Agefi Borrower Profile

The World Bank shopping basket — FRNs and swaps top the list

The **World Bank** for the first time is moving into floating interest rate markets for its funding, with the launch in the near future of US domestic FRNs with margins linked to Treasury bills.

This is part of its strategy to enter several new markets in its current fiscal year, according to its Treasurer, ***Eugene Rotberg***, who spoke to Agefi in London last week (see accompanying illustration). The other new borrowing vehicle being devised by the **World Bank** is the launch of short-term instruments, offered to Central Banks around the world, which will be geared to the yield on one-year US Treasury instruments.

"There are no financial constraints on the **Bank** as world financial markets are concerned and as we look for a substantially increased role as a major borrowing and lending agency," ***Rotberg*** declares. In the past year, a number of factors have resulted in a step-up in the **Bank's** operations. "The significant flight to quality, as a result of international financial uncertainty, has helped us with our funding. The development of new financing techniques is another factor. Thirdly, many Governments are giving us greater access to their financial markets." ***Rotberg*** says.

The new FRNs the **World Bank** will be offering will be confined to the US market "Because we are concerned about the historic volatility of the Eurodollar Libor rate as a benchmark level for funding," he adds. In September last year, Libor rose to a level as high as 270 basis points over Treasury yields, while in the mid-1970's the differential widened to 400-500 basis points because of a relatively minor banking crisis at that time, ***Rotberg*** recalls.

What margin over TB's would the **World Bank** expect to pay on its FRNs? ***Rotberg*** will not be specific, but says anywhere near the 35 basis points over Treasuries which its 5-year bond issues in the US command "would be attractive to us."

A major "cross currency-interest rate swap" arrangement will be undertaken by the **World Bank** to swap out both the interest and currency elements in its FRN borrowing programme, ***Rotberg*** says. The hint from the **World Bank** is that a swap programme could be effective enough to make the possibility of a Eurodollar FRN launch a likelihood some time in the future. In the meantime, the US FRN programme will probably be confined to around $500m initially.

The new Central Bank facility, described by ***Rotberg*** as a "window" for monetary authorities around the world in which to lodge their reserves, will probably start with a total of $750m. It will be structured in US dollars with an interest rate set over the one-year US Treasury rate, and re-set every month. Probable margin will be around 30 basis points over the equivalent TB instrument.

The one-year instruments can be disposed of easily. Minimum deposit is $5m and no Central Bank can hold more than $200m of the facility, ***Rotberg*** says.

Meanwhile, there will probably be a step-up in the **World Bank's** existing discount note programme in the US.

Why Eugene likes Swaps

The **World Bank** has undertaken swaps in financial instruments raised as part of its borrowing programme totalling some $2.5bn in the last few months, and the technique of swapping will play an increasingly large role for the **Bank** in the future, says its Treasurer ***Eugene Rotberg***.

The **Bank's** worldwide borrowing is now running at about 100 bond issues each year, and some 70 of these are related to swap transactions - with typically Deutschemarks and Swiss francs being secured as the low cost counterpart to its primary borrowings.

Rotberg says swapping results in significant cost savings which can be passed on to the Third World countries which typically are the main users of **World Bank** finance. In the opening months of its current financial year, the **Bank** has raised $3.4bn in the fixed and medium-term bond markets, plus $500m through its US-based discount note programme.

The average cost of these transactions has been 9.65%, with an average life for each deal of some 7.6 years. However, with swaps undertaken on these deals, including transactions in ECU and US and Canadian dollars, their average cost has been reduced to 8.33%.

Last year's average cost of debt, by contrast, was 8.72%, and such savings are passed directly on to **World Bank** clients as the agency's lending rate is set every six months.

In pursuit of increasing debt management skills, the **World Bank** also intends to enter the financial futures markets, concentrating initially on hedging via the various US Treasury bill instruments available.

The **World Bank** is on target to raise between $10bn – $10.5bn this financial year compared with $10.3bn the previous year, and aims at an average cost of borrowing, swaps included, of some 8.50 – 8.75%. At the same time, its liquid cash position is rising – to $13.9bn as of September 30 compared with $13.2bn at the start of the fiscal year. ***Rotberg*** says the bigger cash position, on which its rate of return is 150 basis points over the marginal cost of its borrowing, is becoming increasingly necessary for overall debt management. The **World Bank's** outstanding debt this year is due to hit $50bn. He rejects suggestions that the **Bank** should reduce its cash holdings in order to direct more funds to the needy and cash-hungry Third World.

This cash holding was the subject of increasingly active trading by the **Bank**, which turned over $2 trillion in dealing last year – producing useful interest income and arbitrage possibilities, ***Rotberg*** says