



Emerging debt challenges for developing countries: apparent easing, persistent fragilities

Lessons from the new World Bank International Debt
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Introduction - An apparent easing hides deep fragility

At first glance, lower global interest rates have eased external debt pressures on low- and lower middle-income countries (LLMICs) in 2024. Net transfers on external debt – disbursements minus debt servicing costs – have significantly improved for the first time in three years. Many countries have once again issued in global bond markets, gaining access to international finance for the first time in years, reflecting improved investor confidence; external debt to GDP ratios have stabilised; and several countries have completed debt restructurings using the G20's newly established Common Framework (see also IMF 2025).

However, when looking at the latest data, the apparent aggregate recovery masks profound heterogeneity across LLMICs, with diverging trajectories and distinct risks that have made it challenging to build lasting resilience. While this analysis is retrospective and focuses on data covering up to the end of 2024, it provides insights into varying fates of developing countries and their exposure to the ongoing conflict in Iran and the Middle East, the latest in a series of global disruptions since COVID-19. Our analysis suggests that three distinct groups of countries emerge when understanding debt dynamics and policy options. A first group of countries has regained market access, at costs that may prove unsustainable over the medium term. In a second group lacking market access, official development assistance is not supporting recovery; instead, it is bailing out private creditors and leading to a growing share of inflexible debt. A third group includes the most vulnerable countries, which face outright insolvency, with debt burdens beyond sustainable levels.

Our categories capture the differing nature of risks faced by countries. Using the IMF/World Bank Debt Sustainability Framework thresholds, we distinguish countries at risk of insolvency, where the *stock of external debt* (relative to GDP) is high, and countries at risk of illiquidity, where the *flows of debt service* (relative to general government revenues) will be high in the five years to come. Finally, those which do not breach any of the prudential thresholds are considered as facing lower risks. All these assessments are conditional on future growth and domestic developments – all subject to a rising level of uncertainty. Countries at risk of insolvency do not necessarily need a restructuring, but the level of their debt requires tight fiscal policy. Countries at risk of illiquidity might have some fiscal space, but they are constrained by the availability of external financing for their elevated borrowing needs.

With the reopening of markets for LLMICs since the end of 2024, another distinction is warranted. Within the illiquid category, we further distinguish between countries that issued Eurobonds in 2024 and in 2025 (“market-access” countries) and those that did not (“no-access countries”), as foreign-currency bonds are a primary source of access to external capital.¹ Country classifications used in this report are detailed in the Annex.

Through this lens, our note documents four findings.

- **First, bond market access has become a liquidity divider:** illiquid countries able to issue high-coupon bonds achieved some modest short-term relief and a return to positive, or at least less

¹ As markets remained closed for low- and middle-income countries in 2022 and 2023, most countries structurally accessing markets issued in either 2024 or 2025.

negative, net transfers, while those without access face continued outflows and mounting fiscal and foreign exchange pressures.

- **Second, this liquidity provision came at a steep cost:** average coupon rates of 7–10% translate into rising medium-term debt service, which is worsened by rising costs across all creditor categories – including multilaterals. Moreover, these countries continue to suffer from liquidity shortages, reducing their growth potential.
- **Third, retrenchment by private creditors and China is being financed by multilateral inflows** that are absorbed by debt service rather than by financing productive investment, creating widespread leakages, particularly for illiquid countries without access to bond markets. Moreover, the rise in senior debt discourages further private flows.
- **Fourth, the liquidity squeeze is increasingly a foreign exchange squeeze**, which is particularly hurtful to the growth process. Insolvent countries sit at the IMF's three-month import cover threshold, leaving no margin for shock absorption. Illiquid countries without market access show declining reserves, pointing to a gradual erosion of buffers. Among Eurobond issuers, reserve positions appear stronger on aggregate but mask significant heterogeneity, with some countries remaining highly vulnerable.

While detailed data for 2025 are not yet available, similar trends are likely to continue, as Eurobond access has remained highly selective and at costs well above historical averages. These findings carry direct implications for the design of restructuring frameworks, the scaling and targeting of concessional finance, and the sequencing of policy responses across the illiquid-insolvent spectrum.

2. Debt risks in developing countries: down, but still significant

Based on World Bank data and IMF projections, we can project future external debt stocks and debt service flows. This model developed by Albinet and Kessler (2023) has been updated, and the full analysis, including various shocks, will be released later in 2026. Using thresholds for insolvency and illiquidity breaches from the World Bank /IMF's debt sustainability framework (the so-called LIC-DSA), we determine not only if countries are "at risk", but what kind of risks they face. Countries at risk of insolvency (which for short, we will call **insolvent**) are those that breached their external debt-to-GDP threshold in the first year of data (here, 2024). Countries at risk of illiquidity (for short, **illiquid countries**) are those that breach their external debt servicing-to-general government revenues threshold in any year of projection thereafter (2025-2030), but are not deemed insolvent in the initial year. **Lower-risk** countries are the remaining LLMICs that are not projected to experience both breaches.²

Our projection results, using 2024 data as a base, find that 20 LLMICs are illiquid - of which 8 are classified as market access, and 12 as no-access countries. We also find that 8 countries within the LLMIC group are insolvent. Finally, 30 countries have a low risk of debt distress.

² There is also a small fourth group, "Not in DSA" countries, which have missing data (usually WEO projections), and where we are unable to estimate the debt situation.

These results are slightly more favourable than those we reported last year, with several illiquid but solvent countries moving out of this category and now sitting at the edge of this group. The full list of illiquid, insolvent, and lower-risk countries can be found at the end of this short note in the Annex.

3. The return to positive net transfers masks uneven conditions

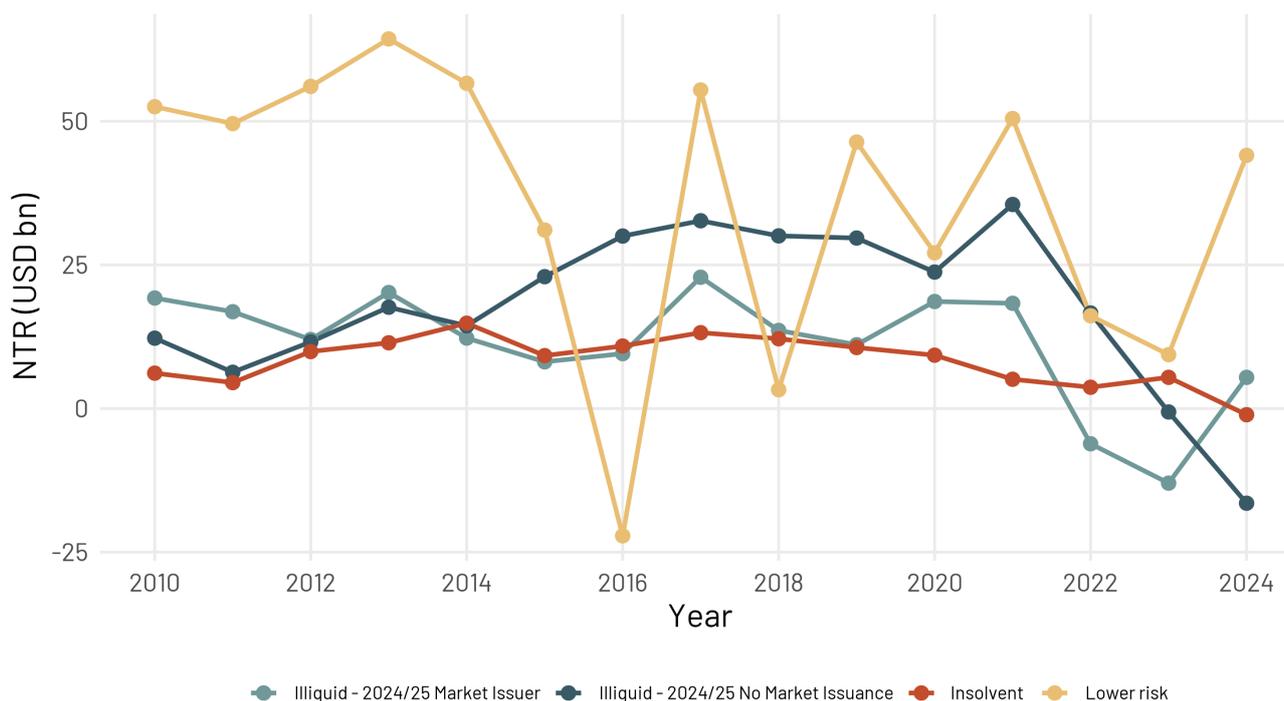
Positive net transfers in 2024 are an important reversal but should not hide two facts: that they remain well below historical averages, and that "risky" countries still suffer from negative transfers.

