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External Shocks, Financial Stability and Debt

by

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External Shocks, Financial Stability and Debt

Implications for borrowing, debt composition and sustainability

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Presentation at 9th UNCTAD Debt Management Conference
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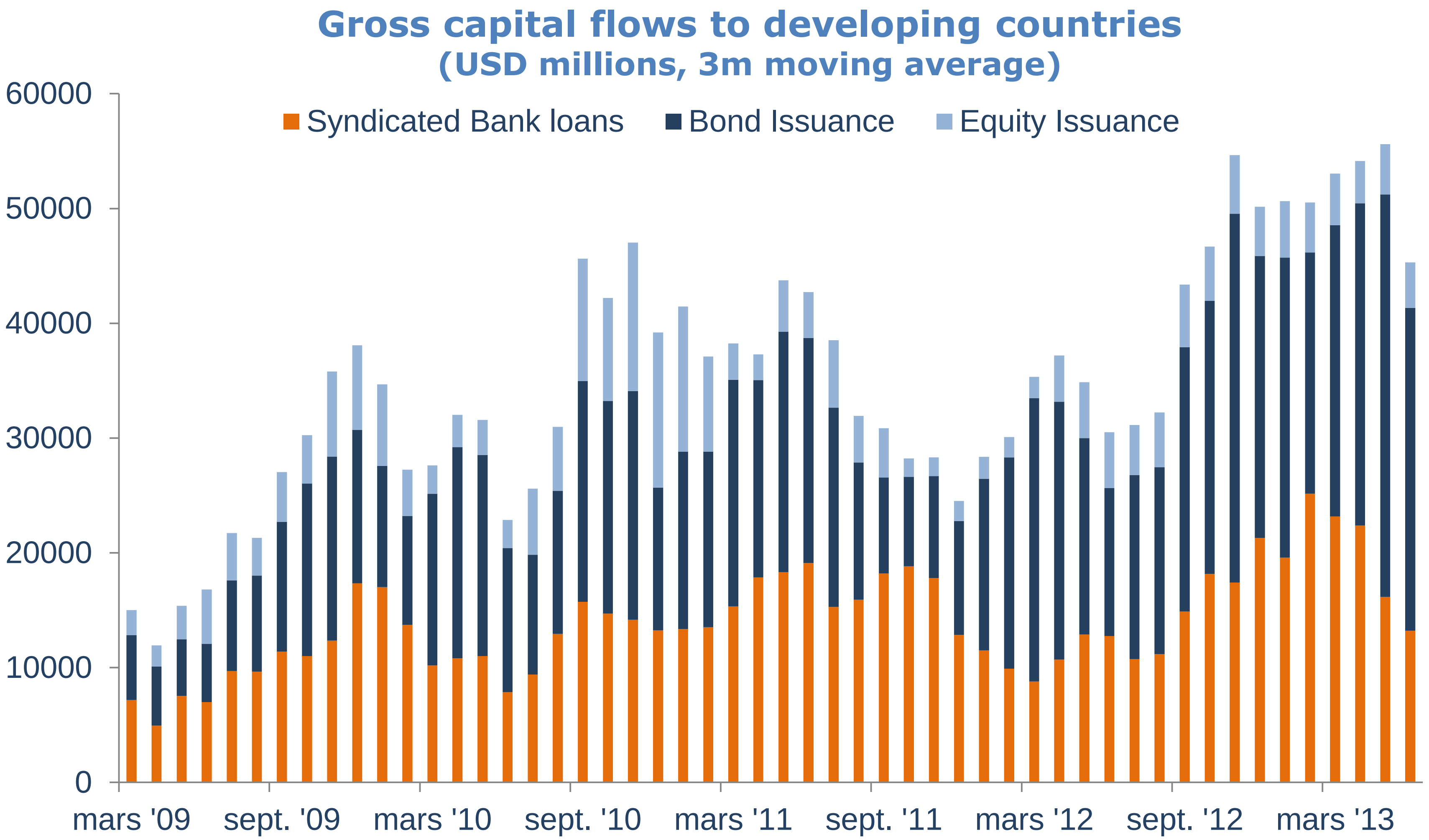
- General Outlook
  - Global risks and challenges going forward
- Developing Countries' Vulnerabilities
  - Does one size fit all?
- Implications for Debt and Fiscal Management
  - The role of the World Bank and other Multilaterals

GENERAL OUTLOOK

GLOBAL RISKS AND CHALLENGES GOING FORWARD

Gross flows to developing countries recovered steadily due in part to QE…

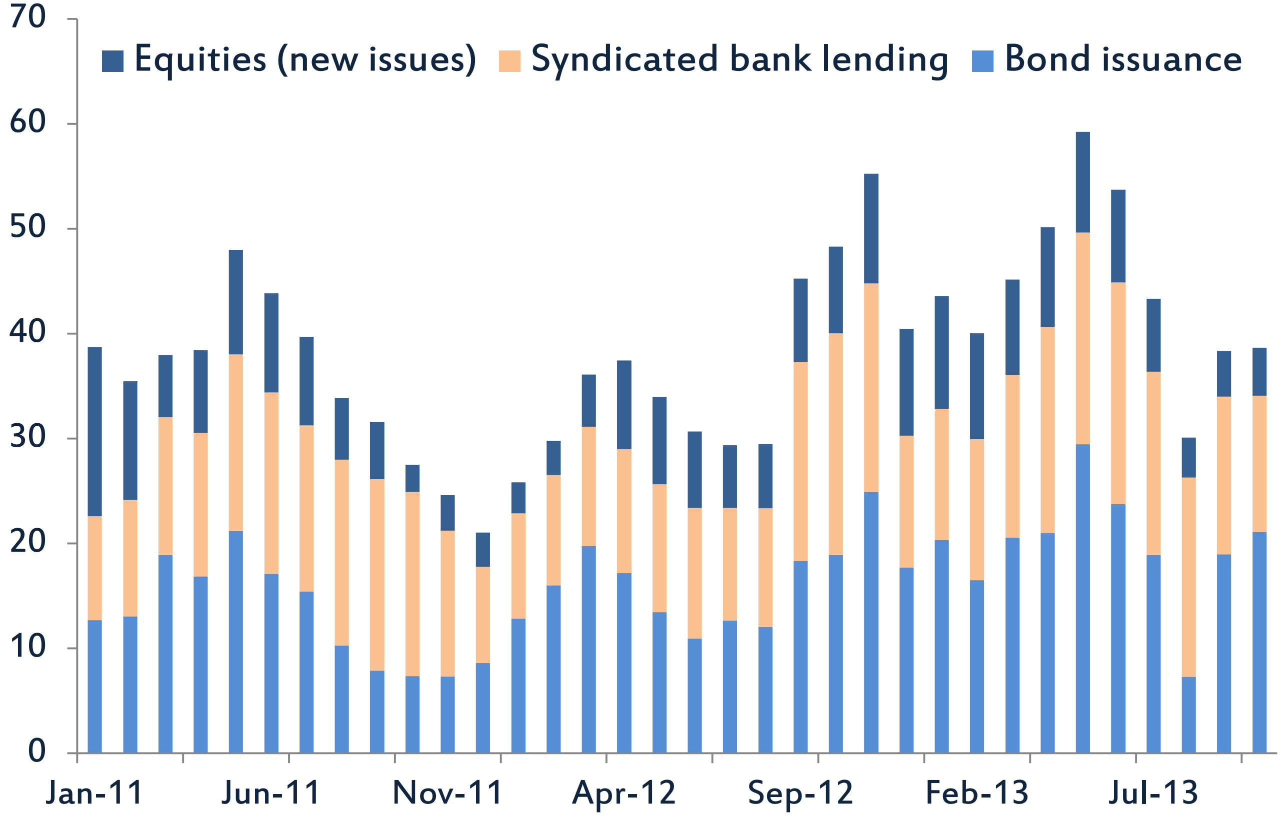


Source: World Bank, DataStream.

