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# Updates on the Bridge to Climate Action proposal

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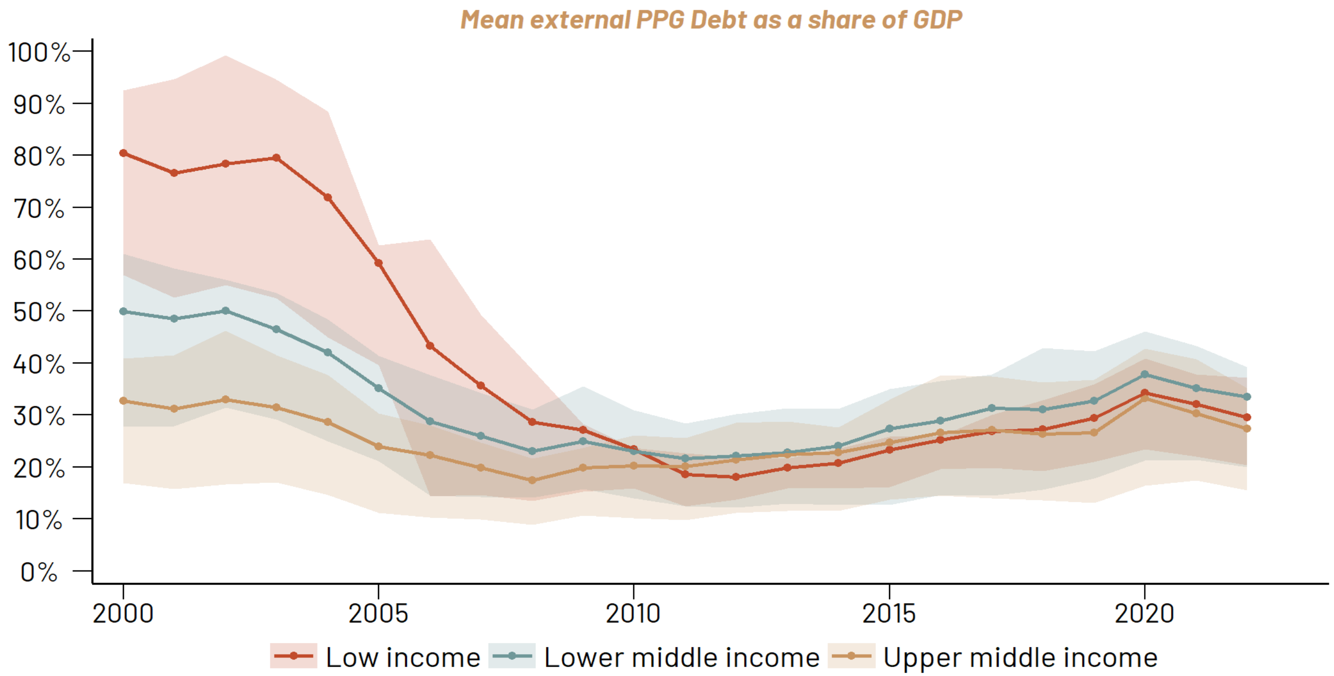
# External debt levels in LICs and LMICs still much below their pre-HIPIC levels

Sources: World Bank International Debt Statistics for debt

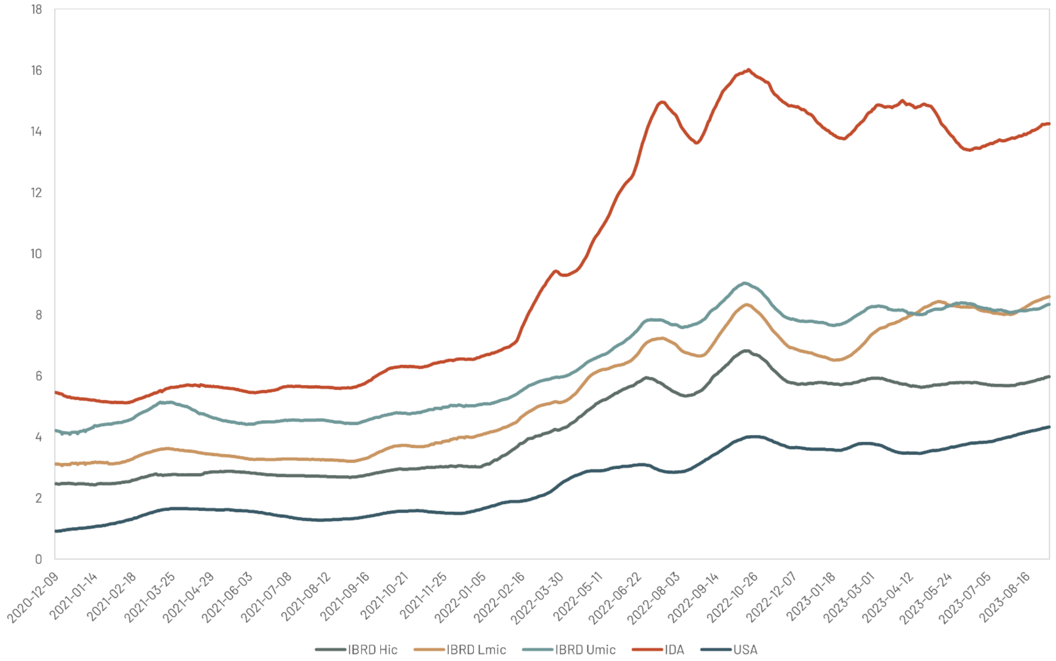
In 2023, only one country, Ethiopia, defaulted.



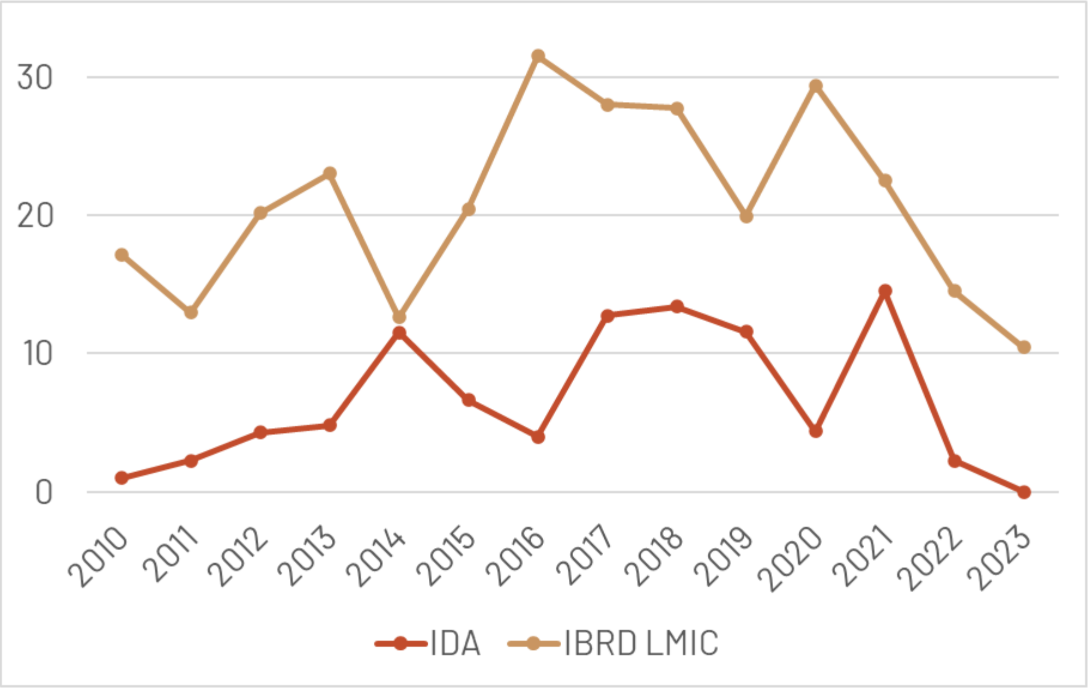

| 2022 PPG debt stock, total and creditor share | | | | |
|---|---|---|---|---|
| | UMICs (ex-China) | LMICs (ex-Ukraine) | LICs | Sub-Saharan Africa |
| Total US$ billion | 1636.8 | 1466.9 | 165.4 | 547.9 |
| IFIs share | 28.3 | 40.1 | 57.0 | 41.7 |
| Bilateral share (ex-China) | 4.2 | 13.7 | 16.5 | 8.0 |
| China share (public and private) | 1.9 | 8.5 | 15.0 | 14.6 |
| Private share (ex-China) | 65.7 | 37.6 | 11.5 | 35.6 |

