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LONDON: Shoppers walking down Oxford Street are seen through a railing in London yesterday. — AFP

G20 plan to stave off debt crises stalls

IMF study on growth-linked debt highlights stigma

LONDON: Global efforts to create a market for growth-linked bonds that could help avert debt crises have stalled because none of the wealthy economies backing the drive are willing to take the lead and be the first to issue, sources told Reuters. Growth-linked, or GDP-linked, sovereign bonds allow a country's repayments to fluctuate depending on its level of economic growth or contraction - meaning, for example, a government would pay less if its revenues were hit by recession.

Policymakers for the Group of 20 major world economies last year agreed on an initiative to create a market for the bonds. They commissioned an International Monetary Fund report into such debt, which could offer poorer economies some respite if they fell on hard times and stave off the kind of defaults seen recently in the likes of Puerto Rico and Ukraine.

The G20's technical staff were briefed earlier this year on the IMF findings, which they will feed back to finance ministers and central bank governors before their G20 meeting in Germany on March 17-18. They were told that the main obstacles to the project was a lack of investor demand and the stigma attached to such instruments, according to two sources close to the discussions. These kind of bonds have so far only emerged from debt restructurings as a way to coax creditors to accept writedowns. One plan mooted by the G20 last year was to have advanced economies issue first to make investors more comfortable with the bonds. But this has hit the buffers for the moment because no country wants to take the risk of being the first to issue the bonds, according to the sources.

'NO BIG BANG'

"The technical discussions have suggested no big bang issuance is expected as of now or coordinated issuance that was initially thought may be possible," said one of the sources who declined to be named as the discussions were private. "It was more a recognition of the work that was done, a sharper understanding of the key impediments and a possible way forward. There is a little more work to be done before these things take off."

The IMF's report on state-contingent debt, which includes GDP-linked bonds, is due to be published in late April. The second source familiar with the discussions added that deep scepticism about growth-linked debt within Germany, the hosts of this year's G20, was also an impediment.

Many in Germany fear Berlin would need to pay too much of a premium to coax traditional investors in bonds, seen as a safer store of cash than stocks, to expose themselves to the potential downsides of growth-linked debt, the source said.

Rafael Molina of Newstate Partners, an advisory firm that collaborated with the IMF on its report by canvassing a broad range of market participants including investors and possible issuers, said: "The feedback has shown that people are intrigued but they want to see the benefits and how it will come out. "There are many concerns and many questions that have to be addressed before growth-linked bonds develop in a way that a market can be created for it."

FIRST MOVER

Argentina, which takes over the G20 presidency next year, offered investors growth-linked warrants during debt restructurings in 2005 and 2010 but they cost the treasury billions of dollars as the economy recovered. And while the Bank of England has steered a market group to develop a legal framework for growth-linked bonds, uncertainty over Britain's economic trajectory as it leaves the European Union makes it an unlikely proving ground for these bonds. In a paper last month, think tank CIGI said the United States would be the best place to kickstart this project. However, if promoting a market more beneficial to others comes at a cost to the US economy, it may jar with President Donald Trump's "America First" mantra, the sources said.

France, which on Friday hosts a workshop on GDP-linked securities, was the first eurozone country to sell bonds linked to inflation, and one of the first to launch "green" debt earmarked for environmental projects. But a French government official, who declined to be named as they are not authorized to speak publicly, cautioned that upcoming presidential and parliamentary elections in France and the transition to a new leadership meant that any potential issue of growth-linked debt would not be around the corner.

History has shown that the development of a sizeable market for this type of instrument may take decades. Britain was the first industrialized country to sell inflation-linked bonds in the early 1980s, but it was not until the United States and France joined the market in the late 1990s that it began to gain scale. Germany only joined in 2006. — Reuters