DEBT VULNERABILITIES IN EMERGING AND LOW-INCOME ECONOMIES*

Debt side-event during UN GA Second Committee Meeting
October 23, 2018

*Paper prepared for the October 13, 2018 Development Committee Meeting in Bali.

OUTLINE

1. Debt Vulnerabilities in Emerging Markets (EMs)

2. Debt Vulnerabilities in Low Income and Developing Countries (LICDs)

3. A Multipronged Approach for Addressing Emerging Debt Vulnerabilities

Key messages

1. **Public and corporate debt in emerging markets (EMs) have grown rapidly to near record highs, although there is wide variation across countries.** Gross financing needs are high and could rise if downside risks to the global outlook materialize.

2. **About 40 percent of low income developing countries (LICDs) are at high risk or in debt distress**. Rapid debt accumulation has been fueled by new sources of official and market-based finance.

3. **Key drivers of debt build-up.** To some extent reflects a desirable policy response to low commodity prices and low interest rates. But in some cases weak macro-fiscal policy frameworks and shocks (security challenges, natural disasters). "Hidden debt" contributed in some instances.

4. **Public debt-to-GDP ratios are projected to remain contained in many countries**, but policy implementation and global risks could frustrate such an outcome.

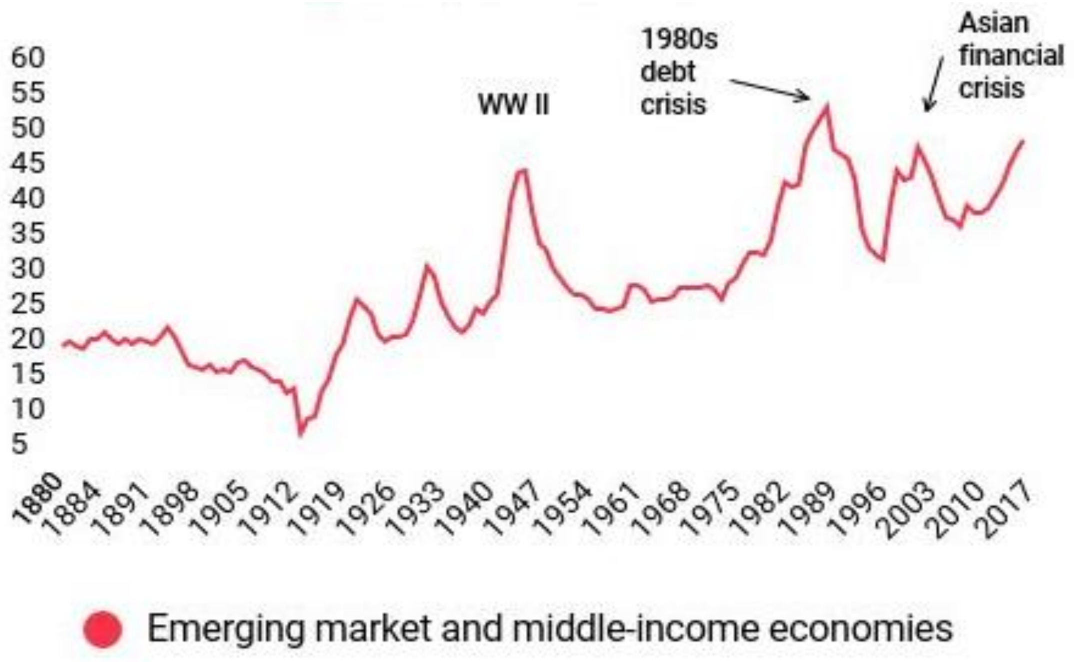
5. **Reforms tailored to country circumstances are needed.** Fiscal adjustment supported by growth friendly reforms; asset and liability management operations to smooth refinancing risks; greater transparency about and management of off-balance sheet risks; stronger domestic resource mobilization; stronger debt management capacity and project appraisal.

6. **The World Bank and the IMF are pursuing a multi-pronged approach** to help countries address debt vulnerabilities: stronger debt analytics; more debt transparency (creditor outreach on sustainable lending and improved data coverage); and improved debt/fiscal risk management, including scaled-up TA on debt management.

2. Debt Vulnerabilities in Emerging Markets

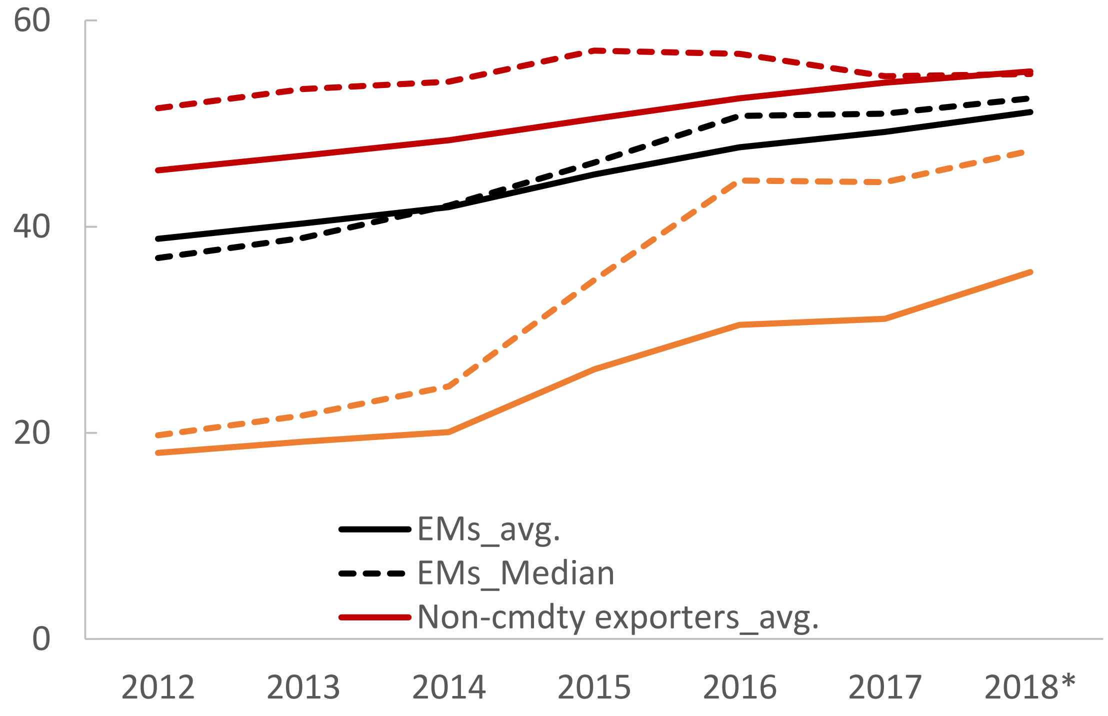
Public debt in EMs has risen substantially, approaching levels not seen since the 1980s debt crisis, driven by adverse shocks and policies.