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

## Rising yields

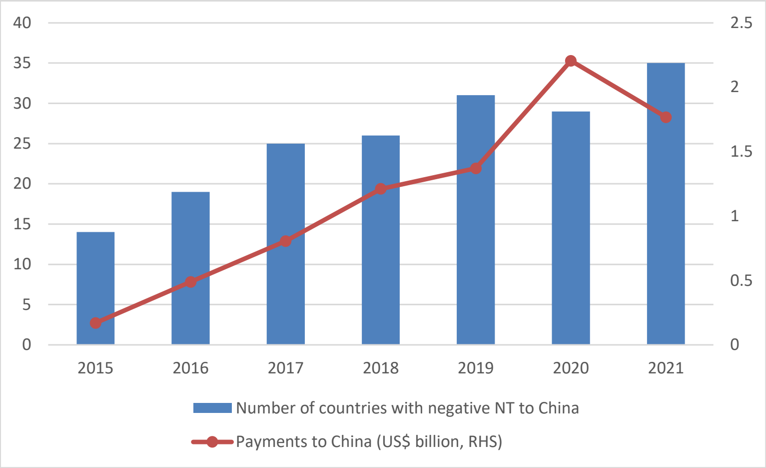


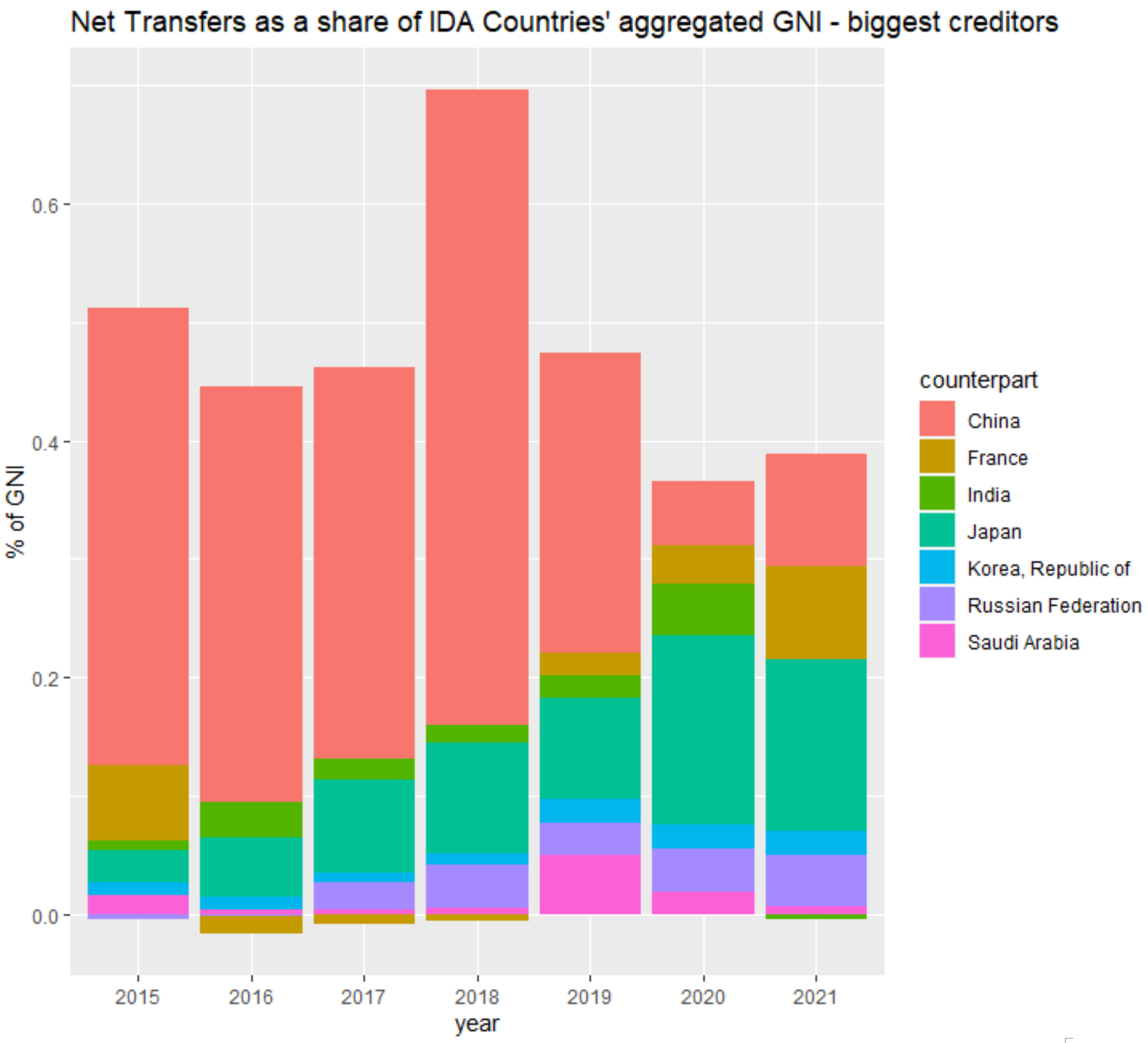

## Leading to Eurobond closing since 2023 – now starting to reopen?



# At the same time, China's dwindling role

Number of countries with negative net transfer to China



# Implications of higher debt service

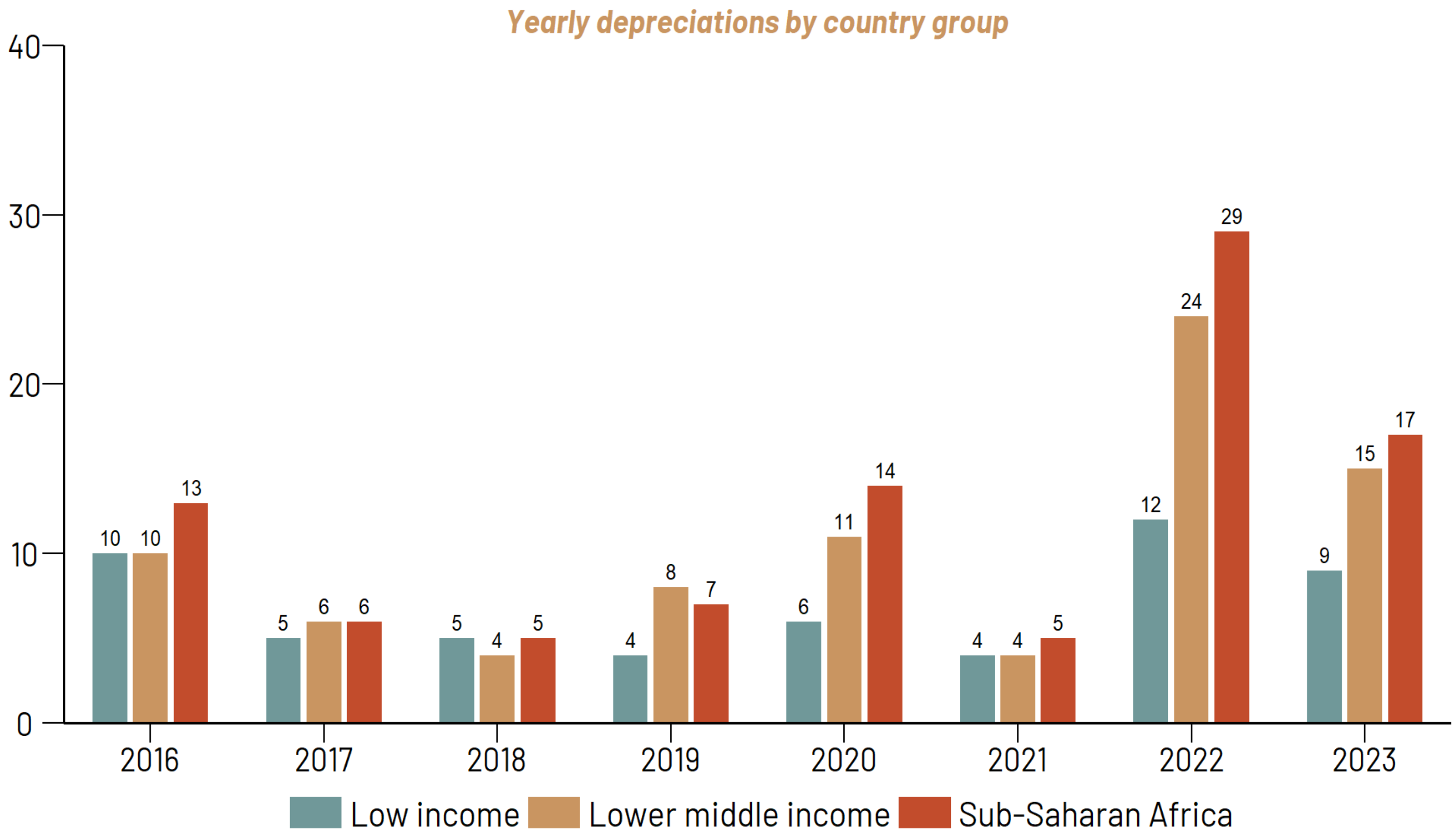
- Aid effectiveness down
- 2023 most likely worse because of interest rate hikes, closing of bond market
- Silent development crisis, & inability to start the green transition
- Pressure on primary balance and exchange rates