In aggregate terms, net transfers to LLMICs fell dramatically from over USD +100 billion in 2021 to USD -5 billion (net outflows) in 2023, recovering in 2024 to USD +27 billion (net inflows). Figure 1 shows net transfers for LLMICs over time since 2010, grouped by DSA category. It reveals that it is mostly in the low-risk LLMICs – a category that had consistently received positive net transfers in the past (except in 2016) –, that net transfers rose in 2024. In all other more distressed groups, net transfers were close to zero, or negative, with marginal changes compared to 2022–23. Among illiquid LLMICs, however, a clear divergence has emerged: those excluded from international markets had average levels and were trending downward, while those with renewed market access recovered, moving from negative to barely positive territory.

This divergence in 2024 was driven primarily by access to private creditors.

- **The countries with a low risk of debt distress were those that managed to secure more private inflows.** They massively improved their net transfers from USD 10 billion in 2023 to USD 44 billion in 2024, being the only group with positive net transfers from private creditors on both public and non-publicly guaranteed debt (totalling USD 33 billion).
- **The group of illiquid LLMICs with renewed market access was able to obtain fresh loans through high-coupon bonds and loans.** But while this enabled them to meet some of their short-term financing needs, they barely managed to achieve just-positive net transfers – a gain from USD -12 billion in outflows in 2023 to USD 5 billion in inflows in 2024.
- **The group of illiquid LLMICs with little to no market access has remained a net payer for a third year in a row, with even more negative net transfers, facing the full weight of their high gross financing needs and limited rollover options, exacerbating their fiscal stress.** These are the countries where the “silent development crisis” is hitting the hardest. In their case, support for the multilateral and bilateral institutions has been unable to make a difference, leaking out massively to other creditors. These countries faced a 20% increase in principal repayments in 2024, while disbursements remained relatively low and unchanged, with the net position falling from USD -1 billion in 2023 to USD -16 billion in 2024.
- In 2024, insolvent countries collectively saw net negative transfers of USD -1 billion.

Figure 1: Net transfers for LLMICs by Debt Sustainability Status



Source World Bank IDS (2025a), Finance for Development Lab

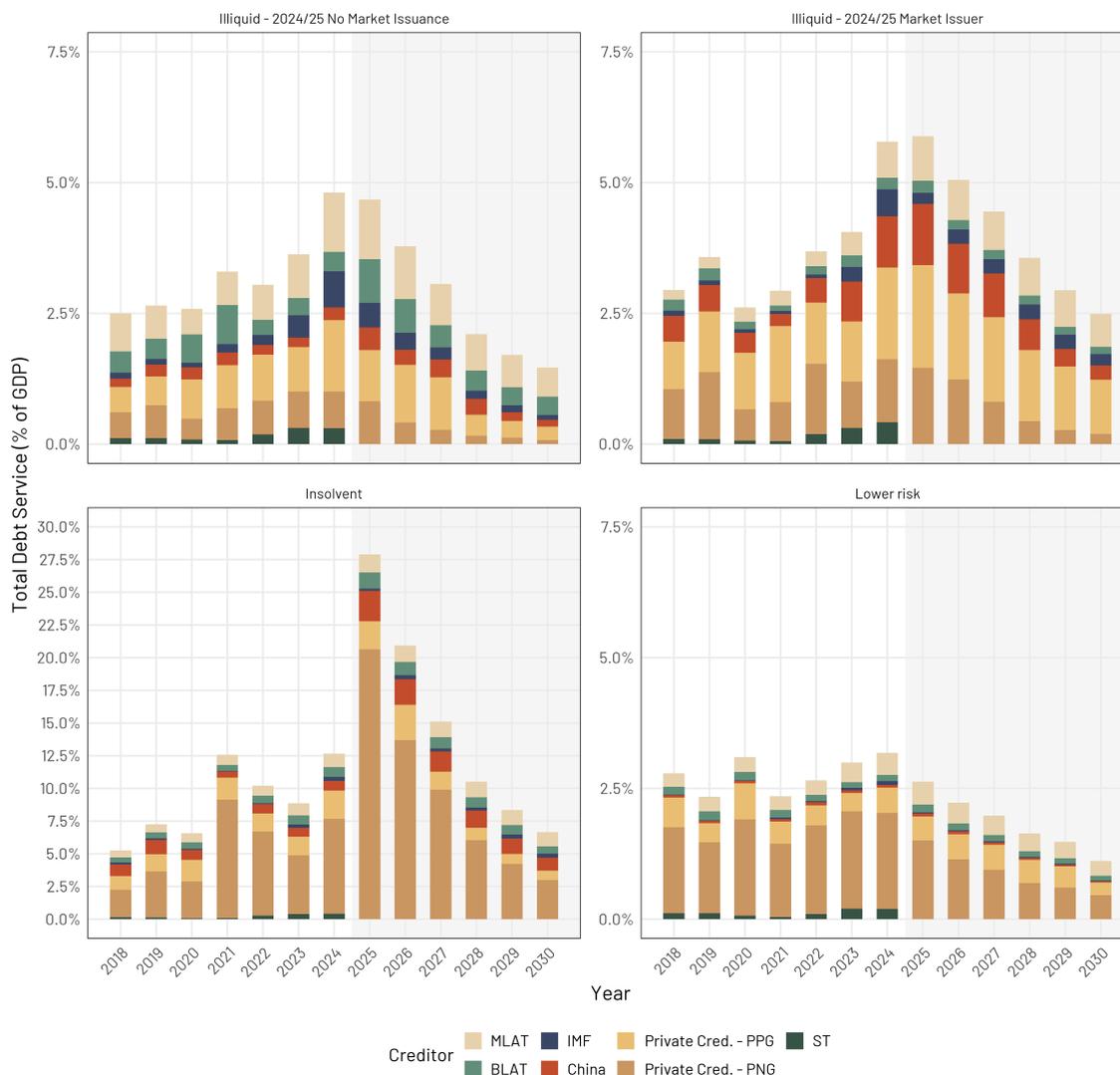
Uneven recovery in liquidity access will continue to present a challenge to LLMICs, as they collectively face a wall of short-term debt repayments. Many LLMICs face repayment walls, reflecting high repayment obligations on large loans contracted in the past decade.³ Figure 2 shows historical and anticipated aggregate servicing obligations for LLMICs' debt by creditor type, for loans issued up to 2024, expressed as a percentage of group GDP. There is significant heterogeneity among the four debt groups in terms of both the magnitude of debt servicing obligations due, and the composition thereof.

- **For all groups, the magnitude of total debt servicing is expected to rise even further than the elevated levels of the past few years.** For illiquid countries, 2025 and 2026 payments are set to peak at around 5% GDP, nearly double their level over the past 5 years. For those with poor market access, these peaks represent imminent refinancing risks if they cannot secure new inflows soon, while those with market access will find it easier to cover short-term liquidity gaps with fresh inflows. Debt servicing for insolvent countries is expected to more than double, to over 20% of GDP. And in contrast, for lower risk countries, debt service is expected to remain contained at just over 3%.
- **The creditor composition of anticipated debt servicing costs also differs significantly across groups.** For illiquid LLMICs with market access, obligations are owed to a mixture of private and official creditors, with China representing a greater share of servicing obligations than ever before in 2025. For those with poor market access, debt servicing obligations are necessarily concentrated in the official sector. Private non-guaranteed obligations - typically the most inflexible - represent the bulk of overall servicing costs for both insolvent and lower-risk

³ Based on available bond-level data, the latter is a primary concern for Egypt, with total debt service obligations set to reach USD 10 billion in 2026, i.e. 15% of general government revenue. Following this is a cumulative USD 11 billion due across 2027 and 2028.

