Section 4 Rising debt risk in emerging and developing countries

During the COVID-19 pandemic, the stagnancy of economic activity has brought about serious recession. In the subsequent economic recovery phase, labor cost rose rapidly in many countries and regions because the fast pace of recovery made it difficult to procure employment again after the job reduction implemented during the recession phase. In addition, logistics cost increased, mainly in the marine transportation sector, because of supply-side turmoil caused by the fragmented concentration of economic recovery in some countries and regions. Moreover, upward pressures on general prices increased because Russia's aggression against Ukraine triggered turbulent fluctuations in commodity prices, mainly energy and food prices. At a time when inflationary pressures were growing worldwide, central banks, mainly those in developed countries, conducted monetary tightening in order to curb inflation: the asset purchase measures taken by the central banks amid the COVID-19 crisis were discontinued and policy interest rates were raised steeply and at a rapid pace.

External debts owed by emerging and developing countries are regarded as particularly vulnerable to the economic turmoil due to the pandemic and geopolitical risks, rising inflationary pressures due to upsurges in logistics cost and natural resource prices, and the effects of the monetary tightening conducted mainly in developed countries to deal with the inflation. Underlying that view is the idea that the burden of external debts on emerging and developing countries will become heavier because those countries are vulnerable to withdrawals of investment funds due to economic downturns and depreciationary pressure on their currencies due to monetary tightening in developed countries because of their adoption of a fixed exchange rate using the U.S. dollar or a basket of major currencies as an anchor, or a pegged exchange rate system intended to limit exchange rate fluctuations in the domestic currency.

The table below (Table I-1-4-1) is a summary of exchange arrangements in countries compiled by the IMF. Summarizing each arrangement, the "no separate legal tender" arrangement is one under which a foreign currency circulates as the sole legal tender and which involves the confirmation of the arrangement by the monetary authority (so-called dollarization). The "currency board" arrangement is based on an explicit legislative commitment to exchange domestic currency for a particular foreign currency at a fixed exchange rate corresponding to the level of foreign currency and involves the confirmation of the arrangement by the monetary authority. The "conventional peg" arrangement is one under which domestic currency is stabilized (pegged), without a legislative commitment, at a fixed rate against a foreign currency or a basket of currencies through a direct or indirect intervention method and which involves the confirmation of the arrangement by the monetary authority. The "stabilized arrangement" entails a spot market exchange rate that remains within a margin of 2% for six months or more and is not floating. The required margin of stability can be met either with respect to a single currency or a basket of currencies. The "crawling peg" arrangement adjusts the exchange rate of domestic currency in small amounts at a fixed rate based on major quantitative indicators and involves the confirmation of the arrangement by the monetary authority. Under the "crawl-like arrangement," the exchange rate must remain within a margin of 2% relative to a statistically identified trend for six months or more and the exchange rate arrangement cannot be considered as floating. The "pegged exchange rate within horizontal band" arrangement keeps the value of the currency within certain margins of fluctuation around a prescribed exchange rate and involves the confirmation of the arrangement by the monetary authority. Arrangements classified as "other managed arrangement" are ones that do not belong to any of the other categories. Arrangements characterized by frequent changes in policies may fall into this category. A "floating" exchange arrangement is one under which the exchange rate is largely determined by the market, without an ascertainable or predictable path for the rate. Foreign exchange market intervention may be either direct or indirect, and such intervention serves to moderate the rate of change and prevent undue fluctuations in the exchange rate. The "free floating" exchange arrangement is one under which foreign exchange intervention is conducted only for the purpose of addressing disorderly market conditions and under which the authorities can confirm that intervention has been limited at most to three instances in the previous six months, each lasting no more than three business days.

Table I-1-4-1. Exchange arrangements by category and adopting countries

Exchange arrangements	Number of adopting countries (total: 190 countries)	Adopting countries
No separate legal tender	14	Andorra, Ecuador, El Salvador, Kiribati, Kosovo, Marshall Islands, Micronesia, Montenegro, Nauru, Palau, Panama, San Marino, Timor-Leste, Tuvalu
Currency board	10	Antigua and Barbuda, Bosnia and Herzegovina, Brunei Darussalam, Bulgaria, Djibouti, Dominica, Grenada, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Hong Kong
Conventional peg	38	Bahamas, Bahrain, Barbados, Belize, Benin, Bhutan, Burkina Faso, Cabo Verde, Cameroon, Central African Republic, Chad, Comoros, Congo, Cote d'Ivoire, Denmark, Equatorial Guinea, Eritrea, Eswatini, Fiji, Gabon, Guinea-Bissau, Iraq, Jordan, Lesotho, Libya, Mali, Namibia, Nepal, Niger, Oman, Qatar, Samoa, Sao Tome and Principe, Saudi Arabia, Senegal, Togo, Turkmenistan, the United Arab Emirates, Aruba, and Curaçao and St. Martin Island
Stabilized arrangement	24	Algeria, Azerbaijan, Bangladesh, Bolivia, Cambodia, Croatia, Egypt, Gambia, Guatemala, Guyana, Iran, Lebanon, Maldives, Mongolia, Nigeria, North Macedonia, Papua New Guinea, Serbia, Singapore, Sudan, Suriname, Tajikistan, Tanzania, Trinidad and Tobago
Crawling peg	3	Botswana, Honduras, Nicaragua
Crawl-like arrangement	24	Afghanistan, Argentina, Burundi, the Democratic Republic of the Congo, Costa Rica, Dominican Republic, Ethiopia, Ghana, Guinea, Lao PDR, Malawi, Mauritania, Mozambique, the Philippines, Romania, Rwanda, Solomon Islands, South Sudan, Switzerland, Tunisia, Uzbekistan, Viet Nam, Zambia
Pagged exchange rate within horizontal bands	1	Morocco

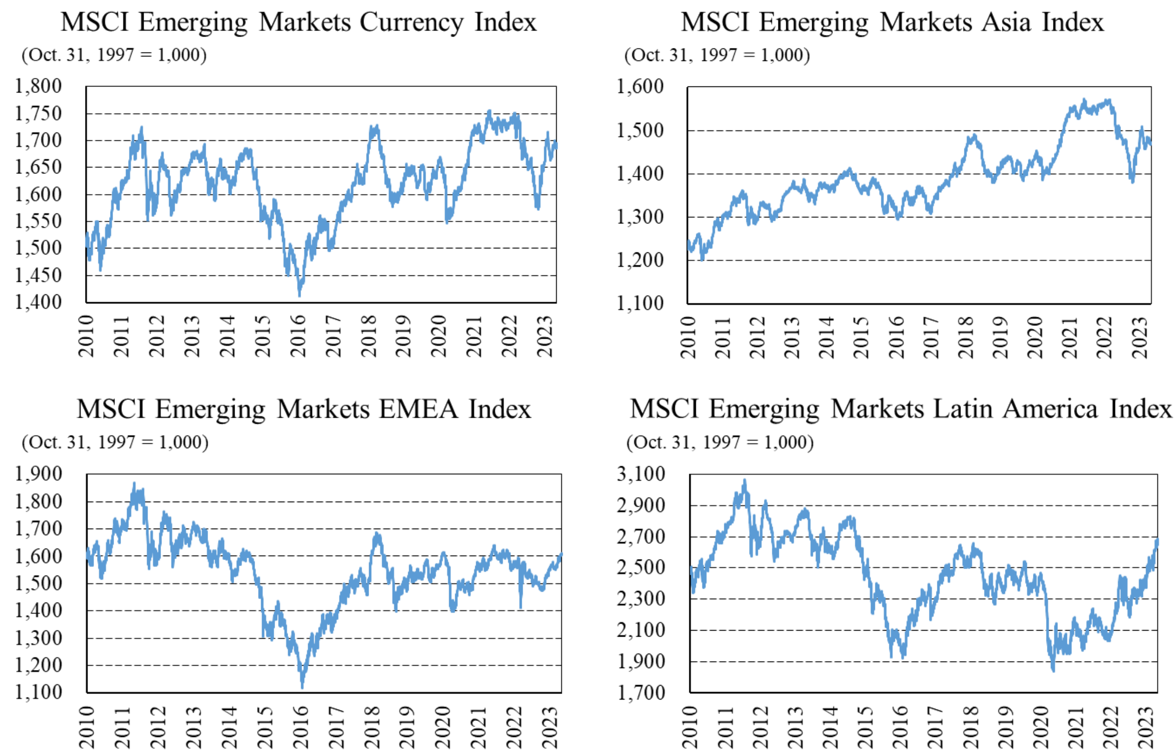
Other managed arrangement	12	Haiti, Kenya, Kuwait, Kyrgyz Republic, Liberia, Myanmar, Sierra Leone, Syria, Tonga, Vanuatu, Venezuela, Zimbabwe
Floating	32	Albania, Angola, Armenia, Belarus, Brazil, Colombia, Georgia, Hungary, Iceland, India, Indonesia, Israel, Jamaica, Kazakhstan, the ROK, Madagascar, Malaysia, Mauritius, Moldova, New Zealand, Pakistan, Paraguay, Peru, Seychelles, South Africa, Sri Lanka, Thailand, Turkey, Uganda, Ukraine, Uruguay, Yemen
Free floating	32	Australia, Austria, Belgium, Canada, Chile, Cyprus, Czech Republic, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Japan, Latvia, Lithuania, Luxembourg, Malta, Mexico, the Netherlands, Norway, Poland, Portugal, Russia, Slovakia, Slovenia, Somalia, Spain, Sweden, the U.K., the U.S.

Note: The total number of adopting countries does not include Aruba, Curaçao and St. Martin Island, or Hong Kong.
Source: *Annual Report on Exchange Arrangements and Exchange Restrictions 2021* (IMF).

According to the above table, most of the countries that do not have a domestic legal tender, or have adopted a fixed exchange rate arrangement or a pegged arrangement to curb exchange rate fluctuations are emerging or developing countries. Generally, those countries conduct market interventions to stabilize exchange rates. In particular, when the depreciation of the domestic currency is pronounced, concerns about a possible shortage of foreign currency reserves tend to grow because of the need to purchase the domestic currency and sell the foreign currency or the basket of currencies used as a reference.

Looking at the trends in the currency indexes that reflect the movements of currencies in emerging and developing regions in general (Figure I-1-4-2), the value of currencies in emerging and developing regions except for Latin America showed pronounced falls in 2022. As mentioned earlier, the value of the currencies of emerging and developing countries tends to fall due to withdrawals of direct investments and portfolio investments by developed countries when the economic conditions have deteriorated or concerns about that risk have heightened. In addition, because central banks in many emerging and developing countries have adopted a fixed exchange arrangement or a pegged arrangement to stabilize the value of the domestic currencies relative to the U.S. dollar or a basket of major currencies, when central banks in developed countries have conducted monetary policy tightening, central banks in emerging countries have tended to take the same action in order to defend their domestic currencies. However, the act of conducting monetary policy tightening in itself raises concerns about its negative impact in those countries' economies, so the monetary authorities in emerging and developing countries face difficult decisions. In financial markets, the difficulty faced by the monetary authorities of emerging and developing countries in making policy decisions may be easily detected, so the value of those countries' currencies tends to fall in some cases.

