Executive summary

Government funding needs and debts, which surged dramatically in 2020 as fiscal deficits increased and economies contracted in the wake COVID-19 crisis, will remain high in 2021

The upsurge in government spending and reduced revenue collection in the wake of the COVID-19 crisis mean that the gross borrowing needs of governments have risen significantly. OECD governments borrowed USD 18 trillion from the markets in 2020, equal to almost 29% of GDP. Compared to 2019, this was 60% more in absolute terms, and 12 percentage points higher relative to GDP. This year's survey results forecast a continuation of this upward movement in 2021, albeit at a slower pace. However, 2021 projections are subject to a high degree of uncertainty largely due to the pace of the pandemic, the global economic outlook and changes in government fiscal policy responses.

The level of outstanding central government marketable debt for the OECD area is expected to increase from USD 47 trillion in 2019 to almost USD 56 trillion in 2020, and to USD 61 trillion by the end of 2021. At the same time, measures to contain the spread of the virus and tackle the health crisis caused extensive short-term economic disruption in the OECD area. In recent months, however, prospects for an eventual path out of the crisis have improved, as vaccination campaigns are under way in several countries. Hence, the OECD estimates that economies will recover gradually in 2021, following the last year's sharp contraction. Against this backdrop, the average level of central government marketable debt-to-GDP ratio for the OECD area is estimated to increase by around 20 percentage points between 2019 and 2021, and reach over 90% of GDP in 2021. However, if large-scale containment measures remain in place and potential additional fiscal policy support needs to be pursued, then, debt-to-GDP ratio may escalate further in 2021.

Interest rates on government securities have declined to record lows, limiting the debt service burden

Despite the upsurge in borrowing amounts in 2020, financing costs of government budget deficits have fallen in the OECD area, thanks to robust investor demand regardless of the significant market disruption in March. Major central bank large-scale asset buying programmes and commitments to keep near-zero repo rates have supported the smooth functioning of financial markets and facilitated the absorption of increased debt issuance. In the euro area, for example, where the European Central Bank has become the largest creditor in several countries, government yields up to the 10-year maturity segment have declined to negative levels for almost all countries.

The low yield environment has made the use of expansionary fiscal policies less costly and more attractive in the fight against the COVID-19 pandemic. The average cost of fixed-rate dollar denominated bond issuance declined from about 2% in 2019 to 0.7% in 2020; and from 0.6% to less than 0.2% for euro denominated bonds. In 2020, more than 20% of the government bonds in OECD area were auctioned at negative yields, the ratio reached 50% for euro area, and 60% for Japan. On average OECD interest spending-to-GDP is estimated to have declined from 2% in 2015 to 1.5% in 2020. Large budget deficits in recent years have led to mounting debt levels, however, the declining size of interest payments has helped to contain the upward pressure on deficits.

Shortened maturities combined with continued large new borrowing needs mean higher rollover ratios and refinancing risk

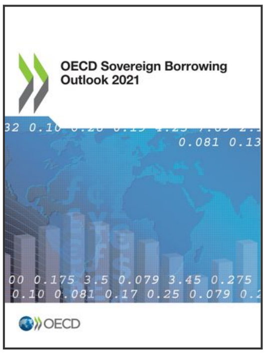
The share of short-term instruments in central government marketable debt issuance in the OECD area, which averaged 40% in the past five years, increased to 48% in 2020. This has also led to a decline in the average term-to-maturity for the OECD for the first time since the 2008 financial crisis. The bulk of the additional cash needs of governments due to the COVID-19 shock has been financed through T-bill issuance, typically considered as a ‘shock absorber’ by sovereign issuers. This trend has been mainly driven by two factors. From the demand side, investor demand was particularly higher for shorter-term liquid assets, during the period of heightened uncertainty in the financial markets in the early stages of the outbreak. From the issuer’s perspective, short-term instruments have been preferred by sovereigns as the size and duration of financing requirement have also entailed considerable uncertainty.

Notwithstanding the cost advantages attached to short-term borrowings, from a risk management perspective, a heavy and continued reliance on short-term financing combined with rising financing needs can amplify near-term refinancing risk, and weaken fiscal resilience. Hence, roll-over ratios of outstanding central government debt have shown signs of deterioration in many OECD countries over the last year. When conditions improve, rebalancing of debt portfolio maturities should be considered to strengthen the resilience of the debt portfolio against refinancing risk. This may also facilitate a smooth exit from expansionary monetary policies, when policy rates eventually rise in the future.

Prudent debt management will be required as financing needs for debt repayments soar and the outlook for the global economy remains uncertain

The OECD area borrowing outlook has been hampered by unusual uncertainties depending on the evolution of the pandemic and the pace of the economic recoveries. It should be noted that efficacy of COVID-19 vaccinations programmes, as well as the efficacy of the vaccines to new virus variants entails risks. A positive outcome can boost confidence in the near-term and limit the need for additional financing. A strong pick-up in activity and inflation from the Q2 2021 onwards may put pressure on interest rates in the financial markets. On the other hand, the materialisation of downside risks may widen government budget deficits and pose challenges to funding operations in 2021.

The current outlook and increased refinancing needs mean that sovereign issuers should be mindful of risks and maintain flexibility in funding programmes. They should carefully manage changes in borrowing programmes and put additional efforts into communicating the changes in borrowing plans with market participants at a time when there is increased attention to the liquidity condition in the financial markets. It would also be prudent to consider rebuilding the contingency funding tools; increasing the financing capacity through new securities; and, calibrating auction sizes to address imperative challenges.



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