EMs: Public Debt since 1880 (percent of GDP)



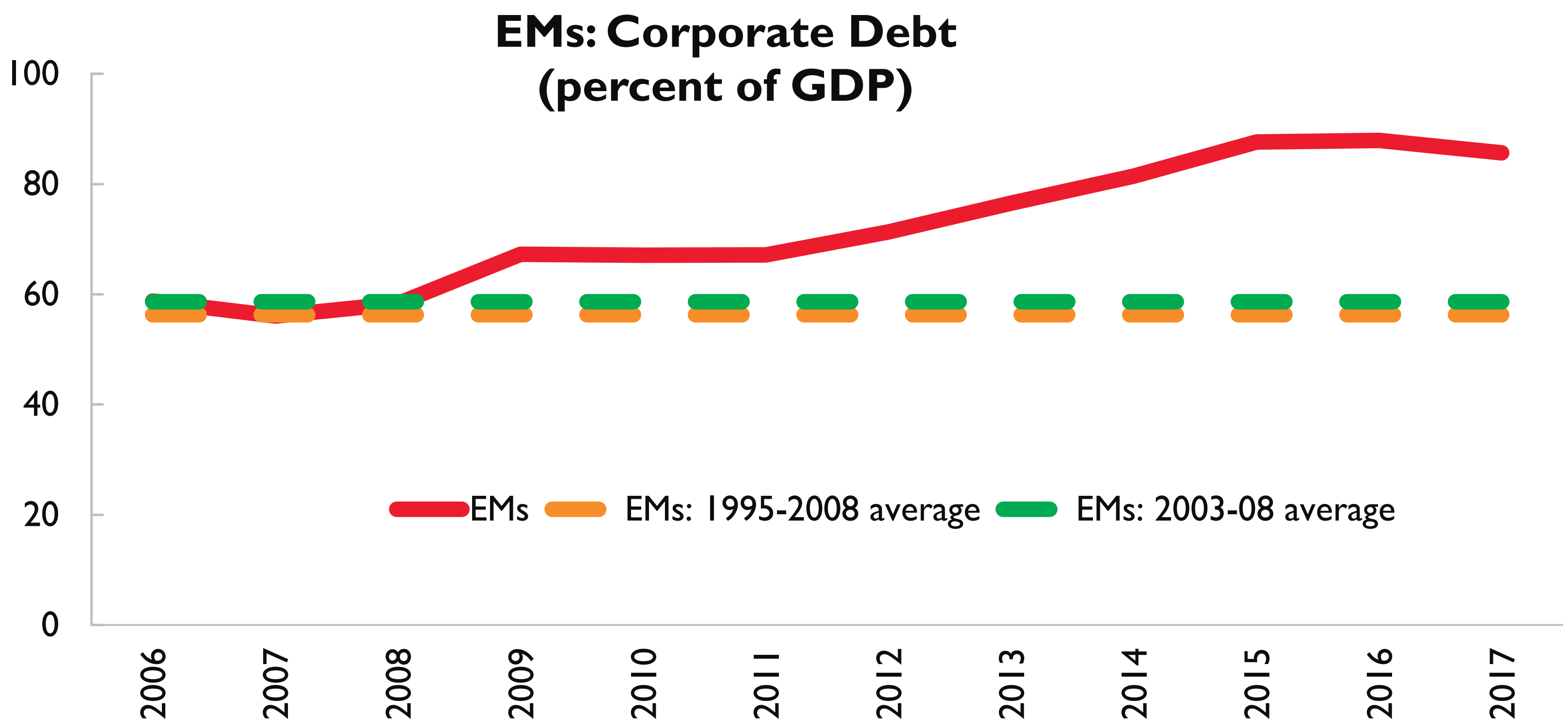
Note: Emerging Markets comprise countries that are neither advanced economies, nor low-income developing economies.
Source: Fiscal Monitor, April 2018 .

