Debt Vulnerabilities in Low-income Countries

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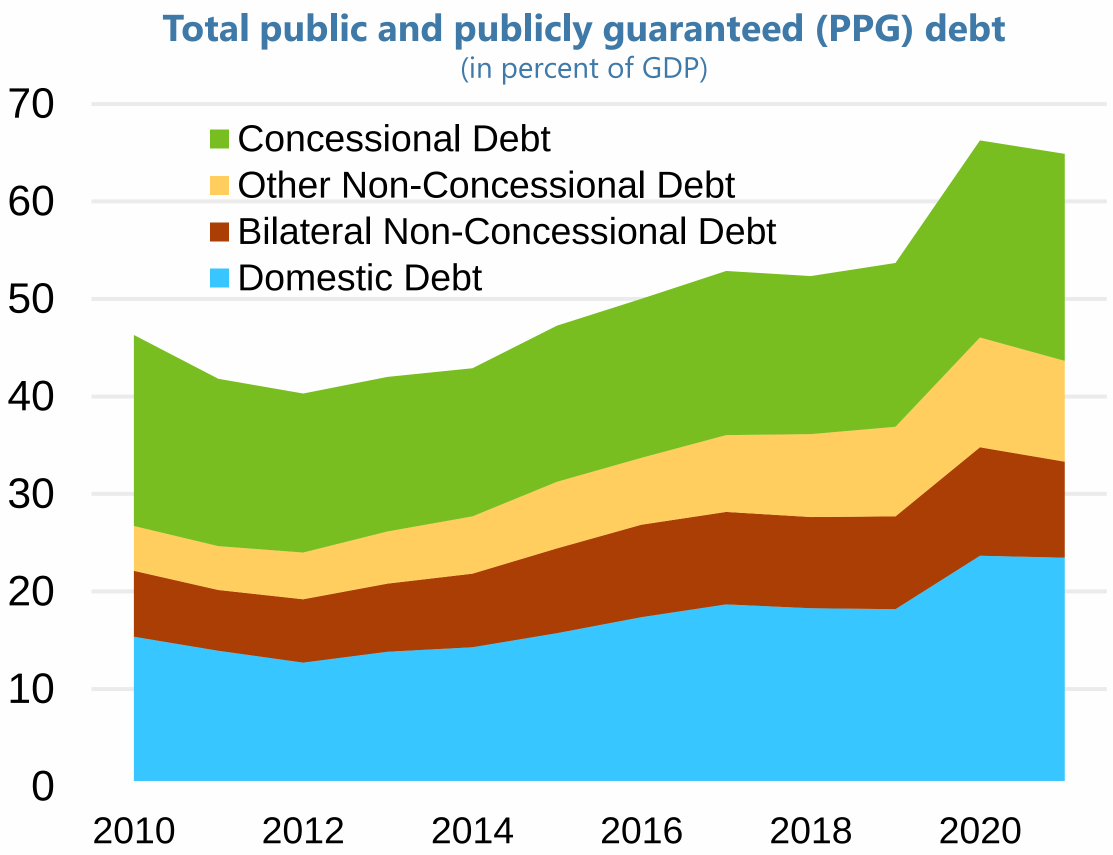
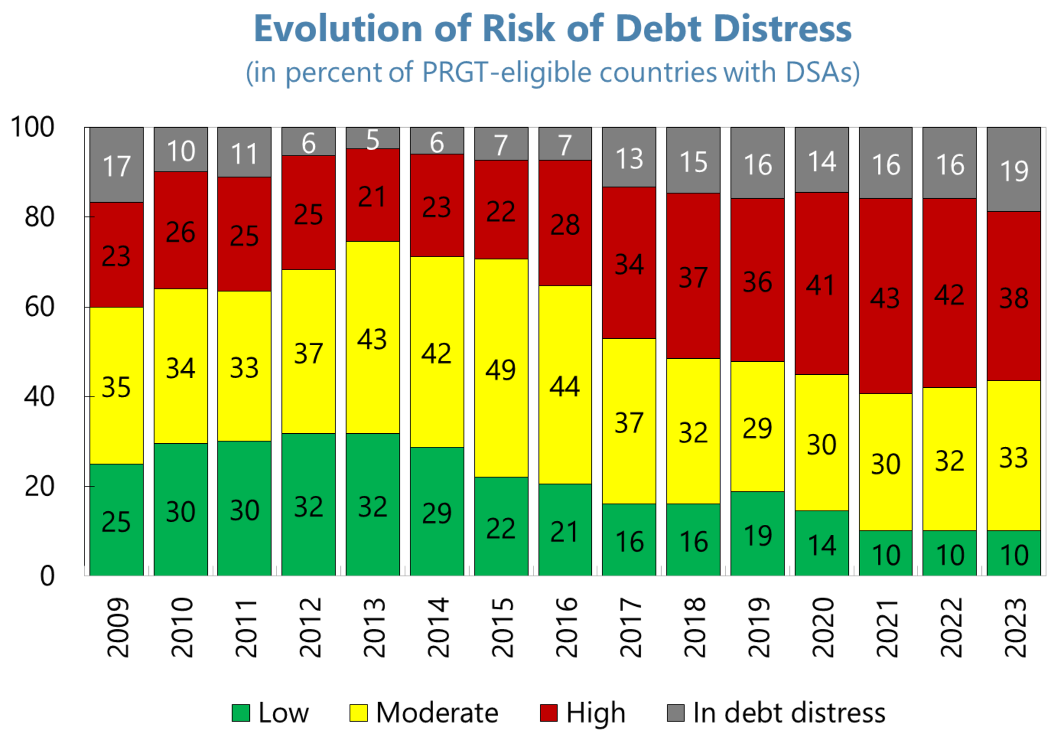
More than half of low-income countries face severe debt vulnerabilities



