

WORLD BANK WEBINAR
Wednesday, April 3rd, 2019, 10:00 a.m. - 12:00 p.m.

***Long-term Bonds: different ways to support
(and benefit from) pension needs***

***Uruguay: The case of Wage-Linked
Sovereign Bonds***

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Organization of presentation



- Context
- Creation of new unit of account indexed to wages (“Pension Unit”)
- Opportunities and policy trade-offs
- Next steps and concluding remarks

Context: the Pension System in Uruguay



- ✓ Since 1989, pension payments in Uruguay are constitutionally indexed to nominal wages.
- ✓ In 1995, a pension reform established a mixed social security regime, with a state-managed pay-as-you-go pillar and an individual capitalization pillar.
- ✓ In the individual savings pillar, Pension Funds managed workers' contributions until their retirement.

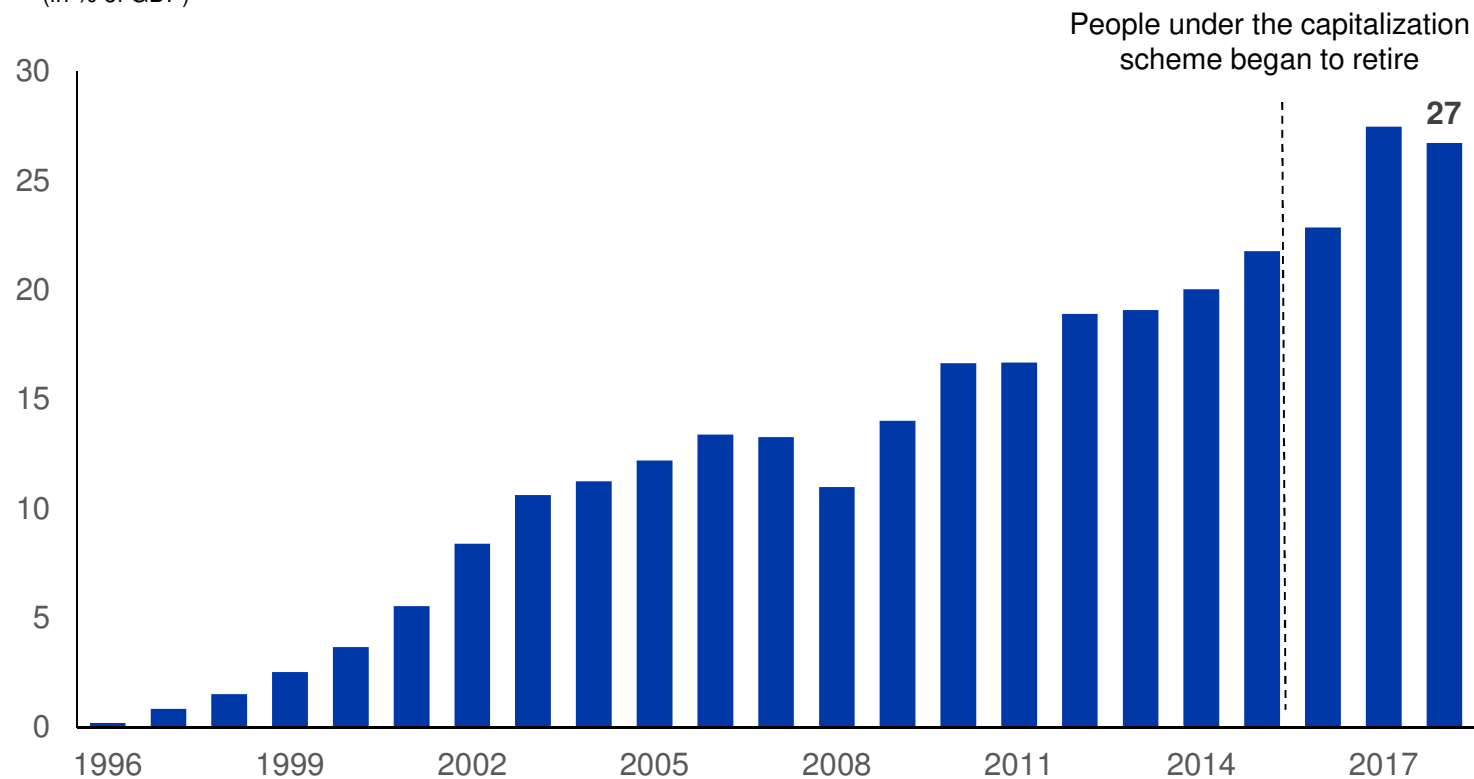
Accumulation Phase: Pension Funds



- ✓ Pension funds` assets under management have continued upward trend

Pension saving fund evolution

(in % of GDP)



