The debt crisis of developing countries: recent developments and a proposal

April 2024

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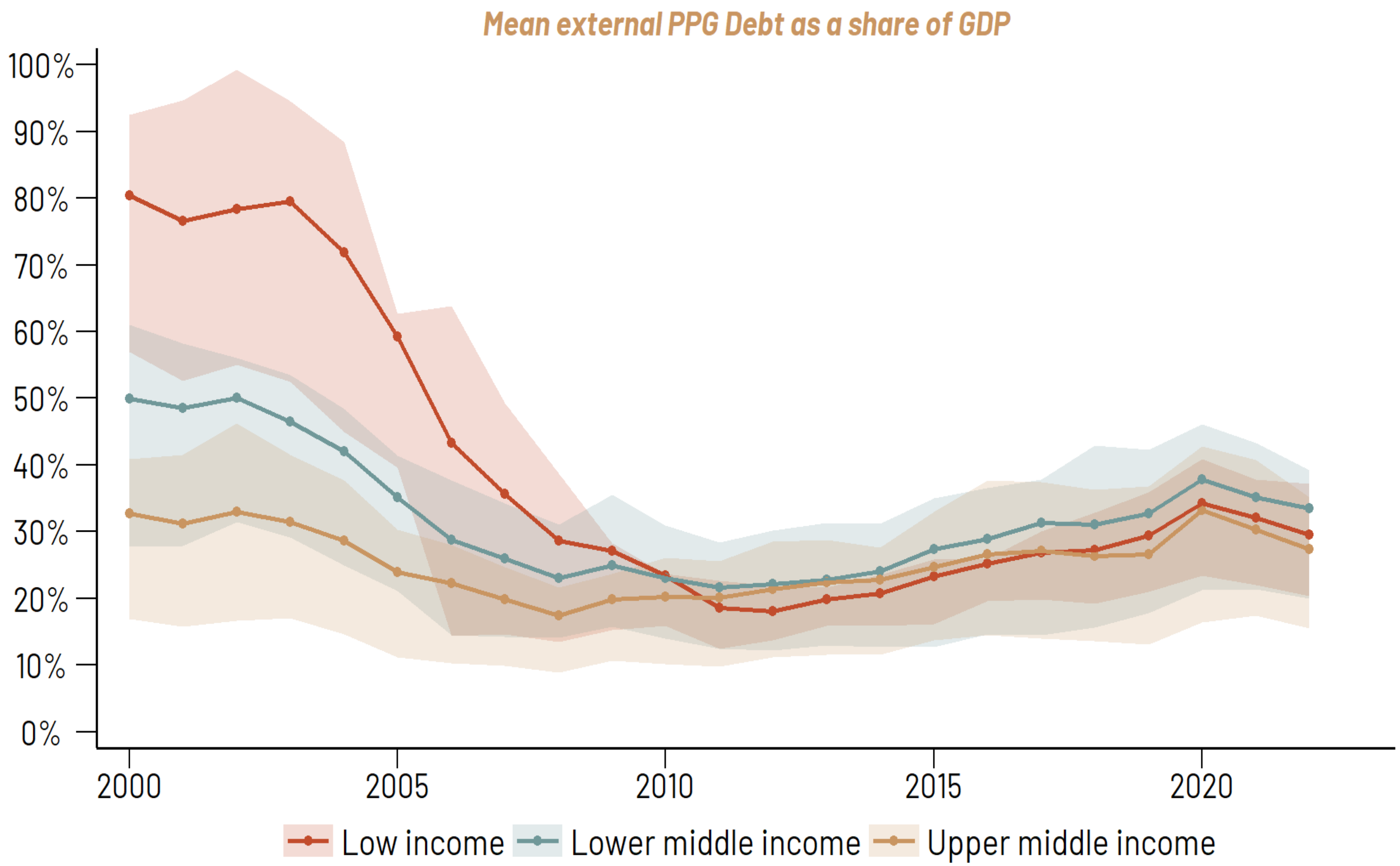
External debt levels in LICs and LMICs still much below their pre-HIPIC levels

Sources: World Bank International Debt Statistics for debt

In 2023, only one country, Ethiopia, defaulted.