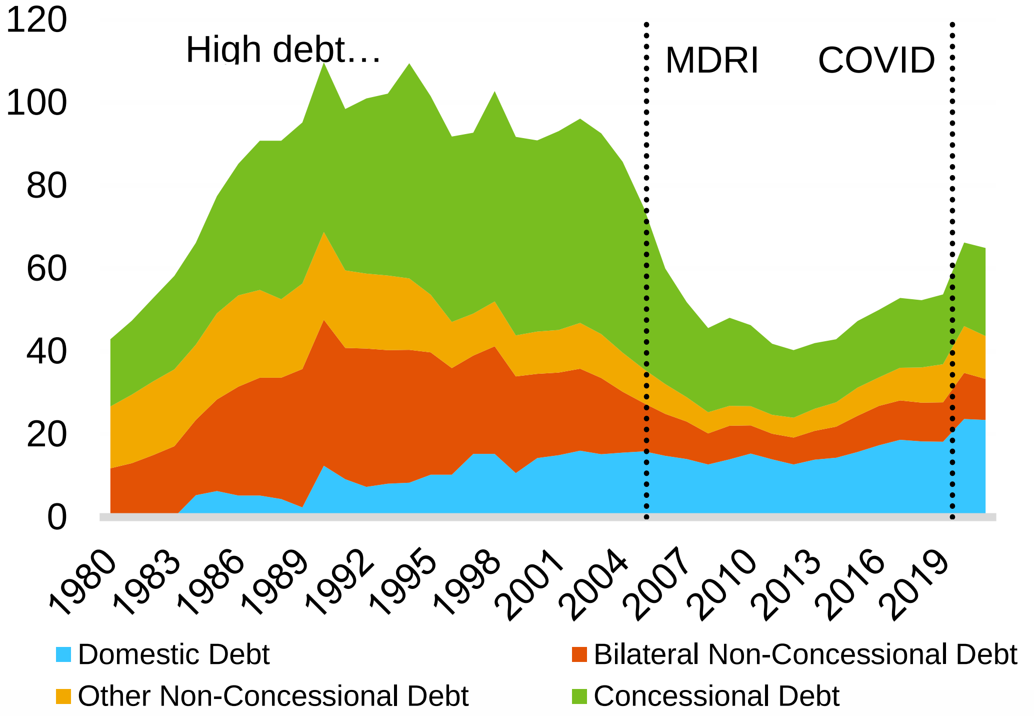


Source: LIC DSA database
As of July 31, 2023

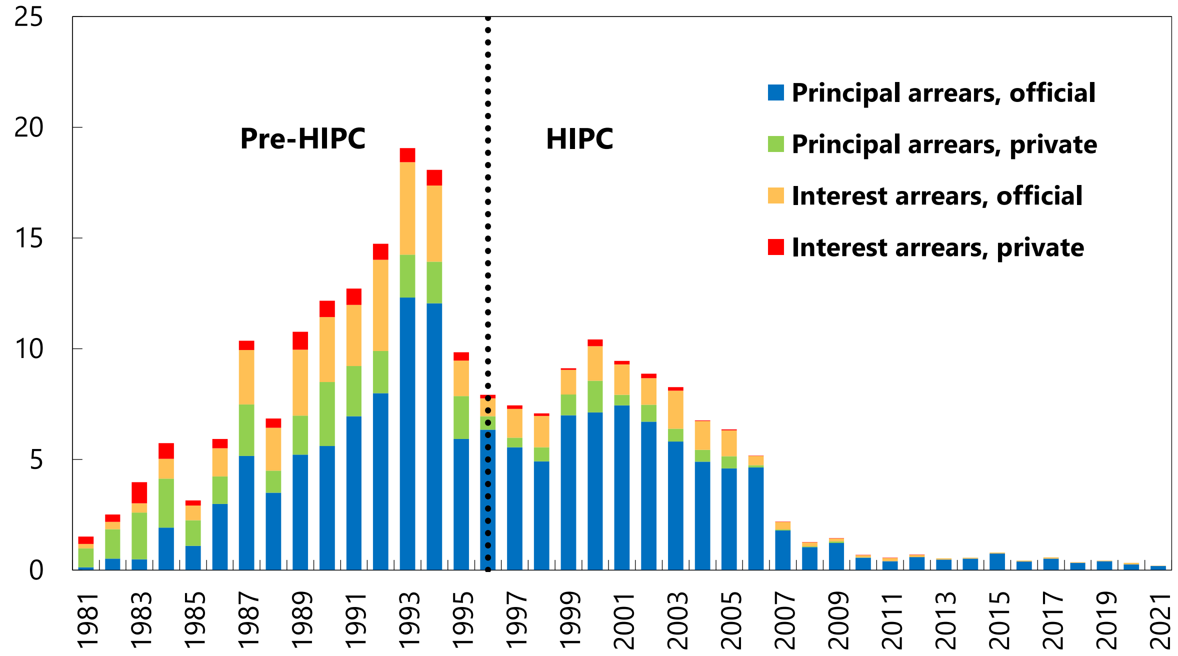
PRGT-eligible countries in debt distress as of August 31, 2023: Republic of Congo, Ghana, Grenada, Lao PDR, Malawi, Sao Tome and Principe, Somalia, Sudan, Zambia, Zimbabwe

Although debt has been increasing in LICs, it remains much lower than pre-HIPC levels

Total public debt
(Median, % GDP)



Accumulated arrears
(Median, % of exports)