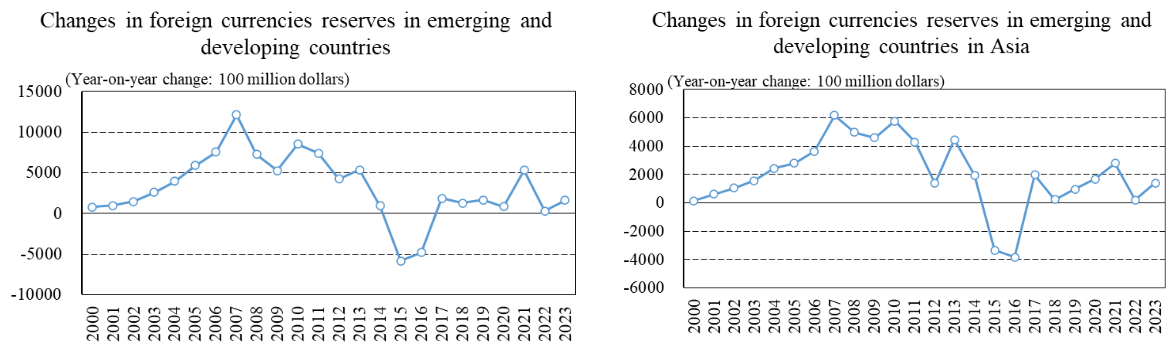
Figure I-1-4-2. Currency indexes in emerging and developing regions

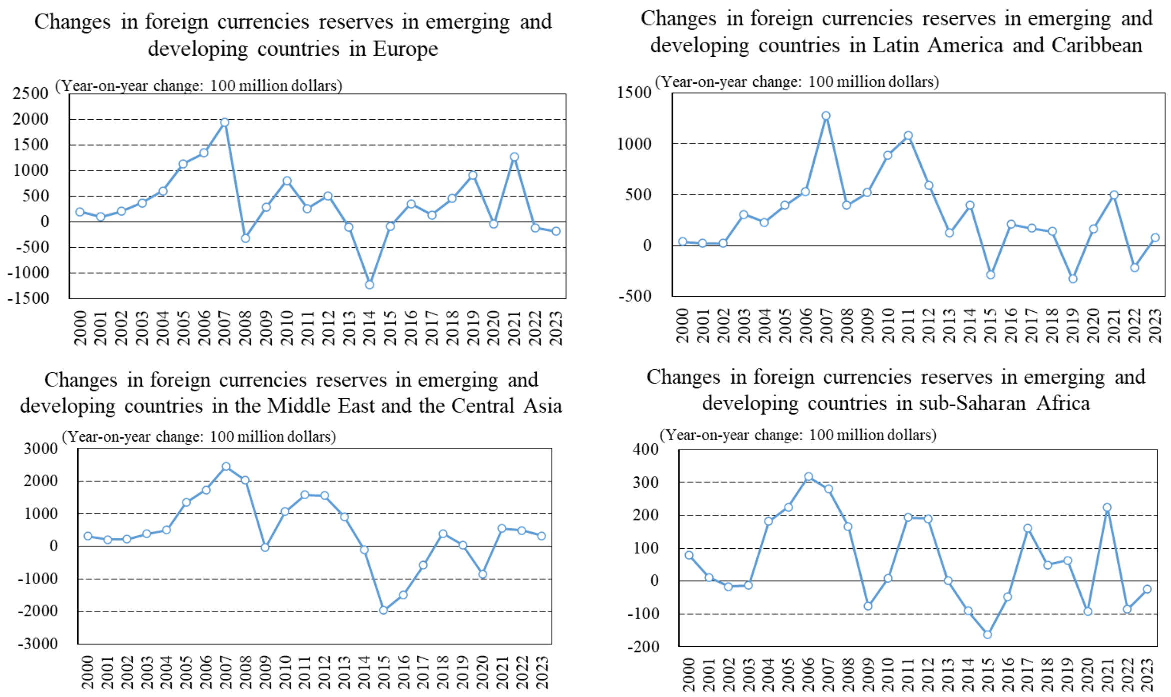


Source: Refinitiv.

In any case, emerging and developing countries need to conduct exchange market interventions involving purchases of domestic currencies and sales of foreign currencies in order to defend their currencies. During that process, the outstanding balance of foreign currency reserves declines, raising concerns over external debt repayment. Changes in the level of foreign currencies reserves by region (Figure I-1-4-3) show that in 2022, the level fell in the European emerging/developing region, the Latin America-Caribbean region, and the sub-Saharan Africa region. This figure indicates that as central banks in the United States and other developed countries raised policy interest rates in the year in order to curb inflation, countries in those regions conducted exchange market interventions involving purchases of their domestic currencies and sales of foreign currencies with the aim of reducing the ensuing downward pressure on their currencies, resulting in a decline in the level of foreign currency reserves.

Figure I-1-4-3. Changes in foreign currencies reserves in emerging and developing regions





Note: The figures for 2023 are IMF estimates.
Source: *WEO* (IMF).

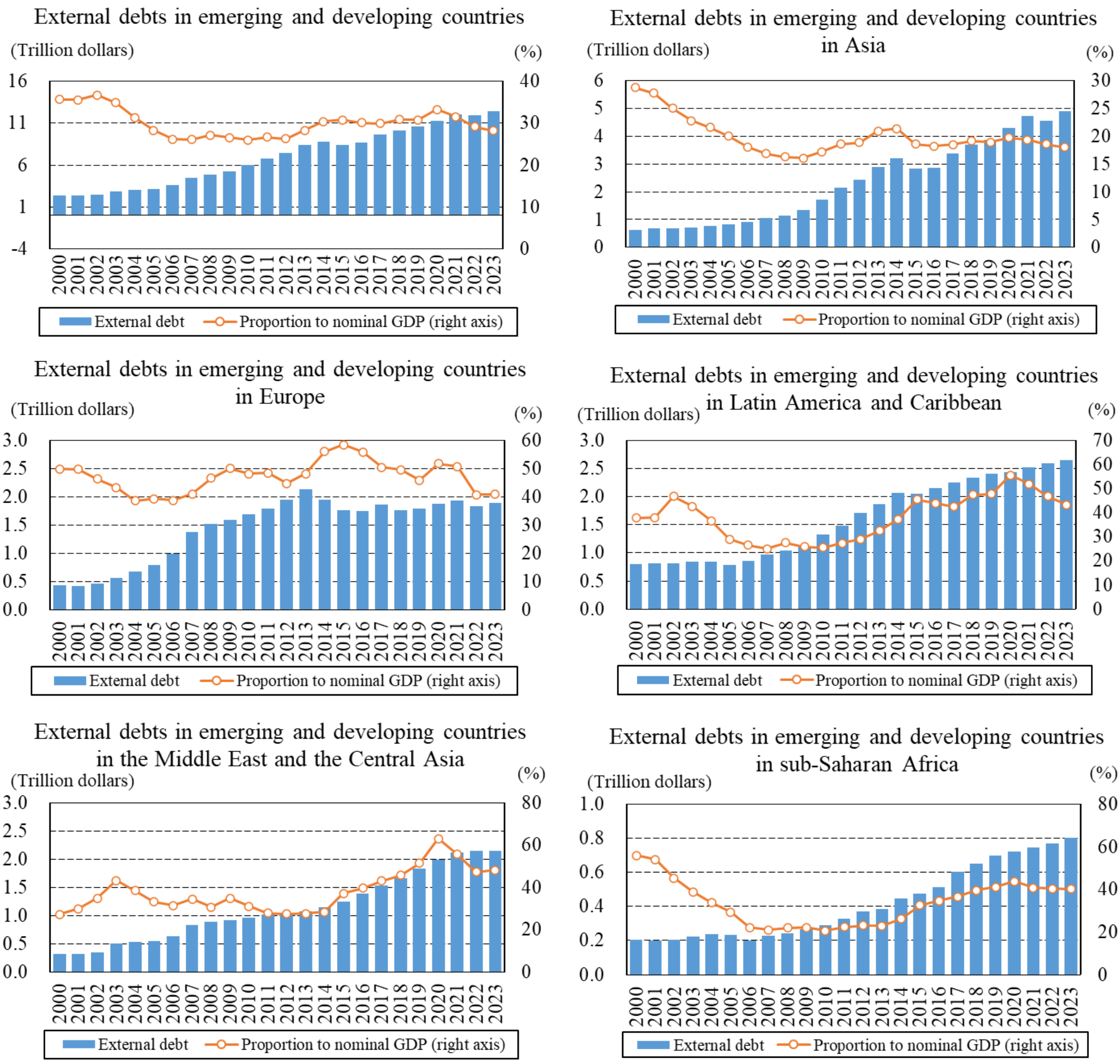
At a time when concerns over external debt repayment by emerging and developing countries are growing, this section will look at the trend in their debts in detail.

1. Pronounced increase in external debts in emerging and developing countries since before the COVID-19 crisis

The figure below (Figure I-1-4-4) shows the outstanding balance of external debts in emerging and developing regions and the ratio of external debts to nominal GDP based on the IMF's regional and income classifications. According to the figure, those regions' debts have two notable characteristics. First, the size of external debts in emerging and developing regions do not appear excessive. Specifically, although the outstanding balance of external debts in each emerging and developing region has been increasing as a trend during the period covered by the figure except in the European emerging/developing region, which is presumed to have been affected by the European debt crisis, the size of debts relative to nominal GDP has not shown an excessive rise since 2020, when the COVID-19 pandemic occurred.

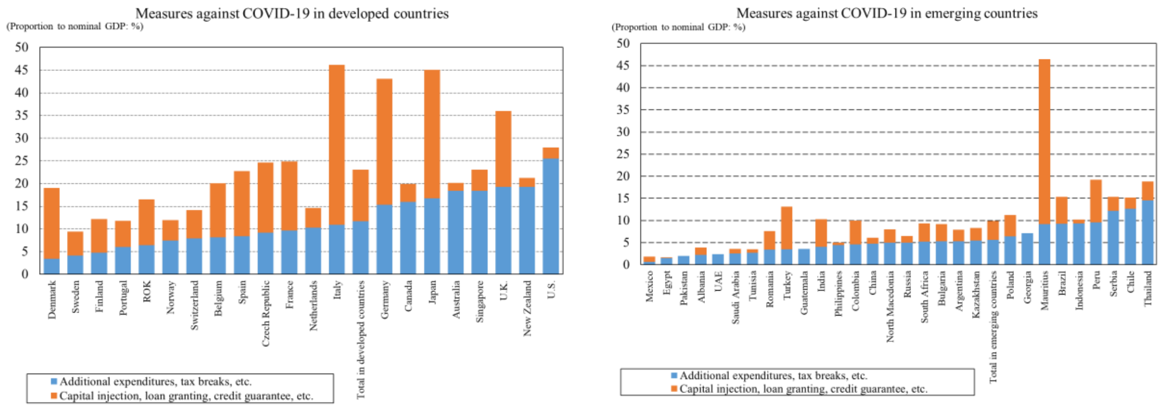
Second, the fiscal conditions in emerging and developing regions have not shown a particular deterioration due to the COVID-19 pandemic, which became serious in early 2020. Indeed, according to the figure below (Figure I-1-4-5), which shows the scale of measures taken by countries as classified by income level in response to the COVID-19 pandemic, on average, the scale of measures taken by developed countries in response to the COVID-19 pandemic is the largest, while the scale of measures taken by emerging and developing countries is limited, although there are disparities across individual countries. The abovementioned two points indicate that although concerns over debt sustainability grow sometimes due to factors such as currency depreciation, there are some factors that have enabled emerging and developing regions to increase external borrowings.

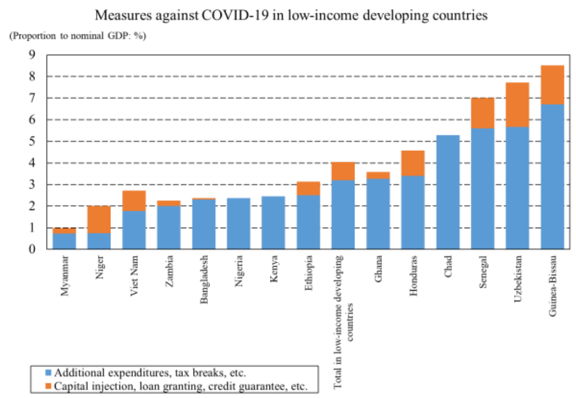
Figure I-1-4-4. External debts in emerging and developing regions



Note: The figures for 2023 are IMF estimates.
Source: *WEO* (IMF).

Figure I-1-4-5. Measures against COVID-19 by regional income classification



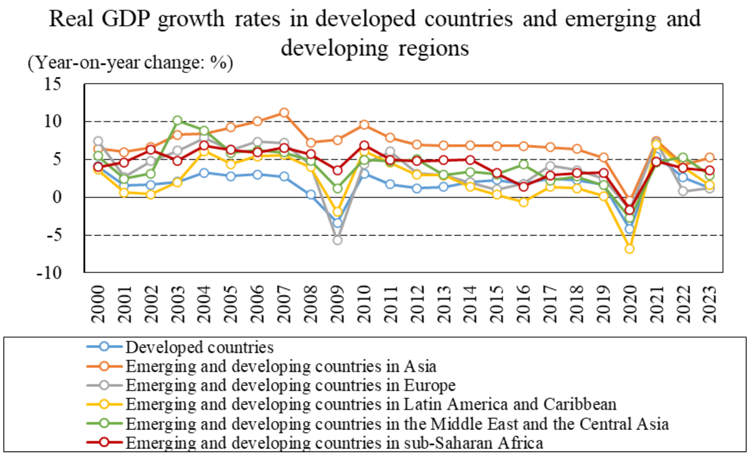


Note 1: As of September 27, 2021.
Note 2: The data on proportion to nominal GDP is based on the World Economic Outlook as of October 2021.
Note 3: The figures for each group total are weighted averages by GDP in U.S. dollar based on purchasing power parity.
Source: *Database of Country Fiscal Measures in Response to the COVID-19 Pandemic* (IMF).

