

# Lessons from the 1980s: Incentives

- Incentives for resolution of losses.
- Banks and creditor governments favor delay.
  - Banks bailed out slowly but at par.
  - Creditor governments hope to recapitalize banks from earnings.
- Debtor governments hope for salvation.
- Residents of debtor countries suffer.
- Resolution eventually forced by debtor governments.

Real Debt of Developing Countries with Debt-Servicing Difficulties (billions of 1982 U.S. dollars)

	To Commercial Banks	To Official Creditors
1982	278	115
1983	290	129
1984	286	143
1985	276	162
1986	278	187
1987	283	224
1988	254	232
1989	241	236
1990	222	251
1991	213	251
1992	200	252

*Source: IMF. World Economic Outlook*

# Why adjustment programs seldom succeed.

- Contagion from sovereign to private credit markets.
- Arbitrage of country risk.
- GDP growth systematically overestimated.
- Return to market always next year.

**TABLE 7.3**

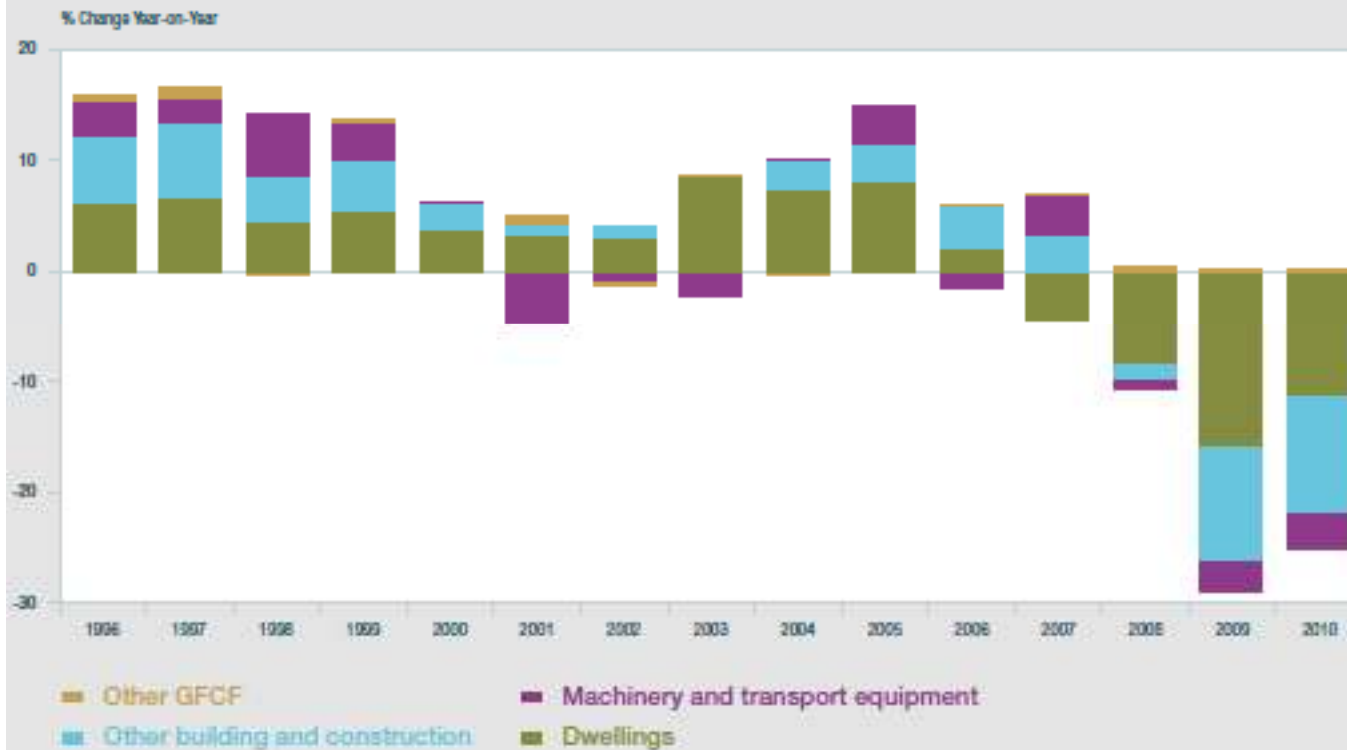
Per Capita GDP Growth in Developing Countries, 1972–91

