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# Default without Sin?

*why do countries default in local currencies*

**MMT Conference**
Leeds
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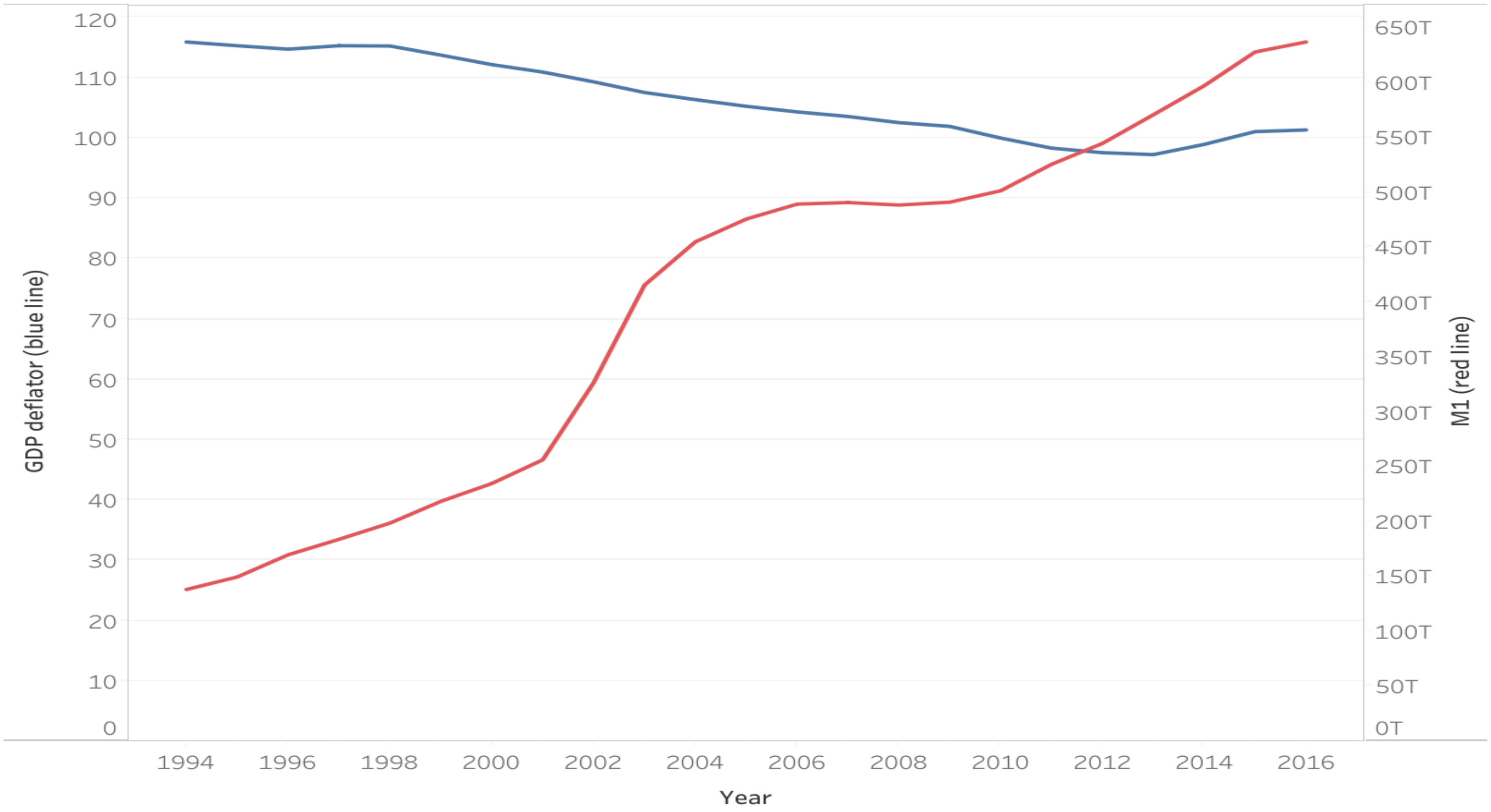
But before the movie starts…

## [redacted] M1 and GDP deflator 1994 - 2017



If you are interested

(or know someone who could be interested)

in being part of a review process for an upcoming book on

**Empirical Stock Flow Consistent** Modelling

please come talk to me later!