2. Various factors behind the increase in external debts in emerging and developing countries

One of the factors that have enabled emerging and developing regions to take external borrowings, as mentioned in the previous subsection, is the high level of forecast growth rates for those regions. The figure below (Figure I-1-4-6) shows a comparison between the past real GDP growth rates and forecast growth rates in the developed region and in emerging and developing regions. It shows that emerging and developing regions, led by the Asian emerging and developing region, have generally recorded higher economic growth rates than the developed region. The high level of economic growth indicates that the level of return from direct investments and portfolio investments in emerging and developing regions is high. This in turn indicates that emerging and developing regions have been favored as investment destinations over developed countries, where investment opportunities are limited because of economic maturity.

Figure I-1-4-6. Real GDP growth rates by regional income classification

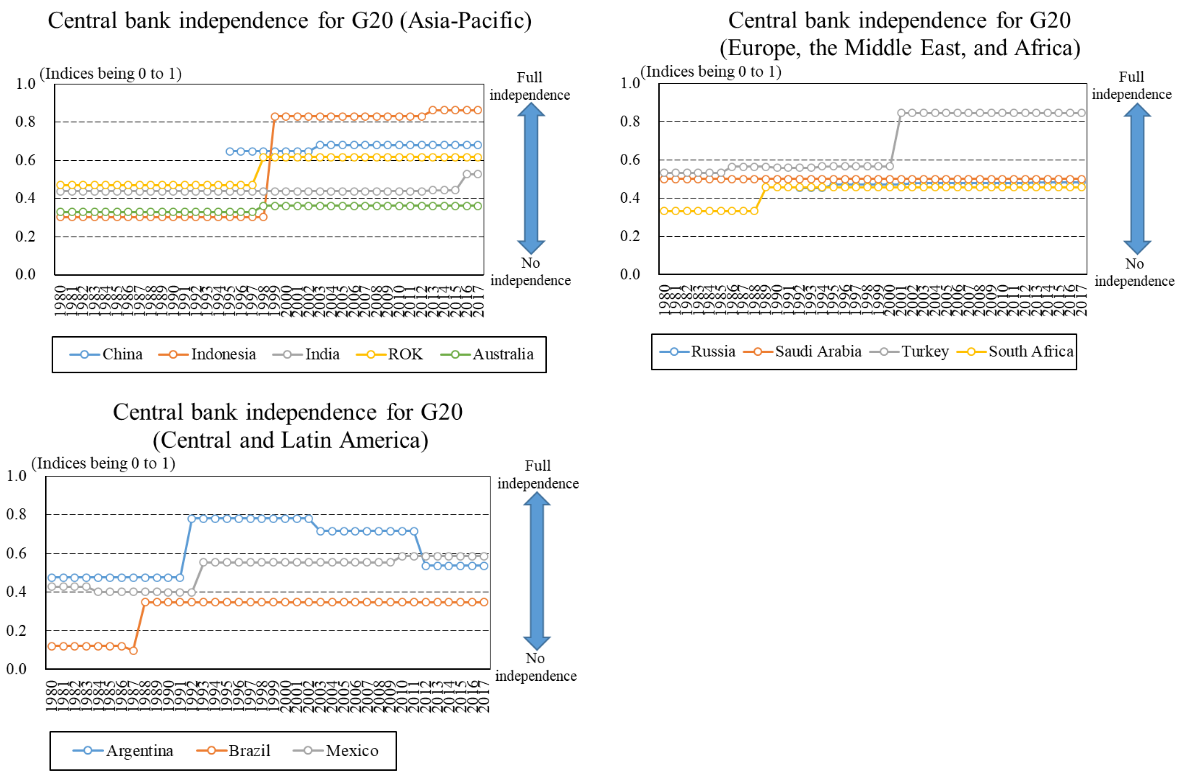


Note: The figures for 2023 are IMF estimates.
Source: *WEO* (IMF).

Another possible factor that has enabled emerging and developing regions to take external borrowings is growing awareness in those regions about economic stability, including the containment of inflation. When a loan is provided at a fixed rate, there is an inducement for the borrower to reduce the real value of debt by boosting inflation before repaying the debt. On the other hand, for the lender side, that would mean the reduction of purchasing power in real terms. Thus, inflation has the effect of transferring purchasing power from the lender side to the borrower side. For the lender, discussing this risk is less relevant when the claim is denominated in its currency. Even so, if measures to maintain stability are taken in an investment destination country/region, instead of escalating inflation and other economic turmoil being left unattended, that could be an important investment decision factor. A typical example is a case of the relationship between a government and a central bank, where the existence of a central bank that aims to maintain price stability is supposed to ensure the implementation of monetary tightening in order to curb excessive inflation despite the presence of an inducement for the government to reduce the real value of debt through inflation and where creditors expect measures to maintain economic stability.

The discussion on the inflation inducement risk eventually relates to whether central bank independence is secured. The central bank independence index is known as a numerical quantified indicator of a central bank's independence, which is a qualitative feature. The central bank independence index reflects the assessment of independence using checkpoints regarding the following independence criteria: independence of the governor and executives, independence of monetary policy, independence of policy goals, independence in setting limitations on the provision of credit to the government, independence of the fiscal position, and independence of information disclosure. The figure below (Figure I-1-4-7) shows the value of the central bank independence index for the central banks of the G20 countries excluding the G7 countries. Although there have not been frequent changes in the value of the index because the revision of the central bank system is infrequent, the independence of central banks has been increasing on the whole in those countries. Thus, the figure indicates that even though borrowing entities have preferred inflation, progress has been made in the development of a system under which the central banks independently conduct monetary tightening. The increasing independence of central banks in emerging and developing countries, coupled with the growing awareness about the containment of inflation, is also considered to be a factor that enables those countries to take external borrowings through increased trust in them.

Figure I-1-4-7. Central bank independence index for G20 (except G7)

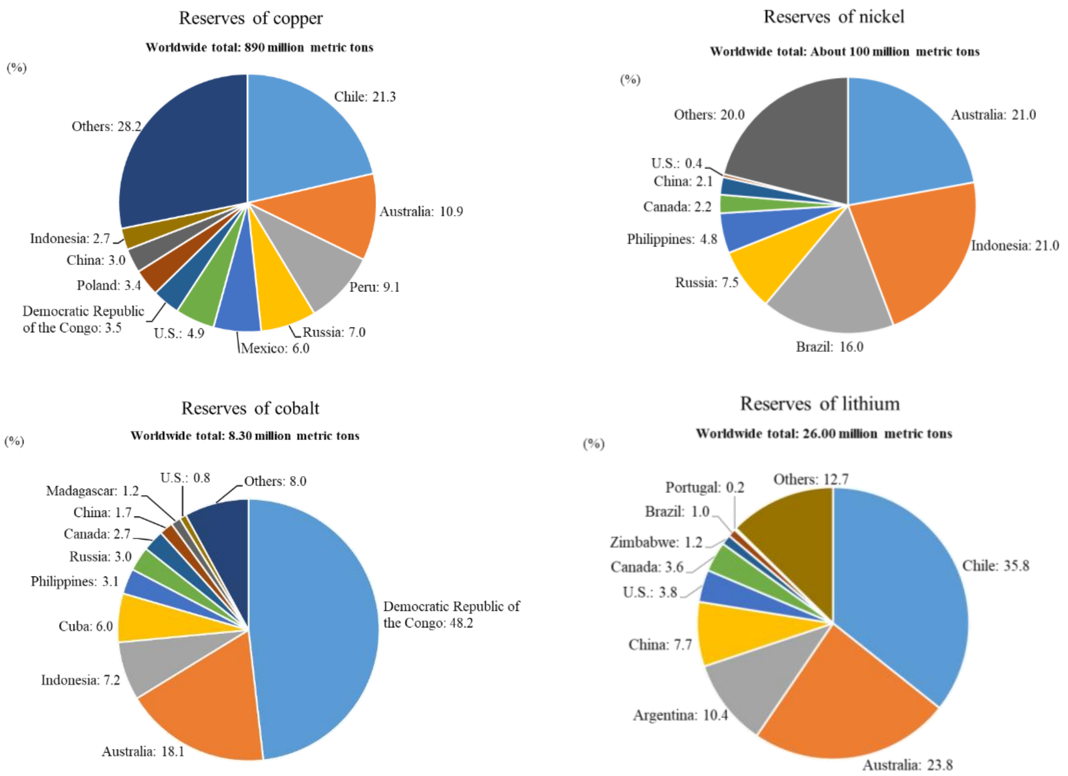


Note: The Central bank independence index is an indicator showing: independence of the governor and executives, independence of monetary policy, independence of policy goals, independence in setting limitations on the provision of credit to the government, independence of the fiscal position, and independence of information disclosure.
Source: Romelli (2022)[16] (https://davideromelli.com/cbidata/).

Furthermore, because of the growing awareness about economic security and building of resilient supply chains in recent years, sustainable procurement of natural resources has become a critical challenge for non-resource countries. The figure below (Figure I-1-4-8) shows the distribution of reserves of major natural resources, including copper, which is important for the building of infrastructure facilities, such as electric cables and water pipes, and critical raw materials of batteries, such as nickel, cobalt, and lithium. This figure indicates that emerging and developing countries have large shares of reserves regarding most of the important natural resources. This means that for non-resource developed countries like Japan, it has become a critical challenge to develop good relationships with those countries through investment in them. The fact that emerging and developing countries are major owners of important resources is also considered to be a factor that has led to continuous investment in those countries, which, from those countries' viewpoint, means a sustained accumulation of debts.

16 Davide Romelli (2022), "The political economy of reforms in central bank design: evidence from a new dataset," Economic Policy, Volume 37, Issue 112, October 2022, pp. 641-688.

Figure I-1-4-8. Reserves of major important resources



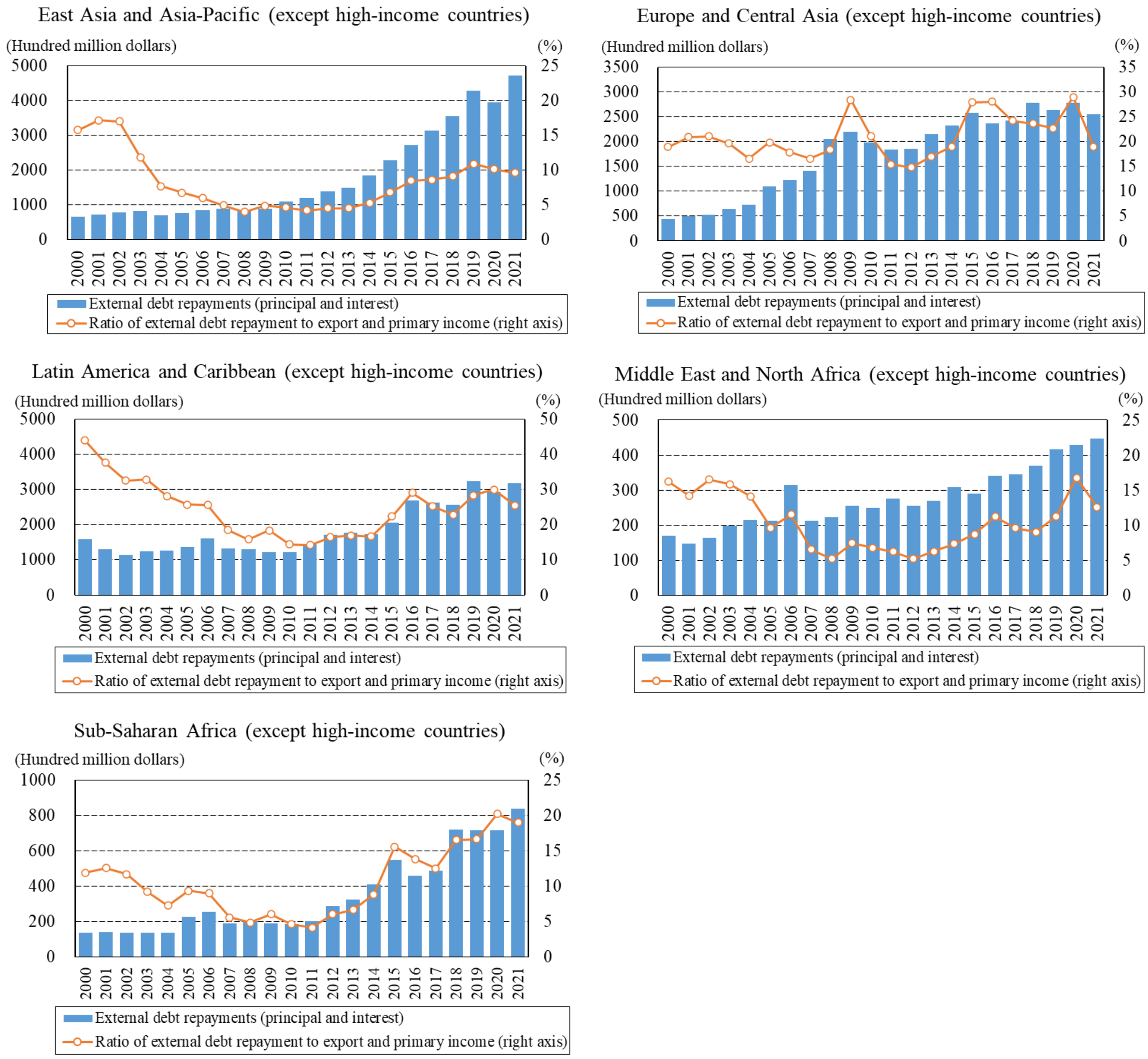
Source: *Mineral Commodity Summaries 2023* (United States Geological Survey (USGS)).

