External Sector Statistics – Adoption of the Sixth Edition of the Balance of Payments and International Investment Position Manual (BPM6)

Methodological note nr.4 – External Debt
June 2015

1. Introduction

In June 2015, the Banco Central do Brasil (BCB) started publishing Brazilian external debt statistics in accordance with the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6)[1] and with the External Debt Statistics: Guide for Compilers and Users (EDS 2013)[2].

The BPM6 and the EDS 2013 have been updated to enhance assessments on countries' external sustainability, given the increasing volume of international capital flows and the increased interdependence in the world economy. This set of updates improves the quality and usefulness of external debt statistics.

This Methodological Note covers general aspects related to the implementation of BPM6 and EDS 2013 and their impact on the Brazilian external debt statistics. The subsequent sections address the concept and the methodological principles of external debt; the major impact on statistics published by the BCB and the changes in the external debt tables of the Press Release of the External Sector.

2. Concept and methodological principles of external debt

The BPM6 establishes the concept of debt instrument according to its obligation of payment of principal and/or interest:

---

[1] The BPM6 is available in English on the IMF website at the address http://www.imf.org/external/pubs/ft/bop/2007/bopman6.htm.
[2] The EDS 2013 is available in English on the TFFS website at the address http://www.tffs.org/edsguide.htm.

*"5.31 **Debt instruments are those instruments that require the payment of principal and/or interest at some point(s) in the future**. Debt instruments consist of SDRs, currency and deposits, debt securities, loans, insurance technical reserves, pension and related entitlements, provision for calls under standardized guarantees, and other accounts receivable/payable.*

*5.32 Debt instruments can be contrasted with equity and investment shares in the nature of the liability and risk. Whereas equity gives a residual claim on the assets of the entity, **a debt instrument involves an obligation to pay an amount of principal and/or interest usually according to a predefined formula**, which usually means that the creditor has a more limited risk exposure. Provided that the debtor is solvent, debt obligations are largely fixed or linked by a formula to some other variable, such as a market interest rate or the price of a selected item. In contrast, the return on equity is largely dependent on the economic performance of the issuer. Because of the different nature of risk, debt is an important grouping for analysis."*

The International Investment Position (IIP) – the broadest statement of external assets and liabilities of an economy – encompasses all the external financial liabilities, including, as a subset, those categorized as external debt. Methodologically, the external liabilities of the IIP can therefore be divided into non-debt liabilities, consisting of financial derivatives, direct investment equity capital and other capital; and debt liabilities.

Similarly, paragraph 2.3 of EDS 2013 defines external debt:

"Definition of External Debt
2.3 The Guide defines gross external debt as follows:
***Gross external debt, at any given time, is the outstanding amount of those actual current, and not contingent, liabilities that require payment(s) of principal and/or interest by the debtor at some point(s) in the future and that are owed to nonresidents by residents of an economy**."*

These liabilities are typically established through the provision of economic value by one unit, the creditor (nonresident), to another, the debtor (resident), under a contractual arrangement that specifies payment terms. For example, considering a loan, the resident shall pay, in the future, principal and/or interest according to a prior agreement.

The methodological definition of external debt transcribed above is not conditional to the place of trading, jurisdiction or currency, and the debt instrument may well be denominated and settled in, for example, goods. However, it is strictly necessary that the creditor and the debtor be residents of different economies, being the debtor the resident of the compiling economy. According to BPM6 and EDS 2013, an institutional unit (company, government agency, an individual, among others) is a resident if the center of its predominant economic interest is located in the economic territory of that economy. "Predominant economic interest" must be understood as the engagement of a unity in economic activities and transactions of significant scale and its intention to remain engaged for an undetermined or a determined period of time, since it is for more than one year. Residents of a country are, among others, all companies operating in its territory, including subsidiaries of multinational companies.

The external debt definition implies that liabilities arranged between two residents do not fulfill the criteria of external debt, even if denominated in a foreign currency. **Analogously, liabilities of nonresidents with an obligation of payment of principal and/or interest, even if denominated or settled in local currency, should compose the external debt**.

The EDS 2013 recommends that debt instruments, in general, be valued at the reference date by their nominal value. However, **for debt securities, once they are tradable, pricing shall be, preferably, at market value**. While the nominal value corresponds to the total outstanding, the market value is given by the price at which the security is traded. The BPM6 defines market value in paragraph 3.67:

> *"3.67 Market prices refer to current exchange value, that is, the values at which goods and other assets, services, and labors are exchanged or else could be exchanged for cash. Market prices are the basis for valuation in the international accounts."*

It is worth mentioning that the market value will reflect the conditions of sale of certain assets in a given period if the market where these assets are traded has liquidity and each asset has an adequate volume of transactions.

3. Main impacts on external debt statistics published by BCB

According to the concept presented by the BPM6 and the EDS 2013, external debt is a liability of a resident unit held by nonresidents, irrespective of the place of trading, the jurisdiction, or the currency in which the debt is denominated. So, even liabilities in national currency, issued in Brazil, must be part of the external debt.

Thus, the **quarterly external debt statistics published by the BCB will encompass the outstanding fixed income securities issued in the domestic market and held by nonresidents**, in particular the corresponding share of the locally issued Domestic *Federal Public Debt* (DFPD).