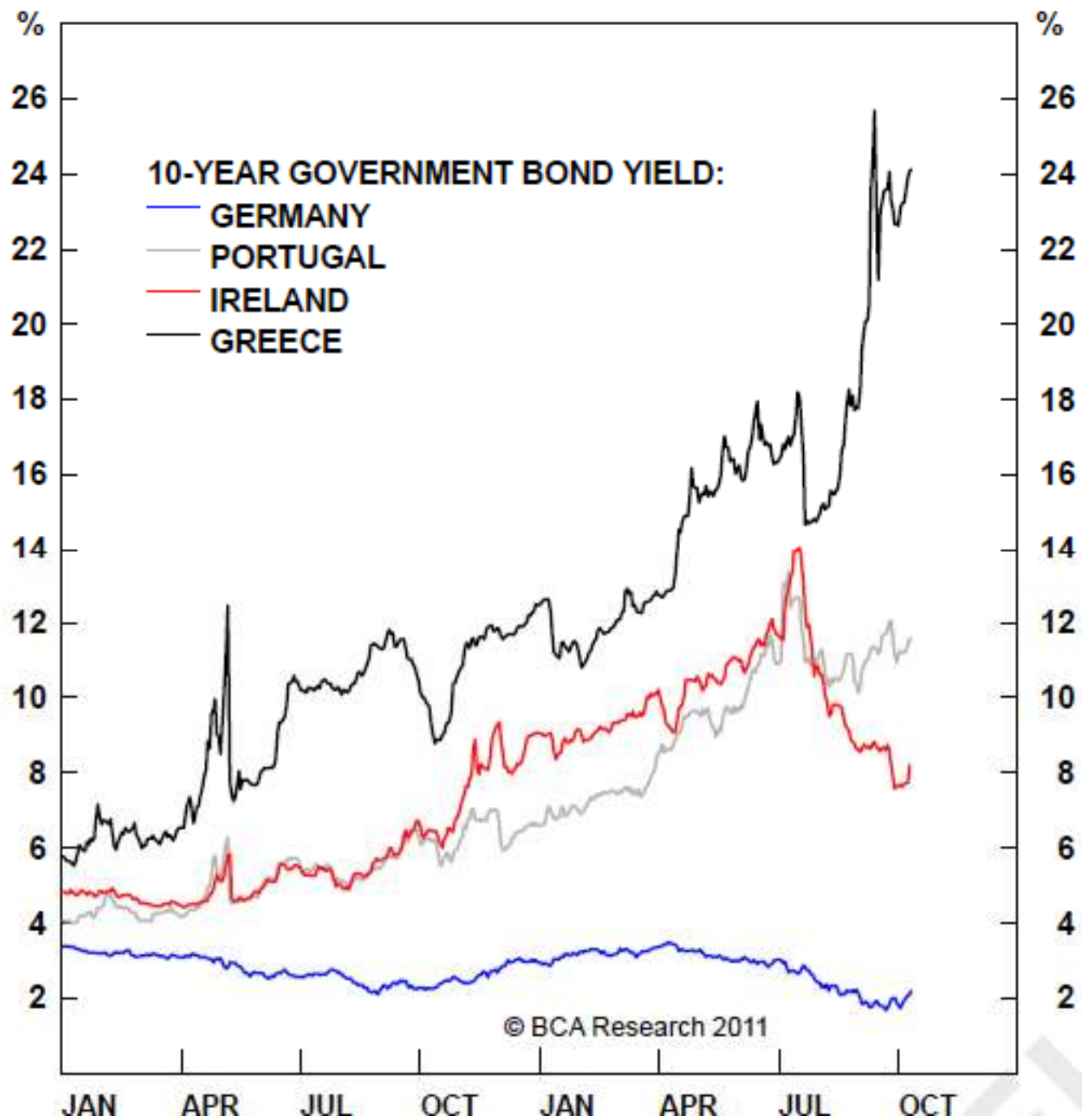
	All Developing Countries	Countries with Recent Debt-Servicing Difficulties	Countries without Debt-Servicing Difficulties
1972–81 <sup>a</sup>	2.3	1.7	3.5
1982	-0.2	-2.0	3.3
1983	-0.1	-3.9	5.1
1984	1.8	0.4	5.8
1985	1.7	1.1	4.8
1986	1.7	1.3	4.2
1987	1.4	0.3	5.3
1988	2.1	-0.2	5.6
1989	0.9	-0.5	2.6
1990	0.4	-2.5	3.5
1991	1.9	0.8	3.4

Source: IMF, *World Economic Outlook*.

<sup>a</sup>Average of compound annual rates of change; excludes China.

**Chart 3: Contributions of housing, other building and construction and all other investment to total investment growth – 1996-2010**