3. Situation of external debt repayment by emerging and developing countries

The previous subsection discussed the background to the increase in external debts in emerging and developing countries. This subsection will discuss the external debt repayments.

The figure below (Figure I-1-4-9) shows the trend in external debt repayments on a regional basis, excluding repayments by high-income countries. The amount of external debt repayments, representing the total sum of principal and interest payments, has been increasing as a trend or stayed at a high level, reflecting the increase in the outstanding balance of external debts as discussed in the previous subsection. One measure of the burden of external debt repayment is the ratio of external debt repayment to export and primary income (external debt ratio), which indicates whether the amount of foreign currencies earned is sufficient relative to the amount of external debt repayments. This ratio has been rising as a trend in sub-Saharan Africa since around 2010, but in other regions, it invariably declined in 2021 due to the normalization of the global economy following the COVID-19 crisis. As the previous subsection showed that the outstanding balance of external debts relative to economic size has not excessively increased, the level of external debt repayments has also not excessively risen on a regional basis. However, as mentioned above, in 2022, currency depreciation occurred widely among emerging and developing countries and the level of foreign currency reserves also decreased in some countries and regions. In light of those circumstances, it is necessary to pay attention to the possibility that concerns about risk regarding external debt repayment may be currently growing with respect to some countries and regions.

Figure I-1-4-9. External debt repayments by region



Source: World Bank.

4. Developing and emerging countries' external debt problem cannot be resolved through restructuring of public debts

It was pointed out in previous subsections that emerging and developing countries have been able to increase external debts because of factors such as the high level of their forecast economic growth rates, the development of the central bank system and the possession of critical resources, and that the situation of their external debt repayment has not been so unfavorable as to raise concerns over a possible debt crisis. However, not all countries have been smoothly repaying their external debts.

When emerging and developing countries are facing difficulty in repaying external debts, the Paris Club serves as a consultative organization regarding debt restructuring and reduction in the case of public debts. The table below (Table I-1-4-10) shows an outline of the Paris Club. Twenty-two countries, mainly developed ones, hold consultations about implementing debt restructuring measures (rescheduling or reducing debts) with respect to public debts with a maturity of one year or more while taking into consideration the situations of individual countries.

Table I-1-4-10. Outline of the Paris Club

Permanent members	- 22 countries (Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Ireland, Israel, Italy, Japan, the ROK, the Netherlands, Norway, Russia, Spain, Sweden, Switzerland, the U.K., and the U.S.)
Type of treated debts	- Public debt (including private debt with public debt guarantees) with med- to long-term maturities (or public debt with maturities longer than one year)

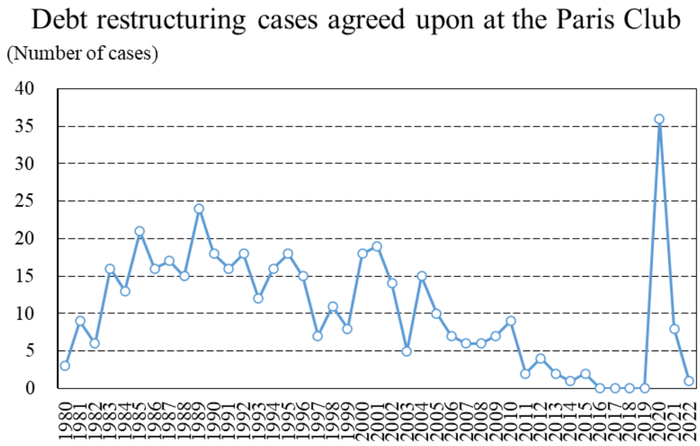
Major methods for debt restructuring	Targets	Major contents
Classic terms	Countries needing standard debt restructuring	- Any country which has an appropriate program with the IMF for debt reduction and financial restructuring - Debts are rescheduled at the appropriate market rate.
Houston terms	Lower middle-income countries with high indebtedness	- Eligibility is assessed by Paris Club creditors, taking into account the track record of the debtor country with the Paris Club and the IMF and various criteria, including at least two of the following three criteria (i) GDP per capita smaller than $2,995, (ii) high indebtedness (defined as reaching at least two of the following three criteria: debt to GDP higher than 50%, debt to exports higher than 275%, scheduled debt service over exports higher than 30%); (iii) have a stock of official bilateral debt of at least 150% of private debt. - Non-ODA credits are rescheduled at the appropriate market rate over around 15 years with 2-3 years grace. - ODA credits are rescheduled at an interest rate at least as favourable as the original concessional interest rate applying to these loans, over 20 years with a maximum 10-year grace. - Debt swap operations may be carried out based on consultations (without limit on ODA loans, and up to 20% of the outstanding amount or 15-30 million SDR for non-ODA credits).

Naples terms	Poorest countries with high indebtedness	- Eligibility is assessed, taking into account the track record of the debtor country with the Paris Club and the IMF and of various criteria, including having a high level of indebtedness, being only eligible for IDA financing from the World Bank, and having a low GDP-per-capita ($755 or less). - Non-ODA credits are cancelled to a 67% level if creditors choose one of the two following options: (1) "debt reduction option" ("DR"): 67% of the claims treated are cancelled, the outstanding part being rescheduled at the appropriate market rate for 23 years repayment period with a 6-year grace period; and (ii) "debt service reduction option" ("DSR"): the claims treated are rescheduled at a reduced interest rate lower than the market rate with 33 years repayment period. (Other commercial options, such as the "capitalisation of moratorium interest" option, which has repayment conditions slightly difference from those of the DSR option, and the "commercial option" with longer repayment profiles are provided, but they have been very seldom used.) - Concerning ODA credits, they are rescheduled at an interest rate, at least lower than the market interest rate, with 40 years repayment period with 16-year grace. - Debt swap operations may be carried out based on consultations (without limit on ODA loans, and up to 20% of the outstanding amount or 15-30 million SDR for non-ODA credits).
Cologne terms	Countries subject to the Heavily Indebted Poor Countries (HIPC) initiative	- Debtor countries must be those defined in the HIP initiative and must be eligible for Naples terms. - They must have a sound track record with the Paris Club and continuing strong economic adjustment. - They must have been declared eligible to the enhanced HIPC Initiative by the boards of the IMF and the World Bank. - Non-ODA credits are cancelled up to a 90% level (or more if necessary) using the "debt reduction option" ("DR"), and the outstanding part is rescheduled at the appropriate market rate with 23 years repayment period with a 6-year grace. - Concerning ODA credits, they are rescheduled at an interest rate, at least lower than the market interest rate, with 40 years repayment period with 16-year grace. - Debt swap operations may be carried out based on consultations (without limit on ODA loans, and up to 20% of the outstanding amount or 15-30 million SDR for non-ODA credits). - Creditors may cancel their commercial claims up to a level higher than the one provided by the Paris Club agreement, after informing other creditors of an increased cancellation prior to such decision.

Source: Paris Club.

Looking at the number of debt restructuring cases agreed upon at the Paris Club and the details of the restructuring measures implemented (Figure and Table I-1-4-11), in 2020, when the COVID-19 pandemic spread worldwide, the number of cases agreed upon rose to an outstandingly high level, with African countries accounting for most of the cases. That was because the Paris Club and the G20 cooperated for the first time in April 2020 in order to deal with the impact of the COVID-19 pandemic on least-developed countries and agreed on the Debt Service Suspension Initiative (DSSI), a framework for rescheduling of public debts, and because most of the countries eligible for the DSSI were African countries. Under the conventional framework, consultations about debt restructuring were started in view of the specific circumstances of developing countries that had fallen into an economic crisis, but under the DSSI framework, debt restructuring is implemented upon application under prescribed conditions in the case of the 73 countries that the G20 and the Paris Club agreed to grant eligibility, resulting in the improvement of the efficiency of agreement on debt restructuring. This was a factor behind the steep increase in the number of debt restructuring cases agreed upon. Given that the scale of countermeasures taken by low-income developing countries in response to the COVID-19 pandemic was limited as mentioned above, the outstandingly high number of debt restructuring cases agreed by the Paris Club indicates that in Africa, where there are many low-income countries, planning and implementing countermeasures in itself was difficult due to economic and social turmoil. However, the DSSI makes it possible to use funds freed up by the postponement of debt repayment for economic and social measures, including countermeasures against the COVID-19 pandemic.

Figure and Table I-1-4-11. Number of debt restructuring cases agreed upon at the Paris Club and details thereof in recent years



2020

Date of agreement	Target countries	Types of debt rescheduling
Mar. 31, 2020	Somalia	Cologne
May 15, 2020	Dominica	DSSI
	Mali	DSSI
May 18, 2020	Grenada	DSSI
May 19, 2020	Cameroon	DSSI
	Nepal	DSSI
May 26, 2020	Burkina Faso	DSSI
Jun. 2, 2020	Mauritania	DSSI

2021

Date of agreement	Target countries	Types of debt rescheduling
Jan. 11, 2021	Kenya	DSSI
Jan. 18, 2021	Uganda	DSSI
Mar. 18, 2021	Saint Vincent and the Grenadines	DSSI
Apr. 26, 2021	Guinea-Bissau	DSSI
	Central African Republic	DSSI
Jul. 15, 2021	Sudan	Cologne
Sep. 10, 2021	Kyrgyz Republic	DSSI
Oct. 13, 2021	Fiji	DSSI

2022

Date of agreement	Target countries	Types of debt rescheduling
Jun. 22, 2022	Suriname	Classic

Jun. 4, 2020	Niger	DSSI
Jun. 9, 2020	Ethiopia	DSSI
	Chad	DSSI
	Pakistan	DSSI
	Congo	DSSI
Jun. 10, 2020	Myanmar	DSSI
Jun. 11, 2020	Cote d'Ivoire	DSSI
Jun. 15, 2020	Comoros	DSSI
	Togo	DSSI
Jun. 24, 2020	Guinea	DSSI
Jul. 21, 2020	Senegal	DSSI
Jul. 27, 2020	Democratic Republic of the Congo	DSSI
Aug.10, 2020	Zambia	DSSI
	Djibouti	DSSI
Aug. 12, 2020	Sao Tome and Principe	DSSI
	Cabo Verde	DSSI
Aug. 14, 2020	Sierra Leone	DSSI
Aug. 27, 2020	Samoa	DSSI
Aug. 31, 2020	Angola	DSSI
Sep. 3, 2020	Tajikistan	DSSI
Sep. 9, 2020	Lesotho	DSSI
Sep. 14, 2020	Maldives	DSSI
Sep. 29, 2020	Mozambique	DSSI
Oct. 7, 2020	Yemen	DSSI
Oct. 12, 2020	Madagascar	DSSI
Oct. 23, 2020	Tanzania	DSSI
Oct. 25, 2020	Saint Lucia	DSSI

Note: The term "DSSI" refers to "Debt Service Suspension Initiative."
Source: Paris Club.