EMs: Public Debt 2013 - 18 (percent of GDP)



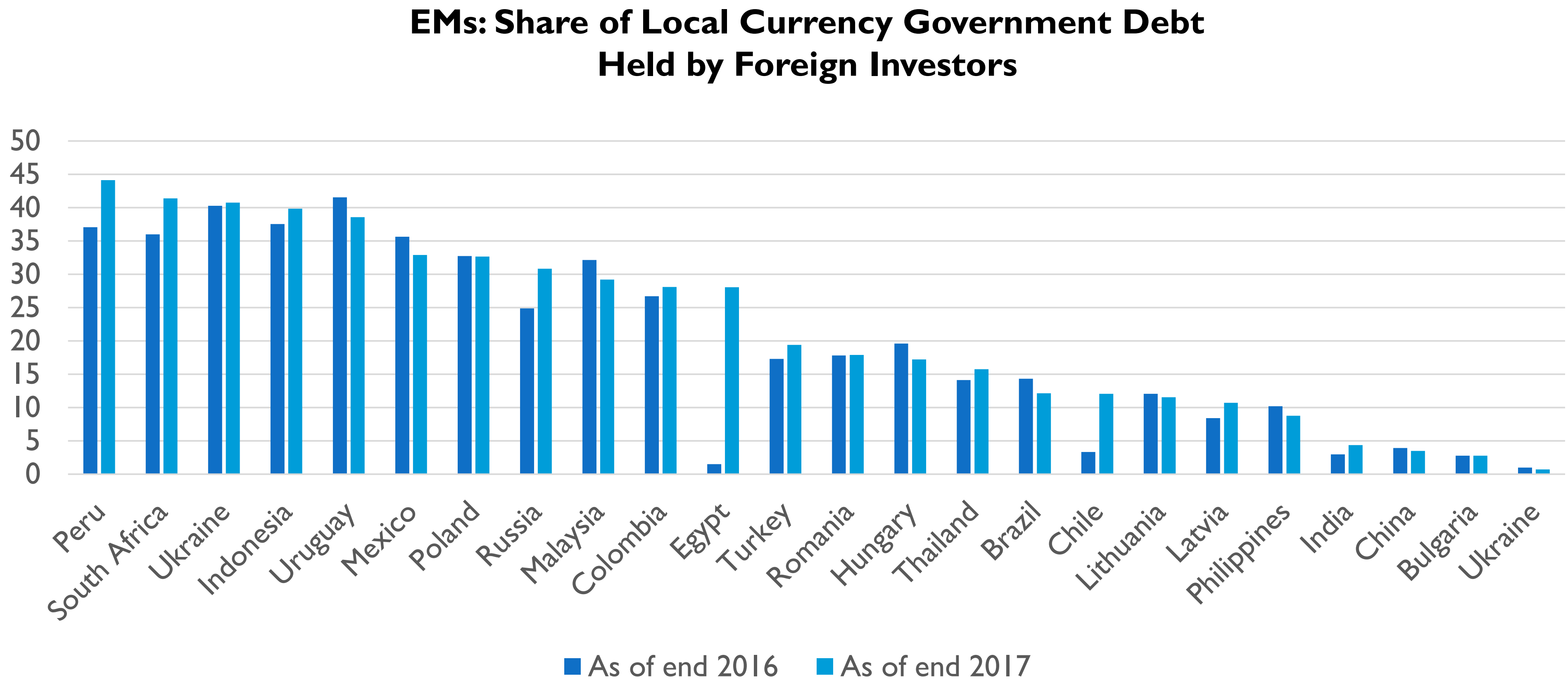
Note: Public debt covers general government gross debt. Commodity exporters are countries where commodities account for at least half of goods and services.
Source: World Economic Outlook Database, April 2018.

Corporate debt in EMs has also grown to record highs, adding to risks.



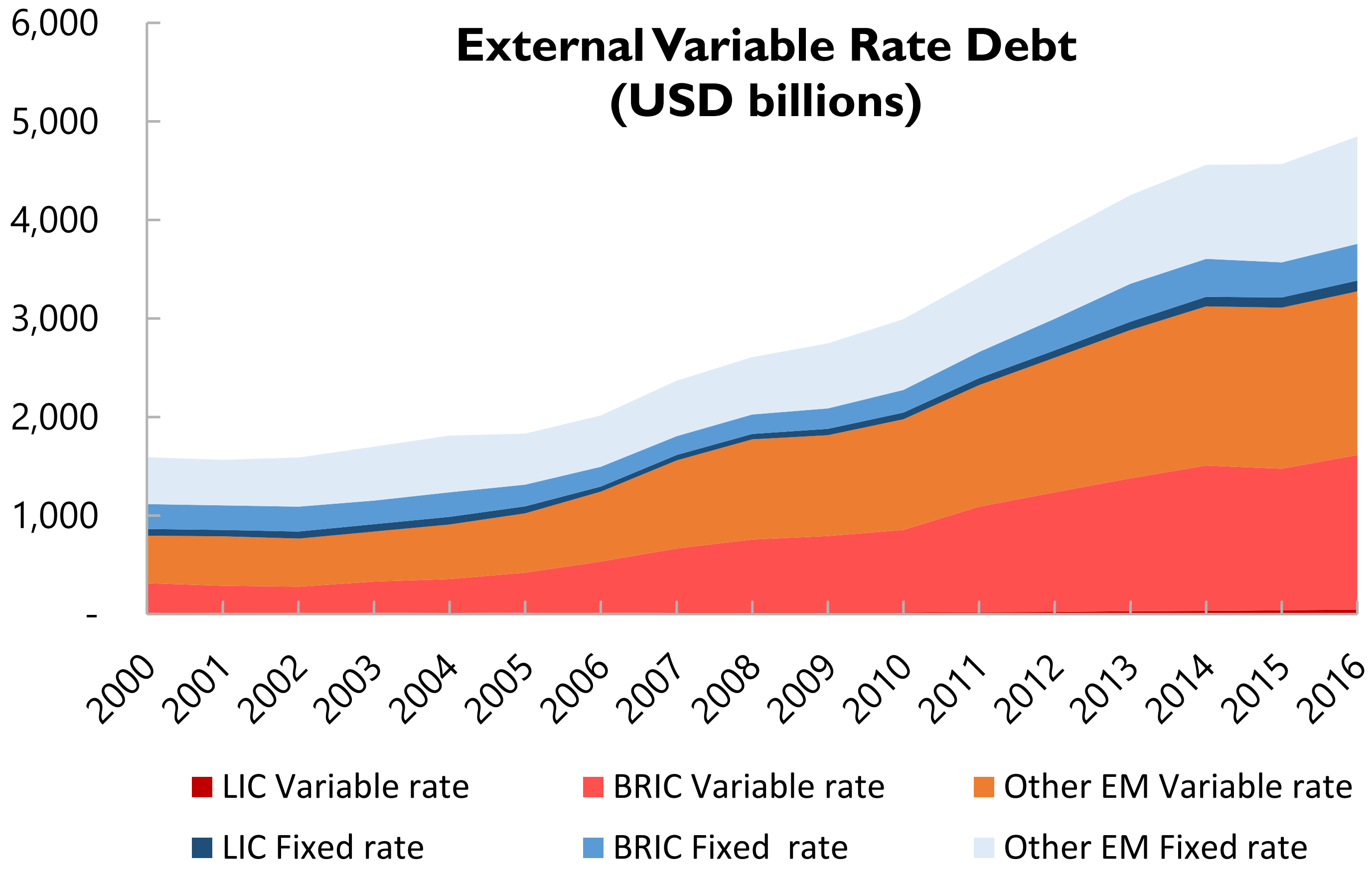
Source: Bank for International Settlement, Institute for International Finance.