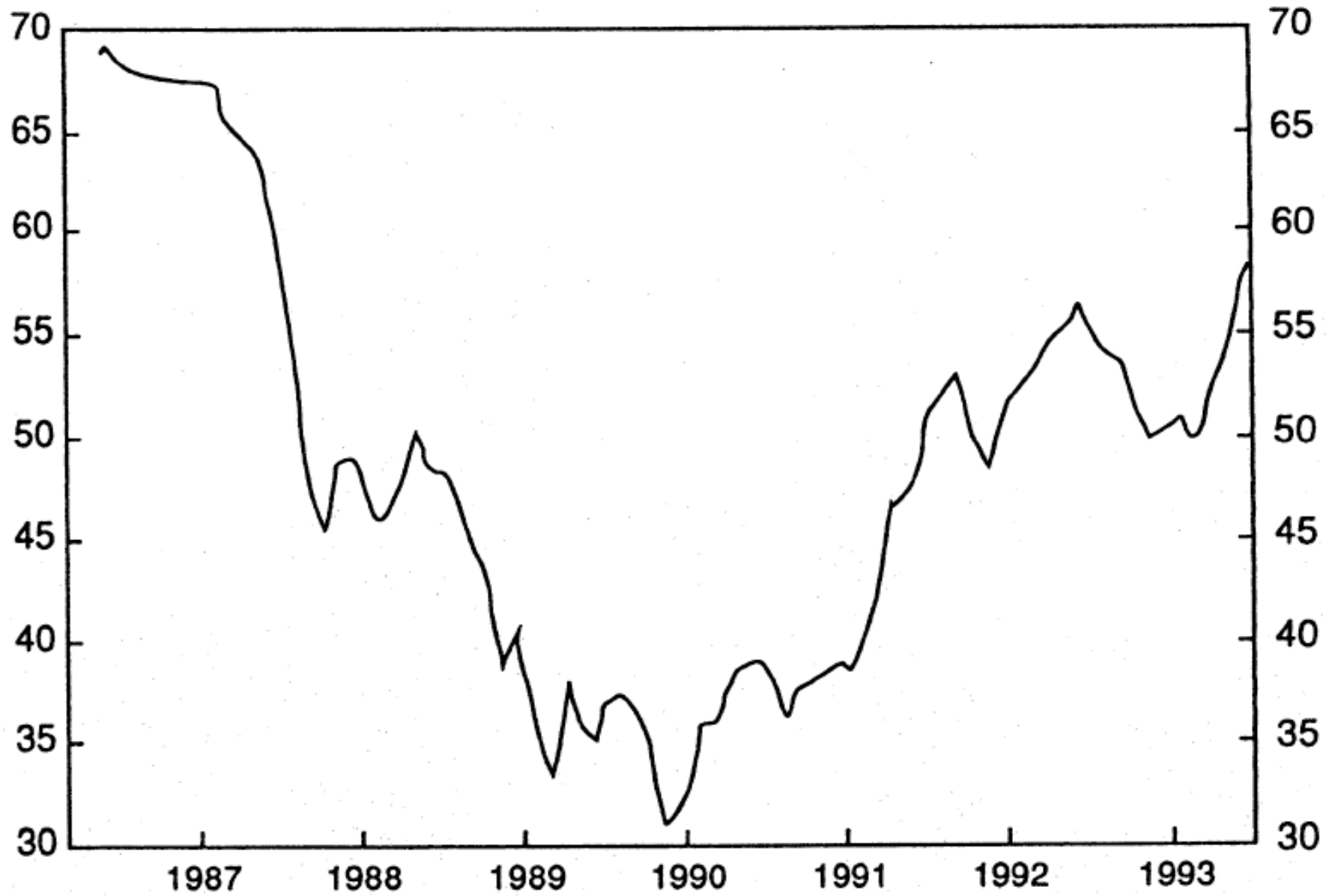
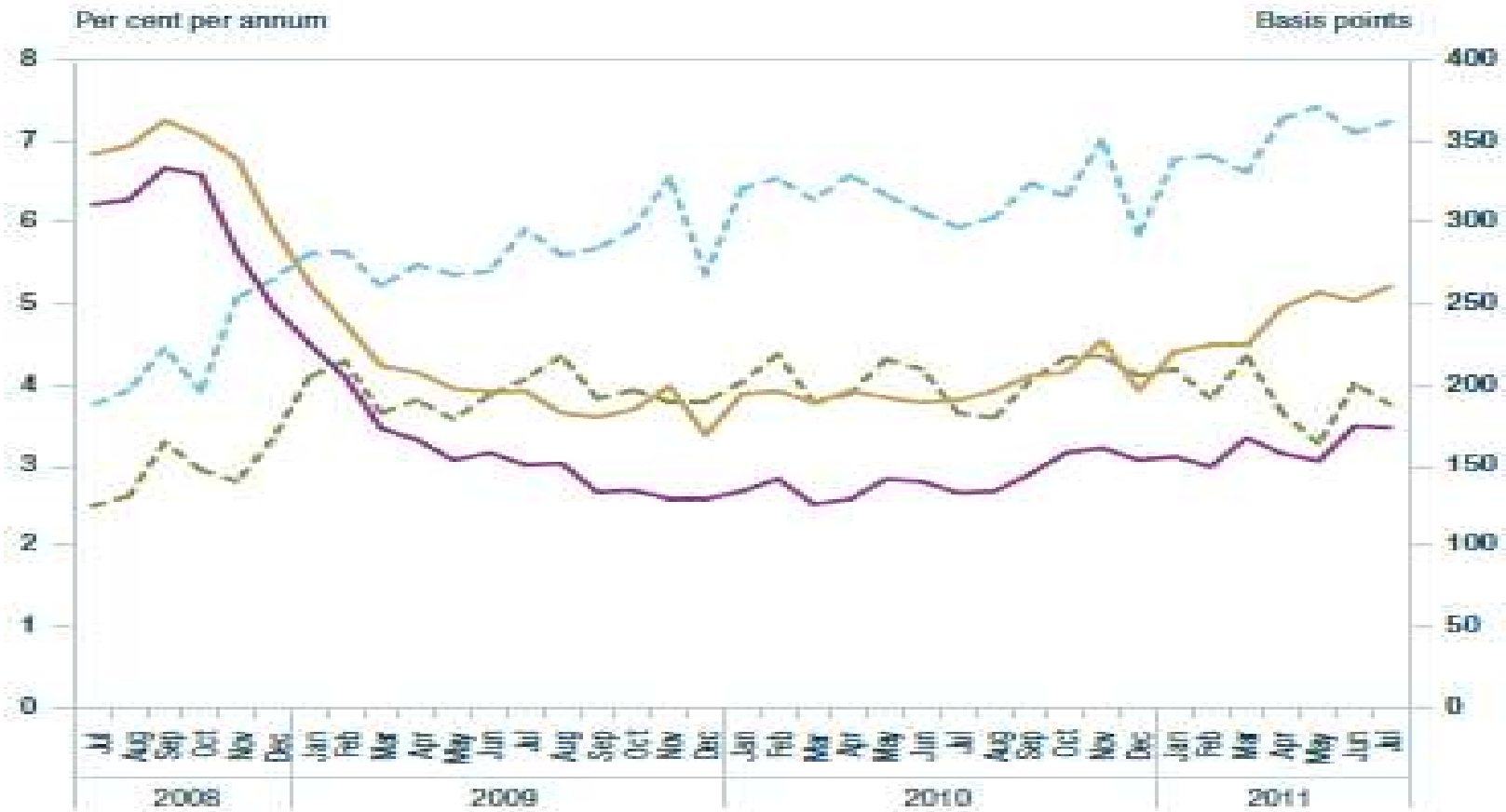