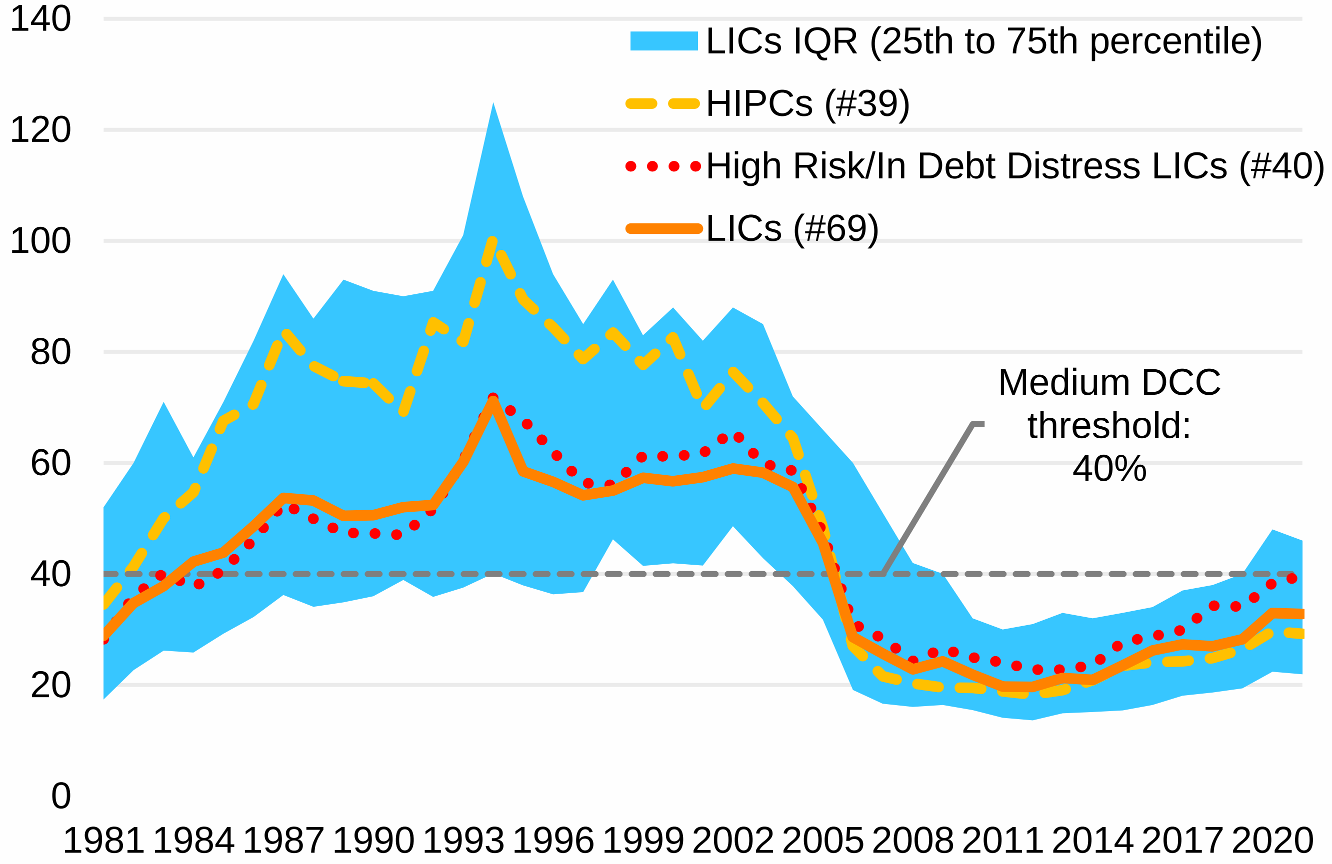


Sources: IMF Global Debt Database, IMF WEO, World Bank IDS, and staff calculations (Chuku et al 2023: “Are We Heading for Another Debt Crisis in Low-Income Countries?”, IMF Working Paper No. 23/79).

Comparing debt burden indicators now to those in the past reveals lower debt risks for now

- Debt burden indicators in LICs today show reduced debt risk compared to the pre-HIPC era.
- The conclusion is consistent across all five debt burden indicators used in the LIC DSF, both within and among different LIC subgroups.