…but fell sharply again in Jun-Aug on "tapering" fears

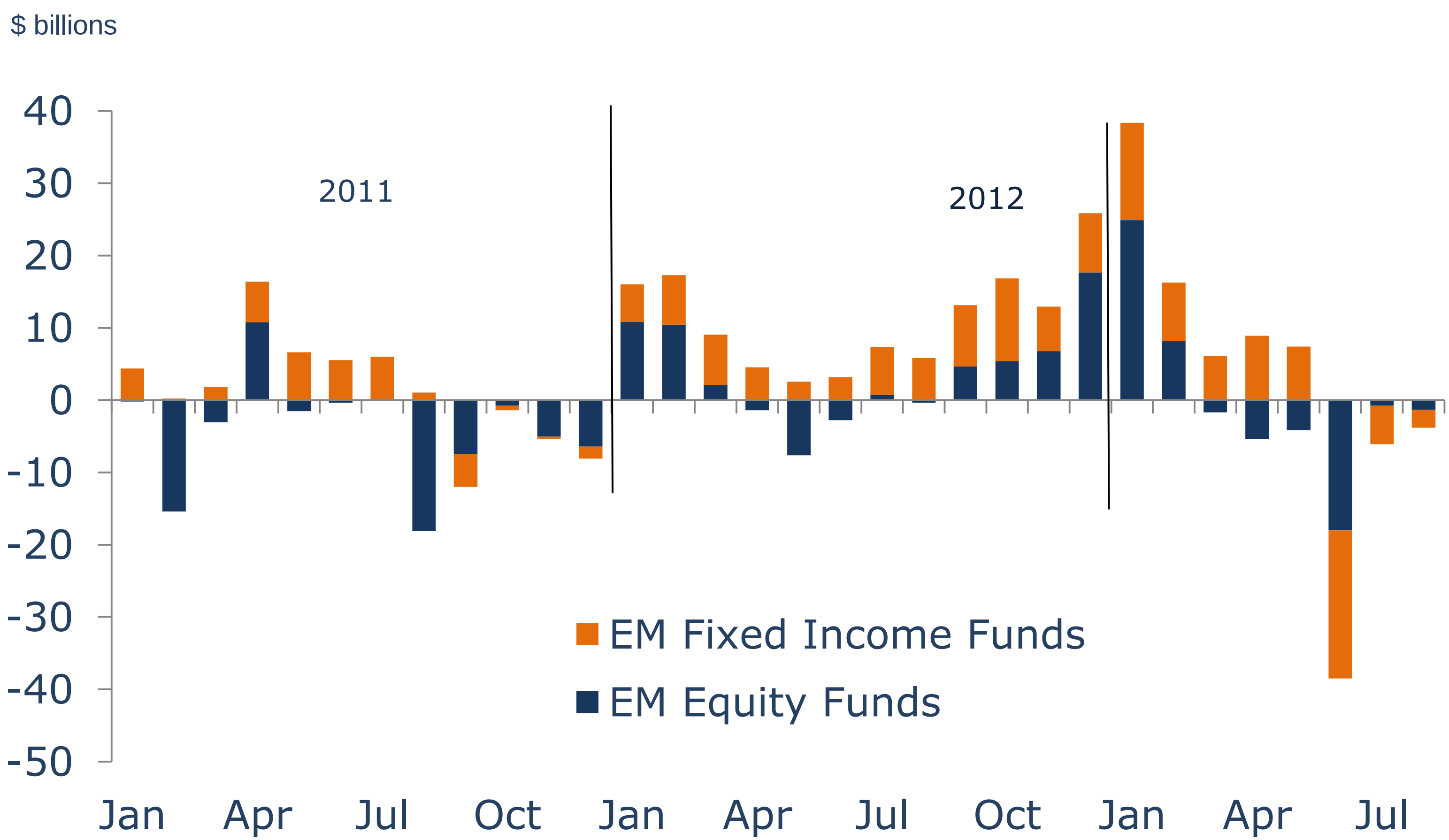
Gross capital flows to developing countries

(US$ billions, 3 month MA)



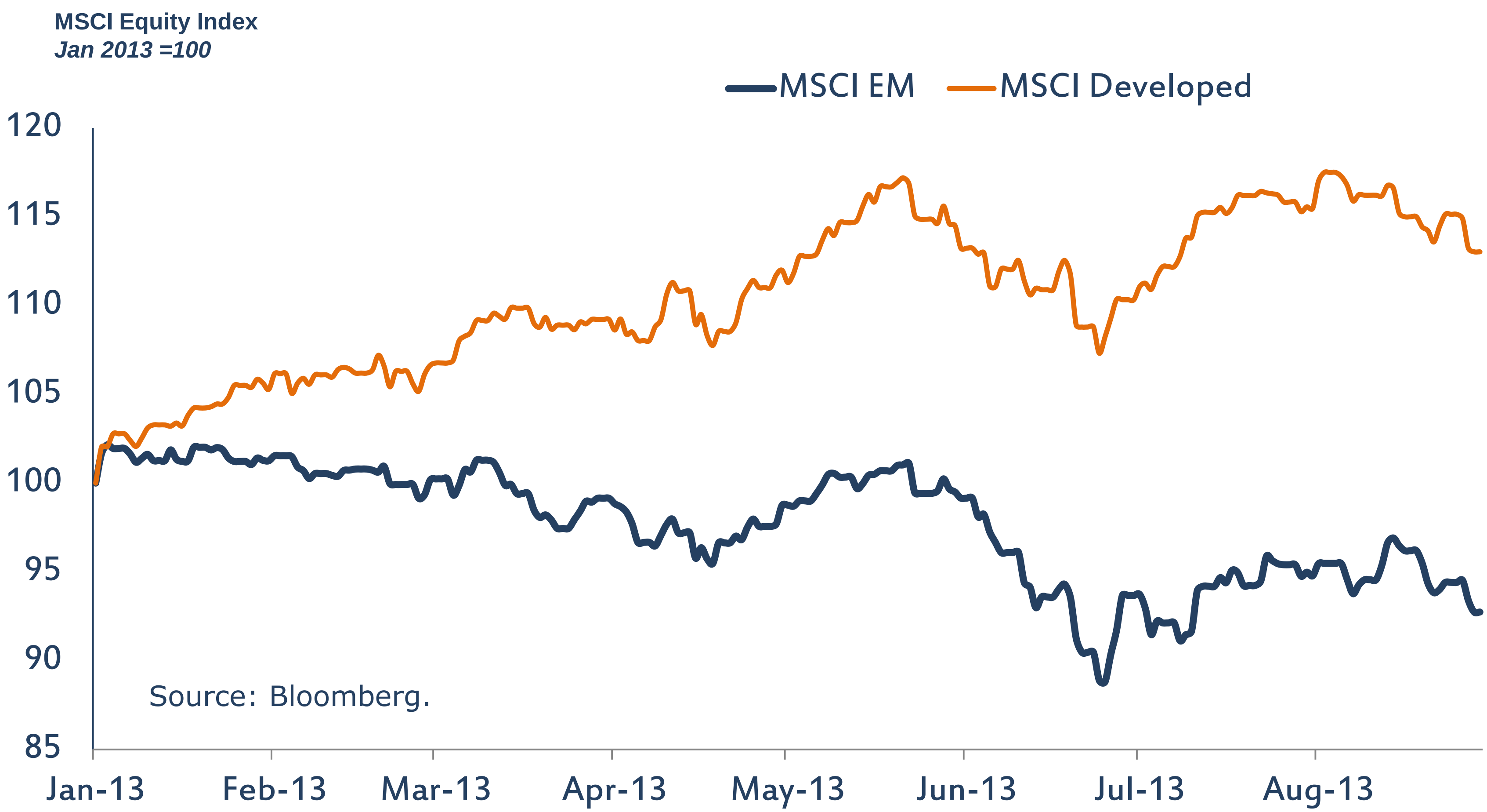
Source: Dealogic and World Bank Prospects Group.