LLMICs. For insolvent countries in particular, obligations to Chinese creditors are the highest of any group relative to GDP at almost 2.5% in 2025, and the magnitude of such obligations are still set to remain larger even in 2030 than in almost any other year up to 2024.

Figure 2: Total Debt Service by Creditor Type for LLMICs by DSA Status



Source: World Bank IDS (2025a), IMF WEO (2025b), Finance for Development Lab. Note: Not a projection. Data for 2025 onwards show only total debt service obligations for bonds issued up to 2024. Future values are likely to change with new debt taken on in 2025 onwards. Pakistan is omitted from the 'Illiquid - 2024/25 No Market Issuance' category due to missing GDP data.

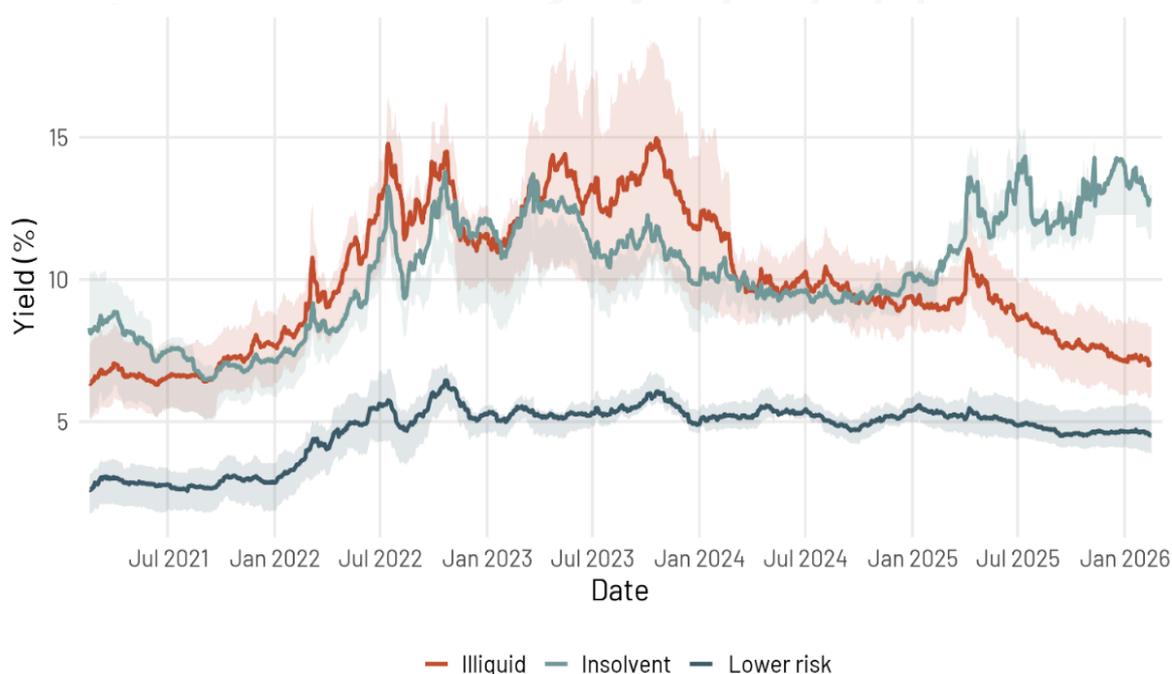
4. Market access is back: at what cost?

4.1 Newly liquidity comes at a steep price

The return to positive net transfers in some markets masks a reassessment of risk appetites by global investors. Baseline global borrowing costs are up since ten-year US Treasury yields surged across 2022-2023, surpassing pre-COVID levels and remaining relatively high throughout 2024, averaging over 4.2% compared to 2.2% in 2019. New issuances by LLMICs in 2024, with a high risk premium, were therefore characterised by continually high average coupons of 7-10%, significantly above pre-2022 levels. While securing immediate cash flows for short-term obligations was necessary, it has come at the cost of expensive future medium- and long-term interest burdens. The full list of LLMICs with market issuances and their weighted-average coupons can be found at the end of this short note, in the Annex.

For the most vulnerable markets, capital costs were high and continued to be so in 2025. In 2025, on average, LLMICs saw a decline in bond yields from over 10% to around 7%. But they remained well above that of upper-middle-income countries, which fell to just over 5% in 2025. One reason for this large gap reflects added riskiness due to agency costs connected to the composition of their external debt – due in particular to highly heterogeneous creditors, and to a growing share of senior debt (Diwan and Harnoy-Vannier, 2024). As shown in Figure 3, countries at risk of insolvency, for their part, consistently faced much higher yields than their lower-risk counterparts, now ranging from 10% to 12% on average, as the bond market views their debt trajectory as potentially unsustainable.

Figure 3: Bond Yield (Mean) - LLMICs with Bonds

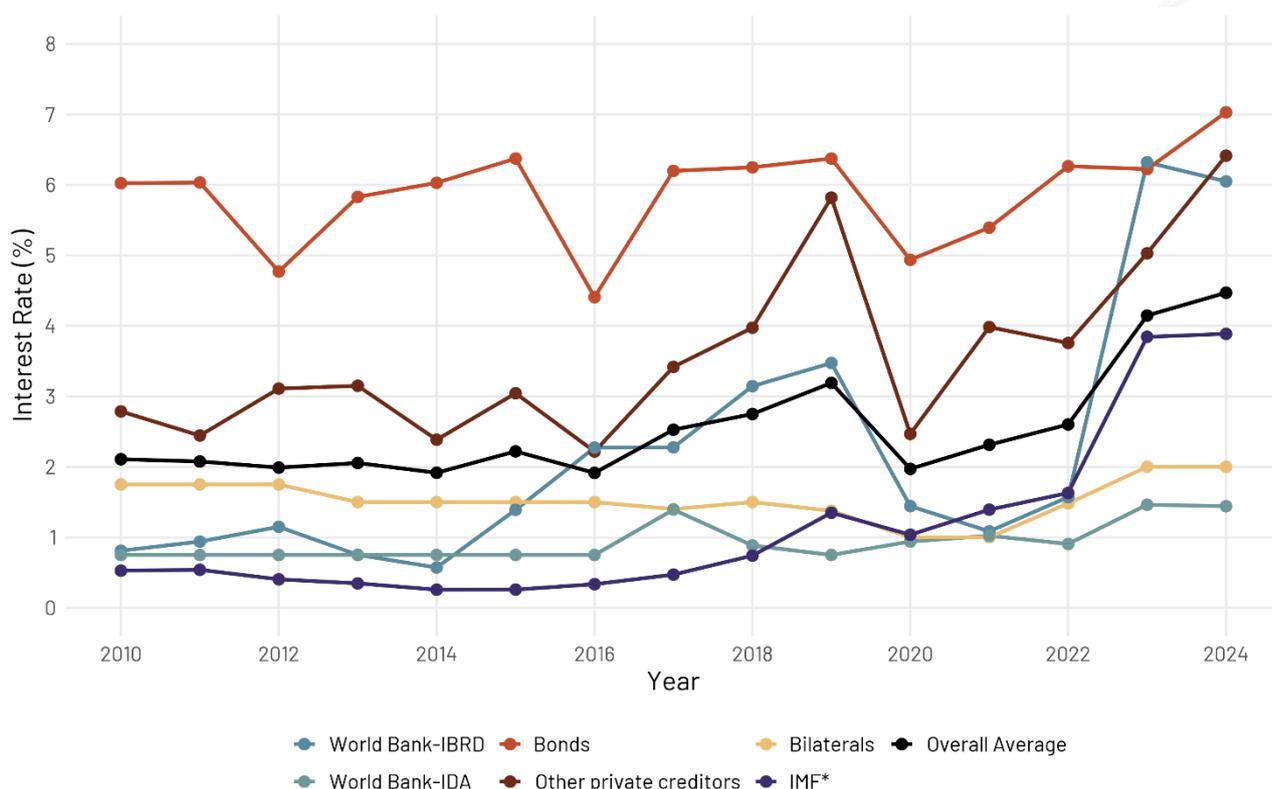


Source: Refinitiv, Finance for Development Lab. Shaded area indicates interquartile range.

