FIFTH OECD FORUM
ON AFRICAN PUBLIC DEBT MANAGEMENT AND BOND MARKETS

Midrand, 29th June to 1st July 2011

Suggested Key Questions on Topic A:
Medium term Benchmarks for Roll-over risk

1. **What is the place of roll-over risk in public debt management? Why does it matter?**

   Roll-over risk is described as the inability to roll-over existing debt because of limited access to the necessary cash or cash equivalents when repayments are due. Debt managers issue regularly in financial markets not only to finance country's budget deficit but also to make principal repayments arising from existing (maturing) debt. Any sudden freeze of the markets may put strain on the budget and may create extra fiscal cost on (by definition) limited funding sources. Indeed, high roll-over risk may create a vicious cycle, in the sense that investors demand higher return on (perceived) riskier public bonds and the increase in borrowing costs push up, in turn, future financing needs, thereby inducing an increase in (already high) roll-over risk. At this point, it is important to keep roll-over risk strictly under control in order to prevent a possible (deadly) threat to the reputation and financing capacity of the government.

2. **What are the possible implications of high roll- over risks (in both the short and long run)?**

   A direct short-run implication of high roll-over risk is the subsequent increase in the borrowing costs. Persistent high roll-over risk decreases the confidence in financial markets and investors may be unwilling to invest in longer term assets. This would reduce the demand for longer term government bonds while maturities get shortened. This in turn could increase the severity of the roll-over risk that sovereign issuers are facing.

3. **What are the methods used for measuring roll-over risk?**

The main methods for measuring roll-over risk is a detailed analysis of redemption profiles and an examination of that part of debt maturing in a certain period together with maturity related figures (average maturity of borrowing, average time to maturity of debt stock, etc.). The timing and amounts of cash inflows and outflows for the relevant periods need also to be analysed.

4. What are the indicators that are used for monitoring roll-over risk?

Possible indicators often used include:

-Average maturity of borrowing

- Average time to maturity of debt stock

- Average time to refixing

-Percentage of debt maturing in a certain period of time (with particular focus on shorter periods)

- Liquidity buffers

5. What are the constraints or limits in managing roll-over risk?

Limited market demand for longer term instruments may impose a natural constraint on managing roll-over risk but, by its nature, difficult to foresee. Forecasting cash inflows for the following periods is another important source of complexity. Indeed, foreseeing all the external events that may cause a stop or a sudden decline in the demand for government securities, while measuring the duration/effect of these events on government securities markets are the key challenges in setting-up the relevant risk management methodologies.

6. What can be done to limit roll-over risk (In the short and long run) ?

An important tool is the availability of short-term financing instruments such as repos in order to address short-term liquidity imbalances. Smoothing out redemption profiles and using a diversified instrument base could provide key strategic advantages in dealing with roll-over risk. Designing and using longer term instruments that would match investor preferences is also an important strategic consideration. Keeping cash reserve buffers would be useful to enhance confidence in the market for the longer-run, because it would guarantee that payment obligations are guaranteed even if new issues would be insufficient.

Buffers can act as a sign of confidence in the direction of investors, thereby easing market stress.

7. **Have you established a strategic benchmark for roll-over risk?**

   Existing benchmarks regarding roll-over risk are:

   -to keep a certain level of cash reserve as a share of average monthly debt redemptions;

   -to increase the average maturity of domestic cash borrowing taking market conditions into consideration and decrease the share of debt maturing within 12 months.

8. **Could you also make recommendations about future capacity-building activities** (including training) by the new OECD Centre for African Public Debt Management and Bond Markets?

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