Developing-country mutual funds also saw a big decline in inflows



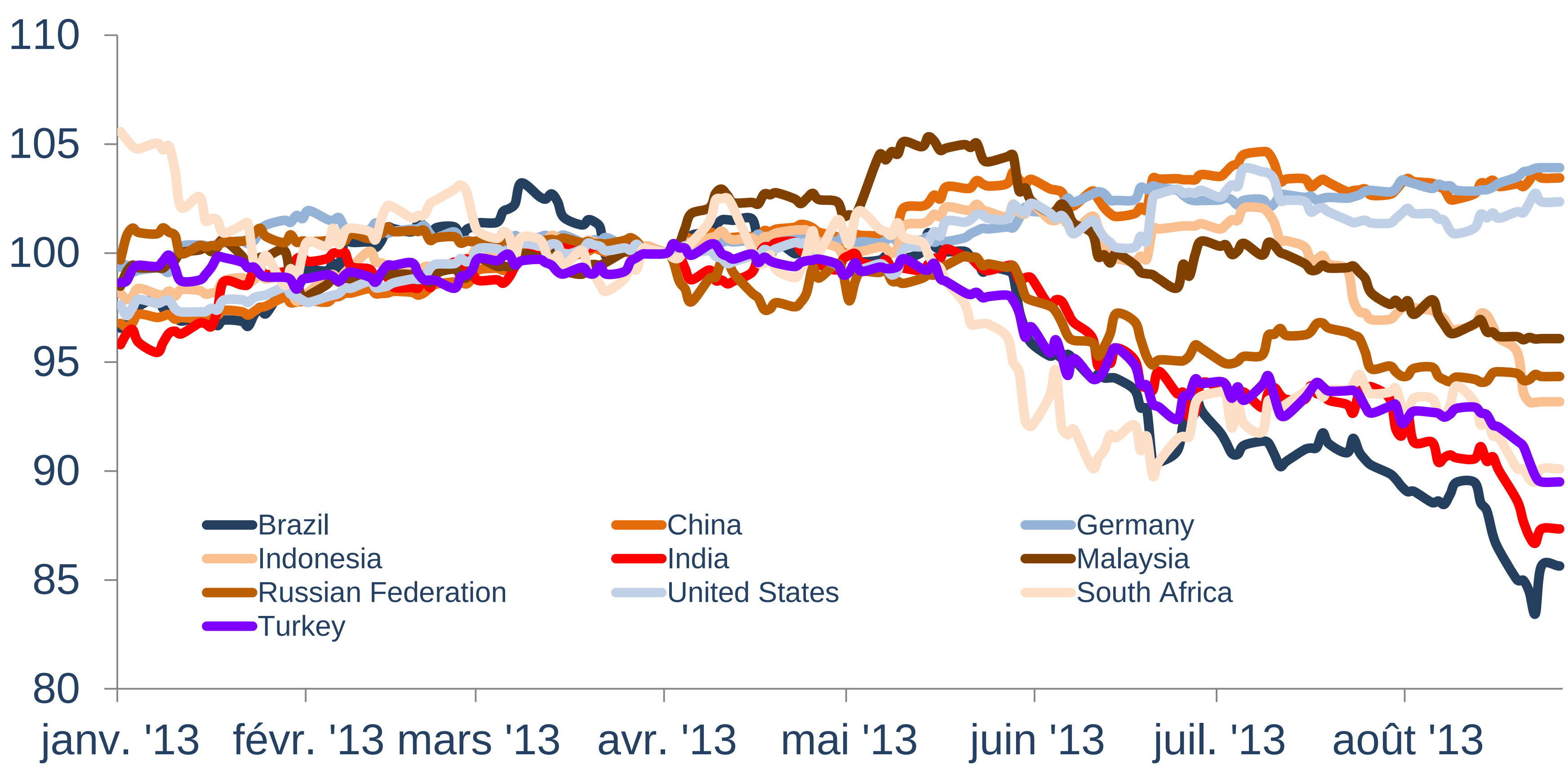
Source: Haver Analytics, EFPRI.

Developing country equity markets dropped with only limited recovery



Concerns over end of QE contributed to of developing country currency depreciation

Nominal effective exchange rate, April 1, 2013=100



Source: World Bank, JP Morgan, DataStream.

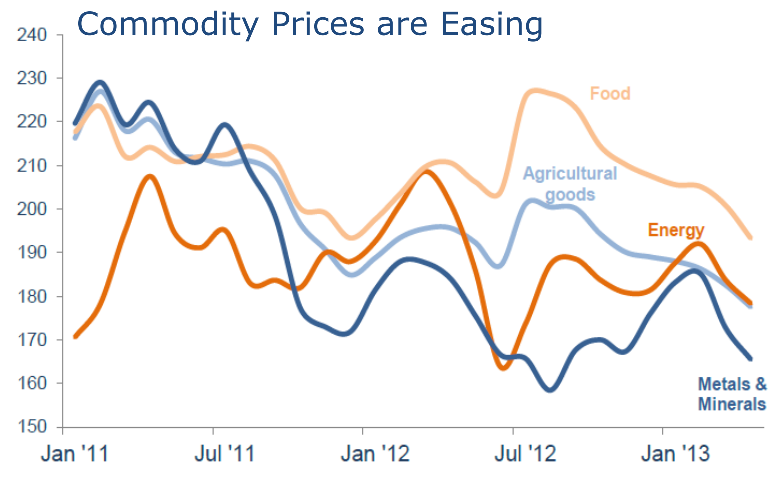
Bottom line: Developing countries still face an uncertain environment

- Global growth has picked up from the weakness of mid 2012, but downside risks remain – the most likely scenario is a slow and lengthy global recovery
    - China's growth strengthening, along with Brazil and Turkey, not a generalized phenomena among develop. countries (i.e., India and Russia lagging)
- Commodity prices will most likely stabilize at lower levels than the record highs of past years

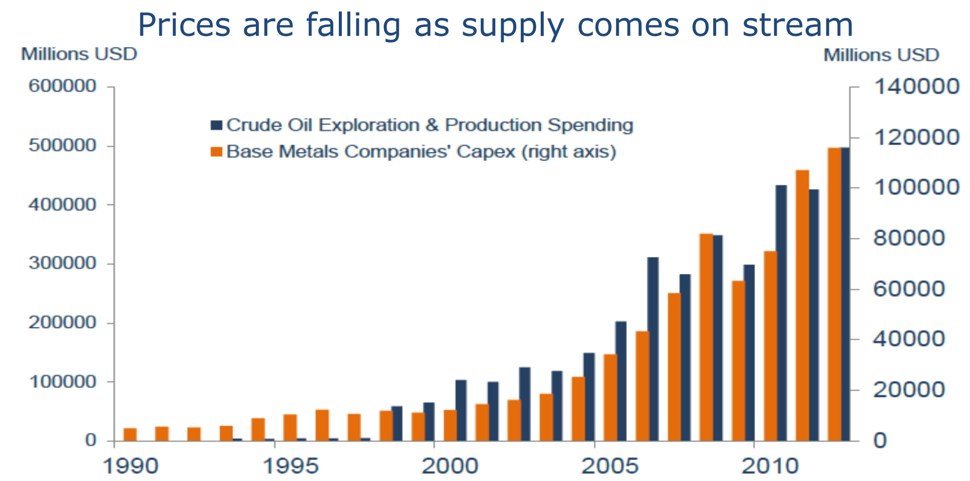
Bottom line: Developing countries still face an uncertain environment

- Global financial conditions better than in mid-2012, but financial risks rising with end of the QE era – taper "crunch" a warning?
  - Tighter international capital conditions increase the risks in economies with large CA and/or government deficits (interestingly also Brazil, India, and Turkey) and in countries where credit has expanded sharply in recent years (Indonesia, Malaysia, and Thailand)
- Developing countries fundamentals and policies stronger than previously, but borrowing pressures could emerge if institutional framework is not strong