Local currency denominated public debt increased until 2013. Rising non-resident holdings of domestic debt adds to risks in some EMs.



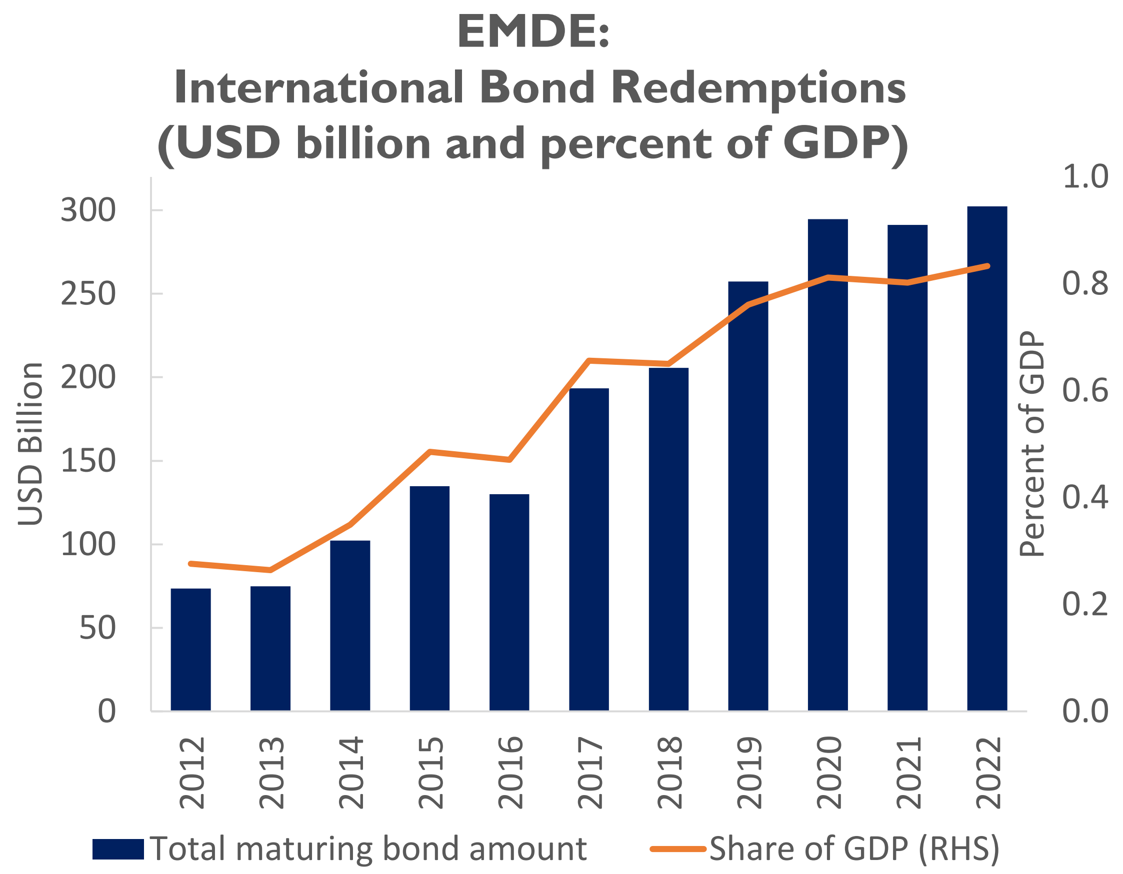
Source: Sovereign Investor Base Dataset for Emerging Markets.

External debt carrying variable interest rates has risen markedly in recent years, adding to debt portfolio risks