Figure 7.1 Secondary-Market Prices for Developing-Country Debt, 1986–93

# Chart 16: Interest Rate on New NFC Loans

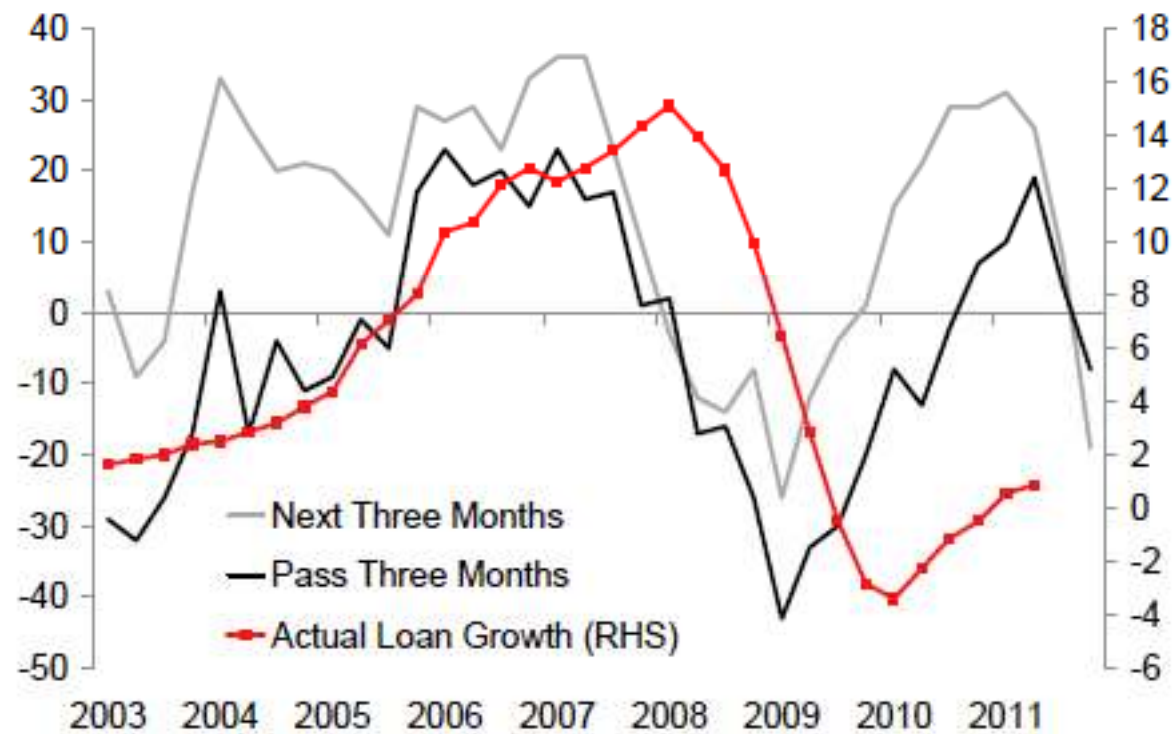


- New loans up to and including €1 million, interest rate (LHS)
- New loans over €1 million, interest rate (LHS)
- New loans up to and including €1 million, margin over 3 month Euribor (RHS)
- New loans over €1 million, margin over 3 month Euribor (RHS)



## ECB lending survey showed a sharp fall in expected and actual corporate lending. Consumer fell materially too

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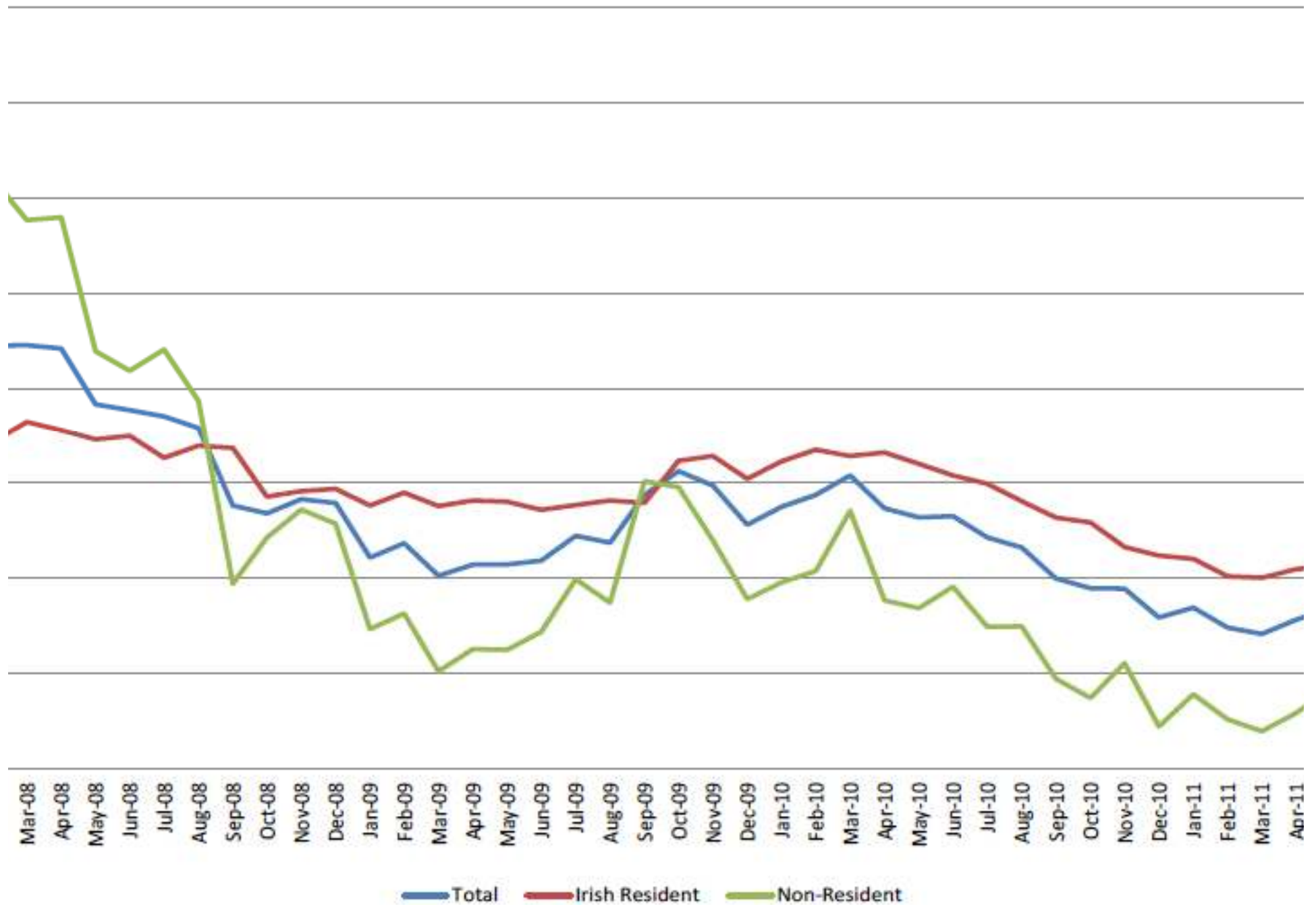