- That said, debt vulnerabilities could reach HIPC-like levels in the medium- to long-term if current trends continue **without appropriate policy interventions**.
- To illustrate, if external debt service-to-revenue ratios continued to increase at 1 pp per annum observed over the past decade (or 2pp for those in DD/HR), liquidity pressures could reach similar levels within 5-7 years (or less for those in DD/HR).

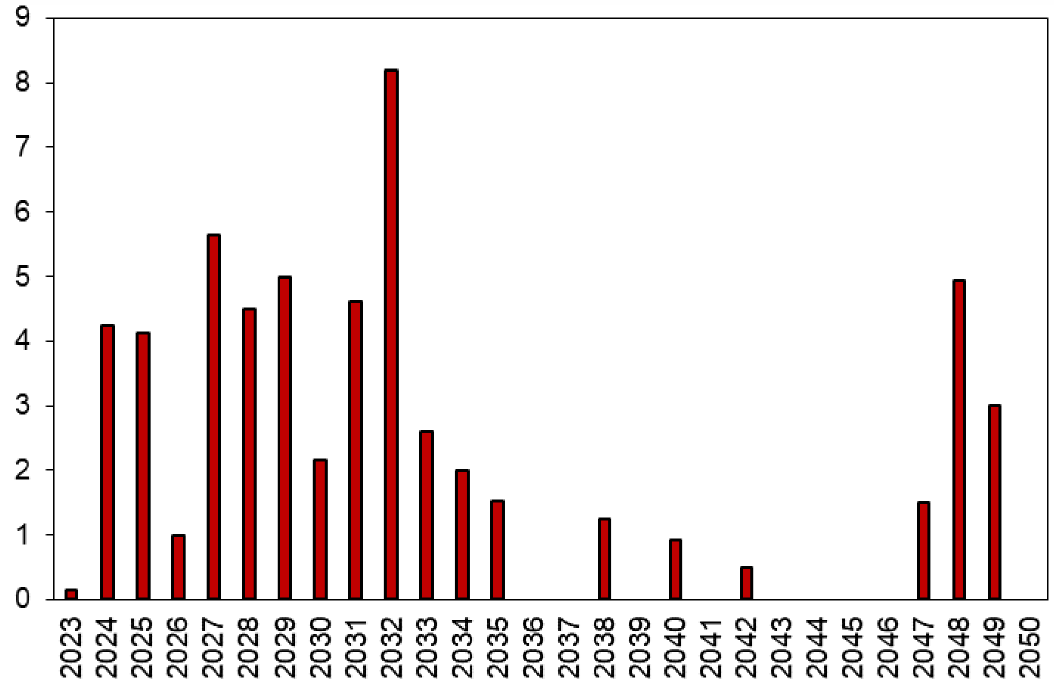
PPG external debt
(in percent of GDP)