The debt restructuring arrangements adopted by the Paris Club include ones that contain a debt swap provision at the discretion of individual countries, although not all creditor countries belonging to the club use such arrangements. Concrete debt swap arrangements include one under which the creditor country sells the debtor country's debts and uses the funds thus earned for the debtor country's economic development projects and one under which borrowings recorded as liability of the debtor country for accounting purposes are swapped for shares that are recorded as own capital, resulting in the reduction of the outstanding balance of debts (Debt Equity Swap [DES]). For example, when an emerging/developing country has agreed to a DES as part of debt restructuring, swapping external debts owed by state-owned companies in the country for shares and transferring the shares to the creditor country is a typical case of this arrangement. The table below shows the debt swap arrangements assumed by the Paris Club and the debt restructuring cases that were agreed upon at the Paris Club and involved a debt swap provision (Table I-1-4-12). Under debt restructuring arrangements, creditor countries expect to receive repayments from debtor countries by reducing their repayment burden through measures such as granting a grace period or lowering interest rates. In the case of debt-for-development swap, the funds freed up are used for debtor countries' economic development projects, while in the case of DES, creditor countries' commitment to the recovery of debtor countries is expected to become stronger because this arrangement means that the creditor countries become stakeholders in the debtor countries.

Table I-1-4-12. Debt restructuring arrangements involving a debt swap provision

Major debt swap arrangements	Details
Debt-for-development swaps	The debtor country directs the servicing of the debt to a fund that will be used to finance development projects in the country.
Debt-for-equity swaps	The creditor government sell its debt to an investor, and the investor in turns sells the debt to the debtor government in return for shares in a local company.
Local currency debt swaps	The creditor government sells its debt to an investor, and the investor in turns sells the debt and invests the fund in local currency in projects in the country for economic development.

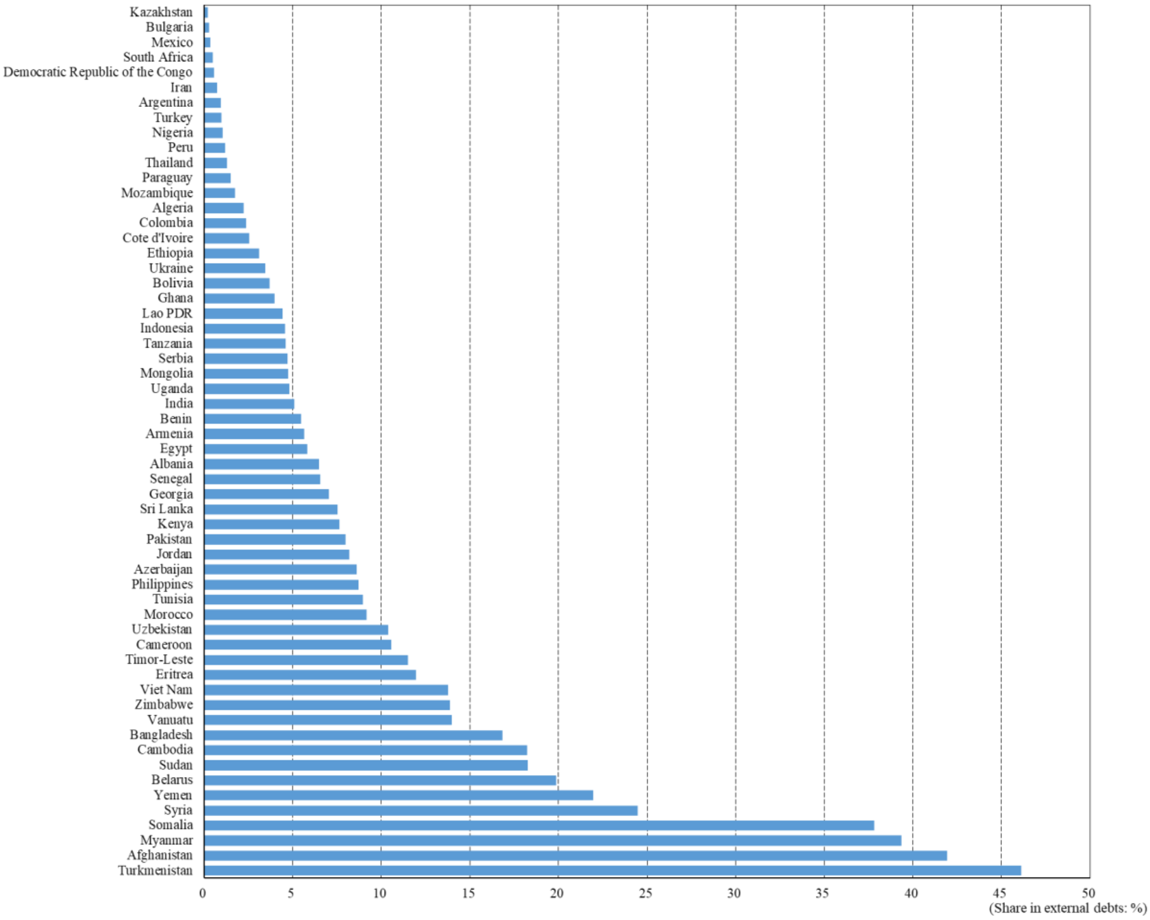
Year	Number of agreed debt restructuring cases involving a debt swap provision	Debtor countries
1990	2	Congo, El Salvador
1991	10	Nigeria, Poland, Egypt, Philippines, Senegal, Peru, Cote d'Ivoire, Dominican Republic, Nicaragua, Benin
1992	12	Ecuador, Tanzania, Bolivia, Morocco, Jordan, Uganda, Togo, Honduras, Mali, Guinea, Sierra Leone, Ethiopia
1993	6	Mauritania, Mozambique, Peru, Guyana, Burkina Faso, Benin
1994	10	Senegal, Niger, Cote d'Ivoire, Cameroon, Central African Republic, Ecuador, Jordan, Congo, Philippines, Sierra Leone
1995	13	Guinea, Cambodia, Uganda, Togo, Chad, Nicaragua, Bolivia, Senegal, Haiti, Mauritania, Algeria, Cameroon
1996	14	Zambia, Honduras, Sierra Leone, Ghana, Mali, Guyana, Chad, Burkina Faso, Congo, Peru, Yemen, Benin, Mozambique, Niger
1997	7	Tanzania, Ethiopia, Guinea, Madagascar, Jordan, Cameroon, Yemen
1998	7	Nicaragua, Uganda, Cote d'Ivoire, Mozambique, Rwanda, Bosnia and Herzegovina, Bolivia
1999	6	Pakistan, Honduras, Zambia, Jordan, Guyana, Mozambique

2000	7	Mauritania, Indonesia, Tanzania, Ecuador, Kenya, Nigeria, Gabon
2001	16	Pakistan, Cameroon, Niger, Malawi, Guinea-Bissau, Georgia, Madagascar, Ethiopia, Guinea, Chad, Sierra Leone, Montenegro, Serbia, Mozambique, Ghana
2002	9	Tanzania, Rwanda, Kyrgyz Republic, Cote d'Ivoire, Indonesia, Ghana, Jordan, Zambia, Nicaragua
2003	1	Ecuador
2004	15	Guyana, Kenya, Nicaragua, Burundi, Honduras, Dominican Republic, Niger, Ethiopia, Senegal, Gabon, Georgia, Ghana, Madagascar, Iraq, Congo
2005	2	Kyrgyz Republic, Dominican Republic
2006	2	Malawi, Haiti
2007	2	Central African Republic
2008	4	Guinea, Togo, Djibouti, Congo
2009	6	Togo, Burundi, Seychelles, Cote d'Ivoire, Haiti, Comoros
2010	7	The Democratic Republic of the Congo, Congo, Guinea-Bissau, Comoros, Antigua and Barbuda, Togo
2011	2	Guinea-Bissau, Cote d'Ivoire
2012	4	Guinea, Saint Kitts and Nevis, Cote d'Ivoire, Guinea
2013	2	Myanmar, Comoros
2015	2	Chad, Grenada

Note: The number of cases may not match the number of countries because some countries have multiple agreements within the same year.
Source: Paris Club.

At the Paris Club, agreement was reached on many debt restructuring cases in 2020, mainly under the DSSI framework, and progress was made in the initiative to mitigate the external debt problem faced by emerging and developing countries. However, it should be kept in mind that the external debt problem faced by low-income developing countries will not be fully resolved. The figure below (Figure I-1-4-13) shows the share of borrowings from Paris Club members in each country's external debts. According to this figure, the share of borrowings from Paris Club members are less than half at most and is below 25% in most countries. If looked at from another angle, in most countries, more than 75% of their external debts are borrowings with a maturity of less than one year or provided by countries not belonging to the Paris Club or by the private sector. In light of that situation, the fact that consultations involving creditor countries not belonging to the Paris Club and private-sector creditors are being held under the Common Framework for Debt Treatments beyond the DSSI, a joint initiative of the G20 and the Paris Club, which was agreed upon in November 2020, represents important progress in dealing with the external debt problem faced by low-income developing countries.

Figure I-1-4-13. Share of borrowings from Paris Club members in each country's external debts (2021)



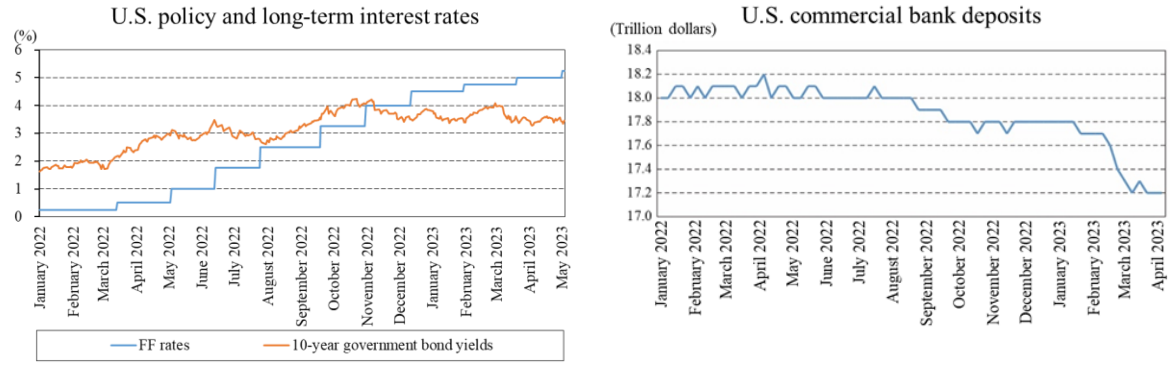
Source: Paris Club and BIS.

5. Indirect impact of policy interest hikes in developed countries on emerging and developing countries

The previous section referred to the implementation of rapid and steep hikes of policy interest rates by central banks, mainly in developed countries, in response to inflationary pressures. In addition, this section pointed out that the burden of external debt repayment by emerging and developing countries as a whole is not excessive. However, it should be kept in mind that those policy interest rate hikes have had an indirect impact on emerging and developing countries through effects on financial markets, such as bond yield rises (i.e., bond price declines) and stock price falls.

Among central banks in developed countries, the U.S. Federal Reserve Board (FRB) in particular quickly responded to inflation, and as a result of steep policy interest rate hikes, bond yields also rose steeply (Figure I-1-4-14). Consequently, the market value of securities held by financial institutions fell. Because of a rush of deposit withdrawals by depositors worried about that situation, liquidity crisis occurred as there emerged a growing risk of shortage of cash held by financial institutions. Moreover, there were signs that the liquidity crisis, which was viewed as an extraordinary situation faced by some particular financial institutions, would spread to other financial institutions at which the value of securities holdings was considered to be large relative to the size of deposits.