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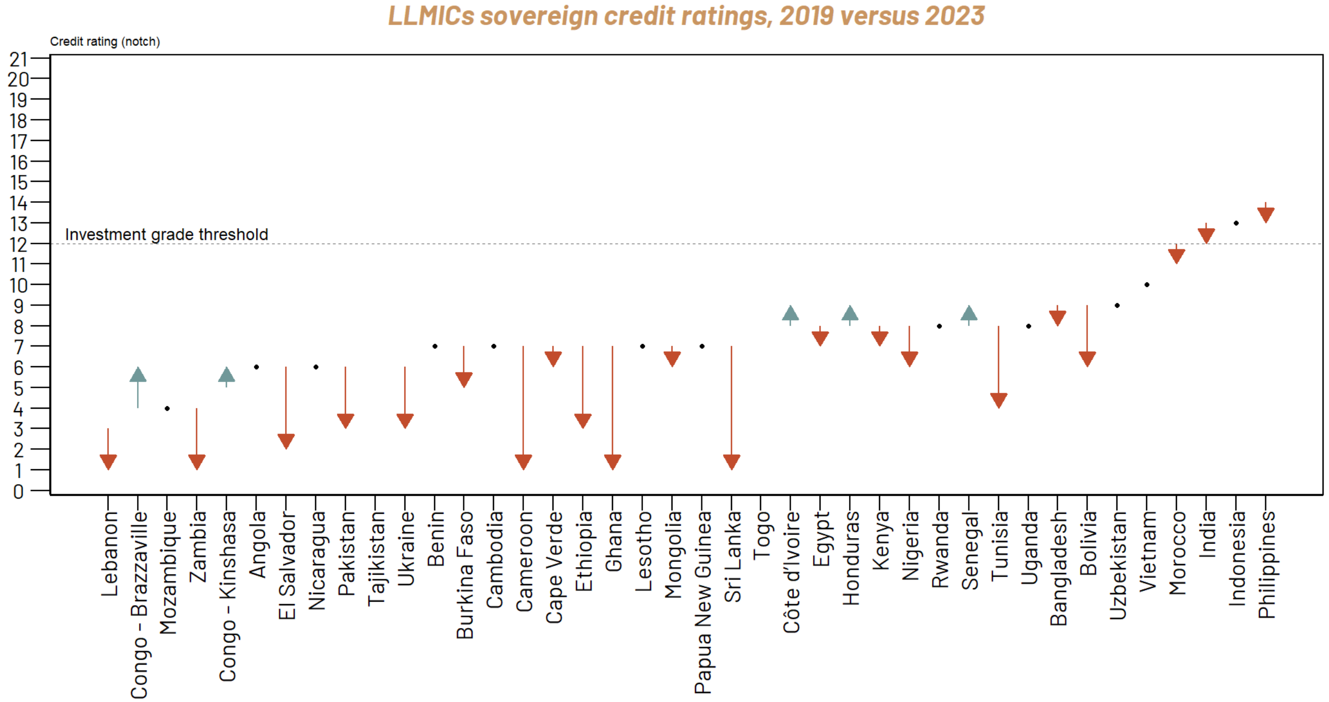
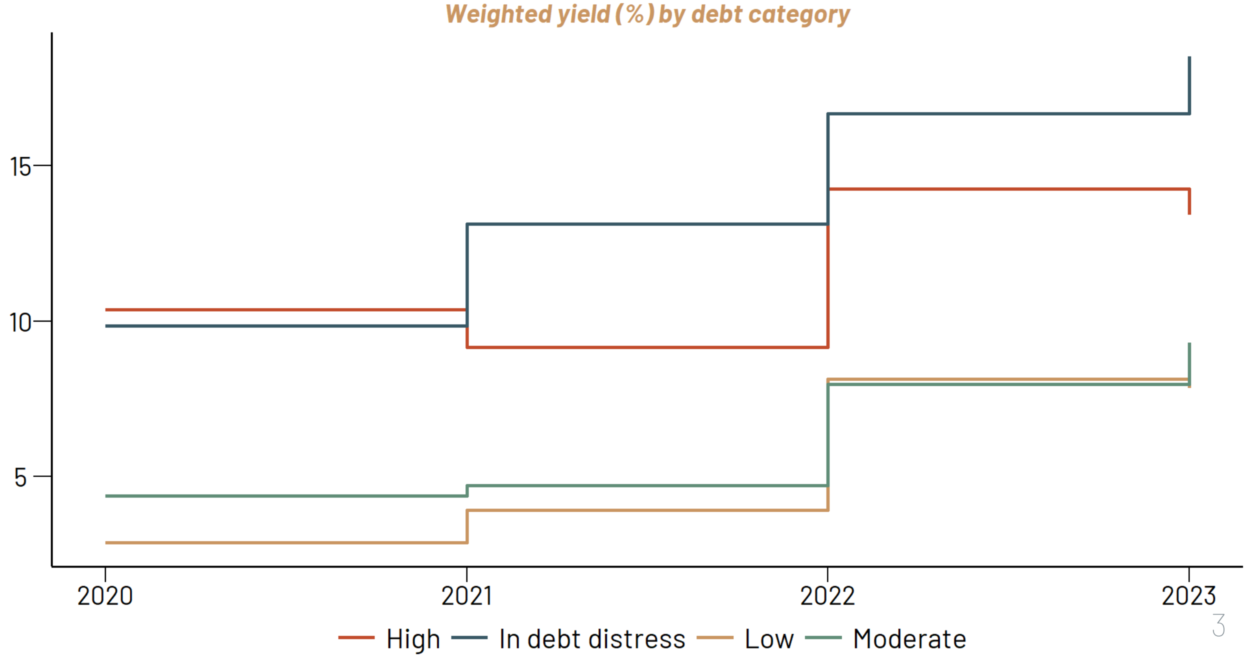
Interest rates shot up by end-2022, leading to a "flight to quality"

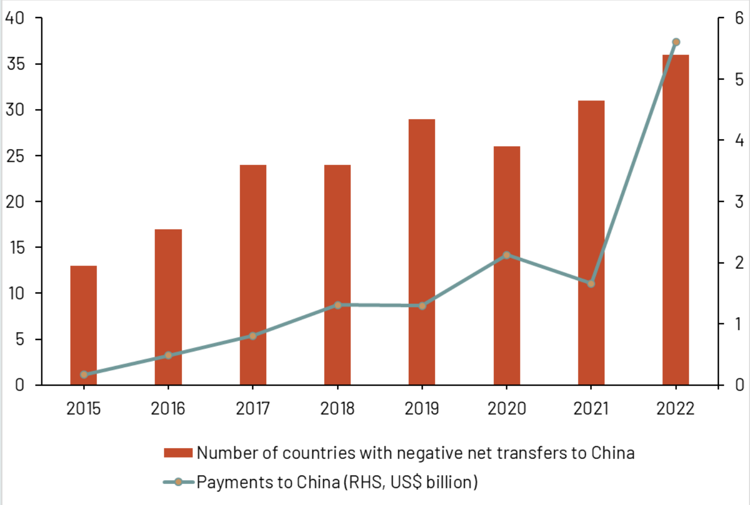
Market closed down at the end of 2022. Most LLMICs can continue to be shunned even if interest rates come down, as their credit ratings have deteriorated.