| | 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: Number of countries that had to depreciate their currencies shot up in 2022 & 2023

Number of countries with more than 10% depreciation

Sources: IMF World Economic Outlook



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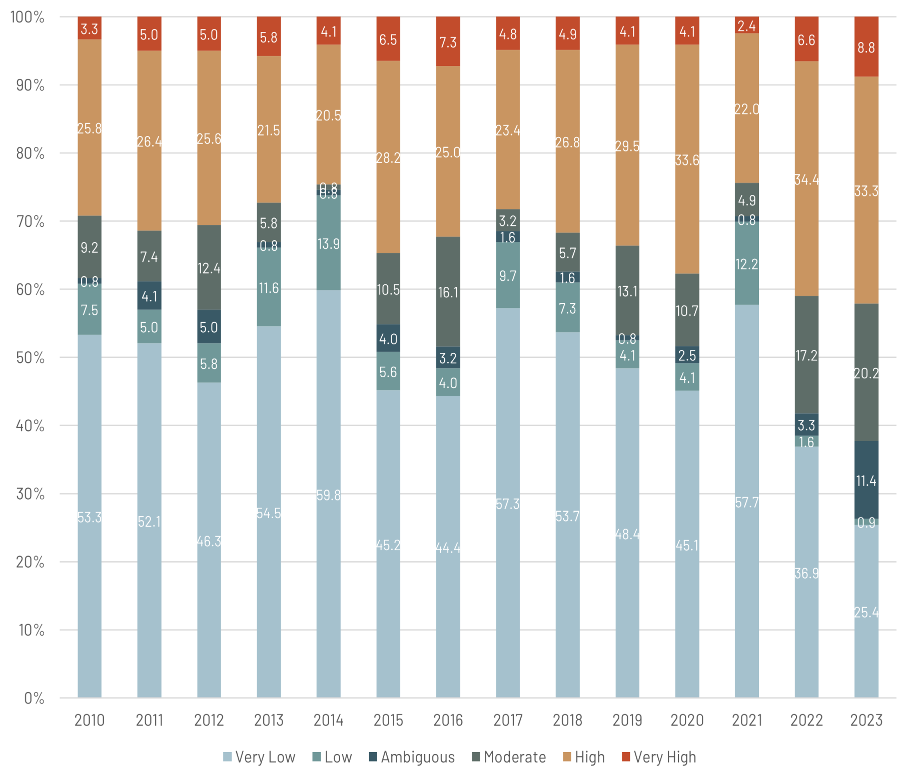
# Are DCs illiquid, or insolvent?




# World Bank / IMF Thresholds

| Debt carrying capacity (CI classification) | PV of PPG external debt in percent of | | PPG external debt service in percent of | |
|---|---|---|---|---|
| | GDP | Exports | Exports | Revenue |
| Weak | 30 | 140 | 10 | 14 |
| Medium | 40 | 180 | 15 | 18 |
| Strong | 55 | 240 | 21 | 23 |

## Illiquidity

This indicates inefficient relations between creditors

Self-fulfilling expectations

With real economy feedback loops – such as investment collapse

## Insolvency

A country is unwilling to pay back its external debts

The cost of default is smaller than the (political) cost of repayment

# We estimate that during 2023-2028, 27-34 countries will breach liquidity thresholds, and 16-19 will get insolvent

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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

## Deteriorating liquidity:

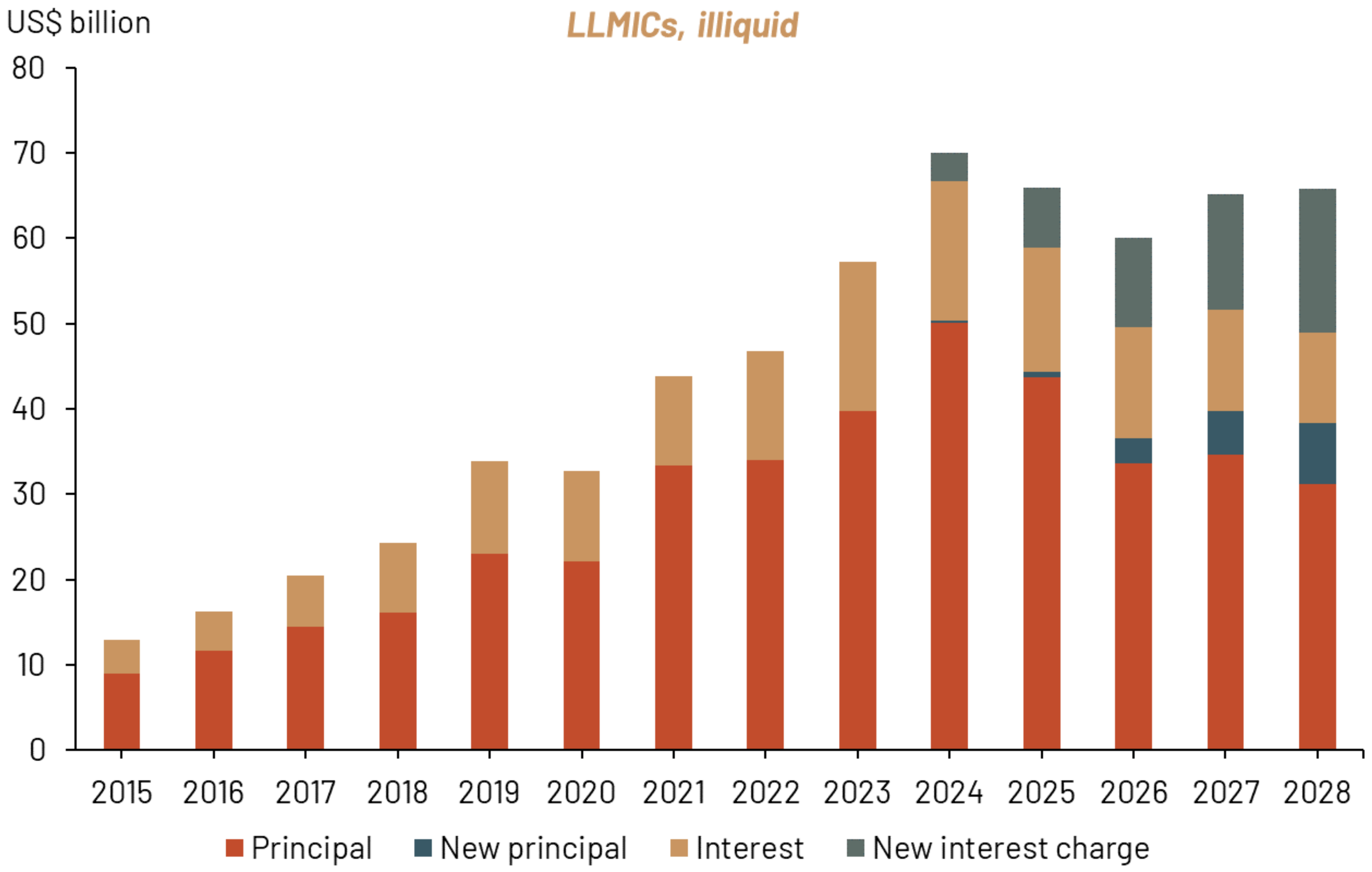
- Interest rate rise in 2023
- Depreciation effect on debt service