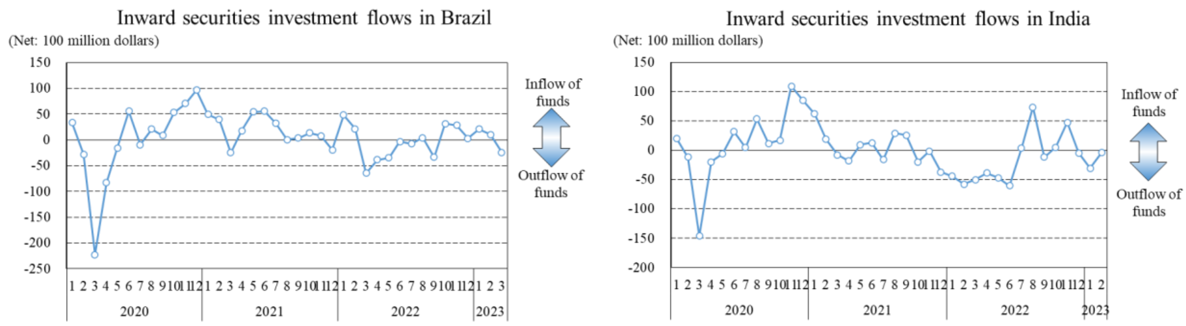
Figure I-1-4-14. U.S. policy and long-term interest rates, and commercial bank deposits

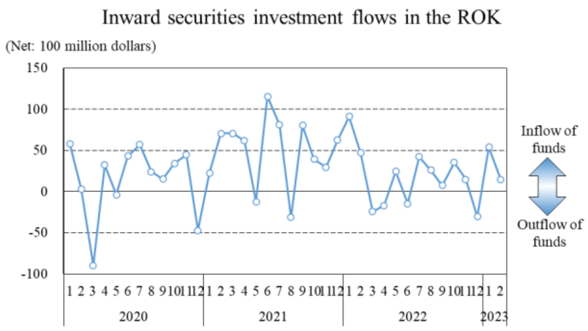


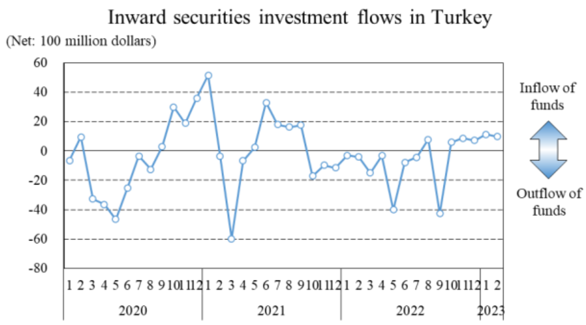
Note: U.S. commercial bank deposits are seasonally adjusted.
Source: Refinitiv, FRB.

The abovementioned financial trends in developed countries may indirectly affect emerging and developing countries. The figure below (Figure I-1-4-15) shows the trend in securities investment in some of the G20 countries, excluding the G7. Since 2022, when the U.S. monetary policy tightening started, fund outflows from emerging countries have become pronounced. In case of a liquidity crisis , in order to increase liquid funds, deposit-taking financial institutions may proceed with the withdrawal of portfolio investments (investments that acquire less than 10% of the voting rights in each investee company), which can be implemented in a relatively short period of time, rather than the withdrawal of direct investments (investments that acquire 10% or more of the voting rights of each investee company and so-called green-field investments used for the construction of offices and factories), which takes a long period of time. Attention should be paid to the possibility that a liquidity crisis in developed countries may affect the currencies and economic growth in emerging and developing countries through the withdrawals of investments by developed countries from emerging and developing countries, thereby producing an impact on the debt problem.

Figure I-1-4-15. Securities investment flows to emerging countries







Note: These graphs show G20 countries, excluding G7 countries, for which data are published on a monthly basis.
Source: Data on the central banks of Brazil, India, the ROK, and Turkey stored in the CEIC.

6. Status of debt risk in each region

The previous subsection analyzed debt risk faced by emerging and developing countries as a whole. As mentioned in the previous section, the size of external debts in emerging and developing regions is not excessively large, but on a country-by-country basis, some countries have already fallen into a crisis, while others are facing an increasing tight fiscal situation. Therefore, this subsection will look at debt risk in individual countries in each region.

(1) Asia

First, let us look at the situation in Asia. In Asia, concerns over debt risk are growing in Southwest Asia in particular, as exemplified by Sri Lanka's default on foreign currency-denominated debts in May 2022.

In Sri Lanka, foreign currency reserves, which amounted to 7.5 billion dollars in January 2020, before the COVID-19 crisis, fell to a quarter, or 1.9 billion dollars, in March 2022 because of the country's chronic trade deficit as well as its inability to earn foreign currencies from tourism and remittances by people working abroad due to the COVID-19 pandemic. As a result, Sri Lanka faced difficulty repaying external debts, so it requested an emergency loan from the IMF in April 2022. In September, the IMF reached a staff-level agreement with Sri Lanka on the provision of a loan based on the Extended Fund Facility (EFF). [17] Thereafter, formal approval was granted for a loan worth around 3 billion dollars in March 2023 following the consent by major creditor countries,[18] which was a precondition for the formal approval. Pakistan and Bangladesh also requested assistance from the IMF.

In Pakistan, where a high year-on-year inflation rate of above 10% continued from November 2021 onward, as well as the depreciation of domestic currency and the decline in foreign currency reserve, heavy rains that started around June 2022 caused damage on an unprecedented scale. In August, the IMF approved the implementation of a loan worth 1.1 billion dollars as part of the EFF worth a total of 6.5 billion dollars, which was launched in 2019.

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17 The Extended Fund Facility (EFF) is a loan facility that is intended to provide medium-term support to countries facing prolonged problems related to the international balance of payments.

18 Of the external debts owed by Sri Lanka, international organizations account for around 40% and bilateral sovereign creditors and private-sector creditors account for around 30% each. Among the bilateral sovereign creditors are China (accounting for 45%), Japan (25%), and India (10%) (as of the end of April 2022).

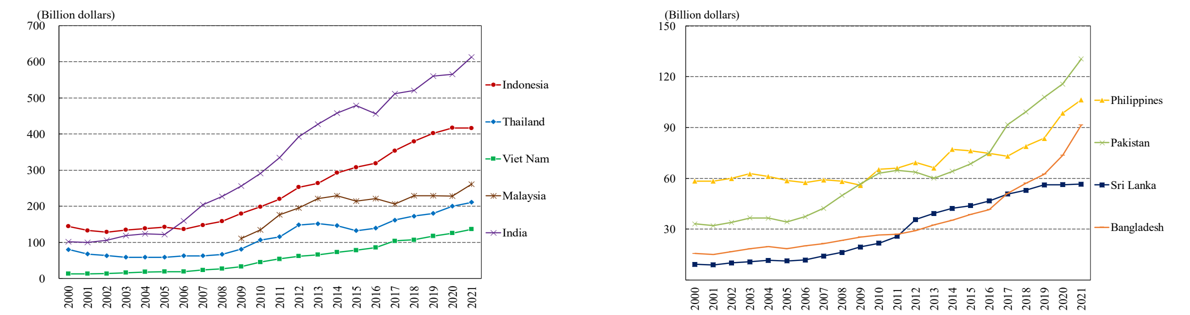
In Bangladesh, the economy was recovering from the COVID-19 crisis when the effects of energy price upsurges due to Russia's aggression against Ukraine led to the deterioration of the current account balance and a fall in foreign currency reserves. In January 2023, the IMF approved loans totaling 4.7 billion dollars under the Extended Credit Facility (ECF),[19] the EFF, and the Resilience and Sustainability Facility (RSF).[20]

Below, we will examine debt risk based on relevant indicators with respect to major countries in Southeast Asia and Southwest Asia.

(A) Outstanding balance of external debts

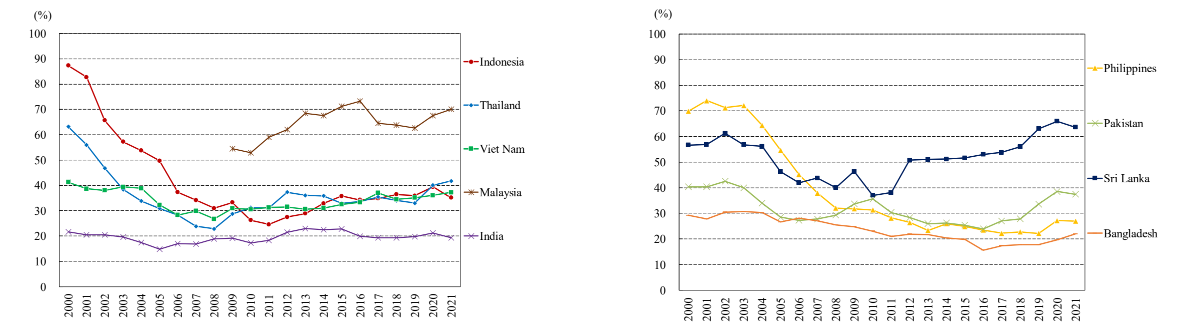
Looking at the outstanding balance of external debts and the ratio of external debts to nominal GDP in individual countries (Figures I-1-4-16 and I-1-4-17), while the outstanding balance of external debts generally increased as a trend, the ratio of external debts to nominal GDP did not rise markedly except in Malaysia and Sri Lanka. In 2021, the ratio of external debts to nominal GDP was high in Malaysia, at 70%, and in Sri Lanka, at 64%. In other countries except Indonesia and India, the ratio rose compared with 2019, before the COVID-19 crisis, but remained below 50%.

Figure I-1-4-16. Changes in outstanding balance of external debts by country



Note: Malaysia started to publish its data from 2009.
Source: World Bank, CEIC, Bank Negara Malaysia.

Figure I-1-4-17. Changes in ratio of external debts to nominal GDP by country



19 The Extended Credit Facility (ECF) is a loan facility that is intended to provide medium-term support to countries facing problems related to the international balance of payments and is targeted at low-income countries.

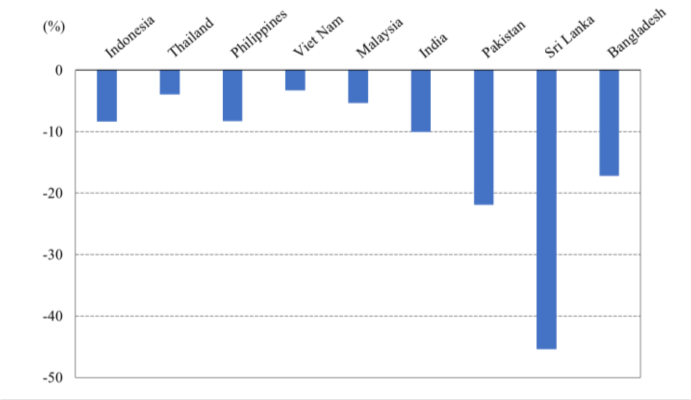
20 The Resiliency and Sustainability Facility (RSF) is a loan facility that is intended to support countries facing structural challenges, including climate change and pandemics, in maintaining economic and financial stability in the long term.

Note: Malaysia started to publish its data from 2009.
Source: World Bank, CEIC, Bank Negara Malaysia.

(B) Share of foreign currency-denominated debts

When the amount of external debts is large, there are concerns that a currency depreciation may increase the burden of repaying foreign currency-denominated debts in terms of domestic currency. Regarding the changes in the exchange rate in 2022 (Figure I-1-4-18), the exchange rates of Southeast and Southwest Asian countries' currencies against the dollar were invariably trending downward. During 2022, the currencies of Sri Lanka, Pakistan, and Bangladesh in particular fell steeply—45% for Sri Lanka, 22% for Pakistan and 17% for Bangladesh. While signs of recovery have been observed since around October in Southeast Asian countries and India, the currency depreciation did not come to a halt in the abovementioned three countries in 2023, with Pakistan's currency plunging further.[21]

Figure I-1-4-18. Changes in exchange rate of each country's currency against dollar

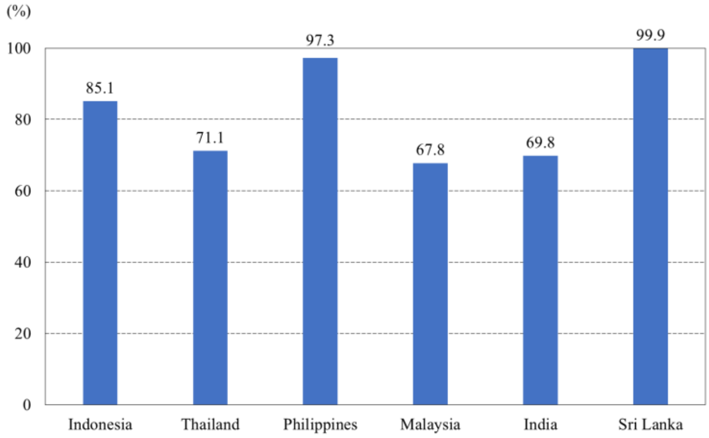


Note: Data from the beginning of 2022 to the end of the year.
Source: Refinitiv.