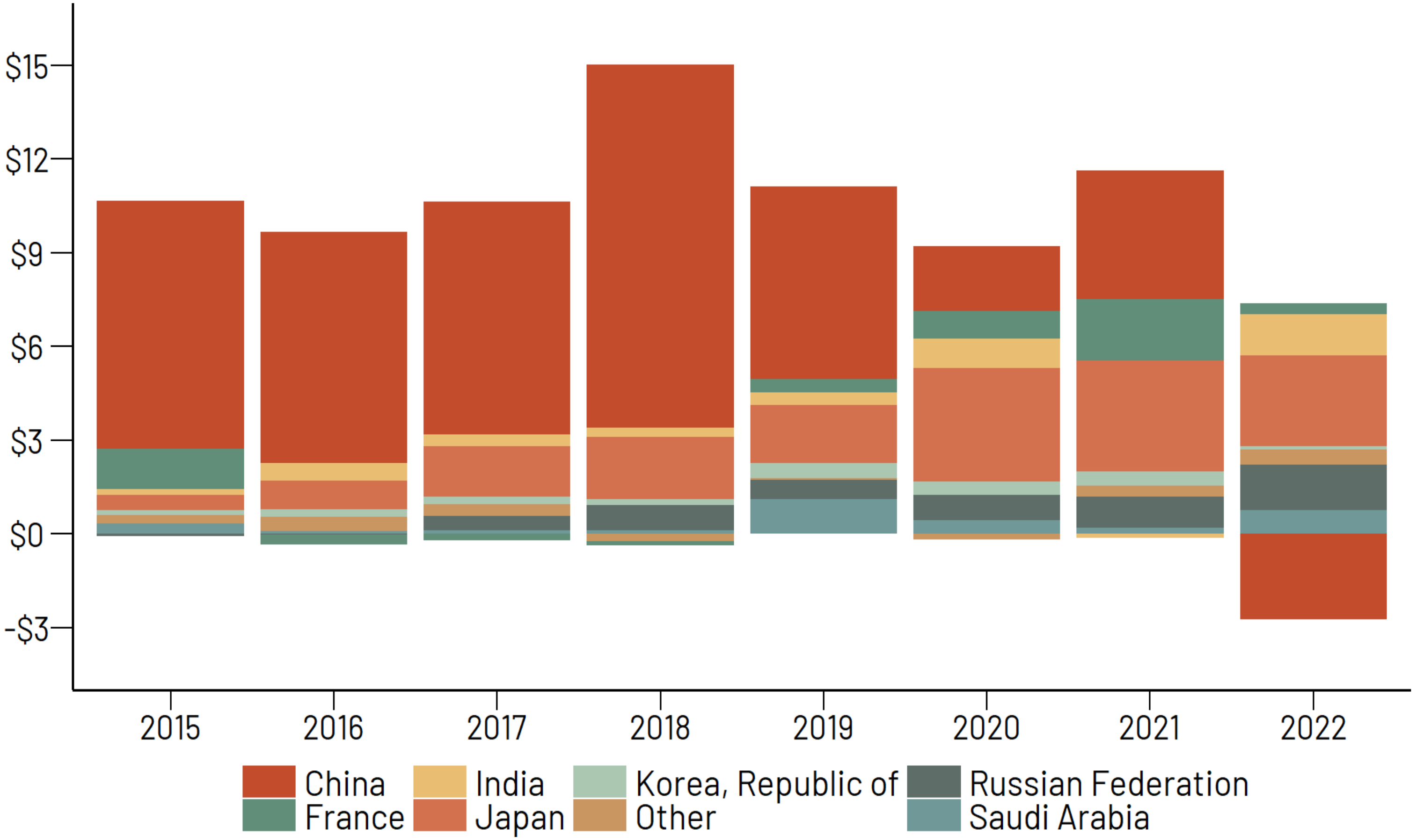


At the same time, China's dwindling role

Number of countries with negative net transfer to China

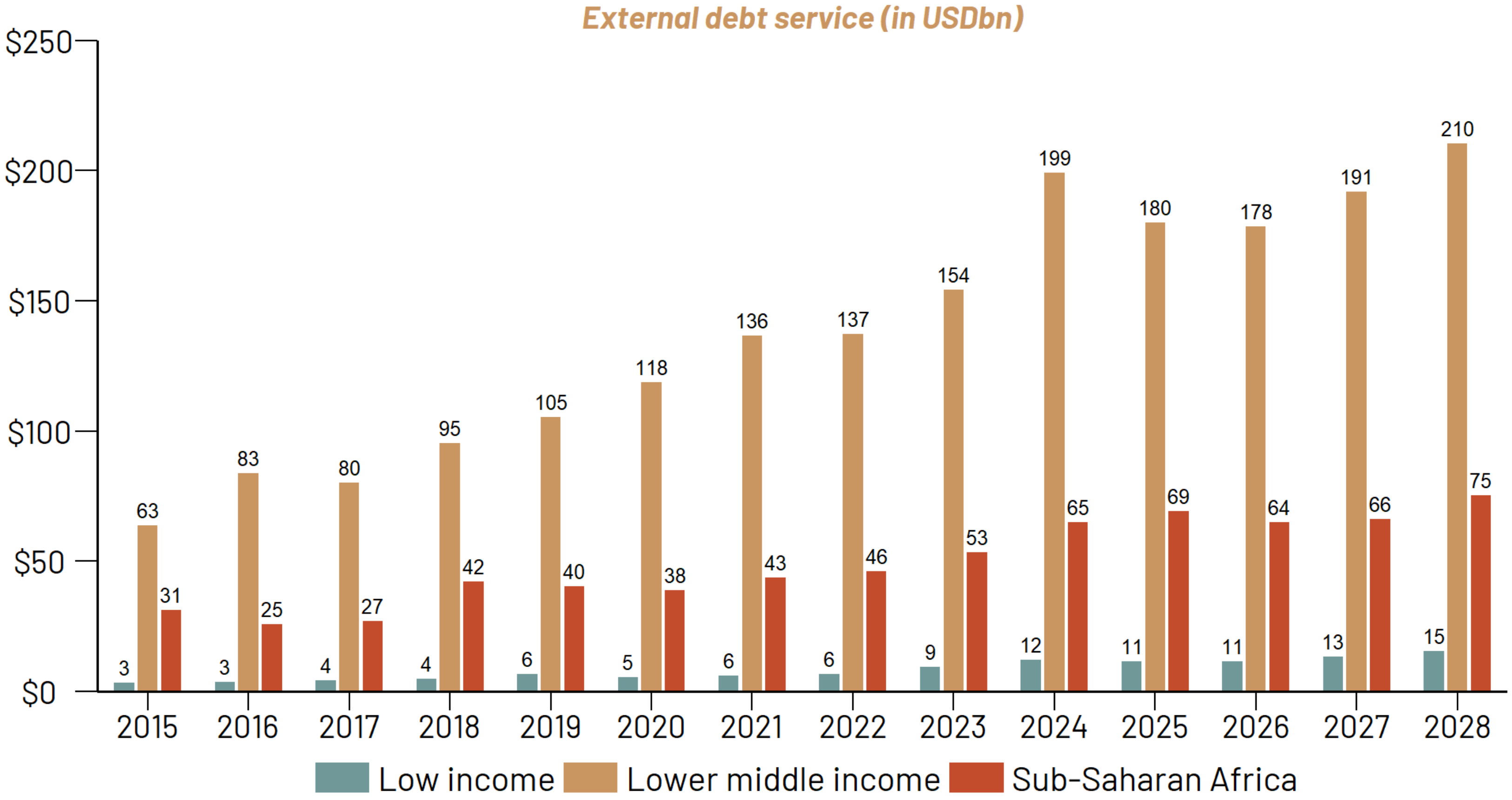


Net Transfers to IDA countries by biggest creditors (US$ billion)



Debt service

Sources: FDL Simulation and World Bank International Debt Statistics