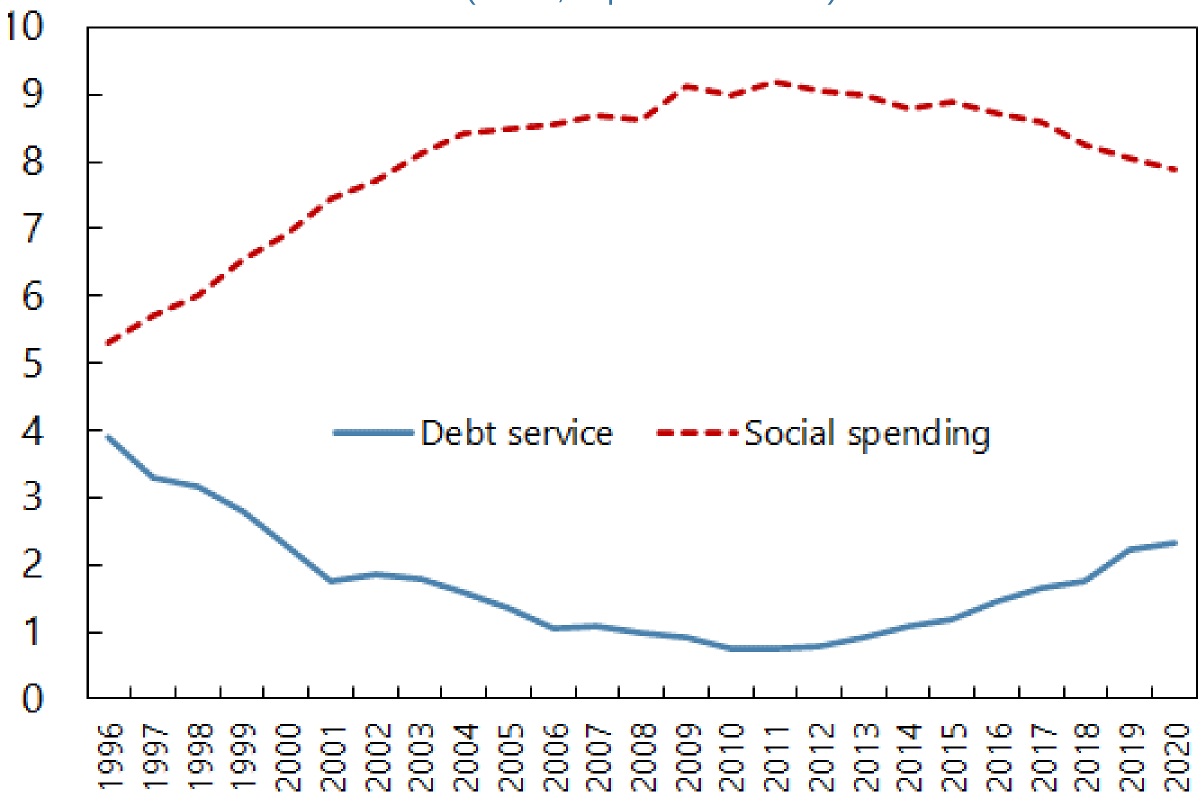
Source: Chuku et al 2023.