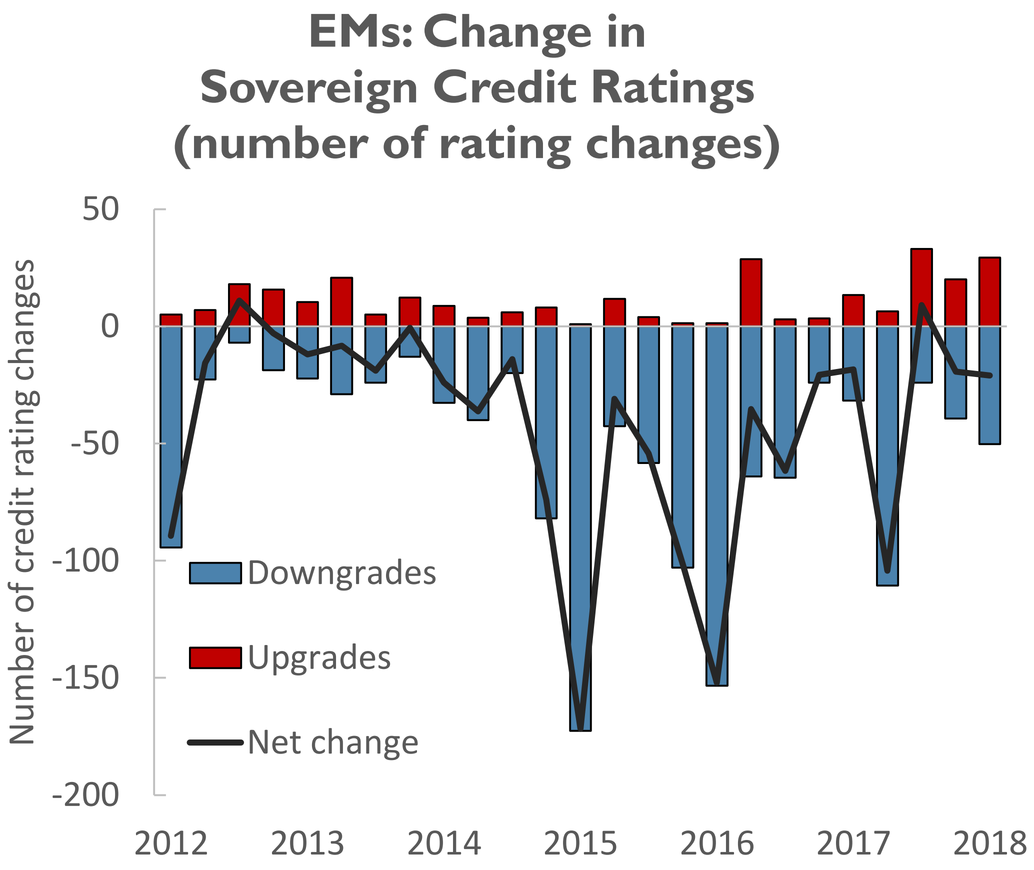


Source: International Debt Statistics.

EMs face a high volume of international bond redemptions in 2019-20 raising refinancing risks when average credit quality has deteriorated.

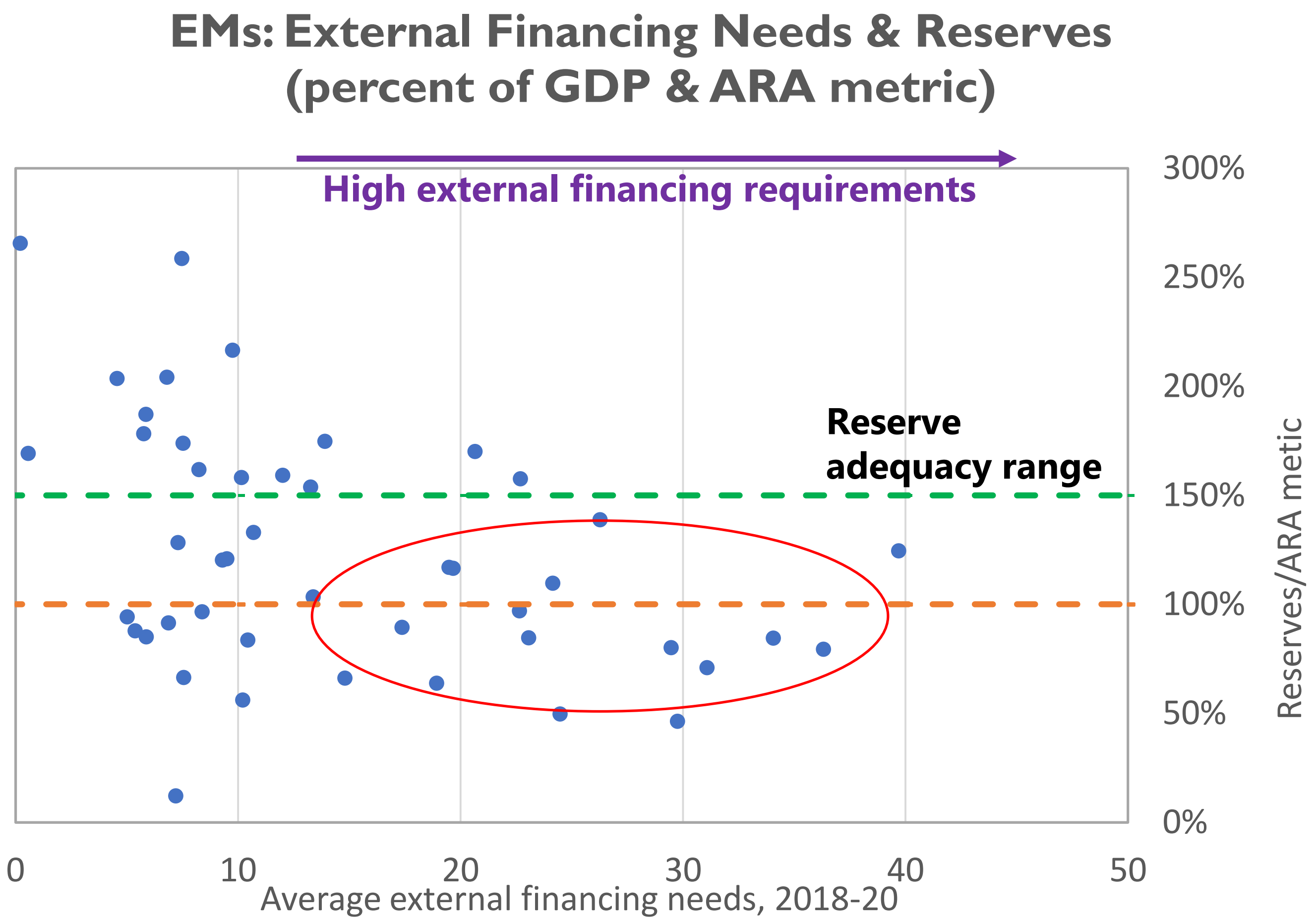


Note: Aggregate includes 68 emerging & developing economies.
Source: Dealogic & World Bank Staff calculations



Source: International Institute of Finance & World Bank staff calculations.