(Curtains opening)

# MMT and the payment of Government debt in its own currency

- A Government that issues debt in its own currency while maintaining control over its monetary policy, does not face a fiscal space of a purely financial nature.

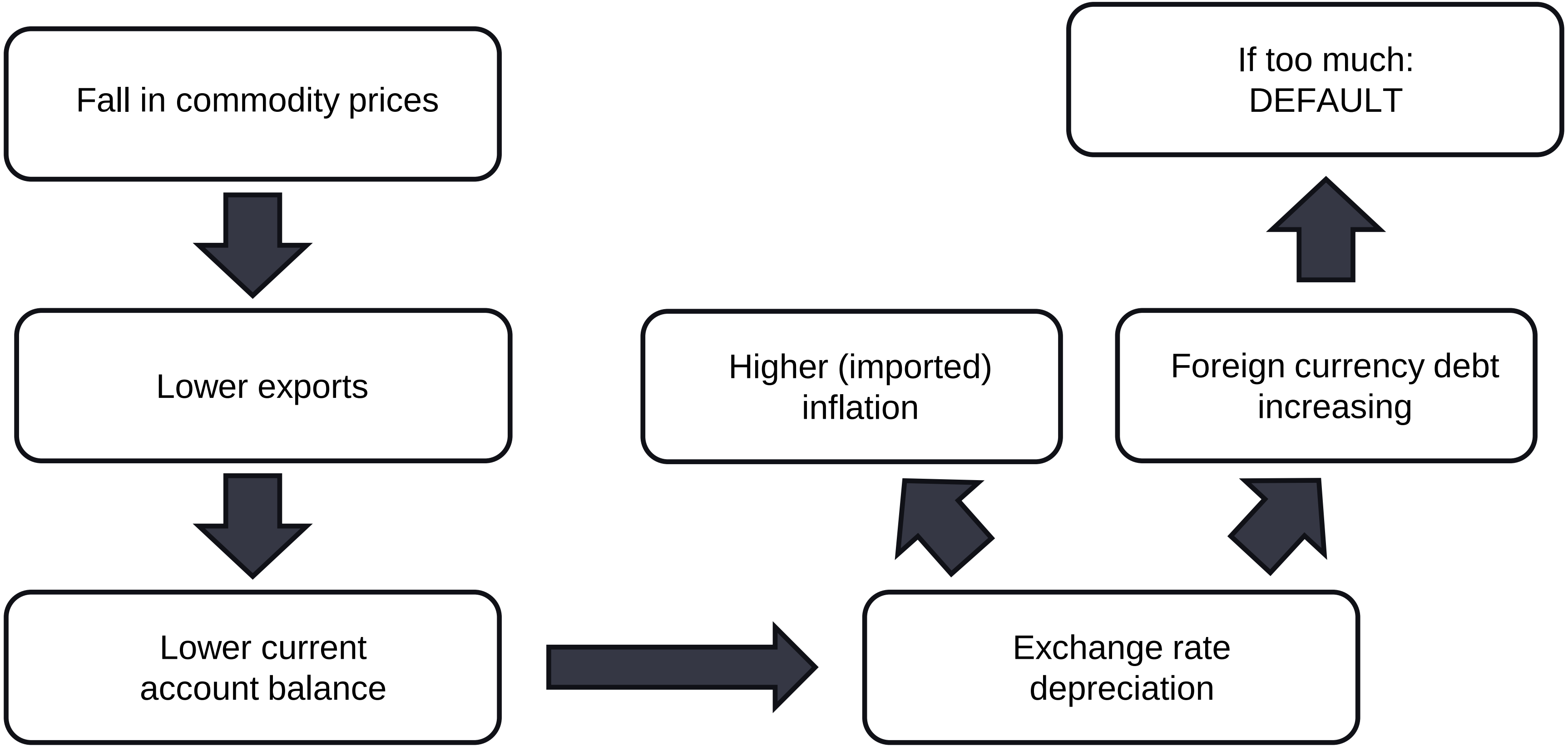
- When liquidity is provided by a cooperative central bank, a Government continuously has the ability to pay – the only risk of default then arises from an **unwillingness to pay** on the part of the Government.