Debt service payments are again beginning to crowd out social spending in LICs

LICs: Eurobond redemptions
(Billion USD)



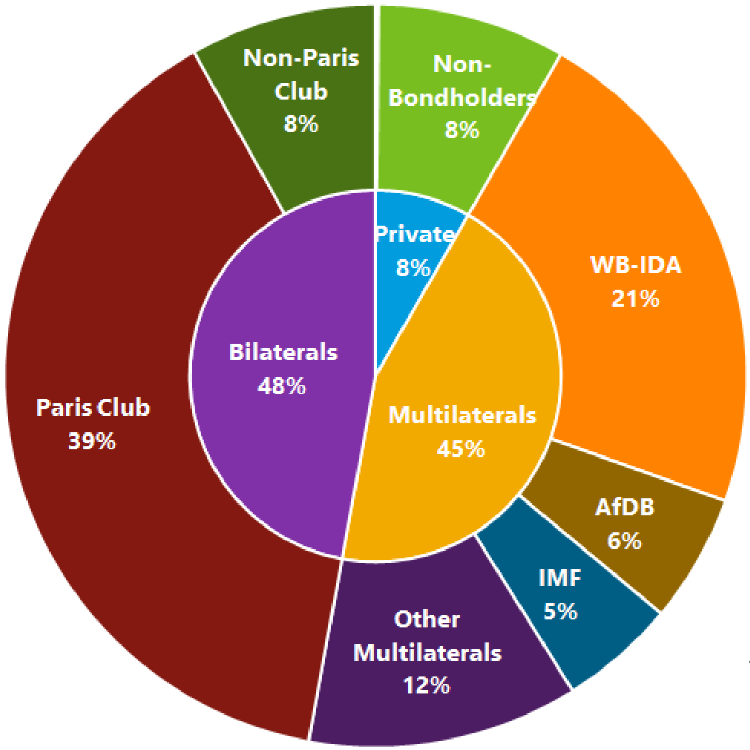
PPG external debt service and social spending in HIPCs
(mean, in percent of GDP)



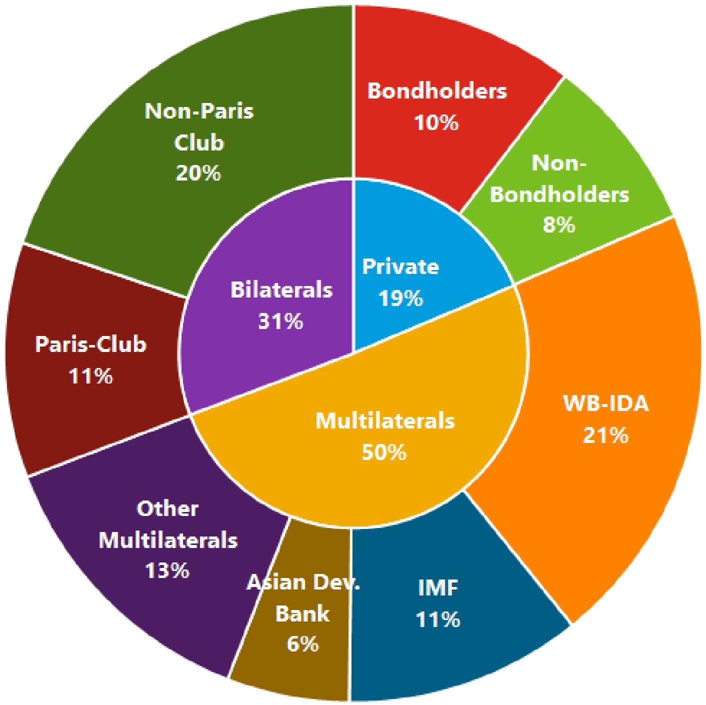
Source: Chuku et al 2023.

Rebalanced financing landscape

1996: Creditor shares in LICs' external debt
(in percent of total)



2021: Creditor shares in LICs' external debt
(in percent of total)