While several EMs have adequate policy frameworks and buffers, there are some countries with large external financing needs, high exposure to capital outflows, and low reserve adequacy ratios that remain vulnerable to a debt crisis.

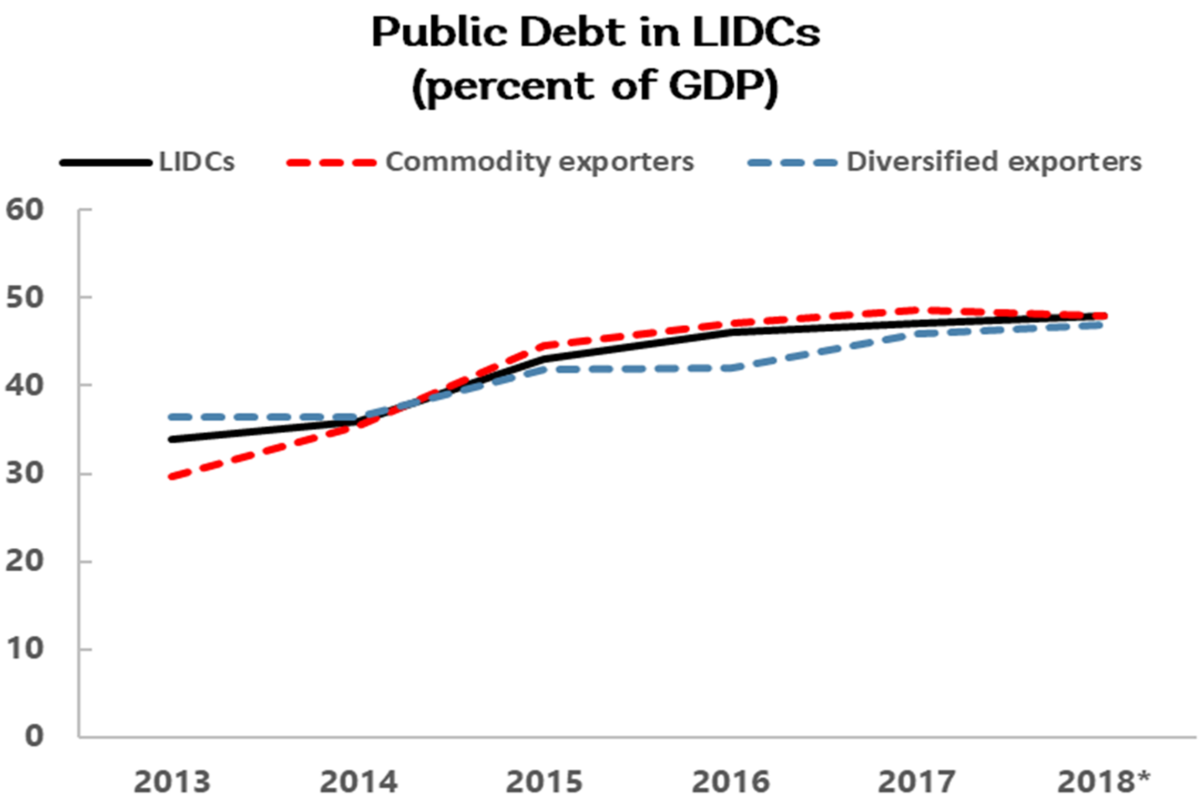


Source: World Economic Outlook Database, April 2018 & World Bank staff calculations.

About half of countries with external financing needs above 15 percent of GDP have reserve levels well below IMF reserve adequacy measures

2. Debt Vulnerabilities in Low-Income Developing Economies

Public debt in LIDCs has increased significantly since 2013, reflecting adverse shocks and policies. "Hidden debt" has ultimately come to light in some cases.

