Editorial

The necessary and prudent measures taken to soften the economic blow from the COVID-19 pandemic have resulted in large fiscal deficits and a marked consequent increase in public indebtedness. Before the outbreak of the war in Ukraine, economies around the world were recovering strongly with a debt stabilising impact, and fiscal and monetary policy support measures were also gradually phasing out. Coupled with the expectation of a change in global liquidity conditions, the war has further heightened uncertainty and is posing challenges for policy makers by simultaneously threatening economic growth and exacerbating already rising inflation. Against this background, the 20*22 Sovereign Borrowing Outlook* analyses recent trends and possible future developments in sovereign financing requirements. It then sheds light on the implications of evolving monetary and fiscal policies and the broader government agenda including sustainability for public debt management.

The outstanding amount of OECD area central government marketable debt increased by more than USD 10 trillion in the two years following the outbreak of the pandemic and was set to reach an estimated USD 50 trillion by end-2021. This edition of the *Outlook* projects that the outstanding level of central government marketable debt will increase by USD 3 trillion to USD 53 trillion in 2022. This represents a total increase of more than USD 13 trillion (33%) in outstanding government securities since the outbreak of the COVID-19 pandemic. That is more than the total debt growth over the decade before this crisis. Furthermore, given the uncertainties around the impact of the war and potential fiscal support to be provided to consumers and business affected by higher food and energy prices, there is a risk of upward deviation from these estimates, particularly in the Euro area.

An increasing outstanding amount of debt means increases in the amount of debt to be refinanced. In view of the rapid pace of debt accumulation and favourable funding conditions, many countries have sought to rebalance their sovereign debt portfolio maturities to ease near-term redemption pressures and to strengthen the resilience of their debt portfolios against refinancing risk. As a result, the average term-to-maturity of outstanding debt has almost fully returned to a pre-pandemic level, standing at 7.6 years in 2021 and reaching record highs in 16 OECD countries including France, Italy, Portugal, Spain and the United States. Despite the extended maturities of new issuance, debt redemption profiles are expected to be elevated and may pose significant challenges in terms of refinancing risks, as 42% of outstanding marketable debt stock will need to be refinanced or repaid within the next three years.

The cost of borrowing is a key determinant of the sustainability of public finances in any country. The surge in borrowing needs following the outbreak of the pandemic was financed at very favourable conditions, largely due to exceptionally accommodative monetary policies. Going forward, however, sovereign borrowing costs are set to increase for both advanced economies and emerging market economies. As major central banks look to tighten monetary policies in response to rising inflation, both maturing debt and new debt issuance will be financed at higher rates. In addition, the tapering of quantitative easing and unwinding of asset purchase programmes will result in an increase in net issuances that have to be absorbed by other investors who may demand higher yields. Finally, a reduction in activity could increase the search cost of primary dealers, which would increase their risk premia to intermediate trade. All of this points to a need for close monitoring of government securities markets, and more careful planning of government' funding operations, taking into account a possible decrease in market liquidity, investor demand for different maturity segments and the balance sheet capacity of primary dealers.

The change in global liquidity conditions is affecting Emerging Market and Developing Economies in particular. Less favourable liquidity conditions are coinciding with increased refinancing needs and deteriorating credit conditions in some low- and lower-middle income economies. These country groups issued more than USD 3.5 trillion of debt in financial markets on average in both 2020 and 2021, roughly 50% higher than the pre-pandemic three year average. Simultaneously, with the exception of the Asian region, the quality of their debt has been deteriorating with a record of 74 credit rating downgrades, reflecting increased risk premia and borrowing costs. Going forward, it is important that these countries continue to receive financial and technical support from international financial institutions in order to manage their debt in a transparent and prudent way. In this context, OECD's Debt Transparency Initiative can contribute to improving the transparency of bilateral lending to low-income economies, subject to continued support from G20 members, governments in low-income countries and engagement from private sector lenders.

Sustainability, which increasingly drives changes in financial markets more broadly, also has implications for public debt management. Environmental, social and governance (ESG) considerations are affecting government securities markets and public debt management practices by feeding into investment decisions, assessments of sovereign creditworthiness and structural budget changes. In response, debt management offices are increasingly playing a support role in national ESG strategies by acting as an interface between the government and financial markets and through the issuance of ESG-labelled instruments in recent years. Reflecting inputs from both OECD and non-OECD countries, this *Outlook* discusses key challenges and risks related to the incorporation of ESG factors into public debt management, and presents the common features of newly emerging leading ESG-related practices in terms of communication, transparency and liquidity.

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