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Net Transfers to LLMICs collapsed

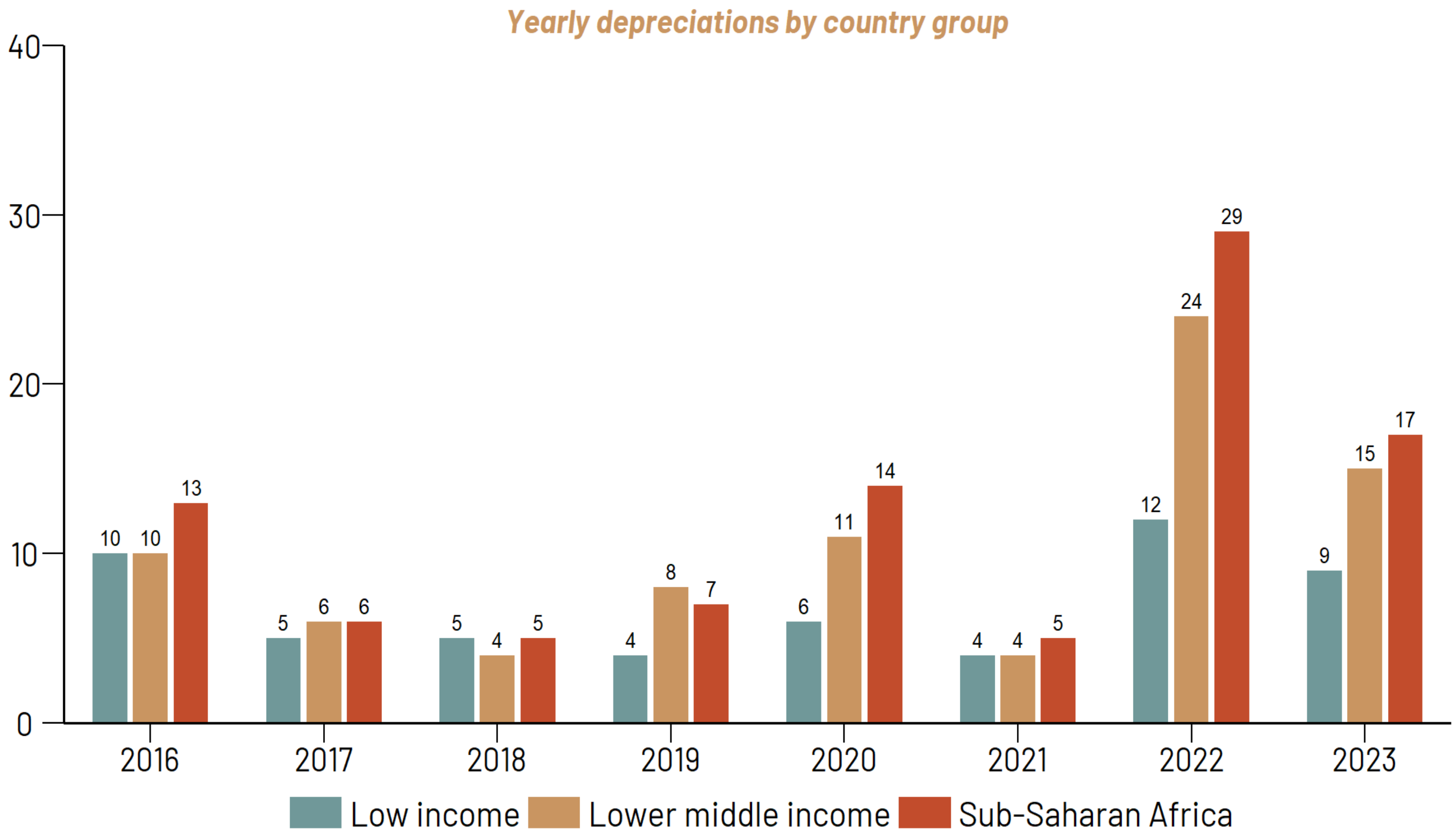
- Aid effectiveness down
- 2023 likely much worse: interest rate hikes & closing of bond market
- Silent development crisis, & inability to start the green transition
- Pressure on primary balance and exchange rates