Source: ECB

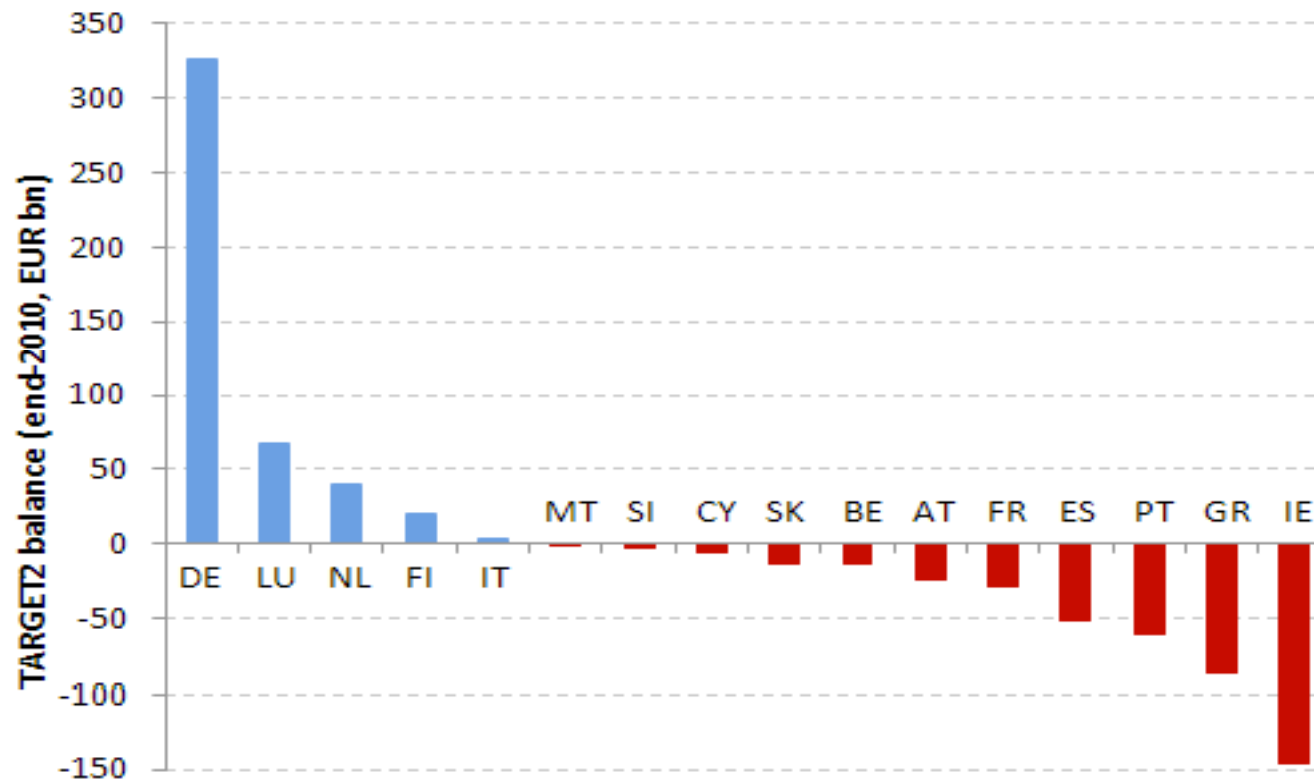
# Projections for External accounts never consider capital flight.

- In 1980s capital flight was the key to inability to reduce external debt.
- For Ireland less pressure from fear of devaluation.
- But domestic and external deposits have moved to other countries.