Sources: Central Bank of Uruguay

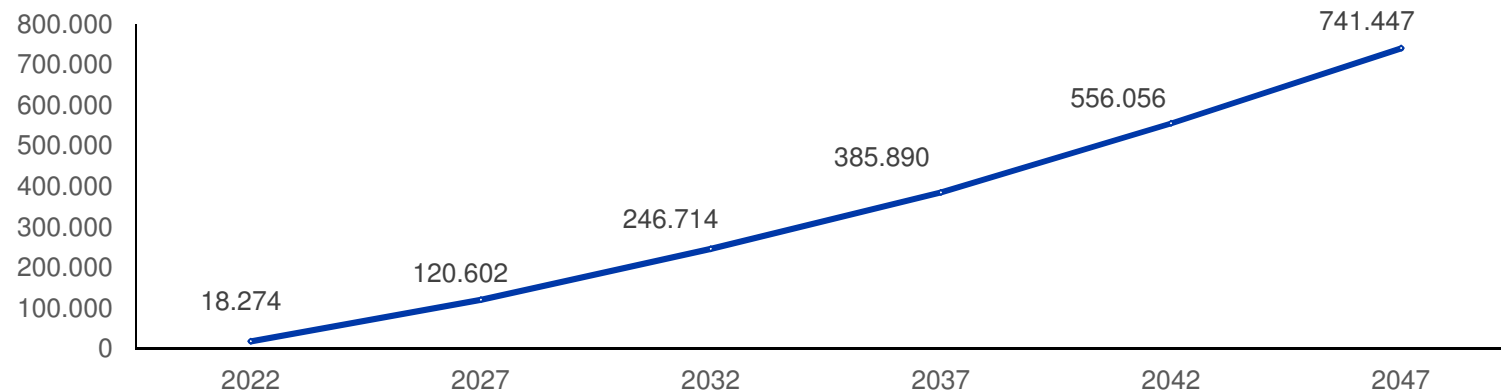
Deaccumulation Phase: Annuity Payments of Insurance Companies



- ✓ At retirement, the pension fund transfers to the insurance company the accumulated balance in the individual savings account, which is then in charge of serving the annuity.
- ✓ Since 2016, as the accumulation stage has matured, the number of retirees that are entitled to receive an annuity began to grow fast, and is expected to increase rapidly.

Amount of annuities expected

(in number of people)



Sources: Dassatti & Mariño, "Maduración del Sistema Previsional: proyecciones y agenda", 2014
<https://www.bcu.gub.uy/Estadisticas-e-Indicadores/Documentos%20de%20Trabajo/3.2014.pdf>

The problem of currency mismatch



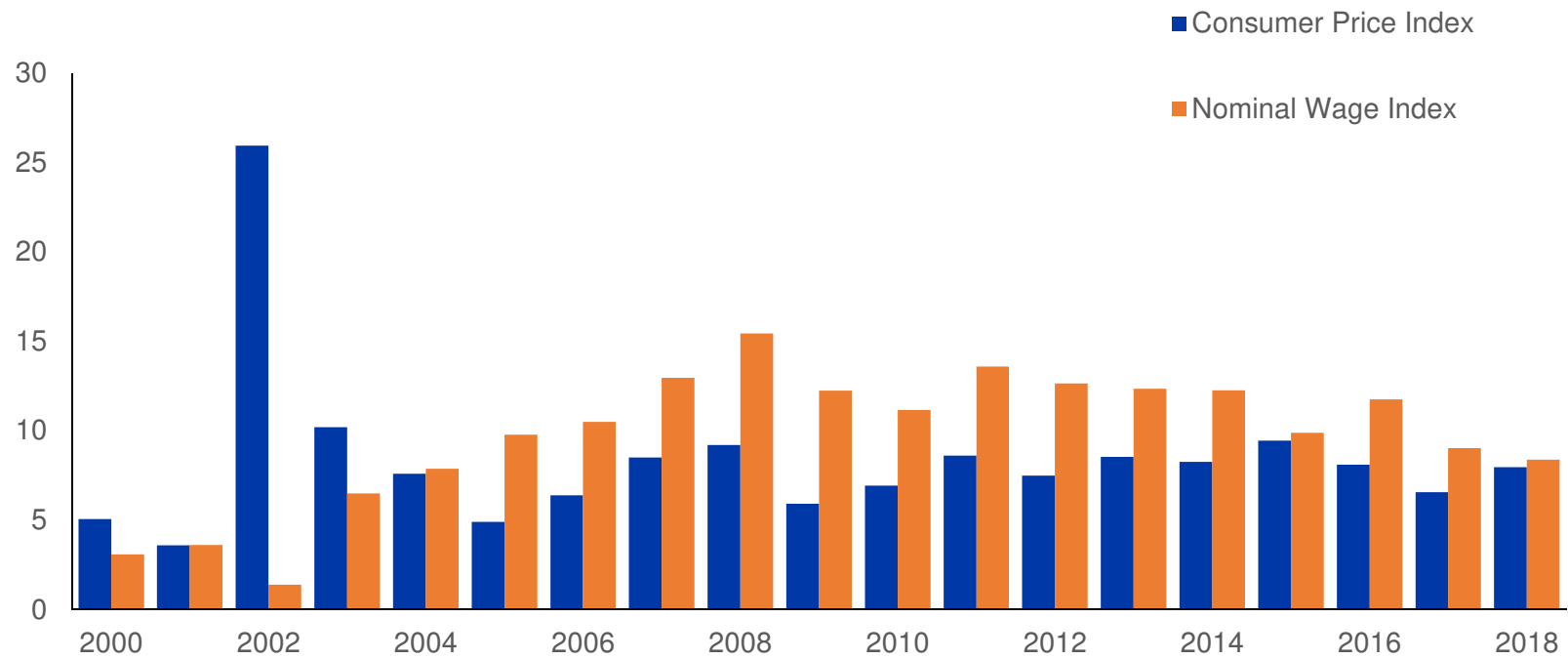
- ✓ Lack of regular supply of long-maturity market assets tied to nominal wages exposed insurers' balance sheets to movements in real wages.
- ✓ CPI-linked instruments were the closest hedge available for annuity liabilities (yet, insufficient).
- ✓ This led private insurers, among other factors to leave the annuity business, leaving the state-owned insurance company as the only active player in the market.