	Total NT	NT on LT Debt	MDBs + IMF	Bilat LT (ex-China)	China total LT	Private creditors	ST NT
2019	105.82	84.45	28.96	1.77	4.65	54.39	16.1
2020	69.44	55.2	68.35	8.69	0.95	3.08	-12
2021	86.26	45.43	27.32	6.46	3.52	11.01	38
2022	20.54	-15.74	32.28	9.81	-6.1	-52.15	35.8

A crisis of liquidity: massive depreciations of currencies in 2022 & 2023

Number of countries with more than 10% depreciation

Sources: IMF World Economic Outlook



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Illustrative Projections

- IR Scenarios:
- current market yield for country
-1% optimistic +3% pessimistic
- Macro from IMF WEO, some deterioration in pessimistic case

Fast deteriorating liquidity:

- Interest rate rise in 2023
- Depreciation effect on debt service

	Country	IMF DSA
LICs	CAR	
	Chad	Moderate
	Ethiopia	High
	Gambia	Moderate
	Guinea	High
	Madagascar	High
	Sierra Leone	High
	Togo	
LMICs	Bangladesh	Low
	Benin	
	Cabo Verde	Moderate
	Cameroon	High
	Comoros	
	Côte d'Ivoire	Moderate
	Egypt	High
	El Salvador	
	Ghana	
	Kenya	
	Mauritania	High
	Mongolia	Moderate
	Nicaragua	
	Nigeria	
	Pakistan	Moderate
	PNG	
	Senegal	Moderate
	Tajikistan	High
	Tunisia	
UMICs	Argentina	High
	Dominican	Moderate

2023-2028:

27-34 solvent/illiquid

16-19 insolvent

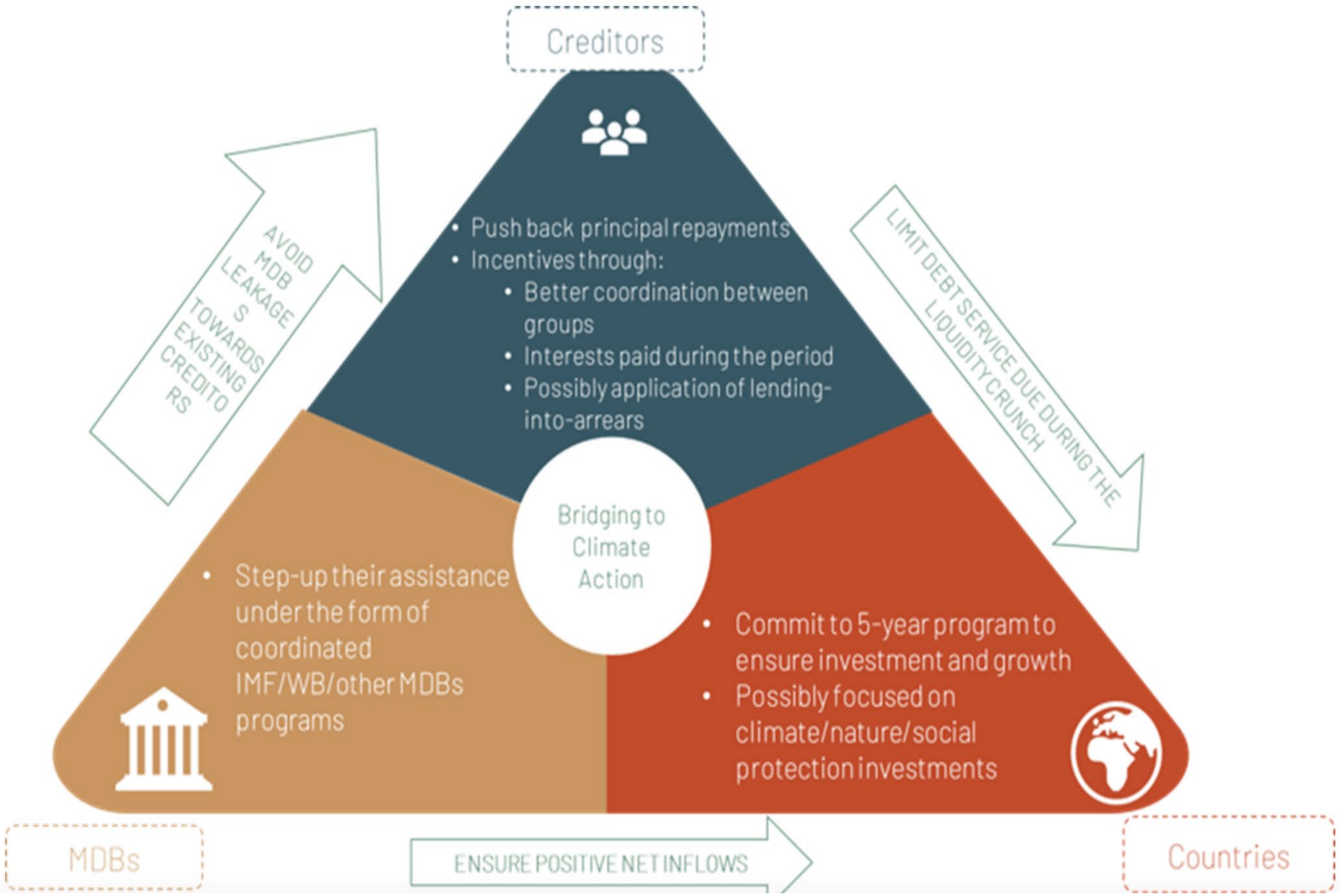
Countries breaching debt solvency in 2023-2028