Meanwhile, the share of foreign currency-denominated debts in overall external debts (Figure I-1-4-19) remained high, above 60%, in all countries for which the data are available. In particular, foreign currency-denominated debts accounted for almost 100% of overall external debts in Sri Lanka and the Philippines, which means that these two countries are significantly affected by the depreciation of the domestic currencies.

[21] As of the end of February 2023.

Figure I-1-4-19. Share of foreign currency-denominated debts in overall external debts

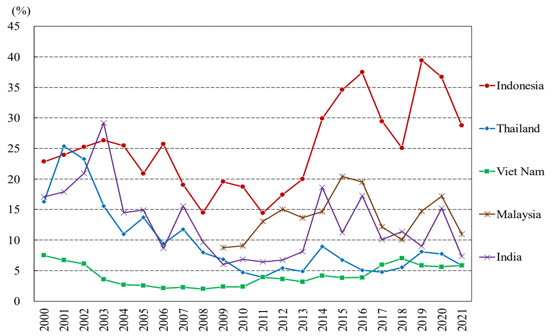


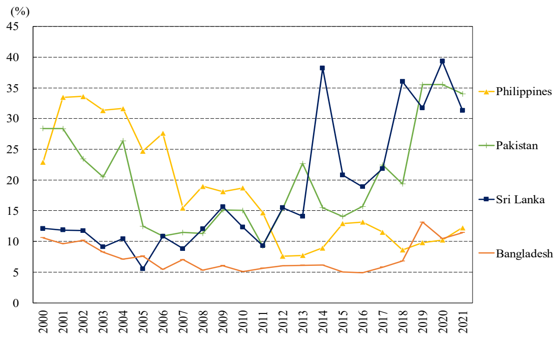
Notes: The data is as of the end of the 3rd quarter of 2022. Viet Nam, Pakistan, and Bangladesh have not published the given data.
Source: World Bank, CEIC, Bank Indonesia, Bank Negara Malaysia.

(C) Burden of external debt repayment

Next, let us look at the external debt repayment ratio as an indicator of the debt repayment burden[22] (Figure I-1-4-20). In countries with a higher external debt repayment ratio, the burden of external debt repayment is heavier. One factor that underlies an increase in the debt repayment burden is the concern of a decline in the ability to acquire foreign currencies. In Indonesia, Pakistan, and Sri Lanka, the external debt repayment ratio has been rising since around 2011 as a trend. As of the end of 2021, the external debt ratios in those countries were high, at around 30%—29% in Indonesia, 34% in Pakistan, and 31% in Sri Lanka. In other countries, the ratio was below 15%.

Figure I-1-4-20. Changes in ratios of external debt repayment by country





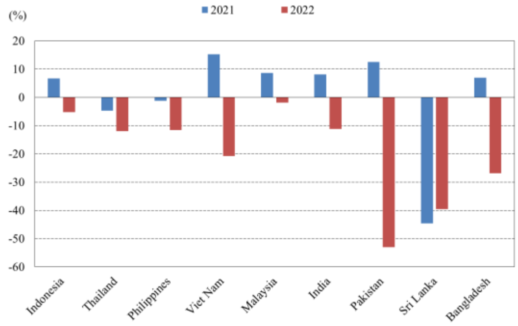
Source: World Bank, CEIC, Bank Negara Malaysia.

22 The external debt repayment ratio, which is calculated by dividing the value of debt repayments by the value of export and primary income, is an indicator of external debt repayability. The higher the external debt repayment ratio is, the heavier the burden of debt repayment is.

(D) Foreign currency reserves

Next, let us look at foreign currency reserves. Although foreign currency reserves have generally been increasing as a trend in recent years, they fell steeply in many countries in 2022. As for the rate of change in foreign currency reserves (Figure I-1-4-21), in Sri Lanka, it fell sharply, 45% in 2021, and 40% in 2022. Foreign currency reserves dropped 53% in Pakistan and 27% in Bangladesh in 2022. In short, the sharp decline in foreign currency reserves in Southwest Asia was pronounced.

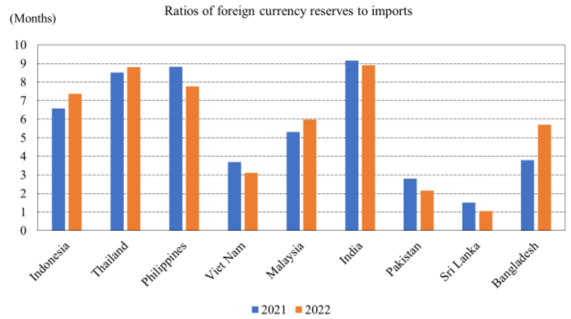
Figure I-1-4-21. Rate of change in the level of foreign currency reserves

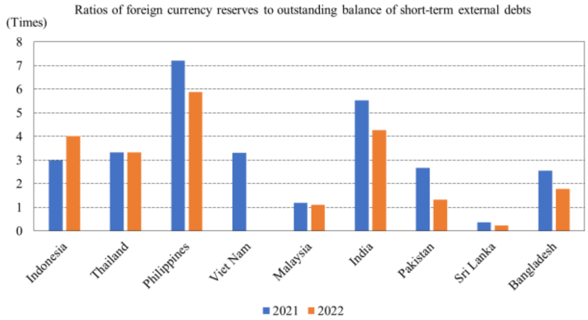


Source: CEIC.

Regarding foreign currency reserves relative to imports (Figure I-1-4-22), the relative level of foreign currency reserves as of the end of 2022 was low, equivalent to less than three months' worth of imports in both Pakistan and Sri Lanka—specifically, equivalent to 2.1 months' worth of imports in Pakistan and 1.1 months' worth in Sri Lanka. In other countries, the figure was equivalent to more than three months' worth of imports. The ratio of foreign currency reserves to the outstanding balance of short-term external debts (Figure I-1-4-22), which is an indicator of the capacity to repay short-term external debts with a maturity of less than one year, in Sri Lanka was 0.2, lower than the threshold of 1 that is considered to be desirable from the viewpoint of ensuring liquidity. In Malaysia, the ratio was also low, 1.1.

Figure I-1-4-22. Level of foreign currency reserves



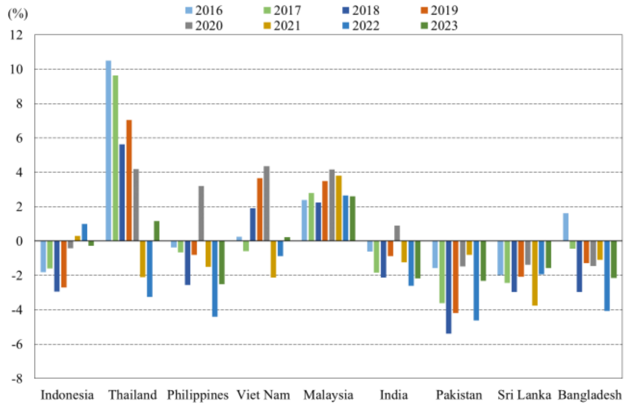


Note: The data on outstanding balance of short-term external debts in 2022 is as of the 3rd quarter of the year. (No data on Viet Nam is available.)
Source: World Bank, CEIC, Bank Negara Malaysia.

(E) Current account balance

Next, we will look at the current account balance. The ratio of current account balance to nominal GDP (Figure I-1-4-23) was in the negative column (which means a current account deficit) in all countries except Indonesia and Malaysia in 2022. In particular, India, Pakistan and Sri Lanka have chronically stayed in current account deficit since before the COVID-19 crisis, and according to the IMF, these countries are expected to remain in deficit in and beyond 2023. If current account deficit continues, it will become difficult to earn foreign currencies through trade in goods and services and direct investment, a situation that means a higher risk for external debt repayment. On the other hand, Malaysia has maintained a current account surplus and, therefore, has a relatively high capacity to earn foreign currencies.

Figure I-1-4-23. Changes in ratio of current account balance to nominal GDP



Note: The figures in and before 2021 are actual values, while those in and after 2022 are forecasts. However, as for Thailand, Malaysia, Pakistan, and Sri Lanka, the figures in and before 2020 are actual values and those in and after 2021 are forecasts.
Source: *WEO (April 2023)* (IMF).

In light of the above, apart from the countries that are already receiving assistance from the IMF, the countries discussed here, such as India and the ASEAN countries, are considered to be facing a relatively low debt risk. Since the Asian currency crisis, those countries have increased their resilience against external shocks by maintaining fiscal discipline and building up foreign currency reserves. Although the ratio of external debts to nominal GDP is high in Malaysia, the country's debt risk is considered to be relatively not high because around 30% of its external debts are denominated in the domestic currency, around 30% of its external debts are loans between banks or between companies, and it has maintained a current account surplus.

On the other hand, Sri Lanka and Pakistan are structurally dependent on external borrowings because they have chronically recorded current account and fiscal deficits since before the COVID-19 crisis, so in order to improve their debt status, they need to shift away from the existing economic structures in the medium to long term while receiving assistance from the IMF.

(2) Central and South America[23]

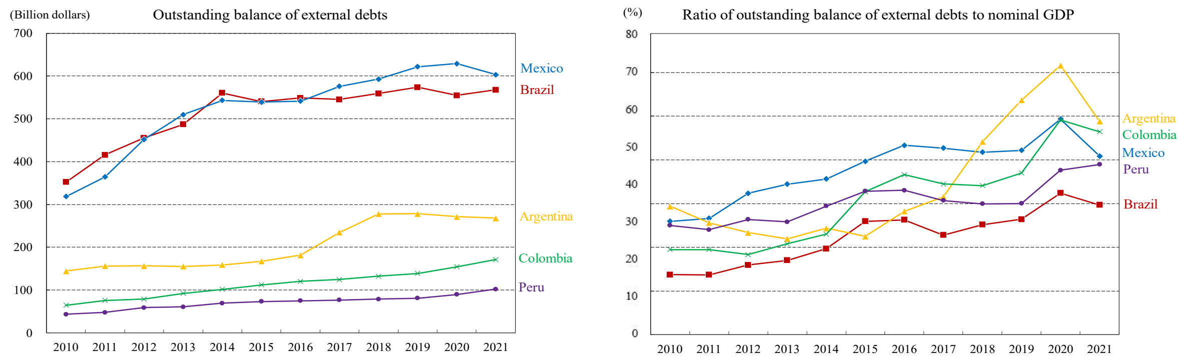
In Central and South America, Argentina is noteworthy from the viewpoint of debt risk. In May 2020, Argentina, a major exporter of corn, soy, and wheat, defaulted. That was the ninth default for the country, which has repeatedly experienced an economic crisis, and the first in six years since 2014. However, unlike in the past crises, Argentina's situation at this time was a "technical default," with its foreign currency reserves remaining at a relatively sufficient level, 42.59 billion dollars.[24] It has been pointed out that Argentina deliberately suspended interest payment because prospects for future debt repayment became dim. Moreover, in June 2021, Argentina requested the relaxation of the repayment terms because of the heavy burden of interest payment and refused to make repayment, raising concerns over a possible 10th default. Eventually, a default was averted as an agreement was reached on continuing negotiations toward debt restructuring, but the situation continues to be severe.

Below, we will look at the level of debt risk in Argentina and other major countries for which the data are available, including Brazil, Mexico, Colombia, and Peru, based on specific economic indicators.

(A) Outstanding balance of external debts

As shown in Figure I-1-4-24: left-side figure, the outstanding balance of external debts is increasing as a trend in all countries under analysis. As of 2021, the outstanding balance was large in Mexico (603.0 billion dollars and Brazil (567.5 billion dollars). The outstanding balance in each of these two countries is more than twice as large as the level in Argentina (267.9 billion dollars), Colombia (171.3 billion dollars), and Peru (102.0 billion dollars). As shown in Figure I-1-4-24: right-side figure, the ratio of external debts to GDP (gross domestic product) stood higher than 50% for Argentina (57%) and Colombia (54%), followed by the ratios in Mexico (47%), Peru (45%) and Brazil (34%).

Figure I-1-4-24. Changes in outstanding balance of external debts and those in ratio of external debts to nominal GDP in five major countries in Central and Latin America



Source: CEIC.