*Countries breaching debt service in 2023-2028*

| Income Group | Country | IMF-WB DSA Risk | Baseline scenario | Pessimistic s |
|---|---|---|---|---|
| | | | Flow only | Flow only |
| Low income | Central African Republic | | ✓ | ✓ |
| | Chad | Moderate | ✓ | ✓ |
| | Ethiopia | High | ✓ | ✓ |
| | Gambia, The | Moderate | ✓ | ✓ |
| | Guinea | High | ✓ | ✓ |
| | Madagascar | High | ✓ | ✓ |
| | Sierra Leone | High | | ✓ |
| | Togo | | ✓ | ✓ |
| Lower middle income | Bangladesh | Low | | ✓ |
| | Benin | | ✓ | ✓ |
| | Cabo Verde | Moderate | | ✓ |
| | Cameroon | High | ✓ | ✓ |
| | Comoros | | ✓ | ✓ |
| | Côte d'Ivoire | Moderate | ✓ | |
| | Egypt, Arab Rep. | High | ✓ | ✓ |
| | El Salvador | | | ✓ |
| | Kenya | | ✓ | ✓ |
| | Mauritania | High | ✓ | ✓ |
| | Mongolia | Moderate | ✓ | |
| | Nicaragua | | ✓ | ✓ |
| | Nigeria | | ✓ | ✓ |
| | Pakistan | Moderate | ✓ | ✓ |
| | Papua New Guinea | | ✓ | ✓ |
| | Senegal | Moderate | ✓ | ✓ |
| | Tajikistan | High | | ✓ |
| | Tunisia | | ✓ | ✓ |
| Upper middle income | Argentina | High | ✓ | ✓ |
| | Dominican Republic | Moderate | ✓ | ✓ |
| | Gabon | High | ✓ | ✓ |
| | Grenada | In debt distress | | ✓ |
| | Jamaica | | | ✓ |
| | Jordan | Moderate | ✓ | ✓ |
| | North Macedonia | | ✓ | ✓ |

*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 | ✓ | ✓ |
| | Ghana | In debt distress | ✓ | ✓ |
| | Lao PDR | In debt distress | ✓ | ✓ |
| | Mongolia | | | ✓ |
| | São Tomé and Príncipe | In debt distress | ✓ | ✓ |
| | Vanuatu | Moderate | | ✓ |
| Upper middle income | Dominica | High | ✓ | ✓ |
| | Maldives | High | ✓ | ✓ |
| | Montenegro | | ✓ | ✓ |
| | St. Vincent and the Grena | High | ✓ | ✓ |
| | Suriname | | ✓ | ✓ |




New interest service considerably higher on new loans and on flexible rate loans.

High DS increases roll-over and thus devaluation risk, which would deteriorate the external debt problem further.

# Leakages out of Net Transfers especially high in « illiquid countries »

Net Transfers, by source, for different risk groups

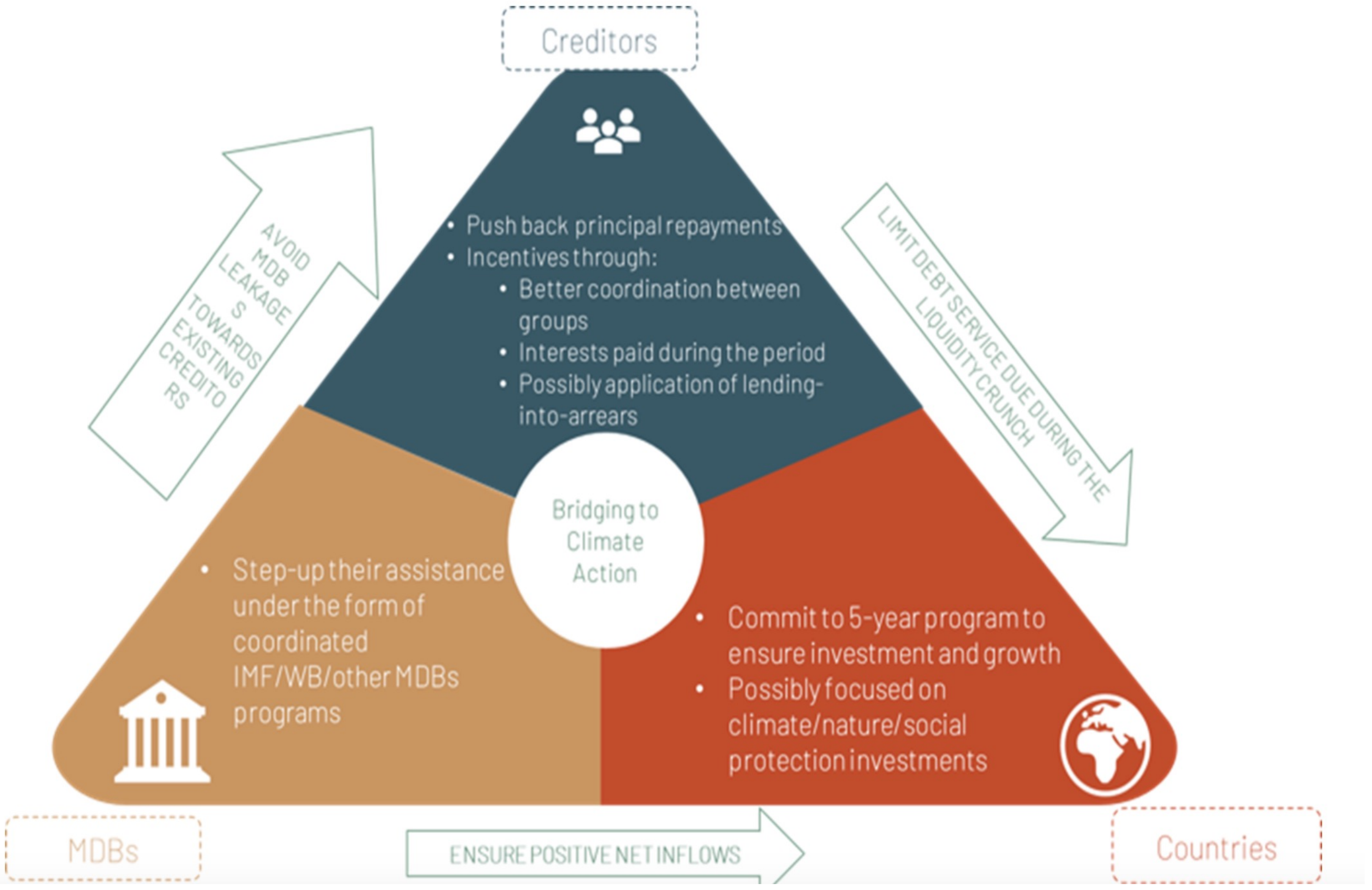
% of GDP, group average, 2019 and 2022

Source: World Bank International Debt Statistics

| Risk group | Year | Total | IFIs | PPG Bilat | PPG China | LT Private | Short Term |
|---|---|---|---|---|---|---|---|
| | 2019 | 2.1 | 1.2 | 0.3 | 0.4 | -0.5 | 0.5 |
| Illiquid | 2022 | 0.4 | 1.1 | 0.2 | -0.1 | -1.2 | 0.1 |
| | 2019 | 5.4 | 1.5 | 0.3 | 0.6 | 6.3 | 0.5 |
| Insolvent | 2022 | -1.3 | 0.2 | -0.1 | -0.0 | -0.2 | -0.8 |
| | 2019 | 1.6 | 0.9 | 0.2 | 0.1 | -0.0 | 0.4 |
| No Risk | 2022 | 1.3 | 1.1 | 0.1 | -0.1 | 0.00 | 0.1 |

