of DMS [and ABP]
  - Mandating those responsible for strategy execution; setting targets and objectives; and subsequent monitoring of performance
- Chaired by the Finance Minister (or senior official): includes representatives from Treasury, Macro-Fiscal and Central Bank): Debt management team is Secretariat
- Note that the Committee:
  - Facilitates separation of policy formation from execution – with benefits to clarity and credibility
  - Ensures DMS is consistent with the thrust of macro-economic and fiscal policy more generally – and does not conflict with monetary policy
  - Helps to buttress operational independence of debt managers, reducing risk that CB (or others) will second-guess or intervene in debt management decisions once the strategy has been set
- Cash Coordination Committee
  - Sub-committee of PDC or meeting separately
  - In any event, must be a mechanism to pass cash flows to CB

Some Issues for the MoU and SLA

MoU

- Joint program for the development of the money market
- How the CB reports its and the market's views about the debt and cash management program and operations (e.g. via PDC)
- Management of PDs / auction counterparties
- Payment of interest on MoF balances at CB
- Information exchanges, respective responsibilities
- Determinants of e.g. the timing of respective auctions and the associated market announcements and any prior warning
- [Where the treasury is able to borrow from the CB], understandings of the limits (sums, maturities, ability to roll over etc.)

SLA

- Includes performance indicators or quantitative targets
- Some examples of issues covered
  - Notice that both sides give of any change in the auction pattern or timetable
  - Turnaround times by CB in handling transactions, e.g. as fiscal or settlement agent.
  - Details of information flows in either direction, with intended timing, e.g. of cash flow forecasts or transactions across the TSA.
  - The basis of calculation of fees paid for the services (potentially covering compensation for any failure to meet the specified service)
  - Exchange of risk-related information (including audit information)
  - The handling of any business continuity problem

Conclusion

- Essential there are mechanisms to ensure consistency at high level between monetary policy, and fiscal and debt management policies
  - In OECD countries and in emerging markets - highlighted by QE
  - CB needs to be engaged in preparation of DMS
- Operational coordination and cooperation between the CB and those responsible for the management of debt or cash is also important
  - The modern management of debt and cash may affect the operations, finance and government balance sheets, the CB and commercial banks
  - Movements of liquidity: but in time reduced fluctuation in cash balances benefits monetary policy
  - Interest payments and transactions fees improve transparency and remove cross subsidy
- Importance of structuring at different levels
  - Areas of contention – but scope for cooperation, especially in money market development
  - MoUs and SLAs bring clarity and remove misunderstanding

Thank You!