Income Group	Country	IMF-WB DSA Risk	Baseline scenario	Pessimistic scenario
			Stock breach	Stock breach
Low income	Guinea-Bissau	High	✓	✓
	Mozambique	High	✓	✓
	Zambia	In debt distress	✓	✓
Lower middle income	Angola		✓	✓
	Bhutan	Moderate	✓	✓
	Cabo Verde	Moderate	✓	✓
	Congo, Rep.	In debt distress	✓	✓
	Côte d'Ivoire	Moderate		✓
	Djibouti	High	✓	✓
	Lao PDR	In debt distress	✓	✓
	Mongolia			✓
	São Tomé and Príncipe	In debt distress	✓	✓
	Sri Lanka			
	Vanuatu	Moderate		✓
Upper middle income	Dominica	High	✓	✓
	Maldives	High	✓	✓
	St. Vincent and the Grenadines	High	✓	✓
	Suriname		✓	✓

Insolvent countries need to go through the painful Common Framework process – there are suggestions on how to improve it

A Liquidity Bridge: "improve over Kenya"

1. Country platform **credibly** invested in (green) growth
2. IFIs x2 **committed** over a 5-year program
3. **No creditor pulls out** capital during period



“Flight against inflation is being won”
“Markets are reopening”

There is now
a risk of demobilization.

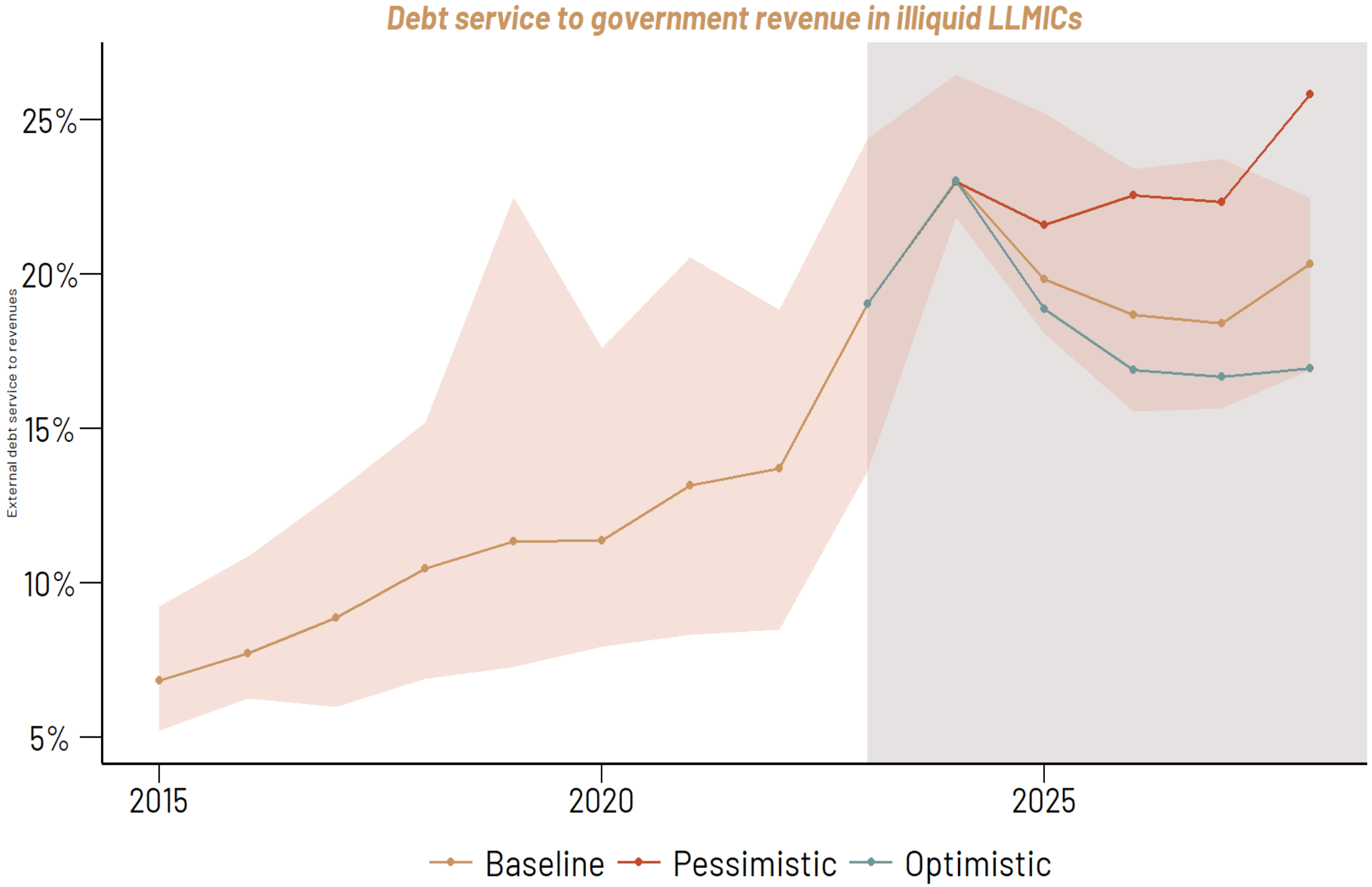
There are two reasons why demobilization is premature