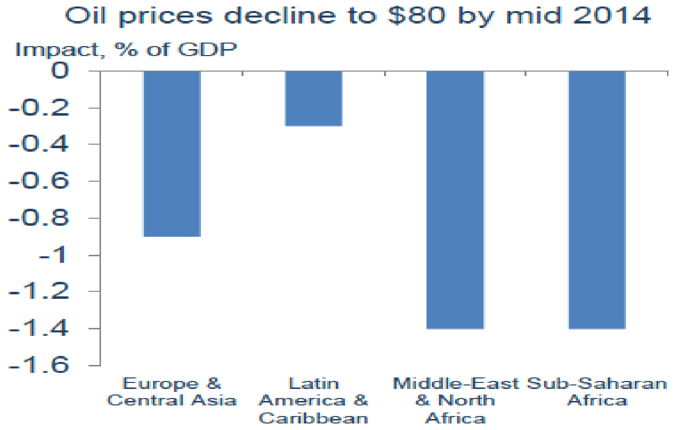
Consideration 1: Commodity exporters at risk if prices ease more quickly

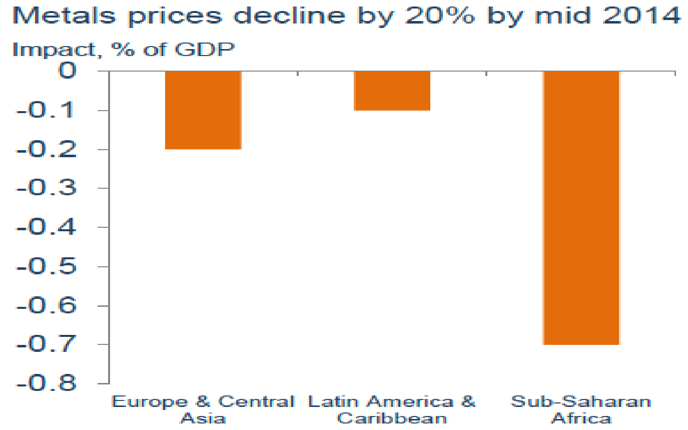


Source: World Bank.



Source: World Bank, Bloomberg.



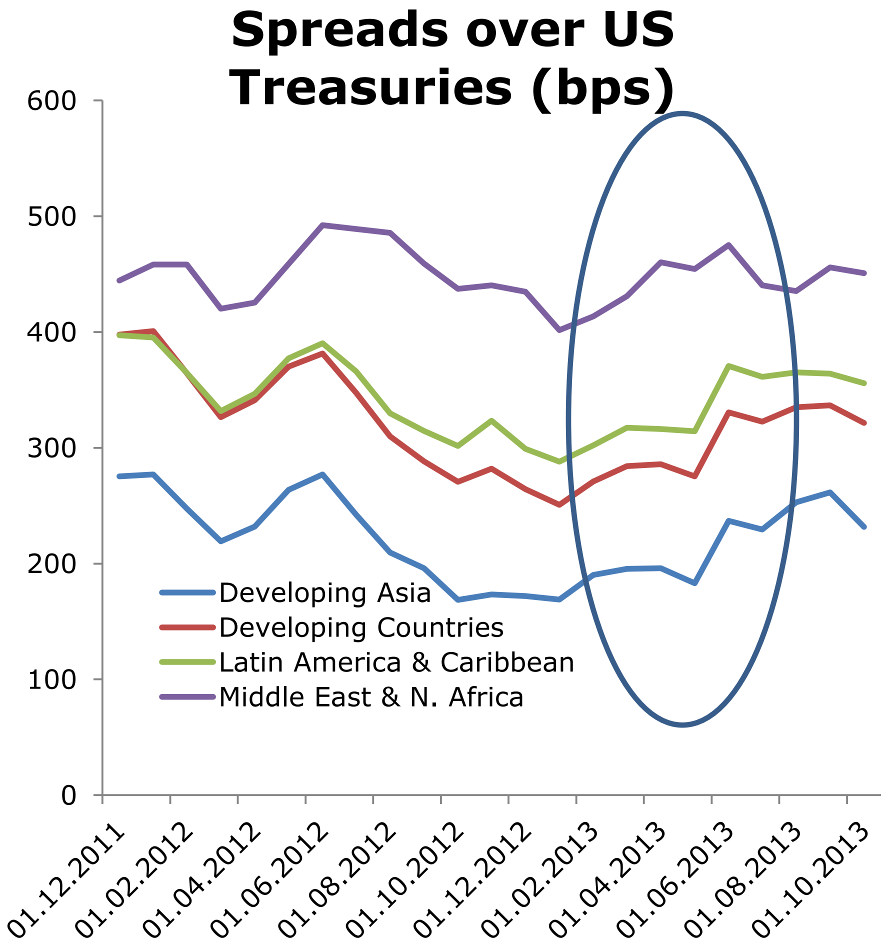


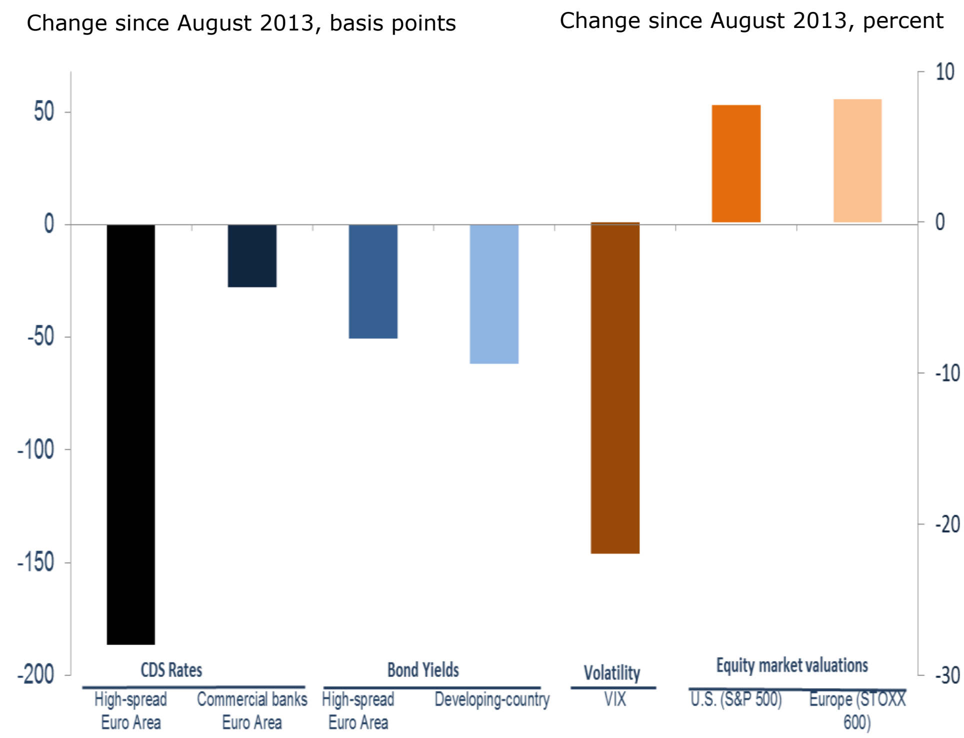
Source: World Bank.

<u>External Risks Rising</u>:

- Global supply is responding to a 5-fold increase in resource investments
- Commodity prices may continue to ease.