# To add liquidity, while minimizing leakages, a Liquidity Bridge

1. Country platform: invest in adaptation, raise revenues over time
2. IFIs x2 over a 5 year program
3. **No creditor pulls out capital during period**



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

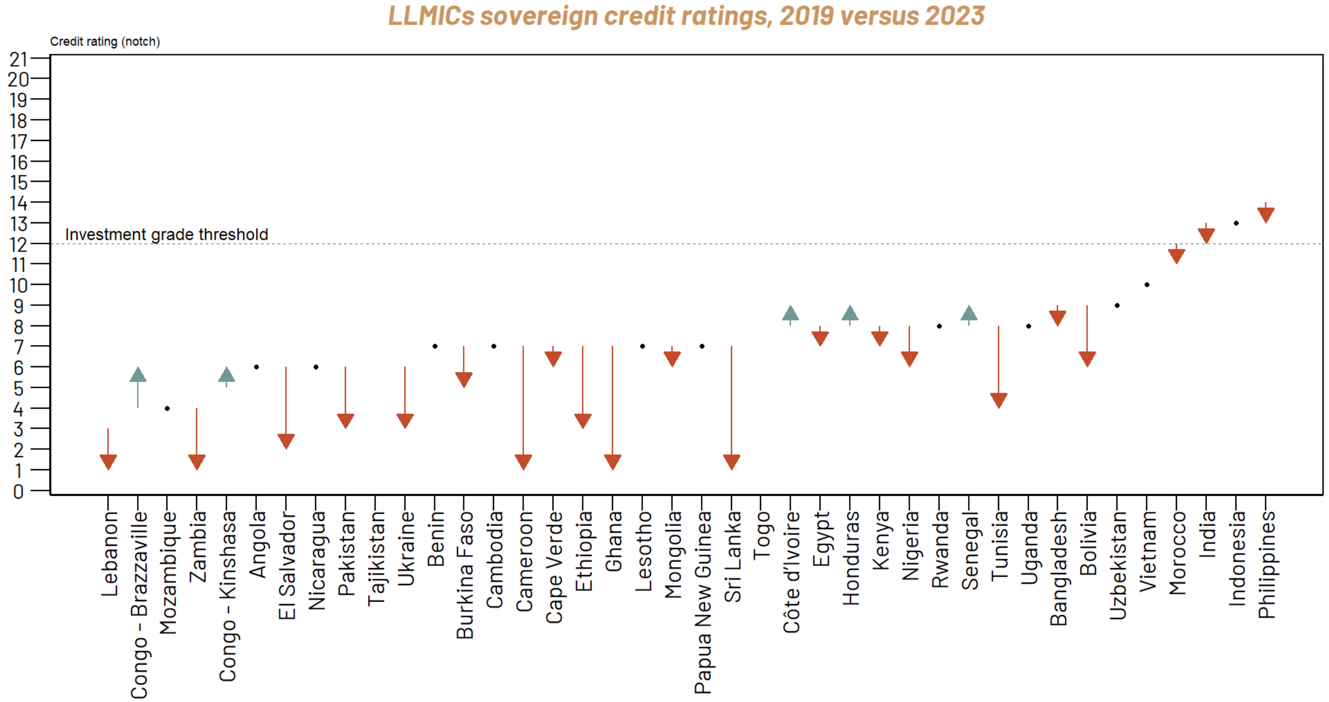
There is now a risk of demobilization.

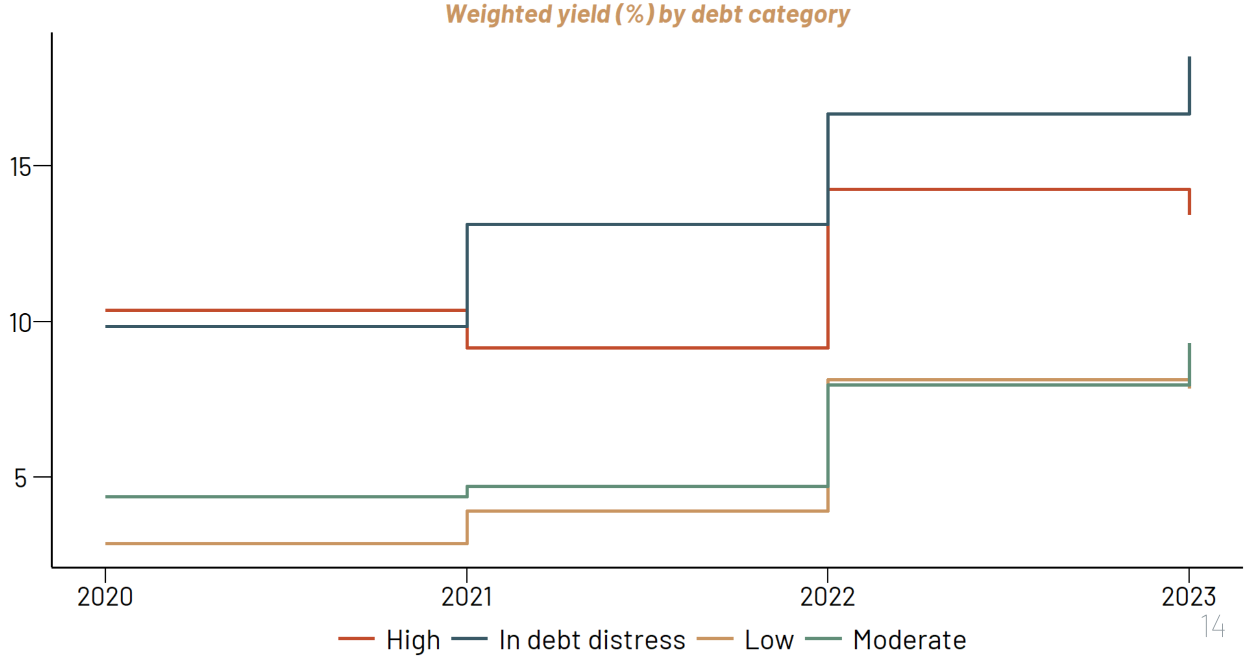
## There are at least 4 reasons why demobilization is premature

A. Interest rates remain high and can rise again
B. Repayment walls are moving – Roll-over risk remains high -> FX pressure
C. MDB surge to get markets to reopen for all illiquid countries way too costly
D. IMF projections are optimistic – reality likely worse