### Chart 3: Private Sector Deposits, Annual Rate of Change



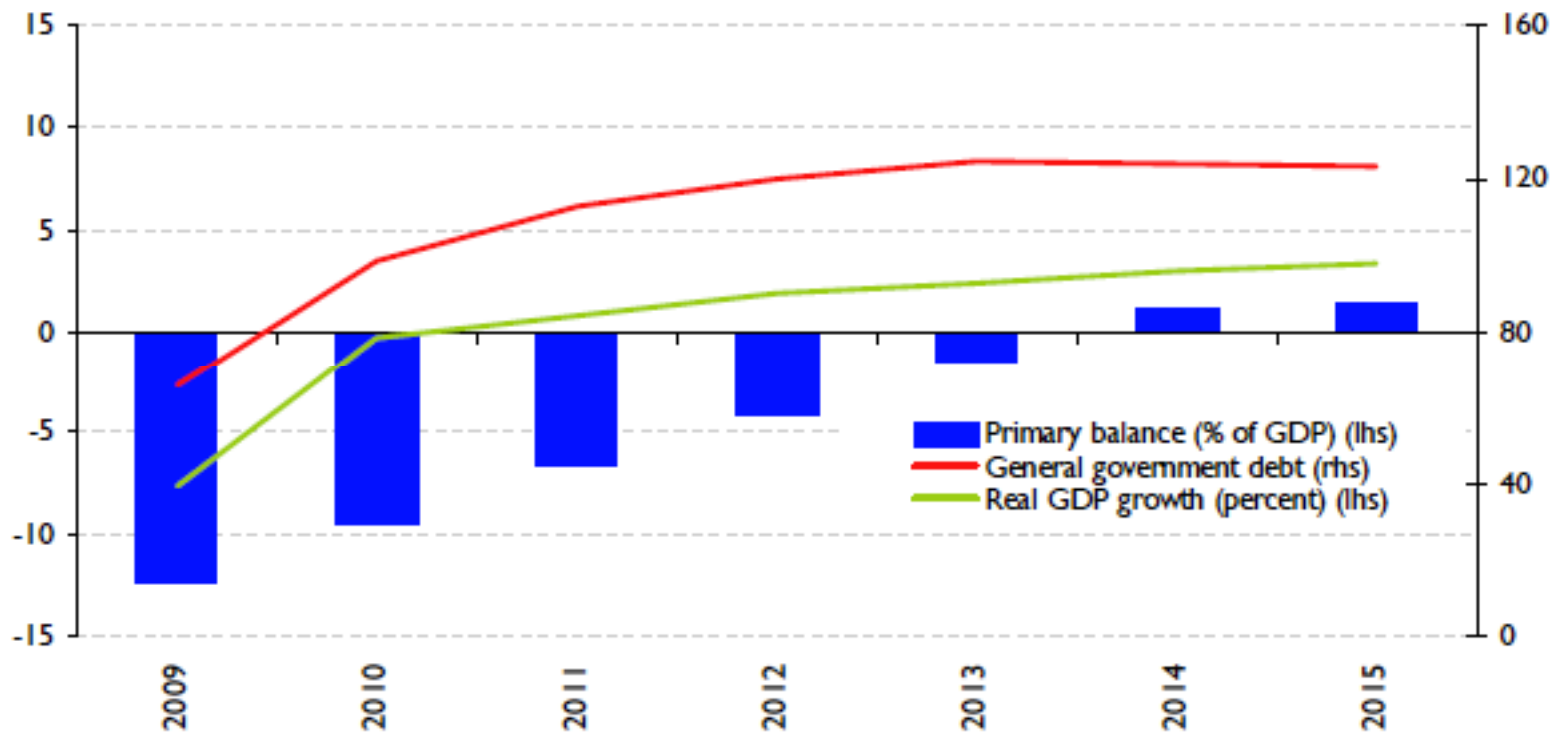
## Target 2 Balances end 2010



Source: Deutsche Bundesbank



**Ireland: projected general government debt and primary balance under current EU/IMF programme (percentage of GDP)**

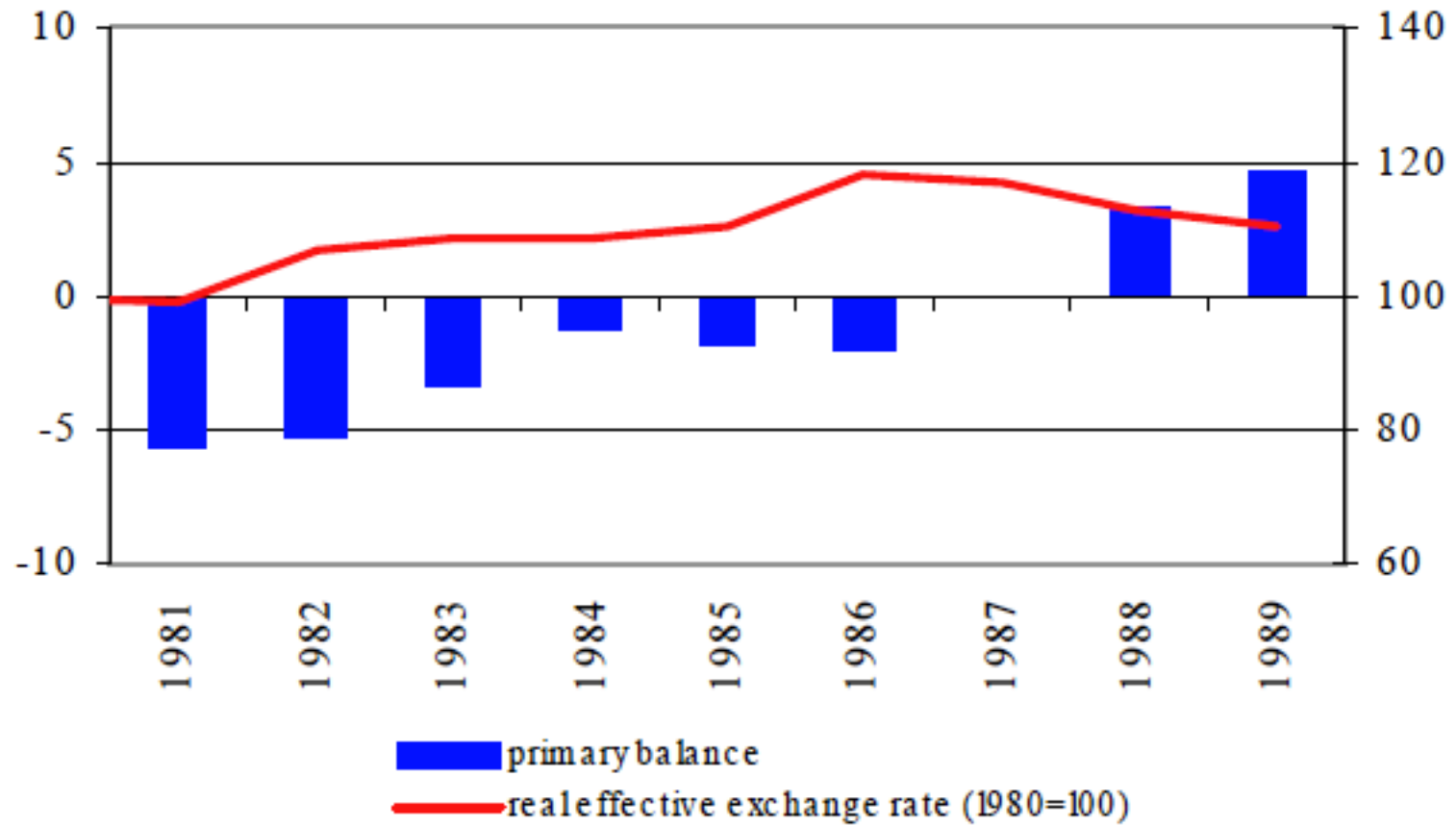


Source: IMF - Staff Report - Request for an extended arrangement

The primary balance figure for 2010 has been corrected for the one-off impact of government support to Irish banks

**General government primary balance**  
(as a percentage of GDP)

**Ireland**



## Primary balances needed to stabilise debt-to-GDP ratio

	Spain	Portugal	Ireland	Greece
Debt-to-GDP ratio projected for 2012*	73.0	92.4	114.3	156.0
<b>r-g</b>				
2	1.5	1.8	2.3	3.1
4	2.9	3.7	4.6	6.2
6	4.4	5.5	6.9	9.4

\*European Commission autumn 2010 forecast

Primary balances needed to stabilise the debt-to-GDP ratio (at the level projected by the European Commission for 2012) in the long run (steady state) under different assumptions for the interest rate-growth differential



