Debt Stocks Meet Gross Financing Needs: A Flow Perspective into Sustainability

This paper shows that changes in gross financing needs have a significant effect on borrowing costs when debt stocks are high

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Abstract

It is well known that no single metric can provide reliable cross-country risk assessments of debt sustainability. While approaches to understanding sustainability have traditionally relied heavily on stock metrics, a consensus is emerging that debt sustainability should be linked to both stock and flow features of underlying public debt. This paper informs this debate by analysing the ability of gross financing needs, the preferred flow metric in current debt sustainability analyses by official institutions, to provide additional information to that provided by standard stock metrics of a sovereign's likelihood of distress. Our main contribution is to document a significant negative effect from changes in gross financing needs when debt stocks are high. These results support the intuition that countries can sustain very large debt stocks if these do not generate unmanageable flow needs. Additionally, we show that sovereign roll-over needs are a critical element driving this effect. Given the role of official lending in taming the dynamics of this component, our findings also inform the literature on the role of official lending in crises resolution.

Keywords: Sovereign sustainability, debt stocks, financing needs, maturity

JEL codes: H62, H63, F34

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