Costs have risen across the entire creditor spectrum, not just private capital markets, as even concessional financing has seen terms tighten. As shown in Figure 4, bond markets are still the most expensive source of finance, closely followed by other private creditors. At the same time, official lending is no longer the low-cost alternative it once was: the cost of borrowing for LLMICs surged in 2023 for all official creditor categories, and these costs have all but stabilised in 2024 at their new historic highs. Most striking is the cost of borrowing from the IBRD and the IMF, which, across 2022-2023, tripled and doubled, respectively, effectively converging to bond market rates. Even concessional funding from IDA and bilateral creditors (the majority of whom are parties of the Paris Club group) has increased to about 1.5% and 2% respectively. Consequently, the overall average interest rate across these groups has climbed to 4.5% in 2024 from 4.1% in 2023, up from 2.6% in 2022.

Nevertheless, many LLMICs have continued to take new loans despite these high costs, prioritising short-term cash over medium-term considerations of fiscal burdens. For these countries, the immediate pressure to roll over maturing debt and minimise cuts in public services outweighs the risks of future insolvency. But without a rapid return to cheaper borrowing rates or a rebound in growth (also, of government revenues, and/or exports), these LLMICs face an increasingly narrow path back to both regaining liquidity and achieving solvency in the future.

Figure 4: Interest Rates Charged on New Loans (Median) by Creditor Group, LLMICs



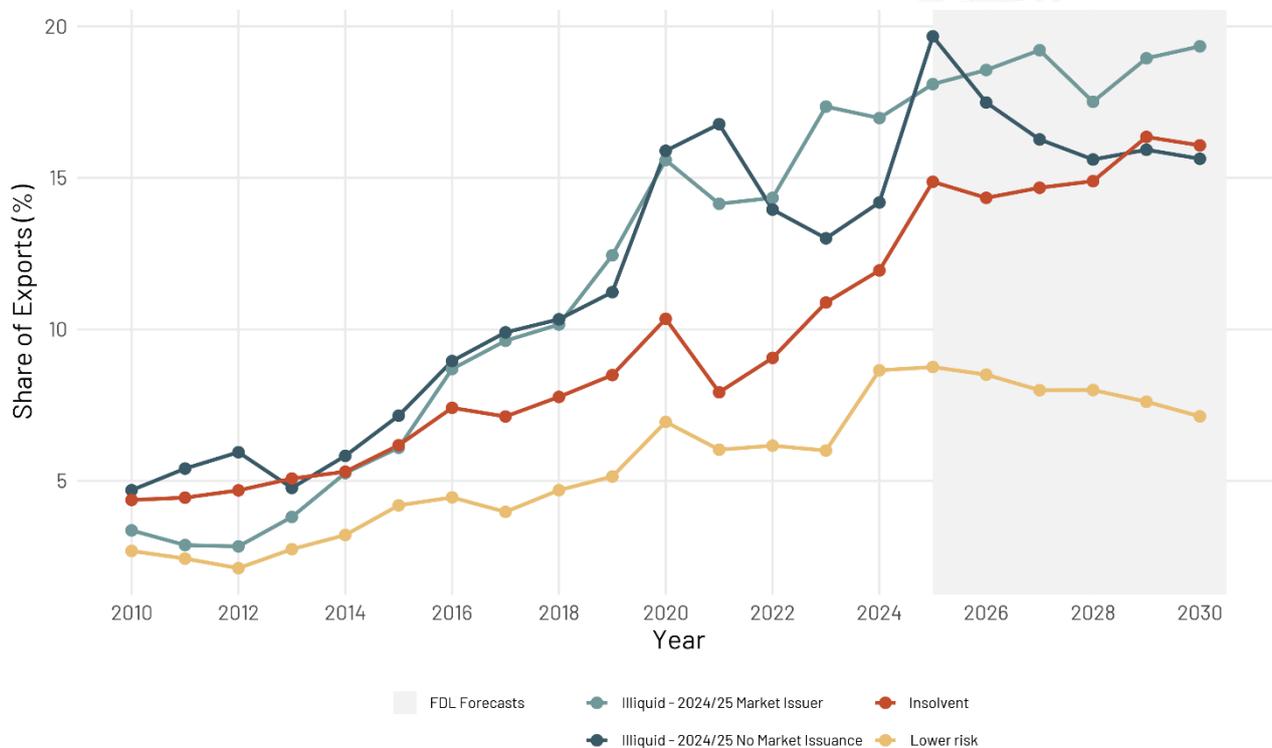
Source: World Bank IDS (2025a). *IMF: implied rate from charges on credit and SDR allocations. 'Overall Average' is mean of other creditor groups.

4.2 From liquidity bridge to solvency risk

Fresh capital raised through 2024 issuances has served its primary purpose: acting as a bridge over immediate liquidity gaps. For illiquid countries that successfully issued Eurobonds in 2024, this has helped improve short-term cash buffers for immediate obligations due in 2024 and 2025, and also for rollover capacity with regard to the repayment peaks expected across 2026, allowing net transfers to be slightly positive. Yet high coupons attached to these new bonds mean that debt service will rise in the medium term. This is the reason why the South African G20 focused on the cost of capital as a key constraint to development (African Expert Panel, 2025) and it could become especially damaging as the war in Iran could hit growth prospects of oil importers.

The net effect – for 2024 issuers and those returning to markets in 2025 alike – is a trade-off in which short-term pressure is alleviated at the expense of worsened medium-term liquidity and solvency metrics. Figure 5 shows median general government debt servicing costs as a share of exports for LLMICS with historical data up to 2024 and FDL projections from 2025-2030. For illiquid countries that issued foreign-currency bonds in 2024 and 2025, the median debt service-to-exports ratio is set to plateau at around 17-18%. Export earnings may increasingly be diverted to service obligations, at the cost of fewer imports and deteriorating fiscal health. For comparison, lower-risk LLMIC servicing costs are expected to remain around a much more manageable 6-8% of exports. Refinancing those high levels of debt service requires a reduction in the cost of debt in the future.

Figure 5: General Government Debt Service (% Exports - Median) for LLMICs by Debt Sustainability Status



Source: World Bank IDS (2025a), Finance for Development Lab

5. Changing creditor structure and seniority effects

5.1 Retrenchment by private and Chinese creditors continues

Negative net transfers from private creditors and China are now widespread across LLMICs, with multilateral inflows increasingly absorbed by debt service to these legacy creditors rather than reaching productive investment. Examining net transfer compositions by creditor type reveals that private creditors – both for publicly-guaranteed (PPG) and non-guaranteed debt (PNG) – are the main sources of negative net transfers across illiquid and insolvent countries, consistent with patterns documented by Diwan & Harnoys-Vannier (2024a). Lower-risk countries are the exception, as they maintain positive net transfers from private sources. In total, 46 LLMICs⁴ display negative net transfers from private creditors in either the guaranteed or non-guaranteed sectors, with Sub-Saharan African countries representing half of this group, followed by East Asian and Middle Eastern LLMICs. Crucially, the analysis reveals that countries without access to international bond markets face even more acute vulnerability: they are shut out not only from Eurobond issuance but also from fresh money from other private creditors.

After serving as a key creditor over the past decade, China has intensified its retrenchment, displaying negative net transfers across all income groups. Debt service on past obligations – to both official and private Chinese creditors – now exceeds new disbursements by USD 19 billion across all low- and middle-income countries, up sharply from USD 8 billion in 2023. Among 76 LLMICs⁵, 50 display negative net transfers with China, of which 38% are Sub-Saharan African (SSA) countries. In the SSA region specifically, 70% of low- and lower-middle-income countries now remit more in debt service to China than they receive in new disbursements. This marks a structural shift – from China as a net provider of external financing to China as a net recipient of debt service flows – with particularly acute consequences for previously China-dependent borrowers, whose reduced access to new Chinese financing is not yet fully offset by alternative sources (Horn et al., 2025).⁶

These negative net transfers to private creditors and to Chinese lenders are largely financed by inflows from other creditors, giving rise to development finance leakages: concessional or multilateral financing flows that, rather than reaching intended recipients for new investment, are effectively intermediated to service legacy obligations to prior creditors. This phenomenon hurts developing countries by denying them the possibility to recover and grow out of their debt problems; it hurts aid agencies by significantly reducing their aid effectiveness; and it also hurts their creditors by pushing solvent, illiquid countries towards insolvency. This inefficient situation reflects the lack of coordination among creditors and the inadequacy of the global financial safety net (Diwan and Harnoys-Vannier, 2024).