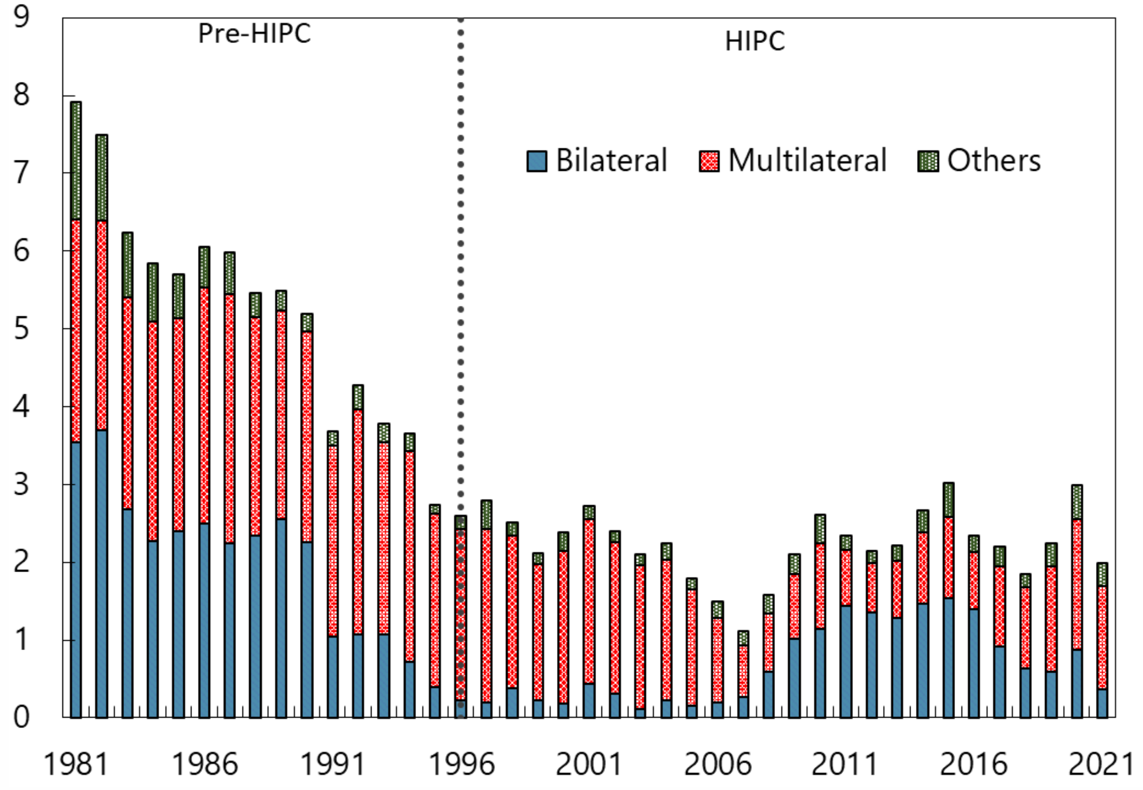
Source: Chuku et al 2023.

- The composition of the creditor base of LICs' debt has shifted away from traditional Paris Club sources toward commercial and non-Paris Club creditors.
- Private creditors and non-Paris club creditors gained the most over the two decades.
- Multilateral institutions also increased their relative exposure to LICs.

Net transfers to LICs have been falling, suggesting official sector donor fatigue

Net transfers to LICs

(in percent of GDP)



- Official sector donor fatigue amidst renewed private sector lending vigor to LICs, could hamper the chances of a HIPC-type debt restructuring framework today.
- Net transfers from the creditor community to LICs in the form of grants and loans minus debt service paid have gradually dropped from 8 percent of GDP in 1980 to less than 2 percent in 2021.

The Fund's role and the changing international debt architecture

- The IMF takes a **deliberate, case-by-case approach** through policy advice (e.g., debt sustainability analysis), financing (at below market rates) and capacity building (e.g., improve debt transparency), to avoid a disorderly debt-restructuring.
- <u>Financing</u>: The Fund provided SDR 35 billion **financing to 50 LICs** between March 2020 and September 2023, and SDR 690 million debt-service relief to 31 poorest countries through the **Debt Relief Catastrophe Containment and Relief Trust (CCRT)** during the pandemic.
- <u>Debt restructuring and change in international debt architecture</u>: G20 and Paris Club members cooperate further to build more universal framework for sovereign debt solution (**"Common Framework"** and **Global Sovereign Debt Roundtable** (GSDR)).
- IMF firmly supports the framework's implementation, together with **strengthening its own debt policies**.

Possible implications of sovereign debt problems for creditors

- **Economic impact in creditor country**:
  - Economic losses: Potential significant losses if the debtor country defaults, depending on creditor structure.
  - Financial stability: Sovereign defaults could precipitate financial stability risks in creditor country, depending on bank/NBFI exposure to sovereign debt.
  - Trade impact**:** Economic hardship in debtor country due to sovereign debt issues could reduce its imports from creditor countries.
  - Foreign exchange and investment risk: Currency devaluation in the debtor country owing to sovereign debts could negatively impact the value of investments held by the creditor country and deter future investment.

- **Global Financial Stability**: Larger economies defaulting on their debt could contribute to global financial instability through contagion effects.