A. Interest rates remain high and can rise again -> Repayment walls are moving – > Roll-over risk remains high

B. MDB surge to get markets to reopen for all illiquid countries way too costly

A. Rescheduling at current terms risky

Expensive new debt and shorter maturities keep walls moving with high-risks of inability to roll over.



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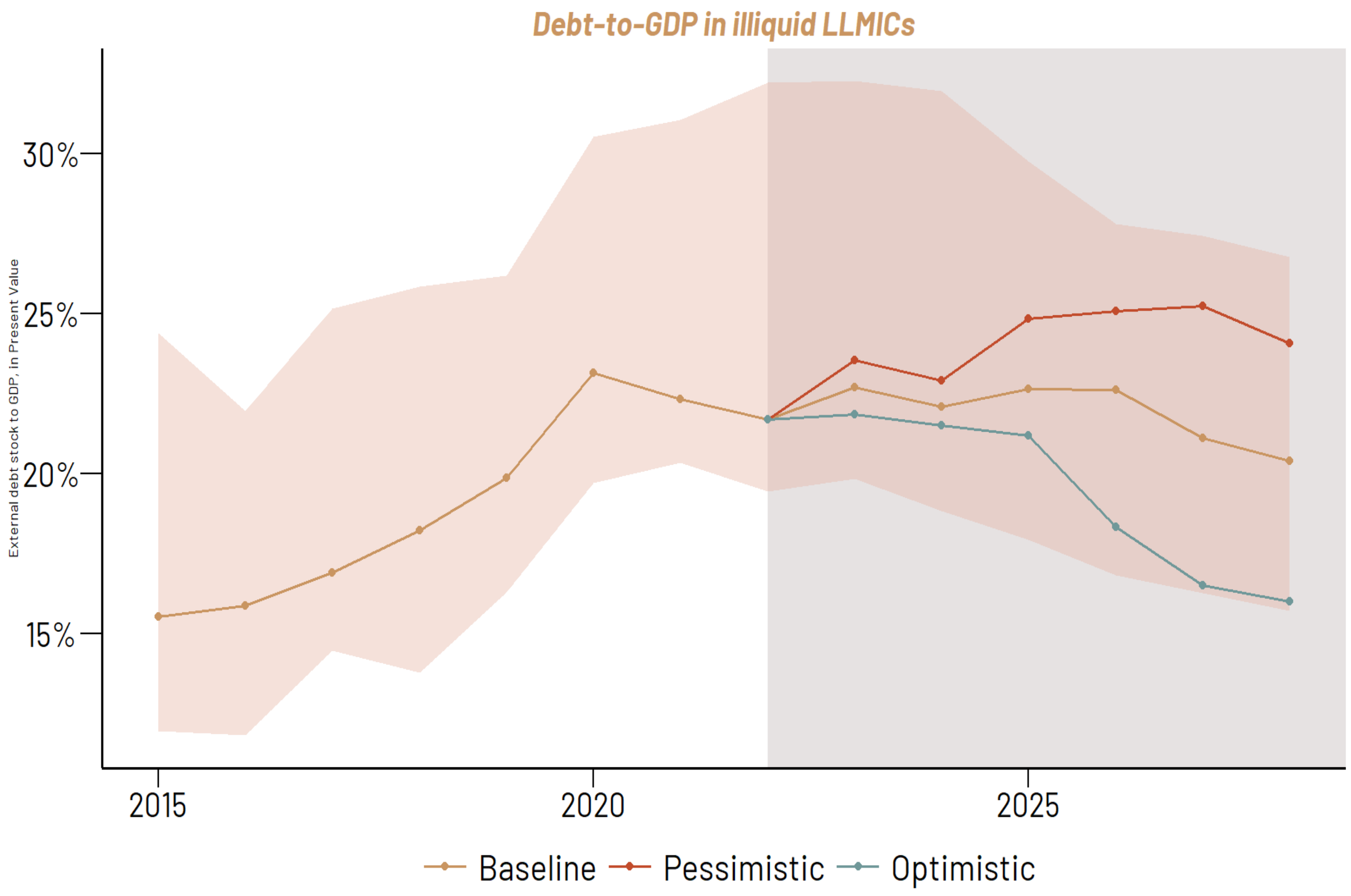
With rising risks of insolvency