The problem of currency mismatch



Inflation and Nominal Wages

(annual change, in %)



Sources: National Bureau of Statistic

Creation of *Unidad Previsional* (Pension Unit)



- 1 08/2017 – Government submitted legislation proposing the creation of a daily accounting unit that would track changes to the NWI.
- 2 04/2018 – *Unidad Previsional* approved by the Congress.
- 3 07/2018 – Government starts issuing NWI-linked instruments as part of its domestic issuance calendar.

➔ Inclusion of UP Treasury Notes in the semi-annual issuance calendar was meant to provide the market with a clear signal of recurrence and predictability.

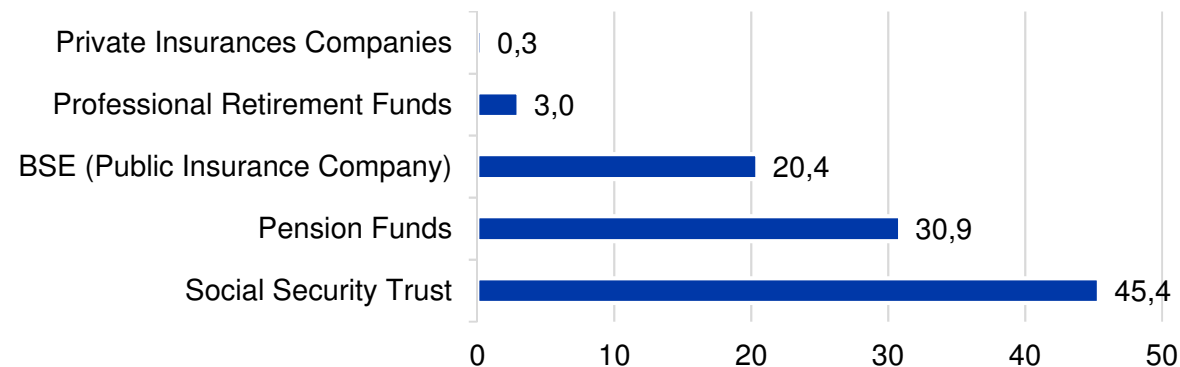
How do UP-denominated bonds designed?



- ✓ UP bonds are provided with a fixed real coupon.
- ✓ Nominal coupon and principal are thereby linked to changes in the NWI, reflected in the daily variation of the Pension Unit.
- ✓ NWI is published by the National Statistical Agency.
- ✓ On-the-run issuances: 5,5y and 13,5y average life

Holders of UP Treasury Notes

(in % of total)