Consideration 2: Yields starting to rise and may continue with QE phasing out





External Risks:

- Potential impacts on interest rates, credit quality and growth from reduction or withdrawal of quantitative easing

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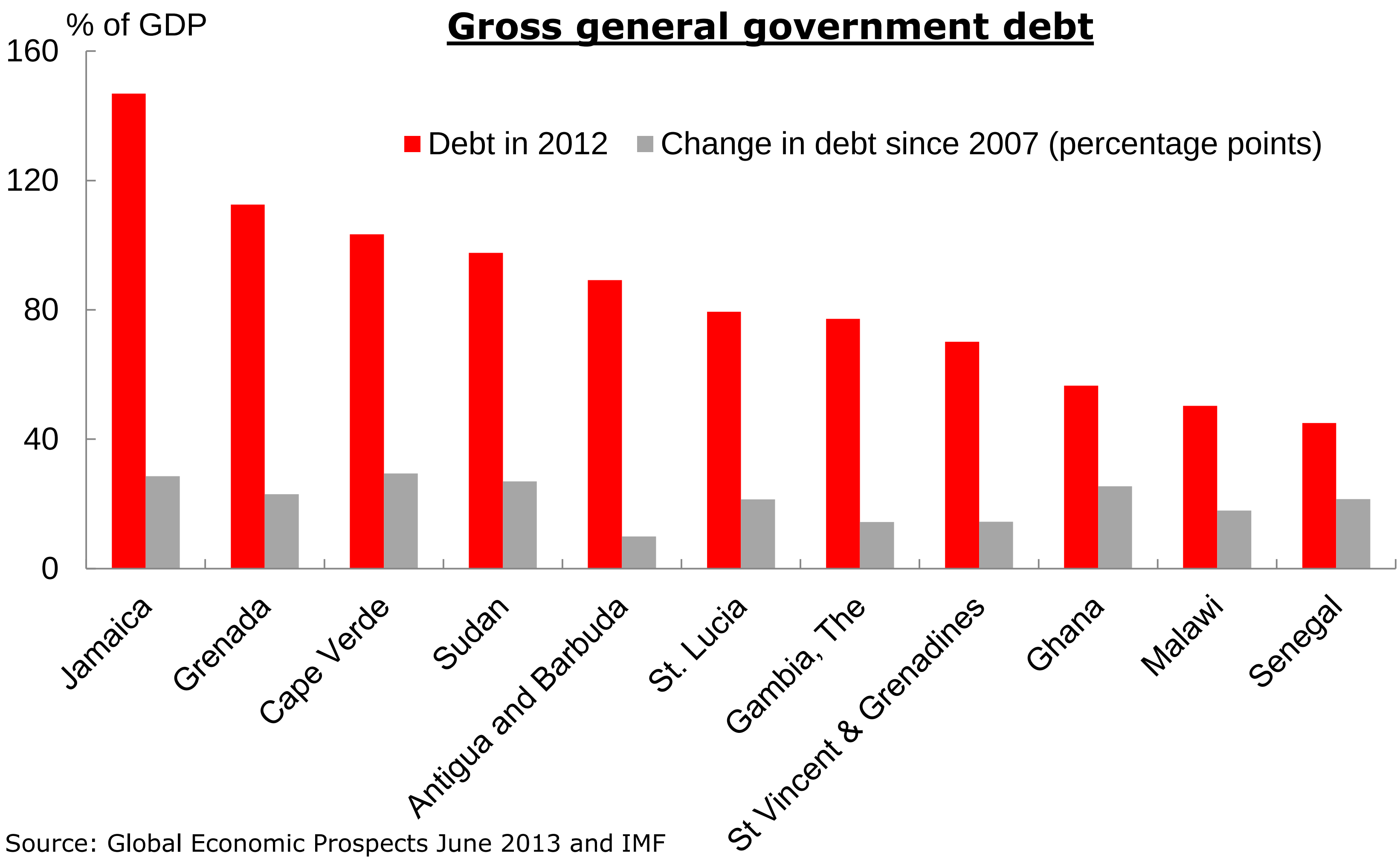
DEVELOPING COUNTRY VULNERABILITIES

DOES ONE SIZE FIT ALL?

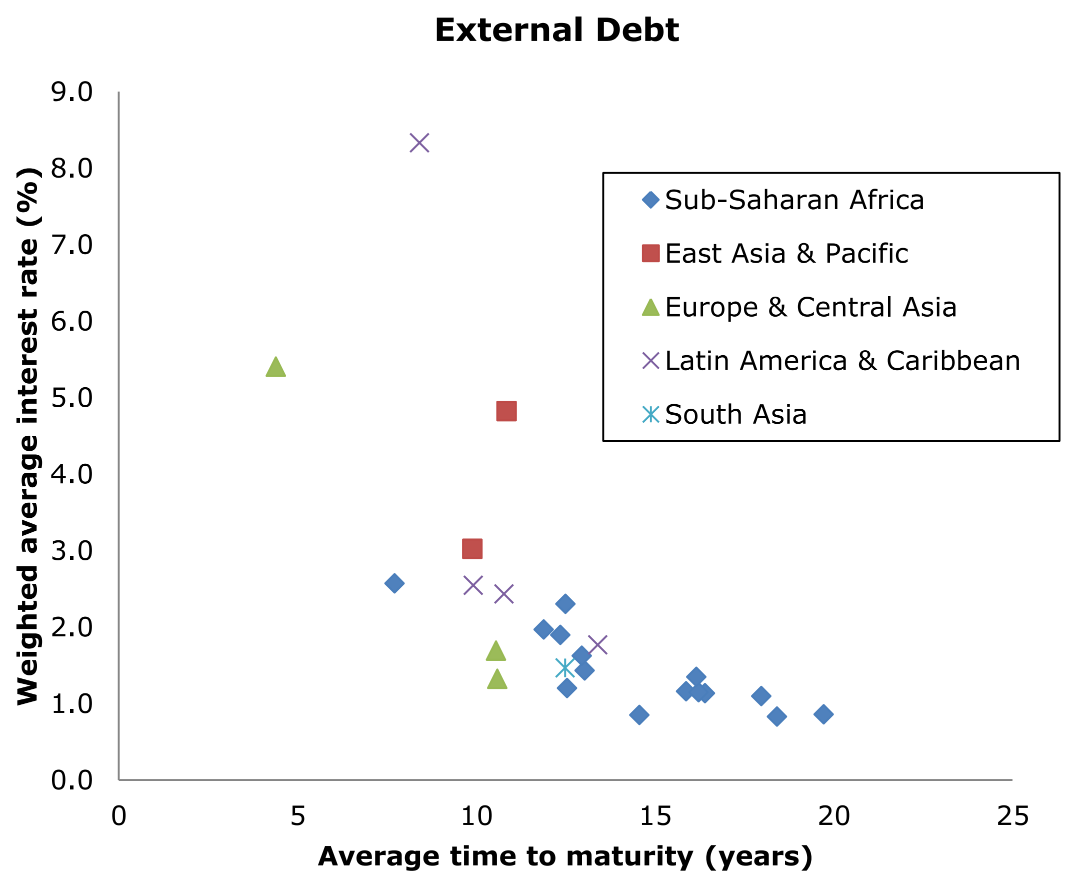
Several countries have rapidly rising gov't debt that poses additional risks