Figure 6 highlights how these leakages exist across all groups. This situation is particularly acute for illiquid countries without market-access. These countries are uniquely exposed: they are the only group for which net transfers from private creditors on publicly guaranteed debt are negative, whereas

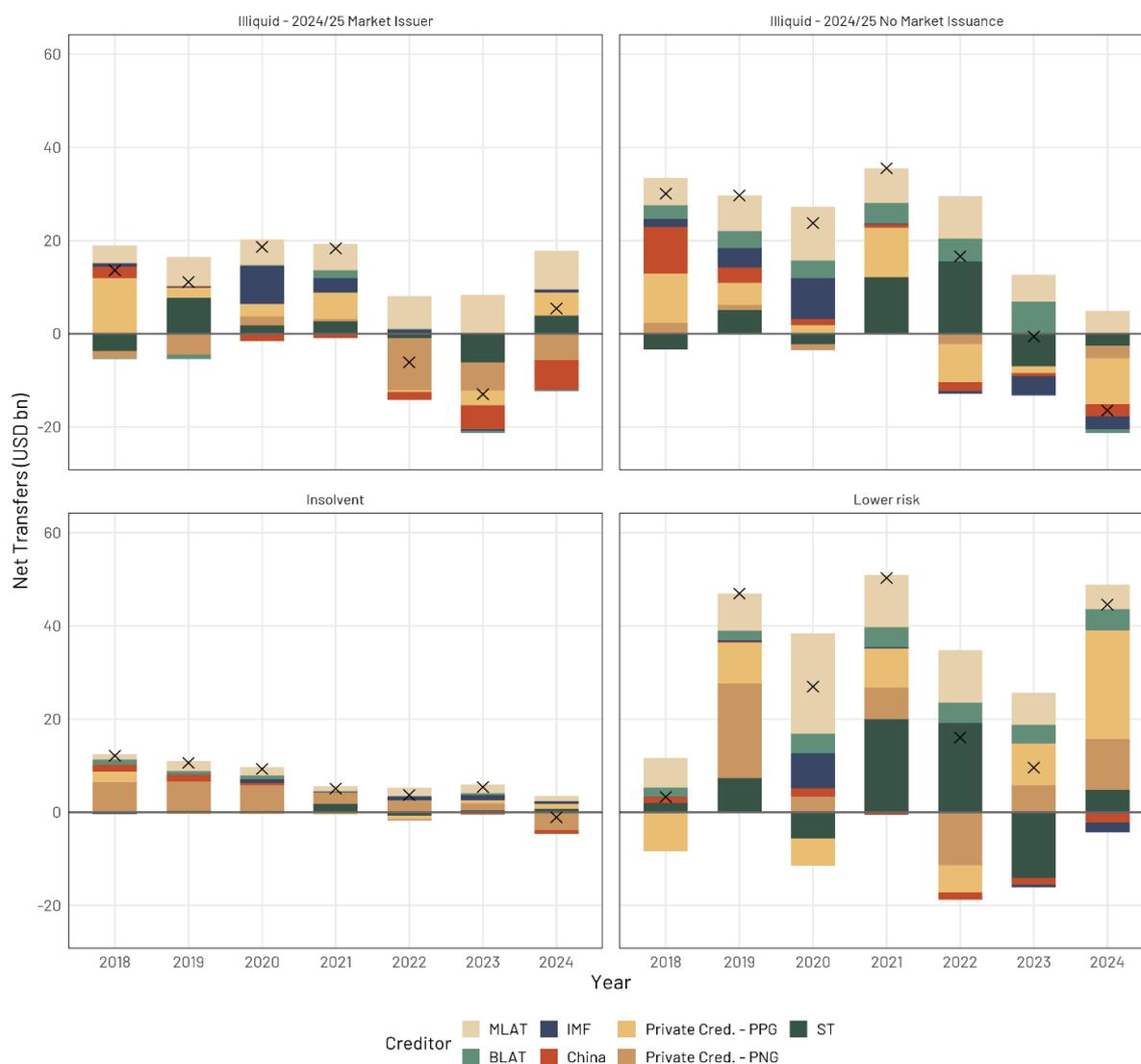
⁴⁴ Also including LLMICs not included in the DSA model because of lack of data. See table in Annex 1.

⁵ *ibid*

⁶ In the latest 5 years plan, Chinese authorities justify the negative net transfers on debt as the end of a first phase of Chinese investment in infrastructure in LLMICs, to be followed by a deepening of FDI and trade relations.

for other categories, only non-publicly guaranteed private debt shows negative transfers. Moreover, the two groups of illiquid countries have particularly large outflows to China. Of the USD 12.5 billion aggregate outflow to China from LLMICs, illiquid assets accounted for USD 9 billion. Hence, in most cases, the positive net transfers from multilateral and bilateral lenders (excluding China) were not sufficient to cover the aggregate negative net transfer position with China and private creditors. In 2024, 42 LLMICs (and 18 UMICs) used multilateral inflows to service legacy obligations to Chinese (both private and official creditors) and private creditors (both public and publicly guaranteed debt, and non-publicly guaranteed debt). In these countries, multilateral resources intended to support development are instead absorbed by debt service on earlier, higher-cost borrowing.

Figure 6: Net Transfers by Creditor Type for LLMICs



Source: World Bank IDS (2025a), Finance for Development Lab

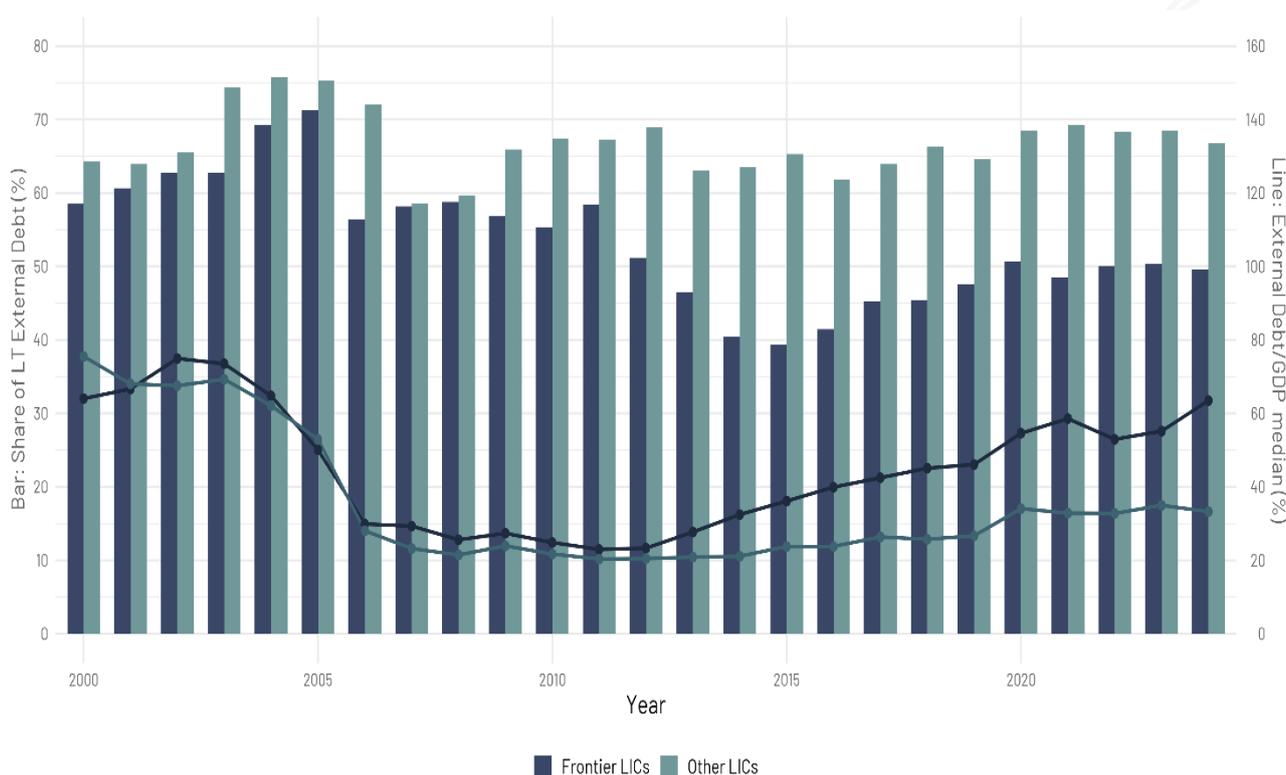
5.2 Seniority, and the double-hit of multilateral leakages

The shift in creditor composition documented above has restructured not just who holds developing country debt, but the seniority hierarchy that governs who gets paid first – and at whose expense.