## A. Interest rates remain high and can rise again

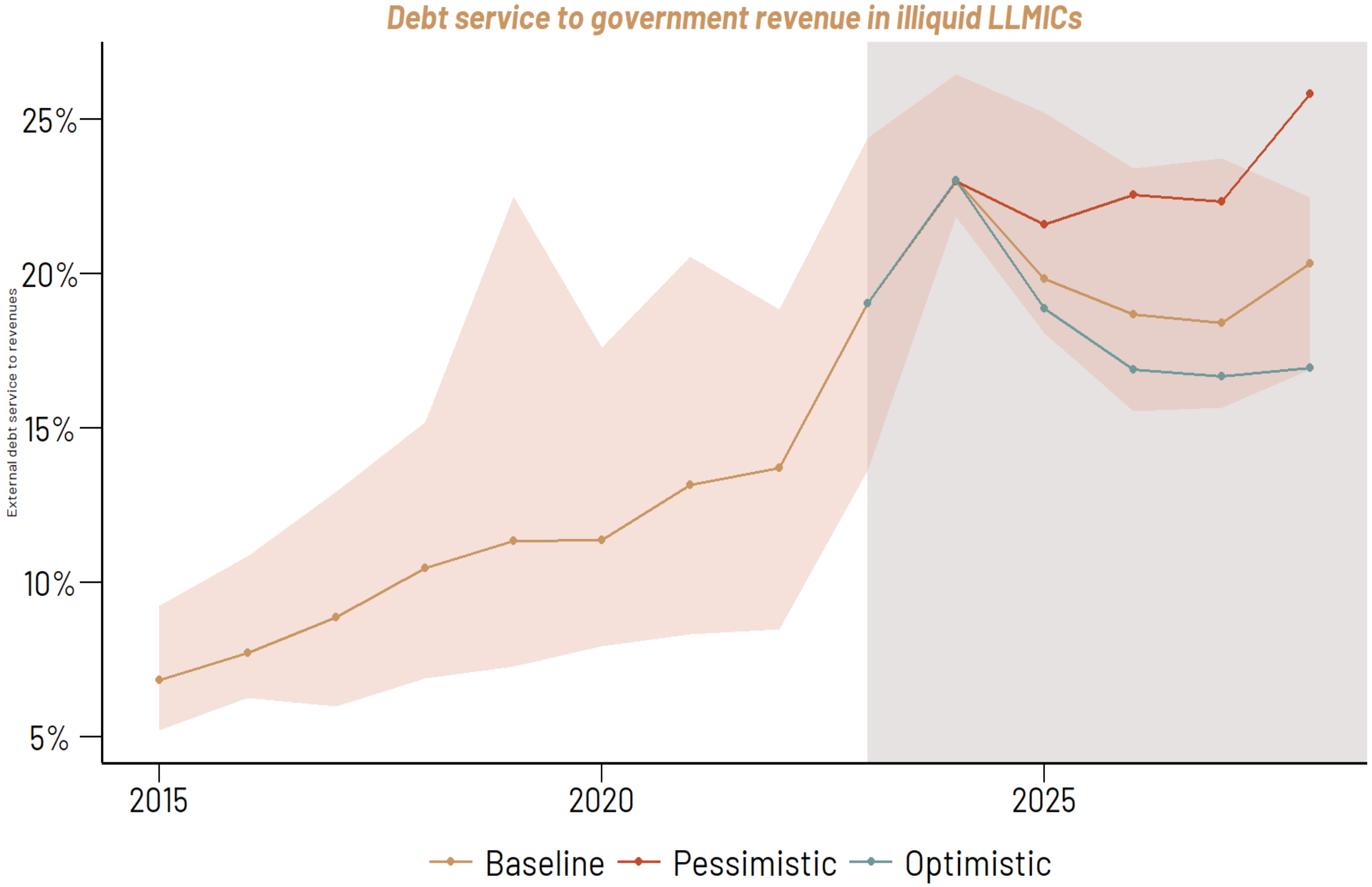
Many countries still shunned by the market, and many can continue to be shunned even if interest rates come down, as their credit ratings have deteriorated.



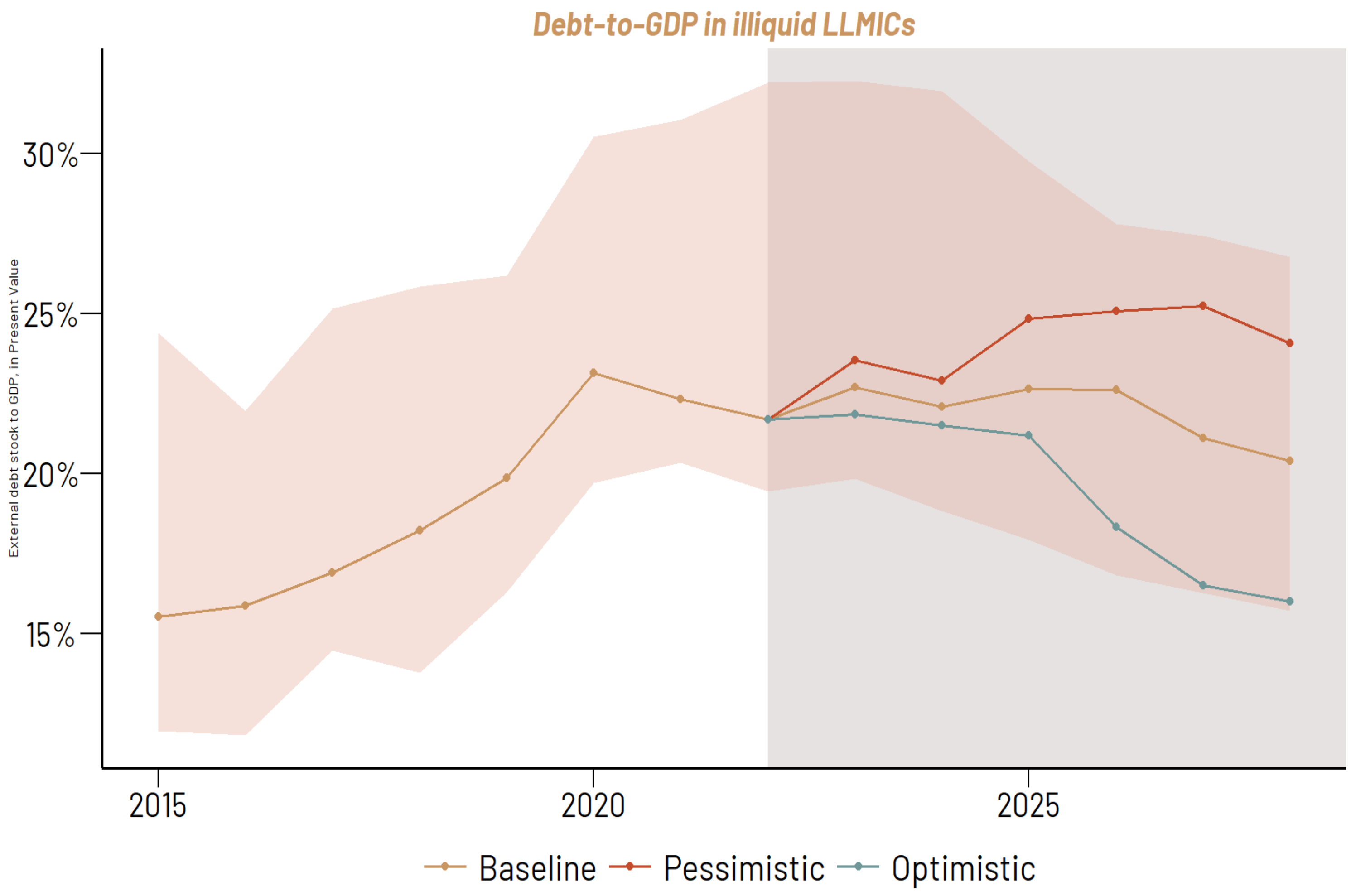
## B. Rescheduling at current terms is too risky