- The ability to pay is attributed to the government's central bank's operation where payment is a matter of crediting an appropriate account, *a process that is not revenue constrained*.

# A relatively consensual idea

- Borrowing in foreign currency is associated with higher risk of default in the broader literature.
- Eichengreen & Hausmann (1999) refer to it as the “original sin”.
- The IMF is (as usual?) rather ambiguous on the matter:
  - Acknowledging the risk of borrowing in foreign currency
  - … while lending to countries predominantly in USD.
- Here, I want to understand why countries default, even in local currency.

# Typical pattern of foreign currency default in emerging countries



# Data on sovereign defaults

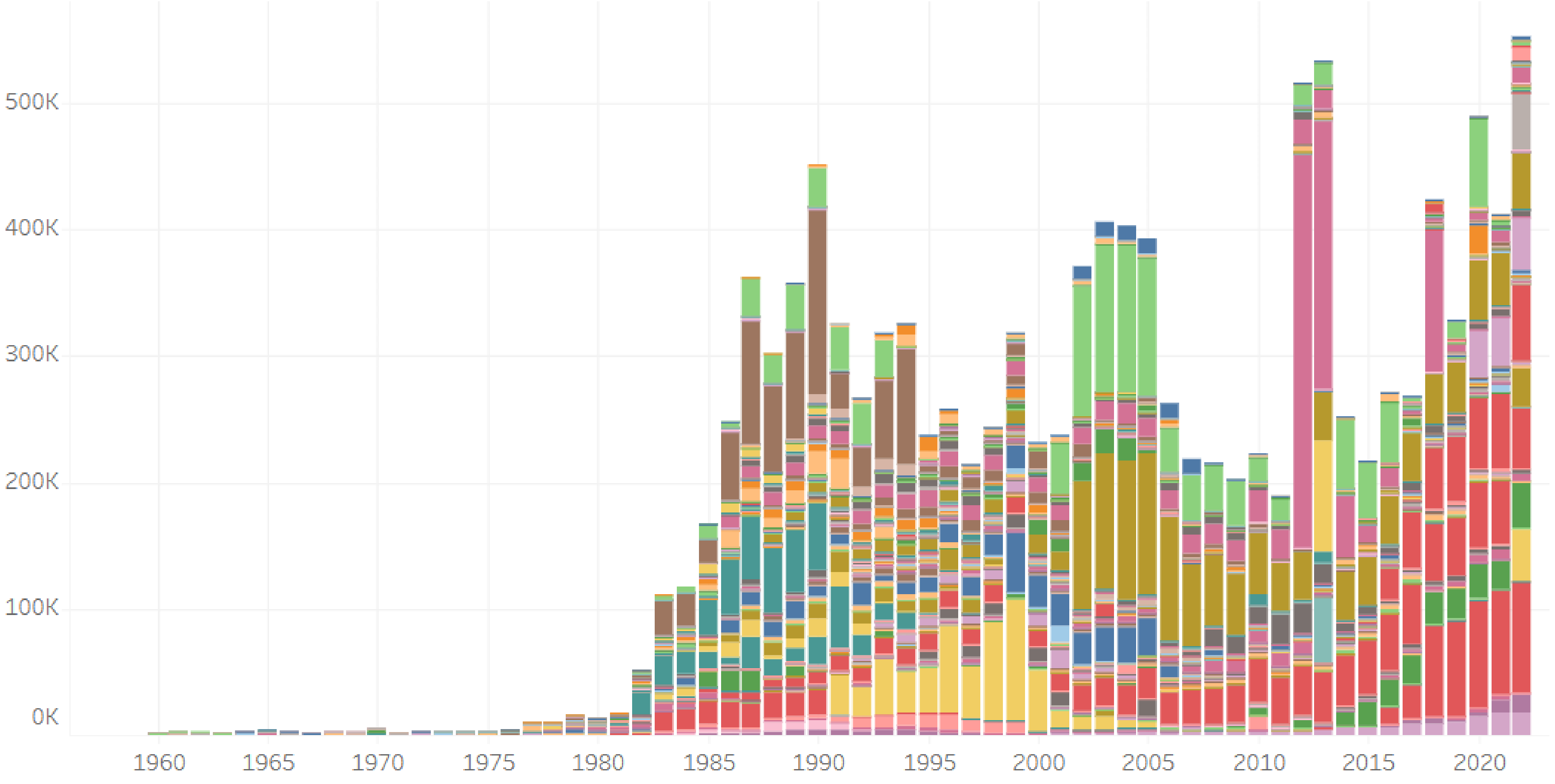
- **Source:**
  Sovereign Default Database by the Bank of England and the Bank of Canada (BoE-BoC, 2023) going from 1960 to 2022.