## Debt/GDP Ratios LAC

1980 37.2

1985 61.3

1986 66.7

1987 68.8

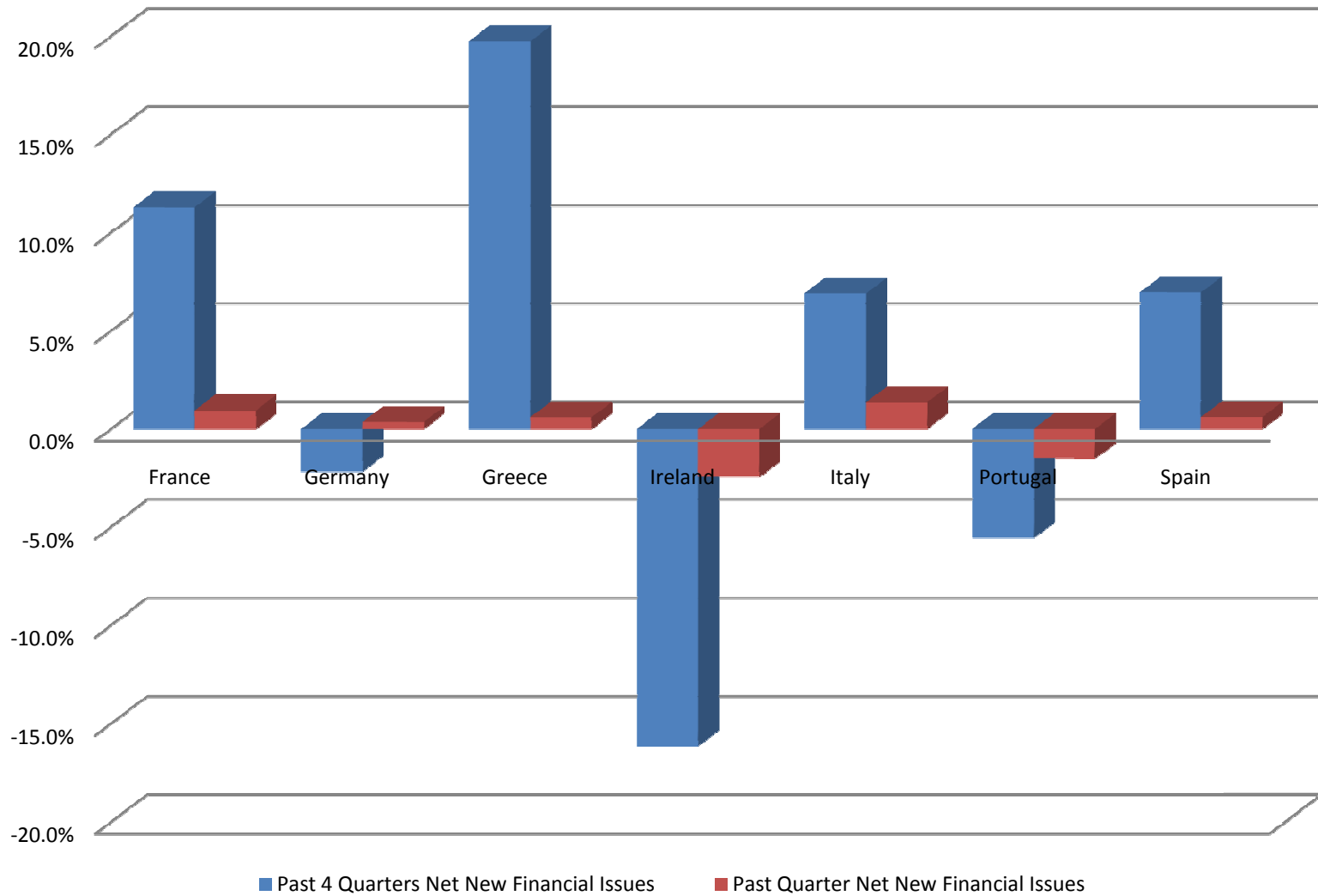
1988 43.5

# Debt exchanges are the likely answer.

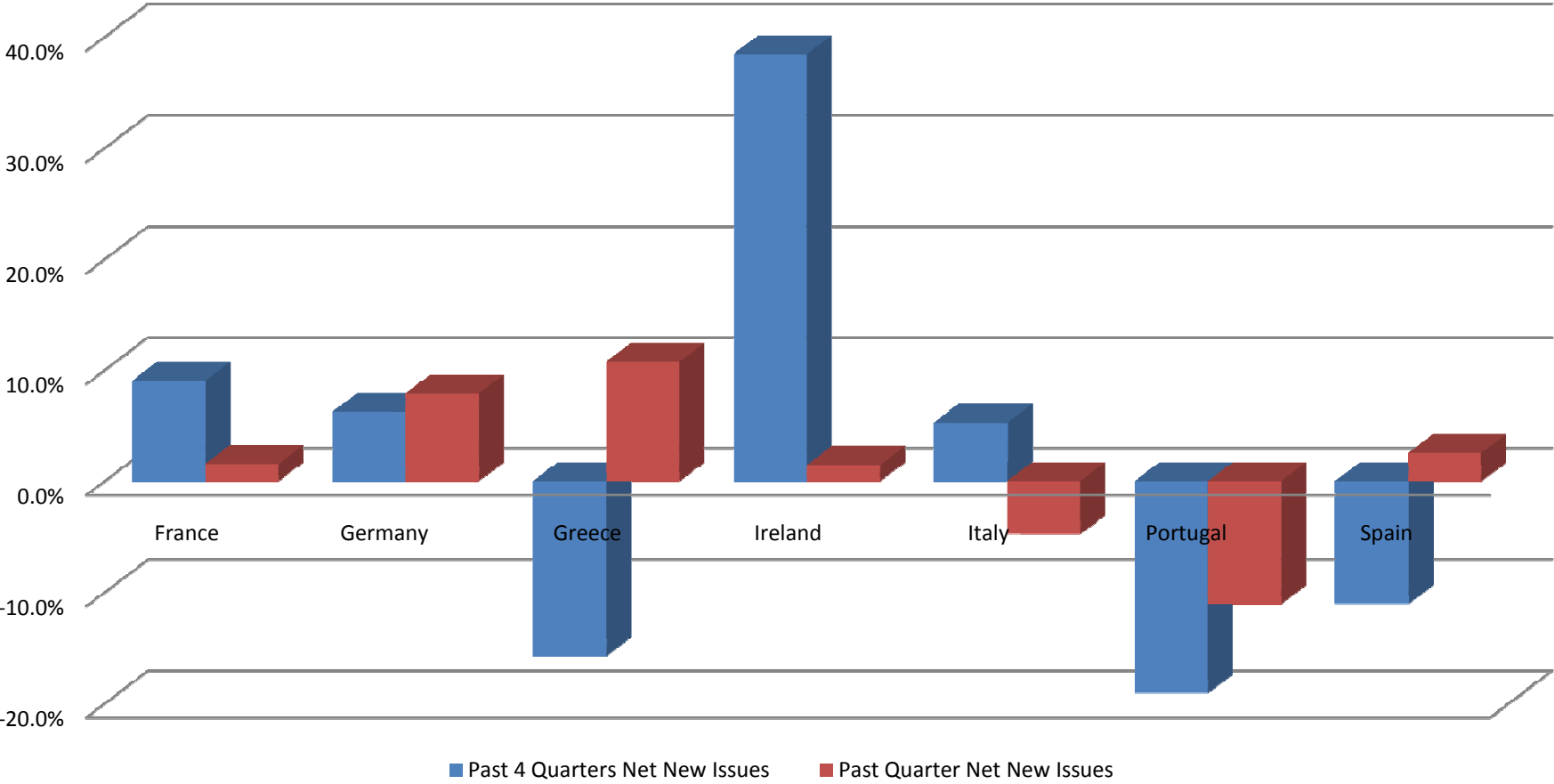
- Resources to keep the exchange voluntary provided up front.
- Some private sector involvement.
- Guarantees provide right incentives for debtor country.