Sources: Ministry of Economy and Finance, as of 03/18/2019

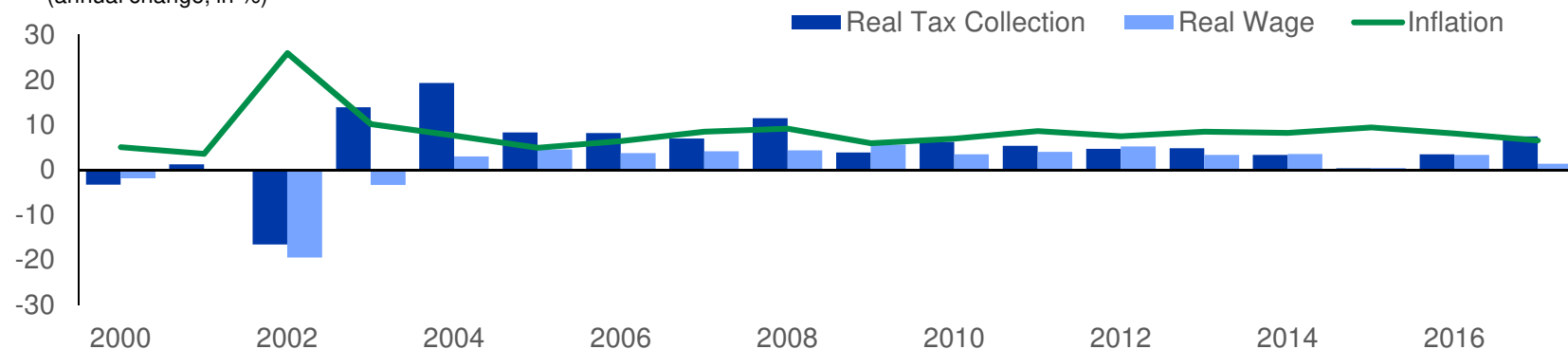
Opportunities for Debt Management



- ✓ Wage indexation provides with a better hedge against output shocks that affect tax revenues.

Tax Collection, Wages and Inflation

(annual change, in %)



Sources: National Bureau of Statistic & General Tax Direction

- ✓ Demand for UP will help to underpin the public sector's debt de-dollarization strategy, broadening its sources of long-term financing in local currency.
- ✓ Informational role of CPI-indexed and wage-indexed market.

Policy trade-offs



- ✓ Ensure the sustainability of the pension reform 2nd stage
 - Need to develop wage-indexed instruments

- ✓ Promote and foster local currency market efficiency
 - Completing markets should take into account that too many different LC issues could significantly fragment the market (liquidity and marketability of issues would decline), disrupting efficient government funding.

 - *Buy-and-hold* market requires a proactive attitude and regular presence.

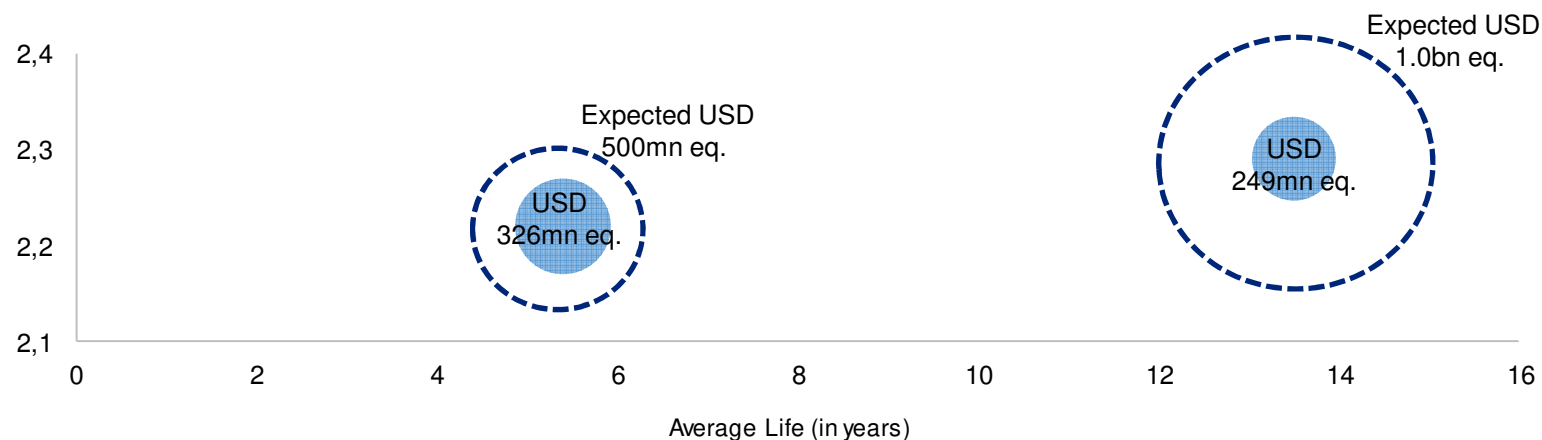
Next steps



- ✓ Underpin on-the-run issuances and add more references in order to promote the development of a yield curve in UP.

Pension Unit Issuances

(latest yield, in %)



- ✓ Evaluate switch of old legacy bonds in *Unidad Reajutable* (closed, one-off issuances) and index swaps between CPI-linked and wage-linked instruments.
- ✓ Promote issuances from other agents (public and private).