- **Reporting convention:**
  Outstanding debt that has failed to be paid on time or whose future payment is subject to a moratorium.
  (As a result, debt waiting to be restructured appears multiple years in a row)

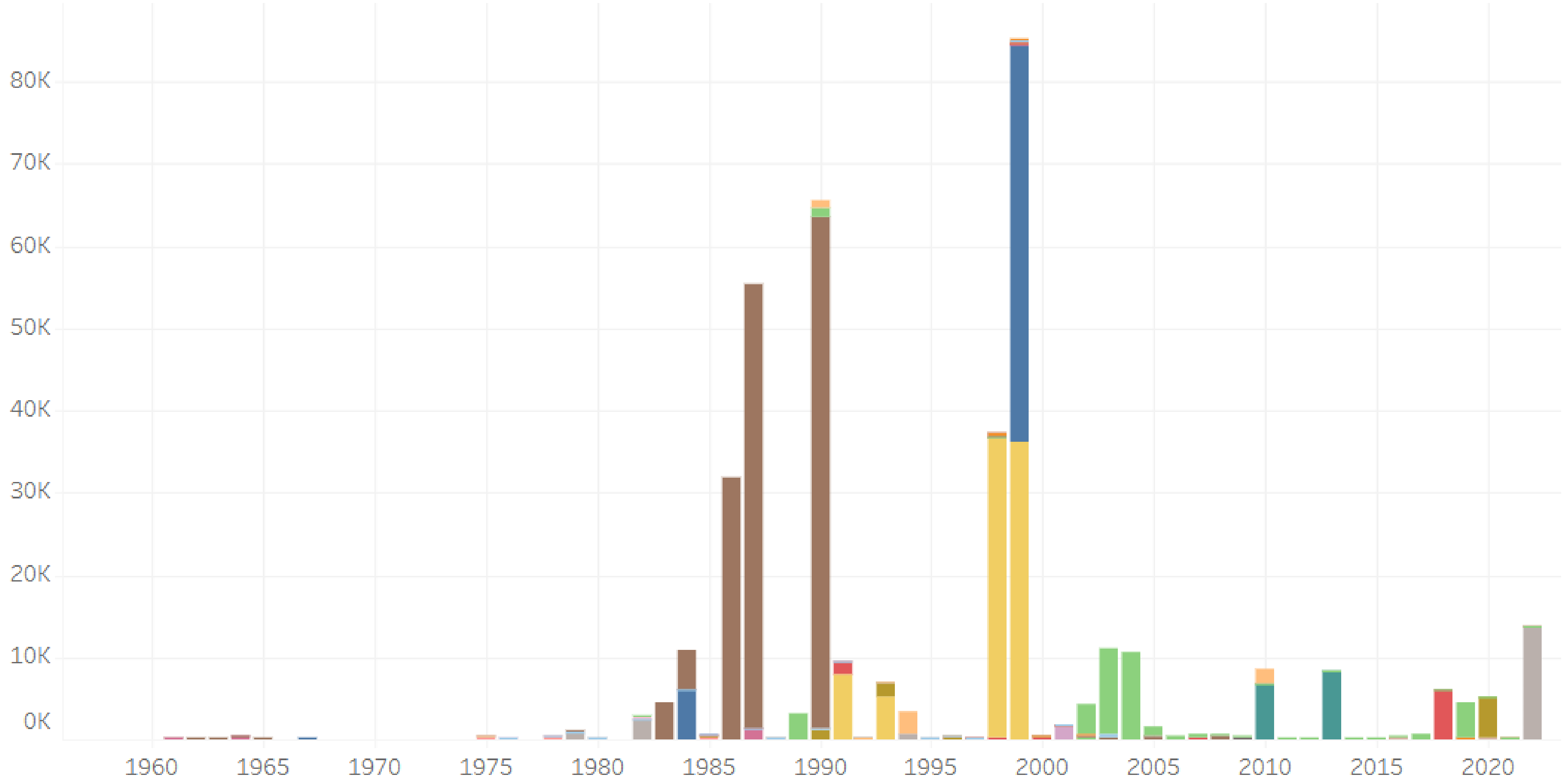
- **Broken down by:**
  Creditor (IMF, Paris Club) and currency (FC, LC)