As private and Chinese creditors have withdrawn and multilateral institutions have expanded their footprint, the seniority profile of LLMIC external debt has shifted materially – with consequences that extend beyond leakages to the broader architecture of debt sustainability, private market access, and burden-sharing in restructurings. IDS data reflects this seniorisation: multilateral institutions and the IMF have increased their share to a median 43% of total long-term external debt in LLMICs – up from 35% in 2019. Because multilaterals and the IMF enjoy de facto preferred creditor status, their claims are paid first in defaults or restructurings, creating a two-tier creditor system where senior claims are ring-fenced while junior private creditors face disproportionate losses. This dynamic can create a doom loop: senior debt leaks out instead of helping debtor countries invest and grow, and junior debts become riskier, even as total debt does not grow. Both effects make it harder for these countries to come back to the market.

A divide in senior debt trajectories has been building since the end of the Global Financial Crisis, between low-income countries with and without access to international capital markets. Figure 7 shows the median share of senior debt (IMF and multilateral lenders) across two groups of low-income countries as defined by the IMF, classifying 17 of them as Frontier Markets, based on their access to international market finance (IMF, 2025a).⁷

Figure 7: LICs Share of Senior Debt (IMF + Multilaterals) & Debt/GDP Median



Source: World Bank IDS (2025a), IMF WEO (2025b).

⁷ Countries eligible for PRG facilities (68 in total); see Annex I for a full list (IMF, 2025a). Frontier Market countries include: Benin, Cameroon, Republic of Congo, Côte d'Ivoire, Ethiopia, Ghana, Honduras, Kenya, Mozambique, Papua New Guinea, Rwanda, Senegal, Tajikistan, Fed. States of Tanzania, Togo, Uzbekistan, Zambia

Senior debt reached close to 70% in 2024 for countries with no market access, while it remained below 50% for Frontier Markets. But at the same time, frontier markets carry a much higher debt-to-GDP ratio than their counterparts – above 62% compared to 33% of GDP – highlighting their greater exposure to solvency risks. In contrast, other low-income countries face greater liquidity risks, as the higher share of senior debt in their creditor structure discourages private creditors from providing the financing needed to meet service obligations.

Debt seniorisation, therefore, carries ambiguous consequences. It stabilises short-term liquidity for the most vulnerable LLMICs via multilateral borrowing that might otherwise be unavailable, averting immediate collapse. Yet it entrenches a two-tier creditor system, crowds out long-term private market participation, biases restructurings toward uneven burden-sharing, and risks prolonged market exclusion. Krahnke (2023) demonstrates that while smaller IMF programs catalyse private flows, large ones reverse this effect due to crowding-out: private creditors anticipate higher losses in restructurings where preferred creditors are ring-fenced, prompting them to exit. Diwan & Harnoys-Vannier (2025) and Liu et al. (2023) show that while the provision of senior IFIs loans initially improves market access because they tend to be concessional, passed a threshold, they increase country risk and lead to higher borrowing costs. In effect, when their level is already large, new senior loans have an opportunity cost: unless they allow the debtor to grow faster, they can end up hurting it.

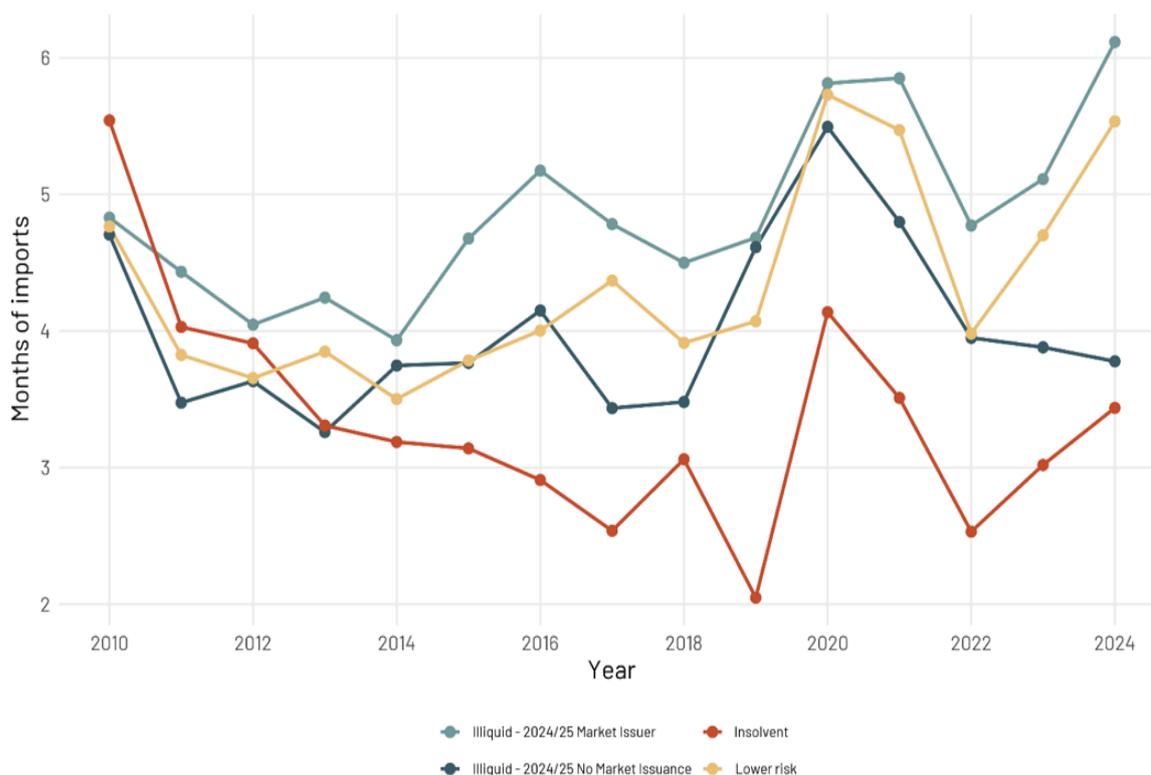
6. Mounting external vulnerabilities

6.1 Scarce foreign exchange is increasingly used to service debt obligations

Despite foreign exchange reserves staying above the IMF's three-month import cover threshold, insolvent and illiquid Eurobond-issuing countries exhibit trends that merit close monitoring. Figure 8, which illustrates reserve dynamics across DSA country groups measured as median months of import cover, highlights these shifts. Insolvent countries now sit at the critical three-month mark—leaving no buffer for shocks—while illiquid countries with no market access, though still above the threshold, have seen their median cover decline from over five months post-COVID to below four months in 2024. Hence, for illiquid countries with low market access, the concern lies less in current levels and more in the downward drift: reserves are shrinking while debt service will remain very high over the next few years, representing more than 15% of exports and with costly obligations maturing over the next two to three years. Their situation should be monitored closely. Meanwhile, lower-risk countries have rebounded strongly to roughly five months of cover, and illiquid Eurobond issuers have also begun rebuilding their reserves thanks to inflows of USD.⁸

⁸ This hides strong heterogeneity between oil exporters (such as Angola) and oil importers (such as Egypt).