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



## And the same on debt

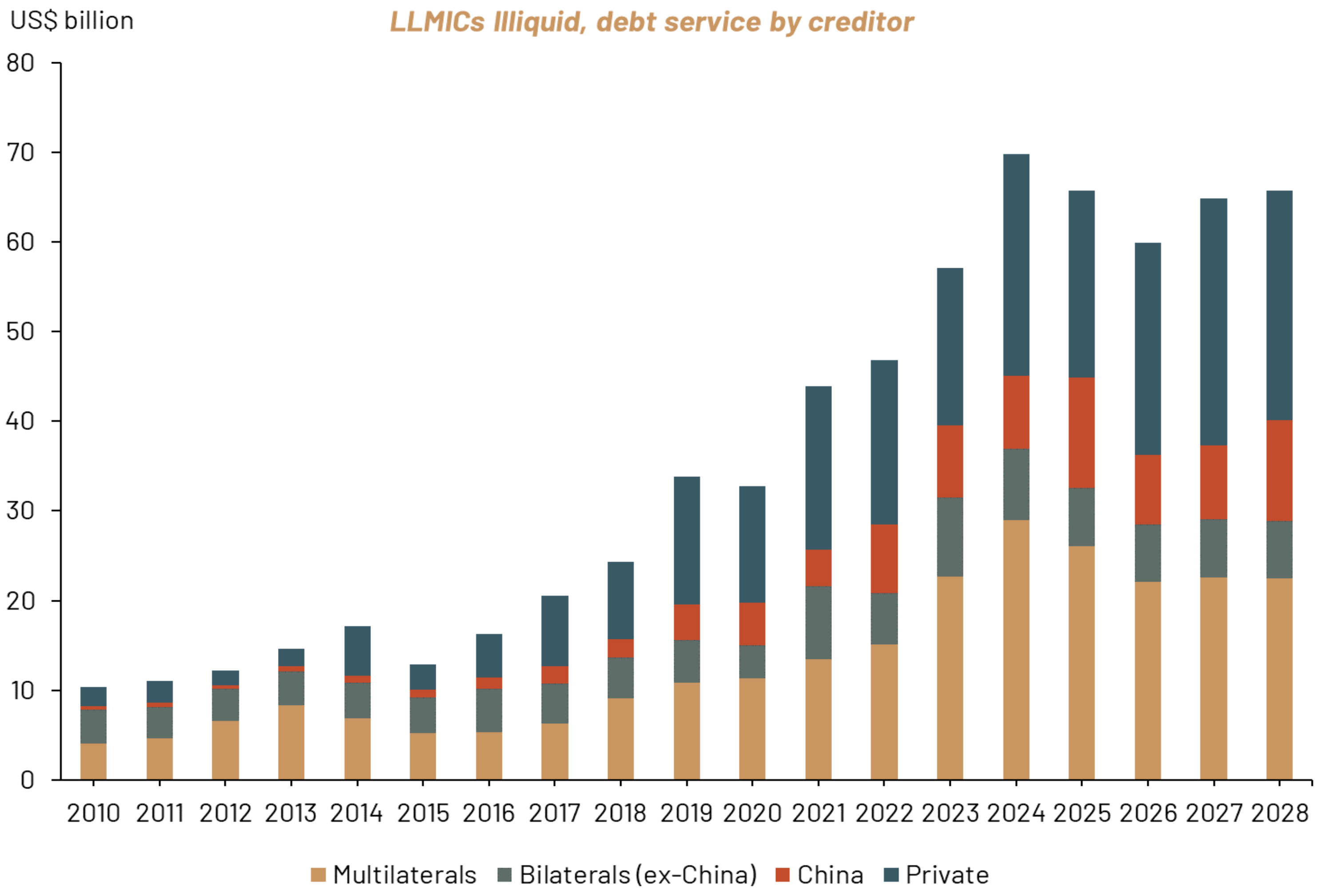
The rise in the risk of insolvency makes it even harder to refinance maturities coming due.



# C. An MDB refinancing strategy is too costly

To refinance DS coming due by all illiquid countries, it would require about $30b/y for private debts, and $10b of bilateral debt, for the next 5 years, about 3 times IFIs flows.

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



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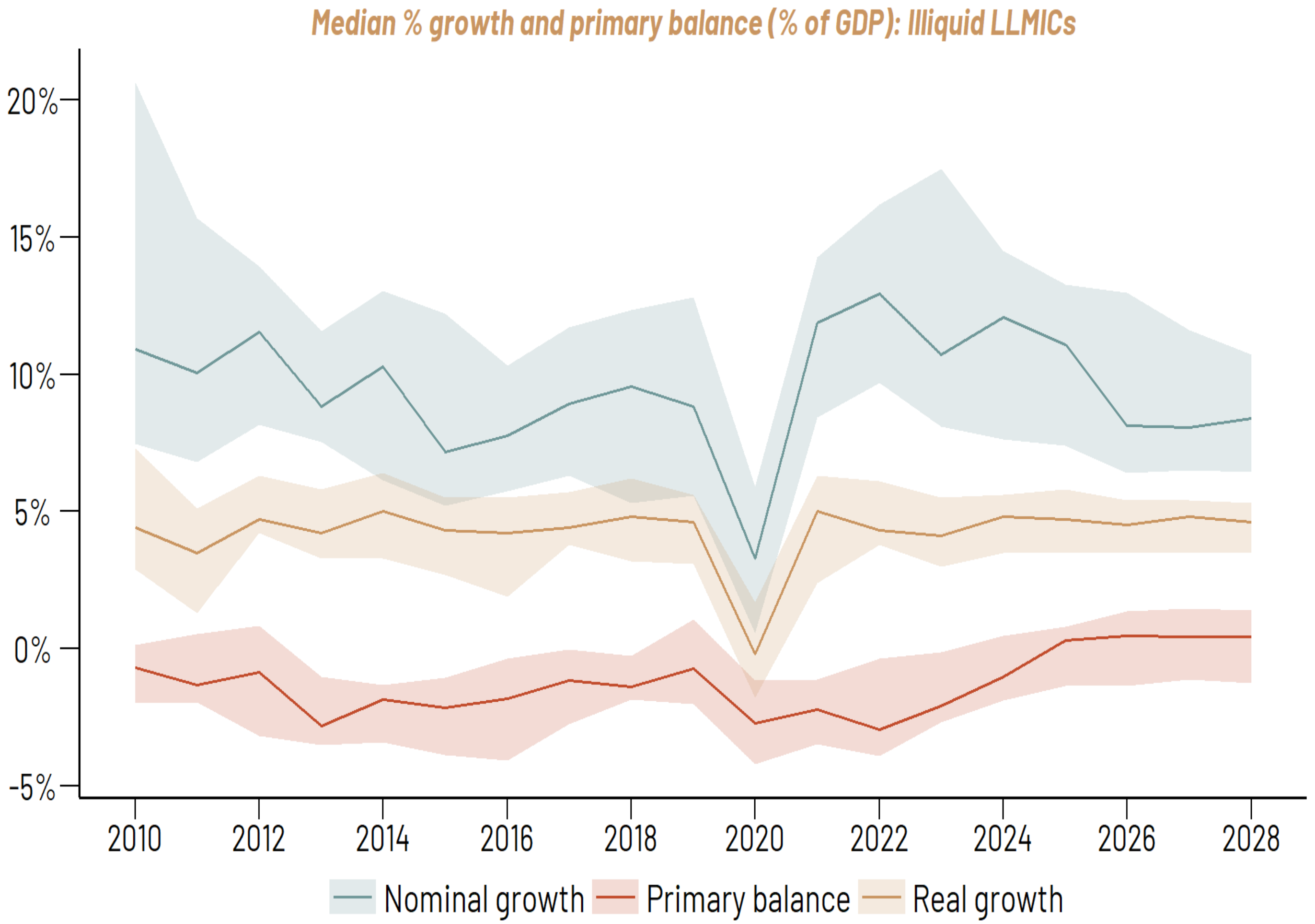


Projections across country groups
(shaded area = lower and upper quartiles)

# D. Projections likely optimistic

We use IMF assumptions on growth and external balances. If things turn out worse (lower growth, higher deficits), the liquidity crunch would be larger.

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# Illiquidity now recognized as the constraint for many countries

- Not only by developing countries, but also IFIs and bilateral lenders
- 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."

## How is the Bridge proposal doing?

Lots of progress

but tensions remain,

principally around how to reschedule/refinance Eurobonds.

- Discussions held with the Paris Club, private creditors, China, and with IMF & World Bank
- IFIs seem to support but need a supportive environment
- US supportive of automatic bilateral rescheduling, with voluntary private sector roll-over supported by enhancements
- China potentially interested, but only if some comparability of treatment with private lenders
- Ideally, a concept adopted by the G20, starting with 3-5 pilot countries, to be expanded if needed in SA's G20
- How to prevent geopolitics from blocking?