Photo by Ehud Neuhaus on Unsplash

# Total defaults - all currencies



# Defaults in local currency



## Share of LC among total outstanding (BoE-BoC, 2023)

# Provisional results

Further determinants of default in local currency debt include (but may not be limited to):

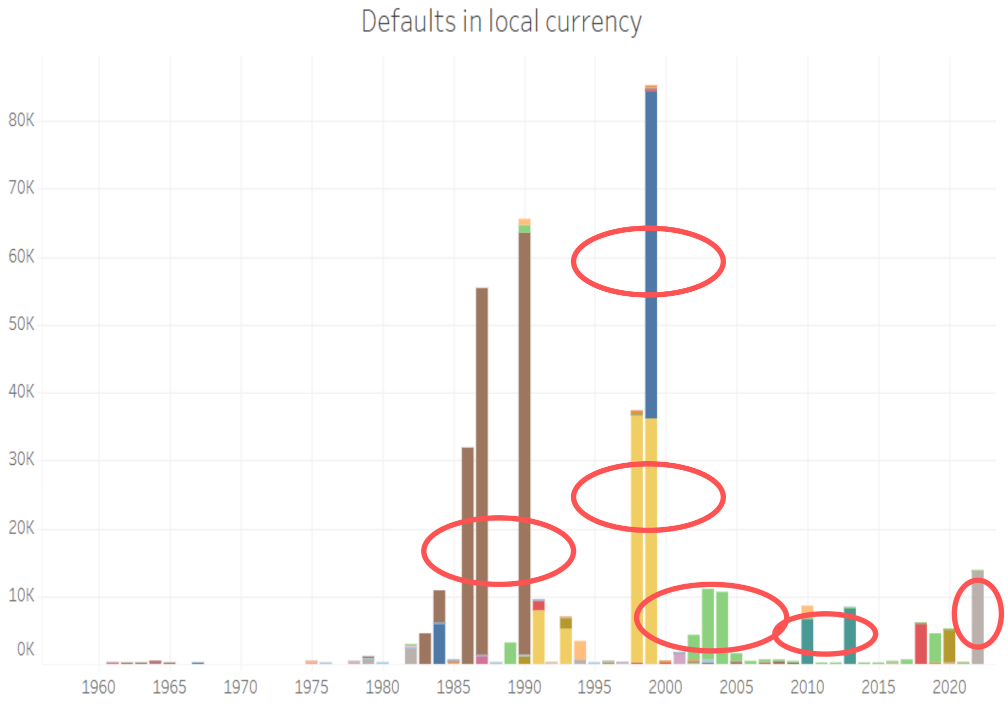
1. Defaulting as **part of a broader package**, which also (and predominantly) involves Government debt denominated in foreign currency

2. Deliberate decision to default on a **particular set of creditors**

3. Default being (almost) a prerequisite to fulfill the conditions to have access to financial aid

# Case studies

1. Brazil 1983, 1987
2. Russia 1998
3. Turkey 1999
4. Argentina 2002-3
5. Jamaica 2010
6. Ghana 2022



# Brazil in the 1980s

| (curr. USD bn) | 1983 | 1987 |
|---|---|---|
| LC debt | 4.452 | 54.000 |
| Total debt | 28.267 | 98.752 |
| GDP (IMF WEO) | 143.652 | 286.539 |
| | | |
| Share of LC | 16% | 55% |
| | | |
| LC / GDP | 3% | 19% |
| Total / GDP | 20% | 34% |

- Part of the broader Latin American debt crisis, fueled by foreign investors, borrowing in USD and explosion courtesy of the Volcker hike.
- **1983**: unlinking debt from inflation (when it is over 100%..!) is considered default by BoE-BoC.
- **1987**: Brazil declared a moratorium on interest payments on approximately $68 billion of its external debt. This was an outright default.
- In both instances, LC default part of a broader package.