Source: Global Economic Prospects June 2013 and IMF

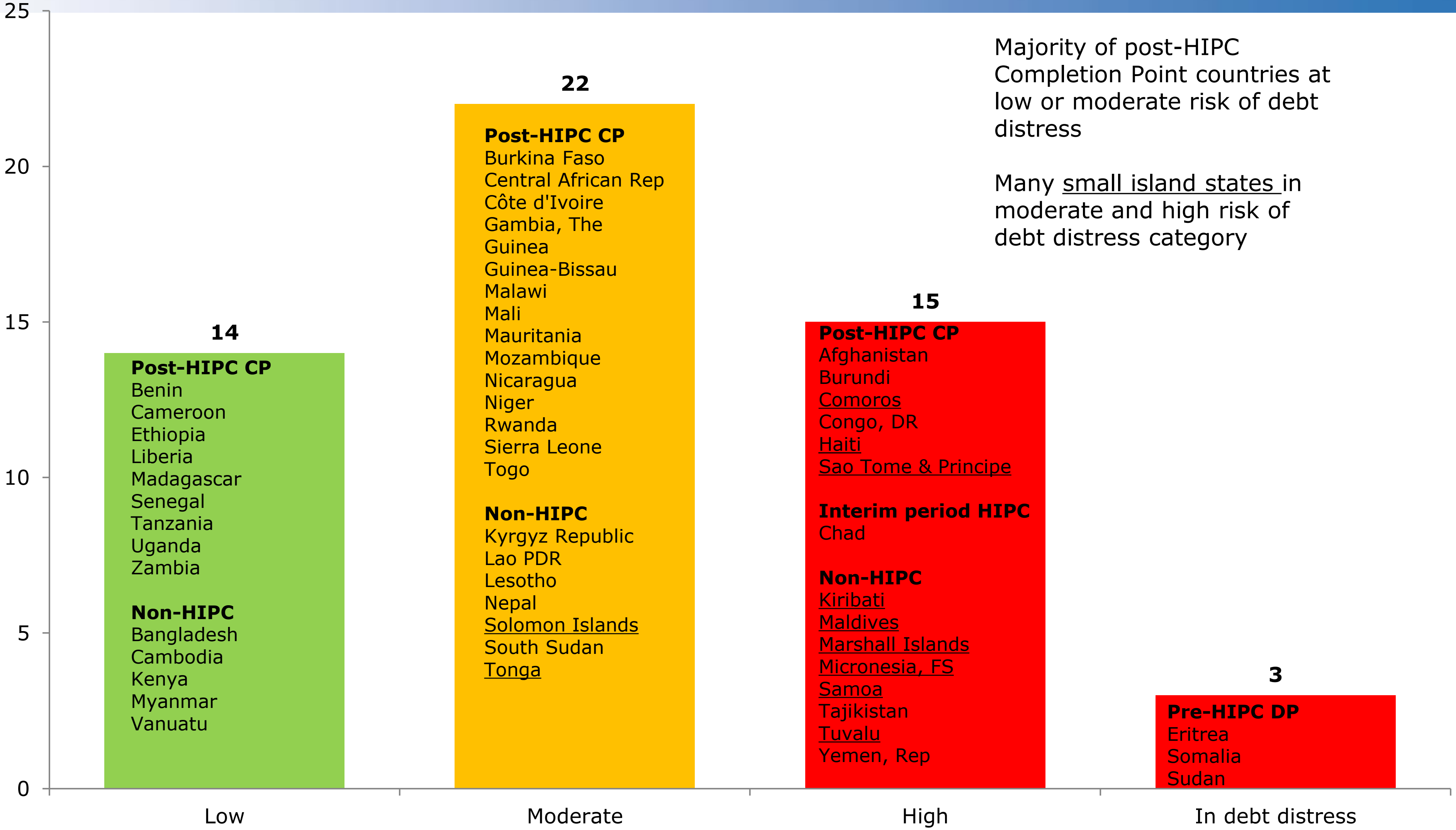
High cost and low maturity of external debt

- Several countries, primarily in Caribbean, Eastern Europe and Africa, have relatively short maturity external debt with high interest rates



Source: World Bank, data from MTDSs between 2010 and 2013

Some countries remain in debt distress or at high risk of distress



Data as of June 2013

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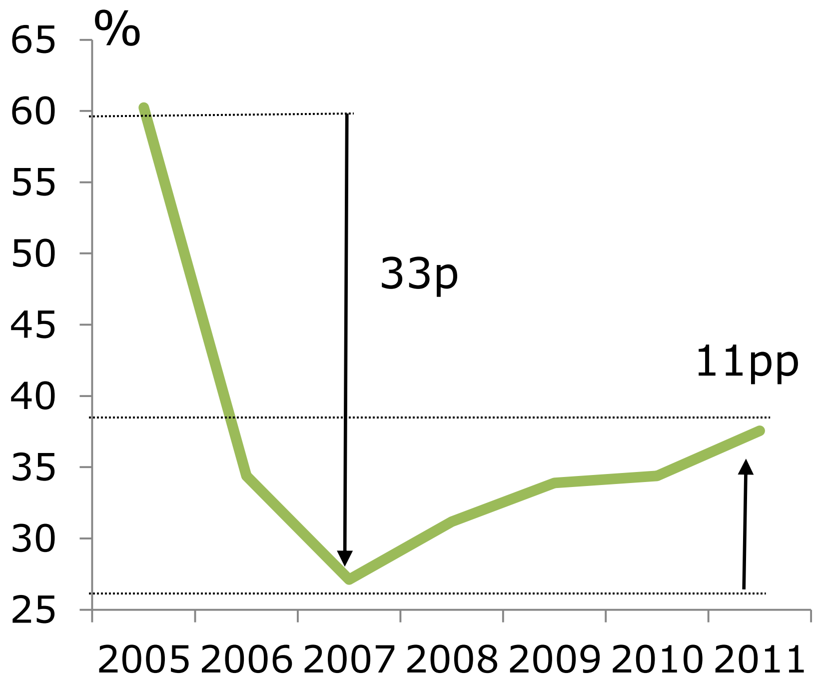
Some post-HIPC countries' borrowing trends are rising rapidly

8 post HIPC countries took 4 years to raise public debt to GDP 1/3 back to pre-relief ratios



Source: Merotto, Stucka and Thomas, 2013

These 8 countries are Ghana, Uganda, Senegal, Niger, Malawi, Benin, São Tomé and Príncipe, Mozambique

In São Tomé and Príncipe, debt increased by 30 percent of GDP

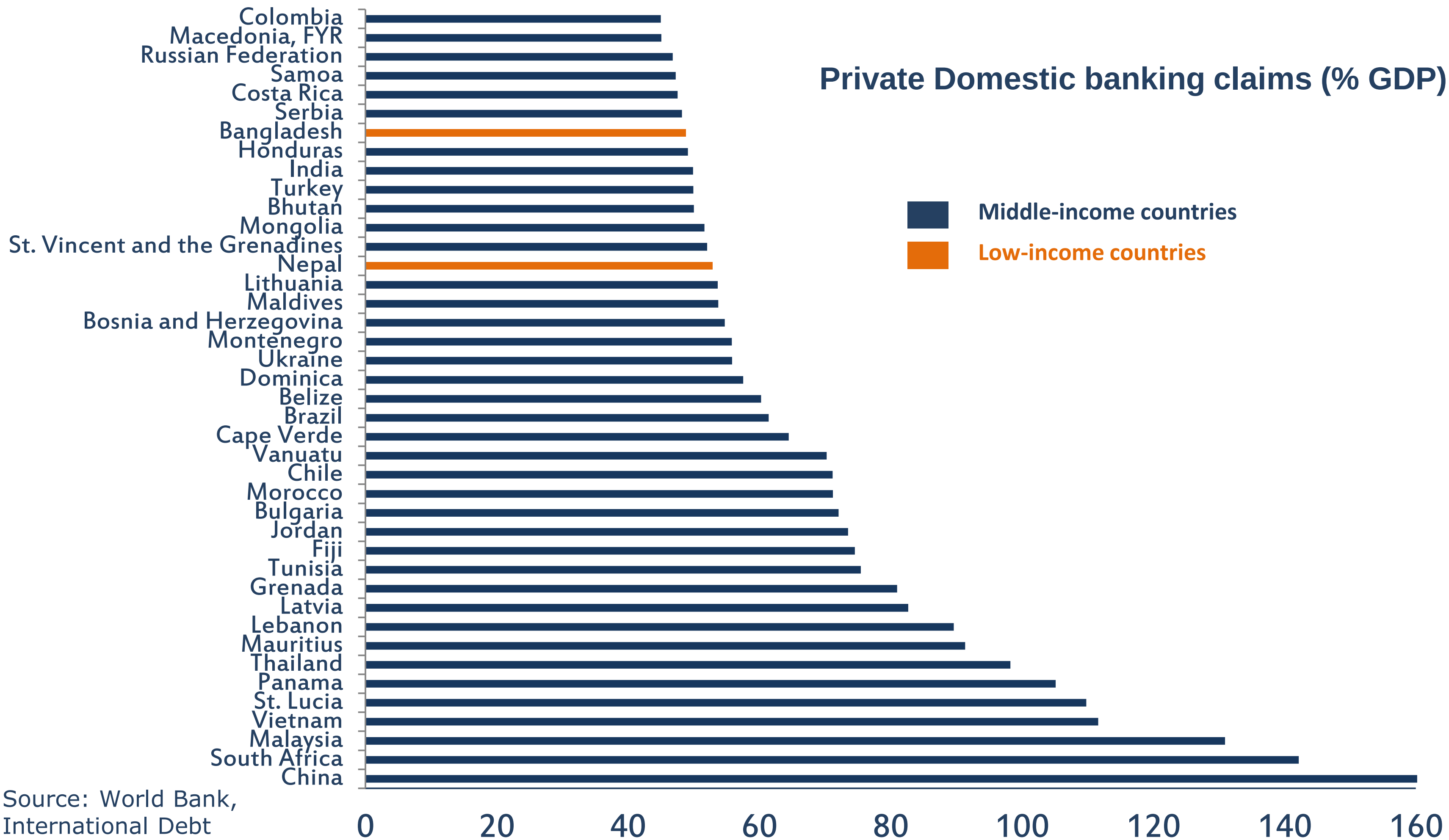
In Senegal and Benin, it grew by 20% of GDP