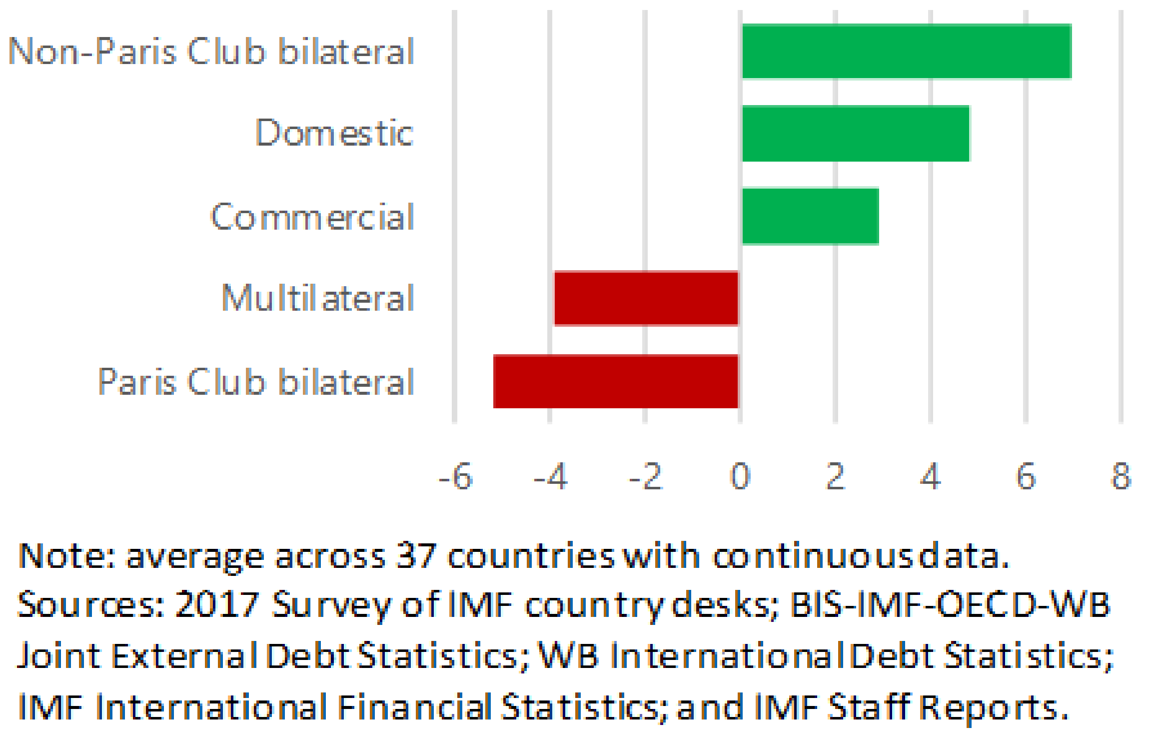


Source: World Bank/IMF LIC DSA Database, September 2018.

Note: Commodity exporters are countries where commodities account for at least half of goods and services. IDA FCS countries have either a) a harmonized average CPIA country rating of 3.2 or less, or b) the presence of a UN or regional peace-keeping or peace-building mission during the past three years. IBRD countries qualify only thanks to the presence of a peacekeeping, political, or peace-building mission.
Source: World Economic Outlook Database, April 2018.

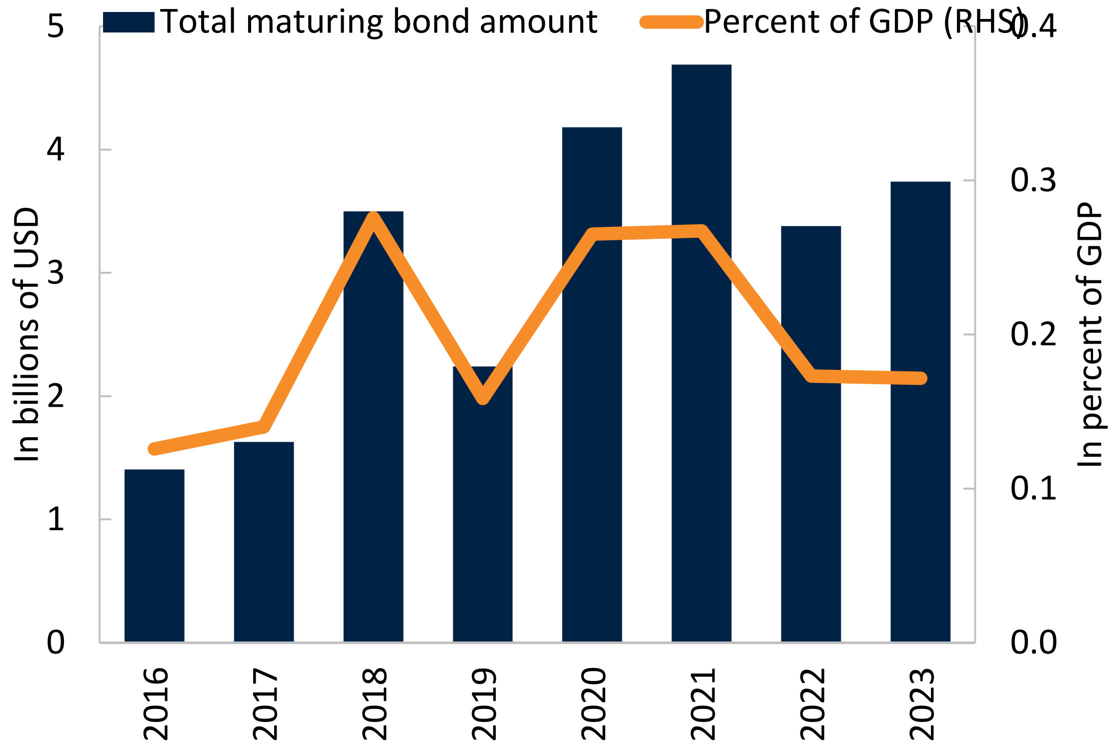
Changes in the composition of debt (with increased reliance on costlier and riskier sources of finance) and large international bond redemptions coming due increase refinancing risks.

LIDCs: Change in Creditor Composition 2007 - 2016 (percent of GDP)