# Russia 1998

| (curr. USD bn) | |
|---|---|
| LC debt | 36.261 |
| Total debt | 36.261 |
| GDP (IMF WEO) | 433.704 |
| | then 209.657 |
| Share of LC | 100% |
| | |
| LC / GDP | 8% then 17% |
| Total / GDP | 8% then 17% |

- **Incremental increase in Russian Gov debt was 100% in local currency**
- Low oil prices deteriorated external position of Russia
- Fiscal situation worsened
- Inflation rose to over 80%
- GKO yields went up to 150% (!!)
- **Default targeted foreign investors**

# Turkey 1999

| (curr. USD bn) | |
|---|---|
| LC debt | 48.280 |
| Total debt | 48.280 |
| GDP (IMF WEO) | 256.566 |
| | |
| Share of LC | 100% |
| | |
| LC / GDP | 19% |
| Total / GDP | 19% |

- **« Pure local currency default »**
- Two earthquakes hit the country, the first one on August 17, at a Richter Scale of 7.6 in the industrial heartland of the country
- Ratio of damaged buildings (including commercial/industrial premises) is 4 times higher than 1995 Kobe earthquake
- Banks were a major holder of Gov bonds: in the period between 1994 and 1998, the government incentivised the banks further to finance the public debt by borrowing from abroad in foreign currency and lending to government in domestic currency.
- The default effectively acted as a **tax on domestic banks.**

# Argentina 2002-3

| (curr. USD bn) | |
|---|---|
| LC debt | 10.000 |
| Total debt | 116.644 |
| GDP (IMF WEO) | 300.000 |
| | Then 142.000 |
| Share of LC | 9% |
| | |
| LC / GDP | 3% then 7% |
| Total / GDP | 39% then 81% |

- Hyperinflation in the late 80s had led to the implementation of a currency board system with a 1:1 XR against USD
- Achieved its goal in the first place (?) then maintained while Argentine fundamentals diverged from the US
- Furthermore, September 11 and the bursting of the dotcom bubble put additional strain, triggering additional outflows
- Argentine ended up defaulting on a huge amount of debt (at the time), **most of it in USD**

# Jamaica 2010

| (curr. USD bn) | |
|---|---|
| LC debt | 6.688 |
| Total debt | 7.500 |
| GDP (IMF WEO) | 13.193 |
| | |
| Share of LC | 89% |
| | |
| LC / GDP | 51% |
| Total / GDP | 57% |

- **Jamaica Debt Exchange (JXD)**
- Jamaica had one of the highest levels of public debt in the world, measured at approximately 140% of GDP.
- **Primarily domestic and denominated in Jamaican dollars.**
- The aftermath of the 2008 global financial crisis strained Jamaica's financial resources further, impacting its balance of payments and reducing government revenue from sectors like tourism and bauxite mining.
- **Undertaken with the goal of meeting conditions to secure a Stand-By Arrangement from the IMF**.

# Ghana 2022

| (curr. USD bn) | |
|---|---|
| LC debt | 13.527 |
| Total debt | 45.000 |
| GDP (IMF WEO) | 72.243 |
| | |
| Share of LC | 30% |
| | |
| LC / GDP | 19% |
| Total / GDP | 62% |

- **Rising public debt during COVID** (seen as a success by external observors)

- **Increase in interest rate on USD debt:**

By the end of 2022, the weighted average interest rate for Ghana's external debt portfolio rose to 6.1%, up from 5.2% in 2021.
The domestic debt saw an even more significant increase, with the weighted average interest rate rising from 17.9% at the end of 2021 to 21.2% at the end of 2022.

- No deterioration of the trade/current account but inflation over 50% and entire segments of the population hit by higher cost of living.

# Summary

| CASE | BROADER PACKAGE | TARGETED DEFAULT | ACCESS TO PROGRAM |
|---|---|---|---|
| **Brazil** | Yes | ? | |
| **Russia** | | Yes | |
| **Turkey** | | Yes | |
| **Argentina** | Yes | | ? |
| **Jamaica** | | | Yes |
| **Ghana** | Yes | | ? |