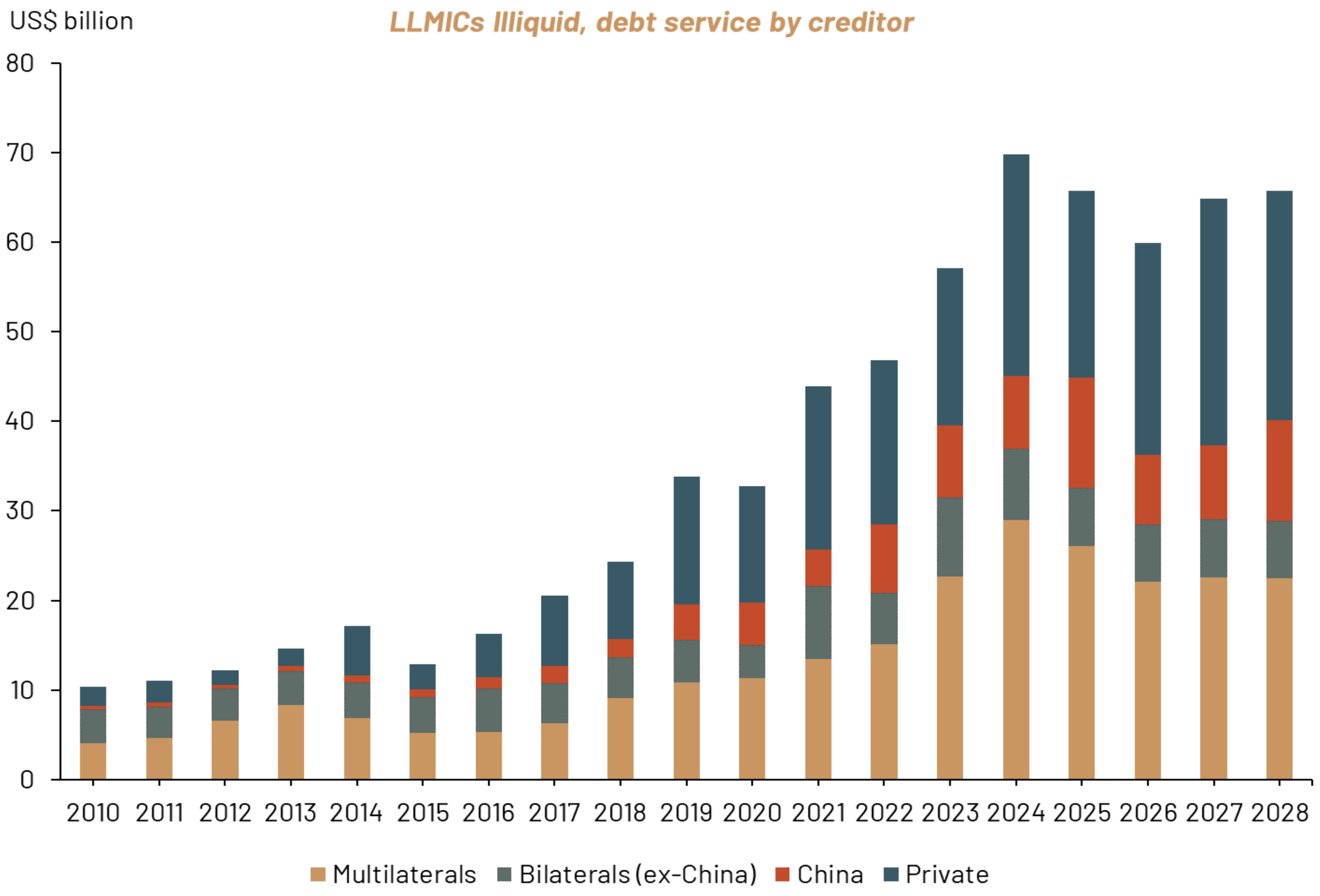
The rise in the risk of insolvency makes it even harder to refinance maturities coming due.



B. An MDB refinancing strategy too costly

To refinance DS coming due by all illiquid countries, it would require about $40b/y for the next 5 years, totaling 2 times IFIs flows over 2018-22.

- China needs a softer-- landing strategy
- Need a gradual shift from frontier market sovereign bonds to green bonds



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Illiquidity now recognized as the constraint for most LLMICs

- Recognizing that some countries are insolvent and need CF treatment

World Bank. Axel van Trotsenburg, January 24

... "These countries do not yet have solvency problems, and thus are not candidates for full-fledged debt restructuring. But they need urgent liquidity support in 2024-25 to mitigate the significant external debt roll-over risks they face."

IMF. Ceyla Pazarbasioglu, January 24

... "The funding squeeze facing low-income countries must be closely monitored. A scenario where sufficient low-cost funding materializes is possible, but there are also scenarios where more ambitious reforms, stronger international cooperation, and faster improvements in the global debt restructuring architecture may be necessary to help them emerge stronger and more resilient."

US Treasury. Jay Shambaugh, April 11

"We are seeing financial flows on net out of low- and middle-income countries... this calls for the international community to step up and take decisive, coordinated actions ... Fund shareholders should not be withdrawing their own financing... Private outflows should not be netting against IFI support."

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How is the Bridge proposal doing?

Progress, but tensions remain,

principally around how to reschedule/refinance Eurobonds.

- IFIs supportive, but need political backing
- US championing bilateral rescheduling, and voluntary private sector rollover
- China interested if comparability of treatment with private lenders
- But MDB scaling up in ambitious country platforms slow in moving

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Thank You

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