Figure 8: Total Reserves as Month of Imports for LLMICs by Debt Sustainability Status

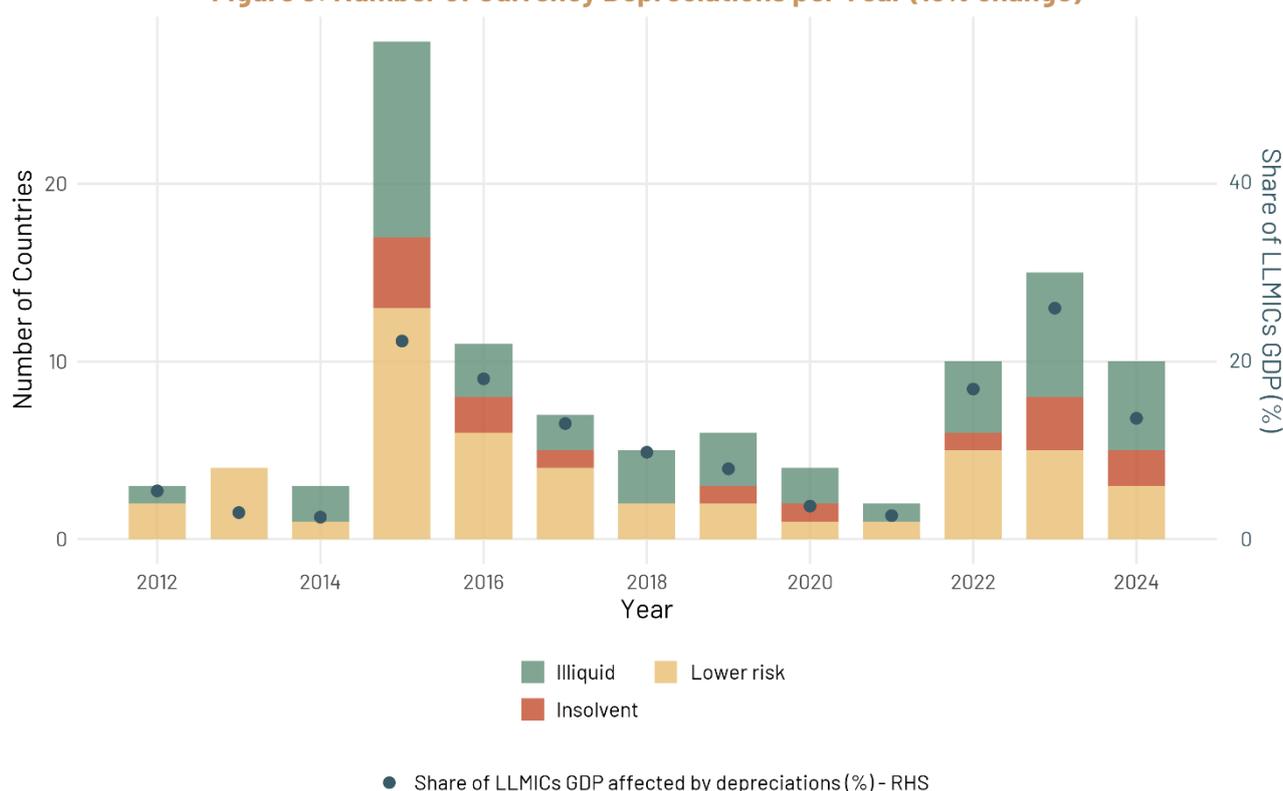


Source: World Bank World Development Indicator (2025b), Finance for Development Lab

Reserve depletion is self-reinforcing: the drawdown of the buffers needed to smooth external payments signals deteriorating creditworthiness, tightening the very access that countries need to rebuild those buffers. This feedback mechanism is well-documented: Catão & Milesi-Ferretti (2014) show that higher net foreign liabilities significantly raise the probability of external crises, especially once they exceed around 50 percent of GDP or stand more than 20 percentage points above the country’s historical average. They highlight how drawing down foreign exchange reserves to meet debt-service obligations weakens the main buffer against external shocks and can undermine investor confidence, amplifying exchange-rate volatility.

The risks carried by such razor-thin margins of reserves are also reflected in LLMICs' heightened exposure to sudden currency fluctuations, with a significant number of rapid depreciation episodes across 2022-24, especially by illiquid countries. Figure 9 shows the number of LLMICs experiencing large depreciations – defined as a fall of more than 15% against 2023 levels – with illiquid countries accounting for the largest share (5 are illiquid, 2 insolvent, 3 lower risk in 2024). Although the total count of large depreciations has slightly declined relative to 2022 and 2023, the cumulative incidence over the past three years remains high by historical standards, comparable only to the depreciations accompanying the 2014–16 commodity price collapse. Countries experiencing a depreciation shock face a higher debt servicing burden for foreign-denominated debt, and in the absence of sufficient inflows of new currency elsewhere to compensate (mainly growth in exports), face an immediately worsened net external position.

Figure 9: Number of Currency Depreciations per Year (15% change)



Source: World Bank World Development Indicator (2025b), Finance for Development Lab

6.2 Debt overhang deters future capital flows

Elevated debt burdens and rising perceived default risk typically lead to debt overhang dynamics in illiquid and insolvent LLMICs. This deters new private capital inflows and raises required returns (Das et al., 2010; Tanna et al., 2018), thereby compounding external vulnerabilities. As the probability of costly restructurings and fiscal consolidation rises, expected returns on new investment fall: both portfolio flows and FDI contract, the former retracts sharply as short-term investors reprice rollover risk, and the latter falls as long-horizon investors discount growth prospects against anticipated fiscal drag (Tanna et al., 2018). This capital retrenchment feeds directly back into the reserve and currency pressures already identified: portfolio outflows intensify exchange rate depreciation, further raising the domestic-currency cost of foreign debt service and tightening the doom loop described above.

While debt overhang similarly impairs the ability to roll over debt, raising the odds of restructuring or arrears episodes that further deepen market exclusion, insolvent and illiquid countries differ fundamentally in their underlying causes. For illiquid-but-solvent countries, the overhang arises from perceived rather than actual insolvency: rollover fears and financing gaps deter capital inflows, even when the debt trajectory remains sustainable – if only repayment walls could be smoothed over time. Here, multilateral support and creditor coordination can stabilize investor expectations by addressing short-term liquidity pressures—without necessitating face-value debt reduction. For genuinely insolvent countries, however, liquidity provision alone cannot restore confidence, as debt overhang persistently elevates sovereign risk, depresses credit ratings, and deters foreign investment, regardless of short-term stabilization measures (Tanna et al., 2018). Only credible debt relief can break this cycle. Delays in restructuring further exacerbate costs—prolonging market exclusion, suppressing investment, and weakening the institutional capacity required to implement eventual agreements—

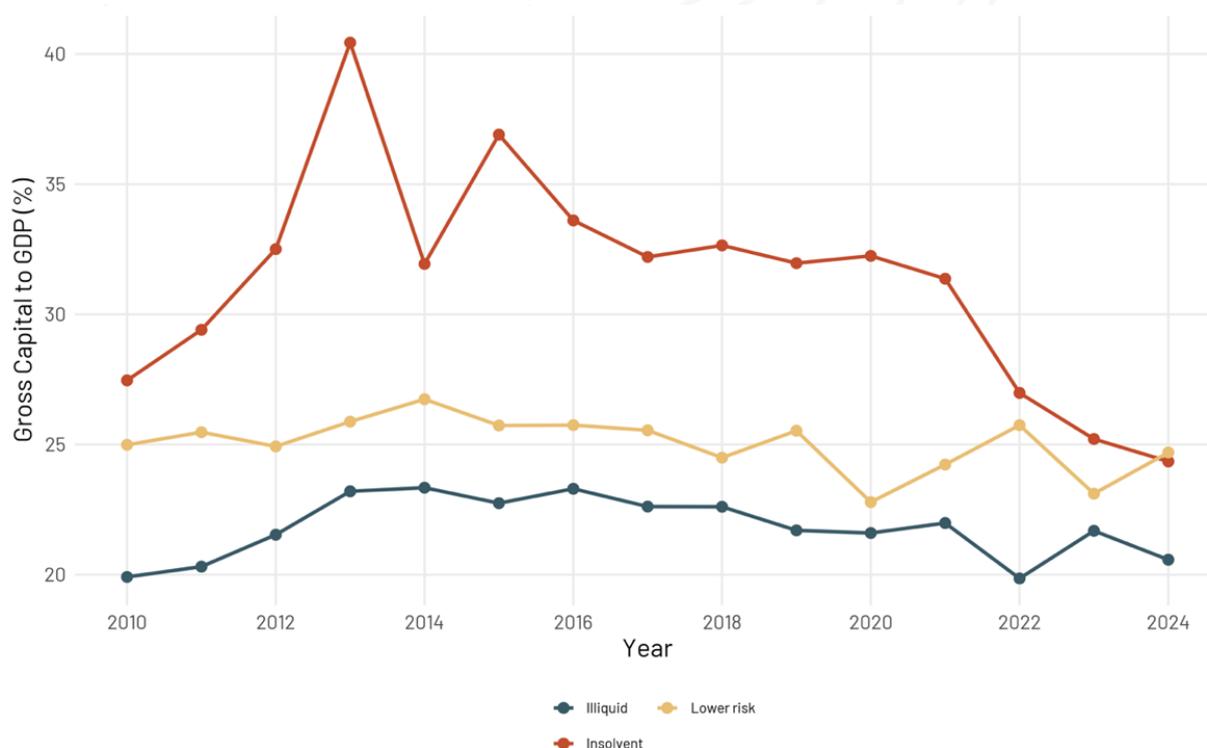
making timely debt resolution the critical policy priority for the most distressed low- and lower-middle-income countries (LLMICs). Admittedly, there is a grey zone between illiquidity and insolvency, complicating decision-making and often leading to the “too-little-too-late” phenomenon.