## Financial Debt Net Issuance in Europe



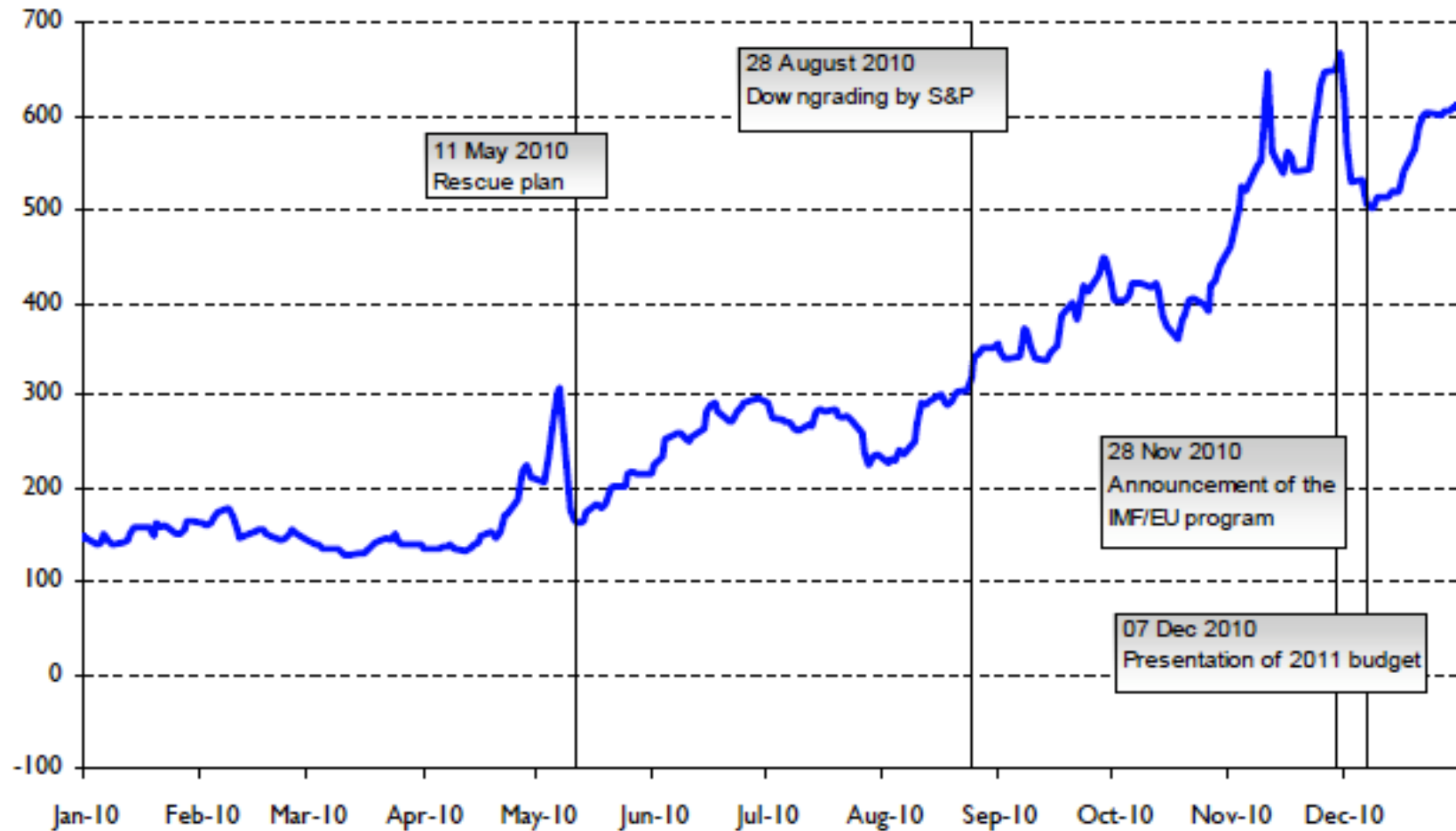
# Nonfinancial Corporate Bond Net Issuance in Europe



## Ireland

### Spread over German 10-year government bond yield

(2010; daily data; in basis points)



Sources: Bloomberg, Thomson Reuters Datastream and ECB calculations.

Data: Bond yield spreads vis-à-vis the German 10-year government bond, end-of-day data.