The inclusion of these securities traded in the domestic market and denominated in Brazilian *reais* in the external debt does not affect the country's outstanding external liabilities, since these liabilities have always been included in the IIP series. **It is only a methodological reclassification in order to consider this external liability, already computed in the IIP statistics, as external debt.**

It is essential to emphasize that the external debt denominated and settled in local currency, of course, does not imply the same level of risk than that arranged in foreign currency. In the first case, the exchange risk is borne solely by the nonresident investor and lender. Additionally, to serve this debt, revenues in foreign currency are not necessary. Finally, fixed income securities traded in the domestic market and held by nonresidents are issued in Brazil and, therefore, are not subject to the legal treatment of other jurisdictions.

The following table presents the outstanding securities traded in the domestic market, denominated in *reais* and in possession of nonresidents, in monetary terms and in proportion to the gross external debt.

US$ billion

Year	Domestic fixed income securities held by non-residents (A)	Gross External Debt (B)1/	Share (%) (A/B)
2007	21,1	240,5	8,8
2008	26,5	262,9	10,1
2009	55,9	277,6	20,1
2010	100,7	351,9	28,6
2011	100,5	415,5	24,2
2012	115,5	455,3	25,4
2013	134,6	486,7	27,7
2014	152,1	560,4	27,1
2015	144,7	554,6	26,1

1/ Gross external debt, including intercompany lending, excluding domestic fixed income securities held by non-residents.

Source: CVM and DEMAB - Central Bank of Brazil.

For the outstanding DFPD, the Special System for Settlement and Custody (Selic) and the Open Market Operations Department (Demab) of the BCB calculates prices observing the yield curve of each security. The Brazilian Securities and Exchanges Commission (CVM) is the data source of the outstanding debt securities issued by private companies in the domestic market and held by nonresidents, also incorporated into the external debt.

The acknowledgment of the outstanding debt securities issued in the domestic market and held by nonresidents as Brazilian external debt is consistent with the addition of the income generated by these debt securities as expense to the primary income (interest) account of the Balance of Payments (BP), after the adoption of BPM6[3].

Another development in the BCB external debt statistics is the market value as

[3] For more details, see "Methodological Note 2 - Current Account - Adoption of the 6th Edition of the Balance of Payments Manual and international investment position (BPM6)" http://www.bcb.gov.br/ingles/economic/nm2bpm6i.pdf

a preferred criterion for valuation of securities. Initially, only federal debt securities will be priced at market values, due to some data source limitations regarding private debt securities' market values. The table below compares the outstanding government securities issued abroad under two criteria of valuation, nominal and market:

US$ million

General Government - Long-term	2011	2012	2013	2014				2015
- Debt securities	Dec	Dec	Dec	Mar	Jun	Sep	Dec	Mar
Market value	49 159	52 388	39 560	39 791	42 499	42 441	42 049	38 187
Nominal value	37 776	37 696	35 668	35 302	36 770	38 441	37 855	35 068
Diference	11 383	14 692	3 892	4 489	5 729	4 000	4 194	3 119

4. Main changes in the external debt tables of the Press Release of the External Sector

The adequacy of Brazil's external debt statistics to the latest international methodological standards requires changes in the tables of the Press Release of the External Sector. Below are the main changes in the tables:

- The outstanding debt securities issued in the domestic market denominated and settled in reais, and owned by nonresidents, are identified separately, given their specificity and different risk levels;

- The expression "intercompany loans" is replaced by "intercompany lending." However, its outstanding value was already being separately identified, because of its different risk level and enforceability degree;

- Data on Federative Republic of Brazil outstanding debt securities issued in the international market are valued at market value. The nominal value will also be informed, but as a memorandum item;

- The item "Other debt liabilities" from "Monetary Authority" is replaced by "SDR Allocations" from "Central Bank". The IMF allocated Special Drawing Rights (SDR) to supplement the international reserves of its members. The allocations are recorded as assets in international reserves and, concurrently, as external debt liabilities;

• The external debt presentation broken down by currency considers the external debt issued in the domestic market expanding the participation of Brazilian *reals* on total external debt. Additionally, liabilities payable in goods are detailed.

Table XXII - Gross external debt

Prior	Current
Gross external debt (A)	**Gross external debt (A)**
Short-term	Short-term
Long-term	Long-term
General Government	**General Government**
Long-term	Long-term
Debt securities	Debt securities 2/
Loans	Loans
Trade credits	Trade credit and advances
Monetary Authority	**Central Bank**
Long-term	Long-term
Loans	Loans
Other debt liabilities	SDR allocations
Banks	**Banks**
Short-term	Short-term
Debt securities	Debt securities
Loans	Loans
Currency and deposits	Currency and deposits
Long-term	Long-term
Debt securities	Debt securities
Loans	Loans
Other sectors	**Other sectors**
Short-term	Short-term
Debt securities	Debt securities
Loans	Loans
Trade credits	Trade credit and advances
Long-term	Long-term
Debt securities	Debt securities
Loans	Loans
Trade credits	Trade credit and advances
Intercompany loans (B)	Intercompany lending (B)
Gross external debt, including intercompany loans C=(A+B)	**Gross external debt, including intercompany lending C=(A+B)**
	Domestic fixed income securities held by nonresidents - denominated and settled in Reais (D)
Gross external debt, including intercompany lending C = (A+B)	**Gross external debt, including intercompany lending and domestic fixed income securities held by nonresidents E = (C+D)**
Memo	**Memo**
	Nominal value: General Government – long-term – debt securities
Outstanding debt payable in goods:	Outstanding debt payable in goods:
Gross external debt (A)	Gross external debt
Intercompany loans (B)	Intercompany lending
Gross external debt, including intercompany loans C=(A+B)	

2/ Debt securities valued at market value.