6.3 Impact on investment and growth

The consequences of low flows of capital to illiquid countries extend beyond the immediate fiscal constraint and threaten long-term growth. These countries have the potential to grow significantly faster if their financing constraints were eased. Their median GDP growth rate averaged 6% between 2015 and 2019, but it has already fallen to below 4% and is likely to decline further in the absence of renewed support for growth-enhancing investment. As shown in Figure 10, investment levels have already contracted sharply, and especially so in the case of illiquid countries.

The inability of illiquid countries to grow out of their financial tightness is especially disturbing when this is due to the leakage of multilateral inflows. This is because such leakages not only prevent the deployment of these funds for investment and to boost buffers, but also add to senior and inflexible debt, reducing access to commercial flows even further. The dynamics revealed by the 2024 IDS data suggest that while the illiquid countries with renewed market access may choose to sacrifice some current growth opportunities for the sake of regaining fuller market access over time, the same bet does not make sense for countries with no prospect of regaining market access anytime soon. In these non-market access countries, the phenomenon is now sufficiently widespread to warrant a structural policy response rather than case-by-case debt-relief negotiations. Reducing these leakages requires forcing creditor coordination, possibly through the G20-Paris Club *Common Framework* – but ideally through a simplified, rapid procedure.

Figure 10: Investment in LLMICs by Debt Profiles - Median



Source: World Bank World Development Indicator (2025b)

7. Short-term outlook and policy implications

This short note highlights how focusing only on the aggregate picture of stabilising debt-to-GDP ratios and the return of positive net transfers for LLMICs hides significant heterogeneous vulnerabilities behind a tentative overall recovery. As highlighted by Indermit Gill, Chief Economist at the World Bank, progress remains modest, and debt is still building in pernicious ways (The World Bank, 2025a). Illiquid, insolvent, and lower-risk countries each face different circumstances and constraints that must be navigated to achieve liquidity and solvency stability. Borrowing costs have declined in 2025, allowing more issuers to come back to markets, even as costs declined, but remained substantial. In 2026, this could come to a stop, as geopolitical uncertainty once again could shut frontier markets out.

For the LLMICs for whom insolvency risk remains the primary issue, progress requires improvements in the way the Common Framework works. Faster and growth-enhancing restructuring requires improvements in the negotiation processes and fairer burden sharing in the form of clearer rules for establishing comparable treatment among all classes of creditors, particularly private bondholders, non-bonded private creditors, bilateral Paris Club creditors, and parties outside the Paris Club, like China.

Liquidity constraints have abated in 2025 and early 2026, but are likely to revert to very acute geopolitical tensions. Affected LLMICs need adequate support to navigate imminent liquidity crests and limit otherwise-avoidable defaults. Eurobond issuances have provided a temporary liquidity for some, affording them some respite, but the higher interest rates demanded of all creditor types (even multilateral and concessional bilateral) translate into large future servicing costs that leave them more exposed to global financial conditions and external shocks, like further hits to US Treasury yields. The goal for these countries is to improve their growth prospects sufficiently to be able to come back to the market voluntarily – this involves stronger reforms and more official flows.

There is a large group of (typically poorer) illiquid LLMICs that have little chance of regaining market access in the medium term, and which require a different treatment. These countries suffer from a large leakage of IFIs' support and a rise in the share of senior debt. Diwan et al. (2024) have proposed that these countries require a concerted debt restructuring. A requirement for such flow relief for “grey countries” can be included in IMF programs, but it rarely is, because of the stigma attached to default. Ways to deal with this include pre-emptive restructuring within a soft window of the Common Framework. In order to avoid discretionary decisions, Diwan & Harnoys-Vannier (2025) propose that flow relief be automatically required as a condition for IFI disbursement for illiquid (“grey”) countries where senior debt exceeds a threshold, such as 60%, in order to improve growth prospects by imposing some level of burden sharing on all creditors.

Finally, the debt flow dynamics described here must be viewed within the broader context of capital flows for development. While lower-risk countries rely more on remittances and net foreign direct investment (FDI), insolvent and illiquid countries depend heavily on external debt net transfers and grants for growth financing. Negative net transfers in these countries thus directly translate into lost investment opportunities, underscoring the urgency of addressing their financing challenges.

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Annex

1. FDL debt sustainability analysis classifications of LLMICs

Illiquid		Lower-Risk	
Bangladesh	Tunisia	Burkina Faso	Myanmar
Central African Republic		Burundi	Nepal
Comoros	2024/25 Market Issuers	Cambodia	Nicaragua
Egypt, Arab Rep.	Angola	Chad	Rwanda
Ethiopia	Benin	Congo, Dem. Rep.	São Tomé and Príncipe
Gambia, The	Cameroon	Eswatini	Sierra Leone
Guinea	Côte d'Ivoire	Haiti	Solomon Islands
Niger	Ghana	India	Tajikistan
Pakistan	Jordan	Kyrgyz Republic	Uganda
Papua New Guinea	Kenya	Lesotho	Uzbekistan
Tanzania	Nigeria	Liberia	Vanuatu
Insolvent		Madagascar	Vietnam
Bhutan	2024/25 Market Issuers	Malawi	
Djibouti	Congo, Rep.	Mali	2024/25 Market Issuers
Guinea-Bissau	Lao PDR	Mauritania	Honduras
Mozambique	Senegal		Morocco
	Zambia		Philippines

Note: 'Insolvent' refers to countries facing an insolvency breach in 2024; 'illiquid' refers to countries not insolvent that are forecast to face a liquidity breach between 2025-2030; lower-risk are those defined neither as insolvent or illiquid. 'Market access' refers to countries that issued foreign currency bonds in international markets in 2024/25; 'no market access' refers to countries that were unable or unwilling to do so. Includes only low- and lower-middle-income countries. Omitted due to incomplete data: Afghanistan, Eritrea, Korea (Dem. People's Rep.), Somalia, South Sudan, Sudan, Syrian Arab Rep., Togo, Yemen (Rep.), Bolivia, Kiribati, Lebanon, Micronesia (Fed. Sts.), Namibia, Sri Lanka, Timor-Leste, Zimbabwe.

2. Market issuances by LLMICs in 2024 and 2025

Illiquid	Total issuance, USD	Coupon, weighted avg.	Insolvent	Total issuance, USD	Coupon, weighted avg.
Angola	1,750,000,000	9.51	Congo, Rep.	670,000,000	9.88
Benin	1,250,000,000	8.13	Lao PDR	300,000,000	11.25
Cameroon	550,000,000	9.50	Senegal	750,000,000	7.75
Côte d'Ivoire	4,350,000,000	8.02	Lower-risk	Total issuance, USD	Coupon, weighted avg.
Jordan	700,000,000	5.75			
Kenya	4,500,000,000	9.20	Honduras	700,000,000	8.63
Nigeria	4,547,465,000	9.48	Morocco	2,200,000,000	4.36
			Philippines	7,790,000,000	5.07

Note: Ghana, Zambia and Sri Lanka are not included in the table as their issuances in 2024 & 2025 are linked to their debt restructuring post default.

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