In Ghana, Malawi, Mozambique, Niger and Uganda it rose by 10 percent of GDP

In a decade these countries will have debt to GDP ratios back at pre-relief levels as percent of GDP

Others on the rise include Ethiopia, Tanzania, Burkina Faso

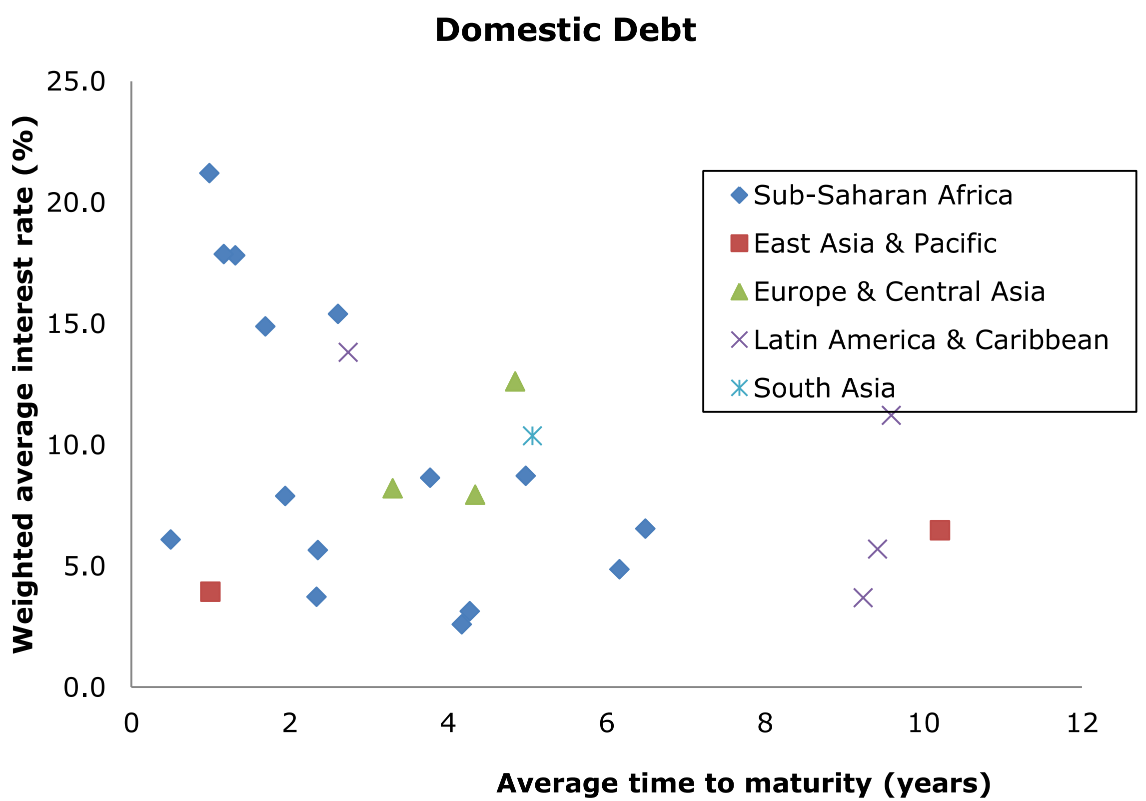
Domestic debt can be problematic when interest rates rise



Source: World Bank, International Debt Statistics.

High cost and low maturity of domestic debt

- Domestic debt markets still underdeveloped, especially in African countries, with short maturities and high interest rates
- Refinancing and interest rate risk high



Source: World Bank, data from MTDSs between 2010 and 2013

For small Caribbean states, debt and other problems still remain…

- Caribbean Countries were not eligible for the HIPC/MDRI debt relief initiatives, and remain burdened by very high debt levels: plagued by oil shocks, natural disasters, high interest rates, and low growth rates
- Five Caribbean Countries are assessed in DSAs to be at a high risk of debt distress or in debt distress: Antigua and Barbuda, Belize, Grenada, Haiti, and Jamaica
- These are among the most vulnerable countries given their reliance on remittances and their growth volatility due to the frequent exposure to hurricanes

IMPLICATIONS FOR DEBT AND FISCAL MANAGEMENT

THE ROLE OF THE WORLD BANK AND OTHER MULTILATERALS

In this context it is critical to decide:

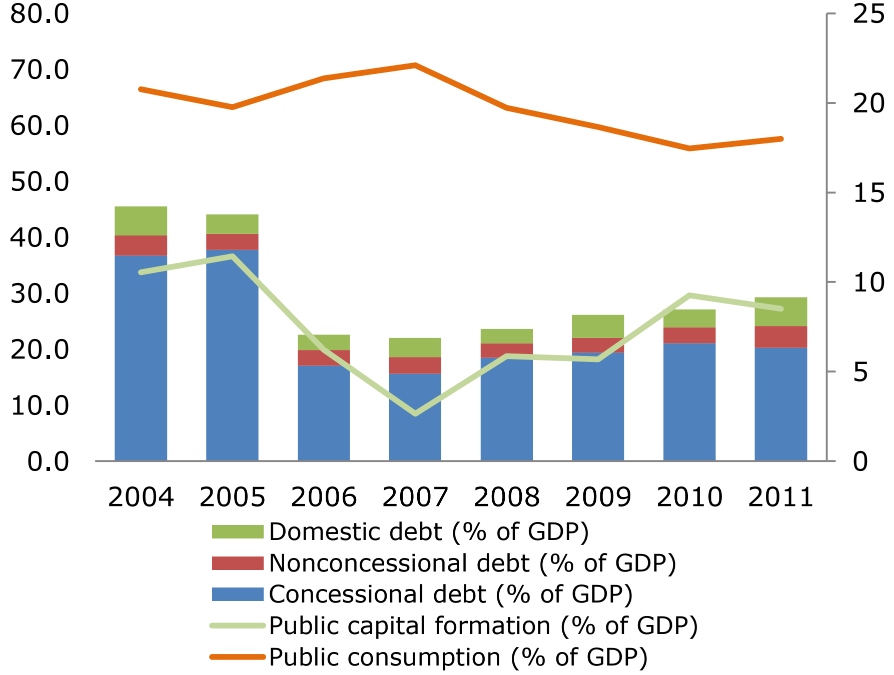
What to finance: Choose feasible projects with the highest social return (*Public Investment Management*)