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# Thank You

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**Contact**

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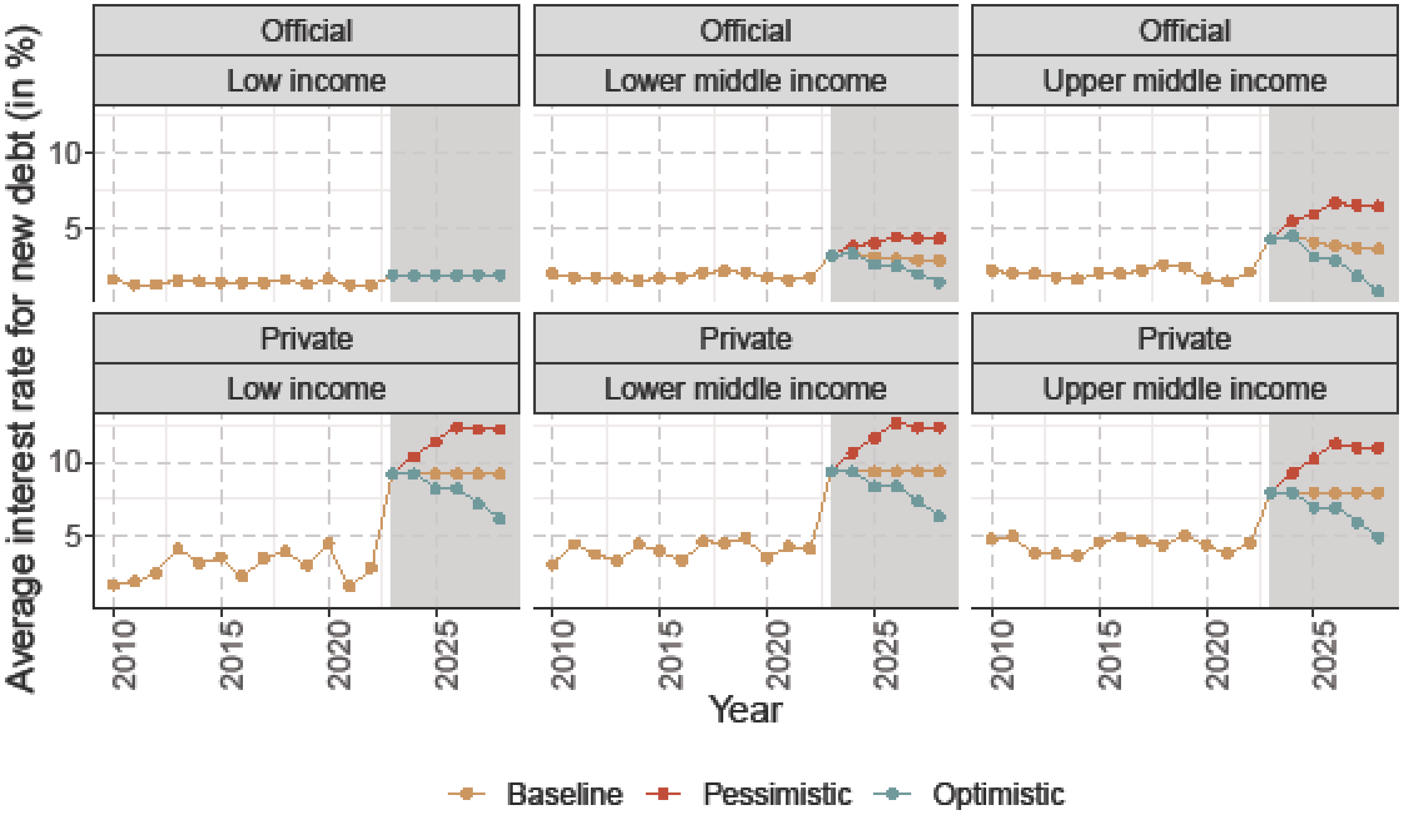
# Scenarios

| | |
|---|---|
| All scenarios | US 10-year declines from 4% in 2024 gradually over 2025-2028, to return at 3% |
| | Inflation rates declines to 2% over the period (i.e., real rates at 1%) |
| | We integrate WEO with recent changes in spot rates against US$ |
| | Private interest rates modelled from current synthetic yield on outstanding debt (as of beginning of March 2024) |
| | IDA interest rate remains stable at its historical country-value |
| | IBRD interest rate equal to US 10-year plus 100 basis points |
| Baseline scenario | All variables remain fixed at their 2024 level |
| Pessimistic scenario | Private interest rates increase until +300 basis points, and then stabilise |
| | Growth declines by 1% in 2026, and again in 2028 |
| | Currency devaluation by 10% and BoP extra surplus of 1% GDP in 2024 and again in 2025 |
| Optimistic scenario | Private interest rates decrease by +100 basis/year from 2025 |
| | Growth increases by 1% in 2026 |
| | Currency appreciation by 5% in 2025, and then stabilisation |

# Interest rates assumptions

under different scenarios.



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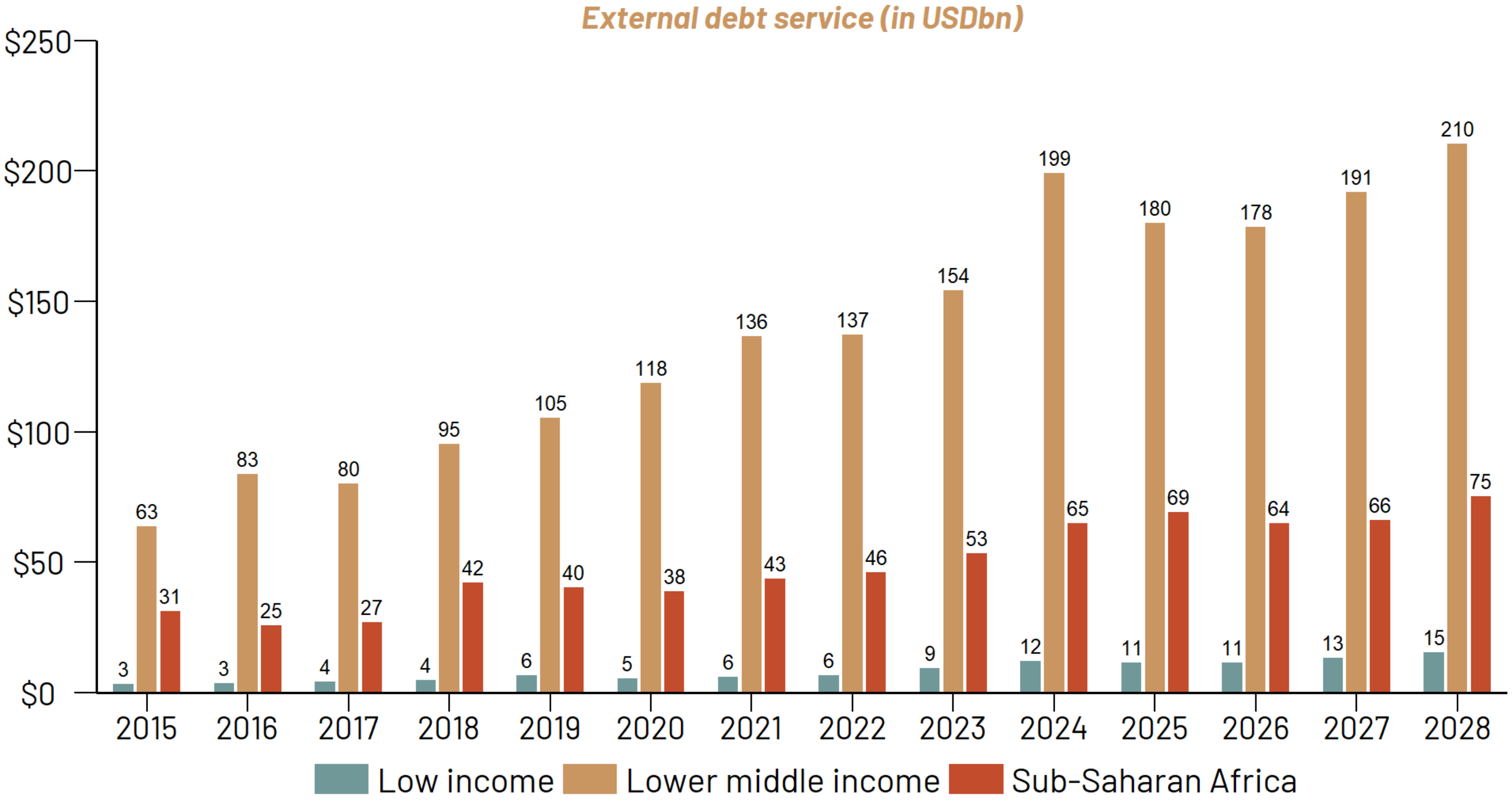
# Debt service

Sources: FDL Simulation and World Bank International Debt Statistics



# IMF projections are typically optimistic

Growth is considerably lower than what actually predicted, and the primary deficit is considerably higher.