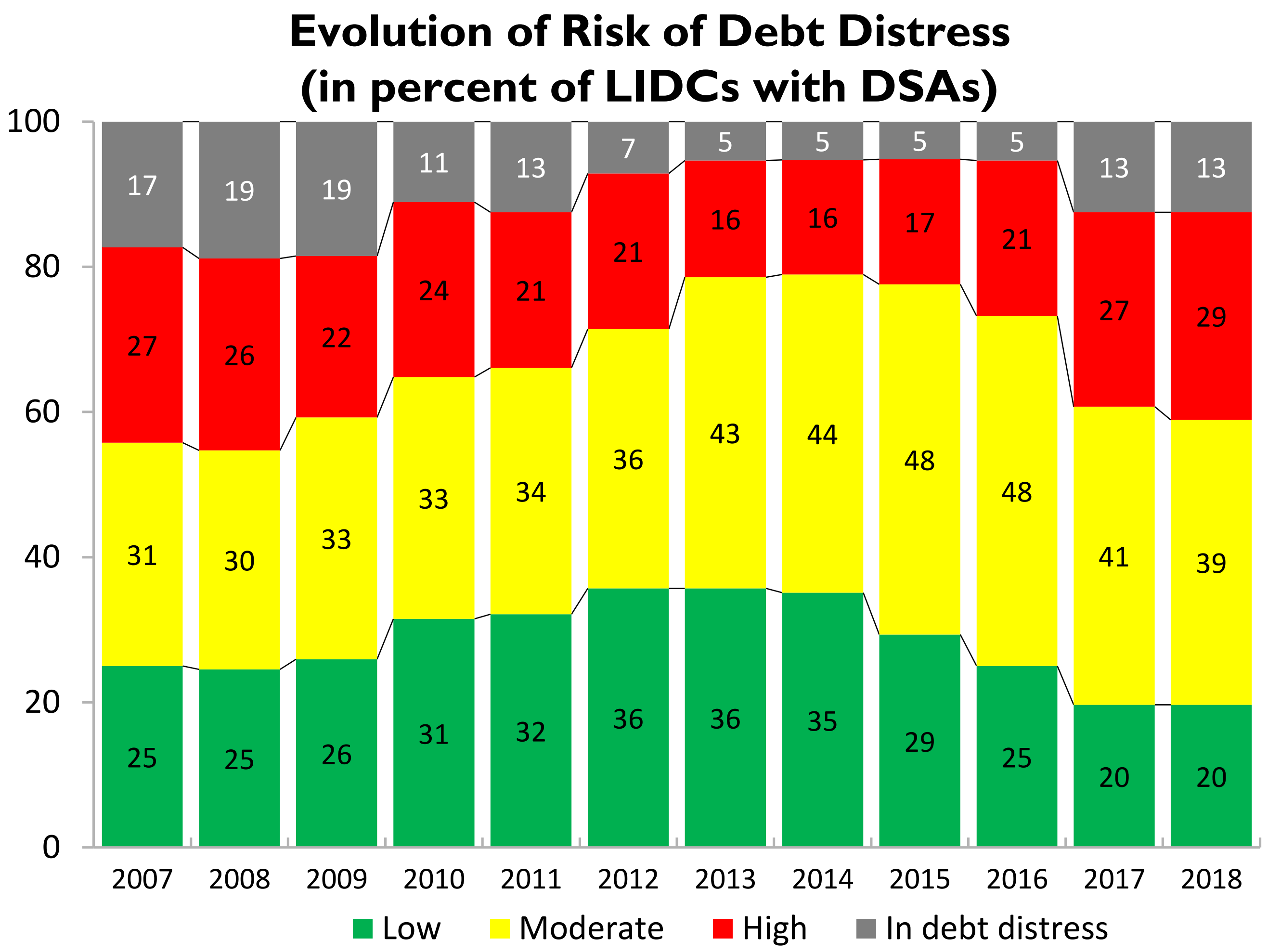
Source: International Debt Statistics.

LIDCs: International Bonds (USD billions & percent of GDP)



Source: Dealogic and World Bank staff calculations.

Rising debt levels and shifts in the composition of debt have increased debt vulnerabilities. The share of LICDs at high risk of or in debt distress has doubled since 2013, reaching 40 percent in 2018.



Source: WB/IMF LIC DSA Database.

3. A Multipronged Approach for Addressing Emerging Debt Vulnerabilities

Looking ahead, public debt is expected to remain contained, but important risks lurk, requiring careful execution of fiscal policies and smooth debt management

1. **Public debt to GDP ratios are expected to ease slightly over the next 3-5 years in EMs and remain contained in LIDCs.** Financing needs forecasts show little change.

   ➢ These projections are based on assumptions of improving fiscal positions, steady growth, and stability in global growth and exchange rates.

2. **Key risks to the outlook include**:

   - Larger than anticipated increases in global interest rates (e.g. due to more rapid normalization of monetary policy in advanced economies)
   - Weaker global growth (e.g. due to curtailment of global trade and investment)
   - Volatility in commodity prices (beyond the expected gradual decline over the medium-term)
   - Poorly executed fiscal adjustments (e.g. with high impacts on growth, due to excessive focus on cutting investment)
   - Outward contagion from unfortunate cases where countries do experience debt distress.

➢ ***It will be critical for countries to implement sound macro-fiscal frameworks, with supporting growth friendly reforms, and to manage their debts well (to keep financing needs from spiking.***

Tailored policy reforms that reflect country specific vulnerabilities will also be important to insulate countries against risks:

Commodity exporters

- Steps to better insulate themselves from volatile commodity prices
- Diversification of their economic base over time

Large corporate debt exposures

- Implement macroprudential policies to mitigate financial sector risks.
- Structural policies to build resilience (like strengthening bankruptcy regimes)

High SOE/PPP exposures

- Improve transparency
- Improve fiscal risk management
- Strengthen corporate governance

LICDs (esp. those scaling up)

- Careful attention to rates of return and quality of investment
- Domestic resource mobilization
- Building capacity to manage debt

The World Bank-IMF have launched a multi-pronged approach to help countries address debt vulnerabilities

Debt Analytics and Monitoring

- Implementation of revised joint Bank-Fund Debt Sustainability Framework (and the to-be-revised MAC DSA)
- Scale-up of analytics on debt issues and fiscal risks
- Strengthen early warning systems

Debt Transparency

- TA to support recording, monitoring, and reporting of debt
- Better access to debt data and analysis from IMF and WBG
- Enhanced creditor outreach

Debt Management

- Scaled up debt management TA
- Tools to improve management of contingent liabilities
- Enhanced operational support to strengthen debt/fiscal policy frameworks
- Extend WBG Debt Reduction Facility
- Supportive IMF and WBG policy framework (Debt Limits Policy and NCBP)

Thank you!