How much to finance: Take into account initial conditions (debt situation), the global environment (volatility) and the country's repayment capacity in the short and medium term (*DSA*)

How to finance (choice of instruments): MTDS cost/risk trade offs; look into macro implications of alternative debt instruments

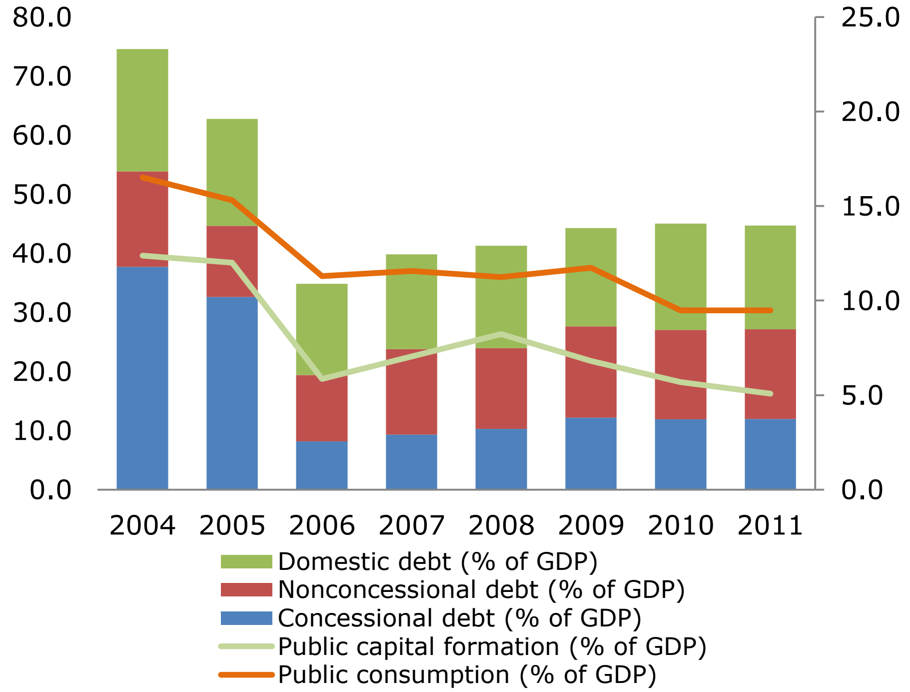
It matters ***how much*** countries borrow, ***for what***, and ***how*** they borrow (instruments)

Burkina Faso



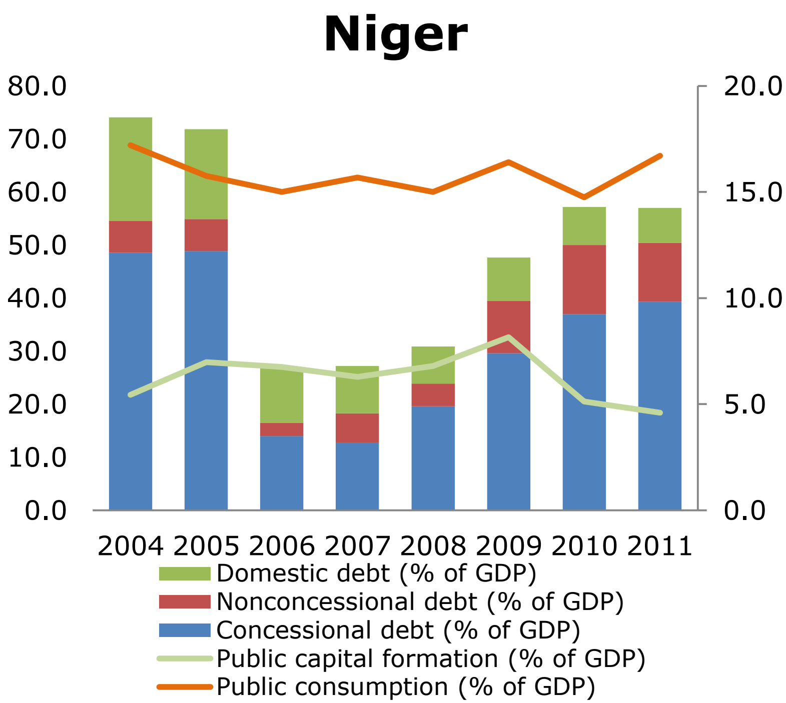
- GDP growth 5.7% per year since ‘01
- Concessional borrowing drove up debts
- Government used it to invest

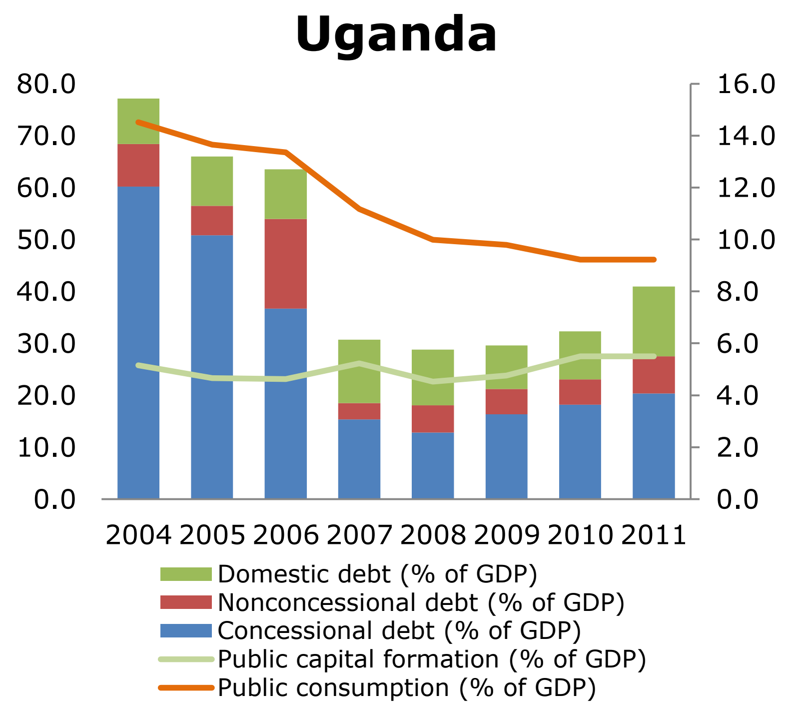
Ghana



- GDP growth 6.7% per year since ‘02
- Non-concessional borrowing drove up debts
- Government got smaller in the economy

… because new borrowing is not always used to finance investment





- GDP growth 6% per year since '01
- Concessional and non-concessional; borrowing drove up debts
- Government investment share of GDP fell

- GDP growth 6.6% per year since '01
- Concessional and domestic borrowing drove up debts
- Government capital share of growing GDP grew – Uganda is investing

Institutional capacity to manage debt is critically important

Debt sustainability		
Debt management		Long term debt sustainability
DeMPA (process)	MTDS (debt composition)	DSF (debt level)

Medium-term fiscal framework (MTFF) linkages with debt strategy (MTDS) & sustainability (DSA)

MTFF Macro, Revenue & Spending	Resources available to finance infrastructure and social spending, and promote economic development. Monitor compliance with rules/targets on spending.	**Planning, fiscal policy & budgetary departments.**
DSA Debt & Budget Balances	Financial viability of debt-financed budget deficits. Monitor compliance with rules/targets on debt and borrowing.	
MTDS Debt, Borrowing Requirements, Financing Options & Market Development	Identification of adequate debt instruments to borrow, given their cost-risk profile. Absorption constraints imposed by market developments and investors' appetite for government debt.	**Treasury & debt management departments. SN finance division.**

What's next?

- There needs to be a greater focus on fiscal sustainability and project management
- Countries need to spend <u>better</u> rather than <u>more</u>
- Sustained growth through better investment is the only way to ensure debt sustainability over the long-term.
- Building up capacity is a continuous effort that the international community need to support.

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