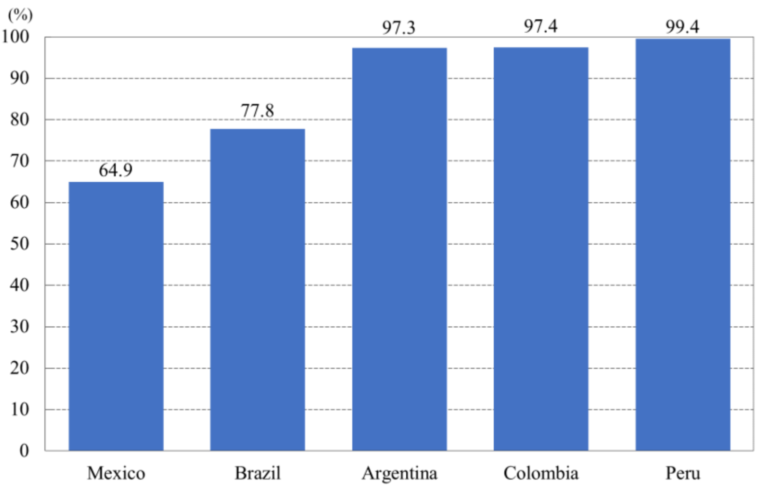
23 Nishihama, T., "ARUZENCHIN, "AETE NO" DEFORUTO WO SENTAKU," "ARUZENCHIN, PARI KURABU TONO GOUI DE JYUUDOME NO DEFORUTO WA KAIHI," World Trends, Dai-Ichi Life Research Institute.

24 As of May 2020.

(B) Share of foreign currency-denominated debts

Next, Figure I-1-4-25 shows the share of foreign currency-denominated debts in overall external debts as of the end of the third quarter of 2022. The share of foreign currency-denominated debts was higher than 60% even in countries where the share was relatively low among the countries under analysis, such as Mexico (64.9%) and Brazil (77.8%). The share was higher than 90% in Argentina (97.3%), Colombia (97.4%), and Peru (99.4%). In those countries, foreign currency-denominated debts account for most of the external debts, so the countries are susceptible to the effects of changes in other countries' economic conditions and interest rates, including an increase in the debt repayment burden.

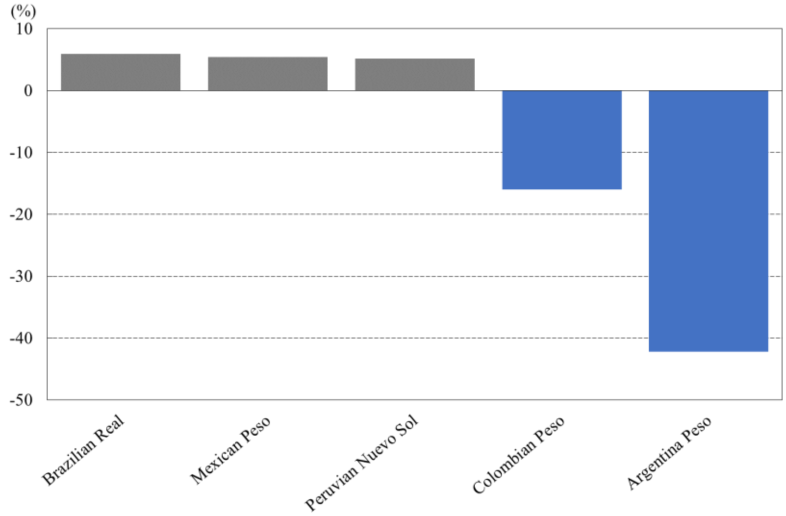
Figure I-1-4-25. Share of foreign currency-denominated debts in overall external debts in five major countries in Central and Latin America



Notes: The data is as of the end of the 3rd quarter of 2022.
Source: World Bank.

Figure I-1-4-26 shows the rate of appreciation/depreciation in the domestic currencies of the countries under analysis against the U.S. dollar. At a time when the steep interest rate hikes in the United States were causing outflows of funds from emerging and developing countries and exerting downward pressures on their currencies' exchange rate against the U.S. dollar in many countries, the currencies of central and South American countries, such as Brazil, Mexico, and Peru, appreciated against the U.S. dollar because interest rate hikes started early in those countries. Specifically, the domestic currency appreciated 5.9% in Brazil, 5.4% in Mexico and 5.1% in Peru. On the other hand, the depreciation of Argentina's currency was outstanding, increasing the debt repayment burden.

Figure I-1-4-26. Rate of appreciation/depreciation in domestic currencies of five major countries in Central and Latin America against U.S. dollar



Note: The data shows the results of comparison between the beginning of 2022 and the beginning of 2023.
Source: Refinitiv.

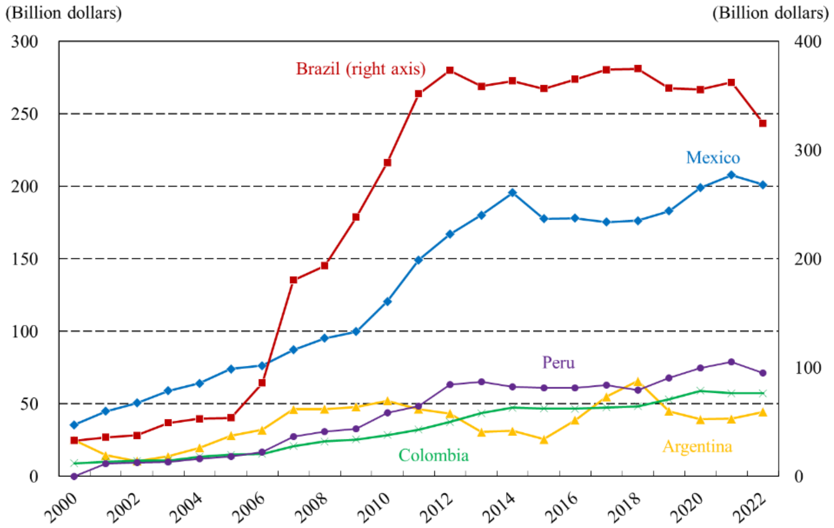
(C) Foreign currency reserves

Foreign currency reserves, which are under the control of the national authorities, such as finance ministries and central banks, may be used for exchange market interventions in times of market turmoil or for debt repayments when the repayment situation has become severe. For emerging and developing countries with large amounts of debts, holding an appropriate level of foreign currency reserves increases resiliency against crises and raises the level of trust from the outside world.

Figure I-1-4-27, which shows changes in the level of foreign currency reserves, indicates that the countries under analysis have been building up foreign currency reserves in light of their past experiences. However, in 2022, the level of foreign currency reserves fell in many countries because the dollar's appreciation accelerated due to rapid interest rate hikes in the United States, causing the countries to sell large amounts of dollars in order to defend their currencies by preventing a sharp depreciation. According to the Assessing Reserve Adequacy (ARA),[25] a dataset published by the IMF as an indicator of whether or not the level of foreign currency reserves in a country is appropriate, the ARA index is far higher than the 1.0-1.5 range, which is viewed as an appropriate level, in Peru (2.42), while the index is within the appropriate range in Brazil (1.36), Colombia (1.29), and Mexico (1.16), meaning that the level of foreign currency reserves was sufficient in those four countries by the IMF's standard. On the other hand, the ARA index was lower than the appropriate level in Argentina (0.74), indicating that the country is facing a relatively high risk regarding foreign currency reserves.

[25] IMF, "Assessing Reserve Adequacy," ARA (April 2023).

Figure I-1-4-27. Changes in level of foreign currency reserves in five major countries in Central and Latin America



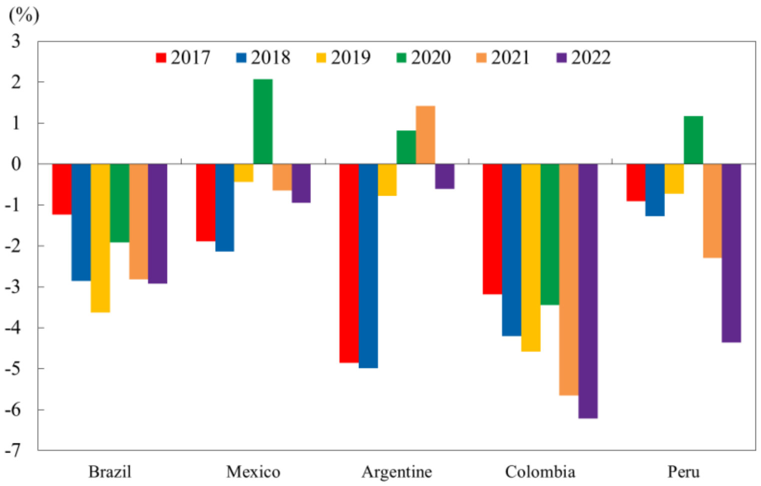
Note: The data on Peru shows that from 2001.
Source: Statistics on countries and regions stored in the CEIC.

(D) Current account balance

When we look at the current account balance as an indicator of capacity to earn foreign currencies against the backdrop of the increasing accumulation of external debt, we can see that the countries under analysis have chronically remained in deficit (Figure I-1-4-28). As background factors, it has been pointed out that it is difficult for the countries to maintain surplus because their main export items, which are primary products, have low value added and are susceptible to international prices.[26] Among the countries under analysis, Colombia in particular has been recording a large deficit. Although Argentina was also recording a large deficit, its currency account balance has improved because the trade balance turned to surplus. Generally speaking, current account deficit does not pose a serious problem if its size remains at a sustainable level and it reflects inflows of investments that lead to economic growth. However, a careful watch needs to be kept so that a steep fall in the level of foreign currency reserves and excessive dependence on procurement of funds from abroad can be avoided.

[26] Horie, M. (2022), "CHUU NANBEI KEIZAI NO GENJOU TO KONGO NO CHUUMOKUTEN," *KEIZAI REPOOTO*, Mitsubishi UFJ Research and Consulting.

Figure I-1-4-28. Ratios of current account balance to nominal GDP in five major countries in Central and Latin America



Source: Statistics on countries and regions stored in the CEIC.

Above, we looked at specific indicators regarding major countries in Central and South America. Although there is no impending economic crisis in this region, the risk level is high in some countries. Argentina's current account deficit shrank considerably in 2022, but its ratio of external debts to GDP and the share of foreign currency-denominated debts are large compared with other countries, and despite the ongoing depreciation of its currency, the level of Argentina's foreign currency reserves is below the appropriate level. In the case of Colombia, not only are the ratio of external debts to GDP and the share of foreign currency-denominated debts large compared with other countries, but also, its current account deficit expanded in 2022. A careful watch needs to be kept on future developments.

(3) Africa

In Africa, Zambia and Ghana are noteworthy from the viewpoint of debt risk.

Zambia defaulted in November 2020, becoming the first African country to do so since the onset of the COVID-19 pandemic, because it became difficult to make interest payments on dollar-denominated government bonds. Zambia, which is located in southern Africa and is a major producer of natural resources, such as copper and cobalt, had been heavily indebted since before the COVID-19 crisis, with the outstanding balance of its external debts amounting to 27.25 billion dollars (equivalent to 119% of GNI[27]) in 2019. Later, Zambia eventually faced difficulty in repaying debts because of the combined effects of a copper price decline due to reduced demand amid the COVID-19 crisis, a decrease in revenue due to an economic slump, and increased expenditures due to fiscal assistance measures. At a meeting of the IMF Executive Board in August 2022, the provision of loans totaling around 1.3 billion dollars over three years and two months to Zambia was approved, and the country is striving to rebuild its fiscal position.

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[27] GNI (gross national income) = GDP (gross domestic product) + net income receipts from abroad (including incomes earned by people who work abroad (for a period shorter than one year)). When expressing the debt size, the World Bank uses the ratio to GNI instead of the ratio to GDP.

Ghana defaulted in December 2022 and announced that it would temporarily suspend repayment of external public debts, including most of the bilateral loans. Ghana, which is a major produce of cacao and gold, continued to record an economic growth rate higher than 6% in terms of real GDP from 2017 onwards, but it was severely hurt by the COVID-19 crisis as well as the consequences of the deterioration of the Ukraine situation, such as a large-scale capital flight, escalating inflation, and the depreciation of its currency. The outstanding balance of debts about quadrupled over a period of around 10 years, from 7.73 billion dollars (January 2012) to 29.19 billion dollars (November 2022). Ghana's currency, the cedi, depreciated around 60% against the U.S. dollar in 2021, while the inflation rate stayed above 50% from November 2022 onwards. Ghana has agreed to receive financial assistance worth 3 billion dollars from the IMF and is striving to restore debt sustainability.

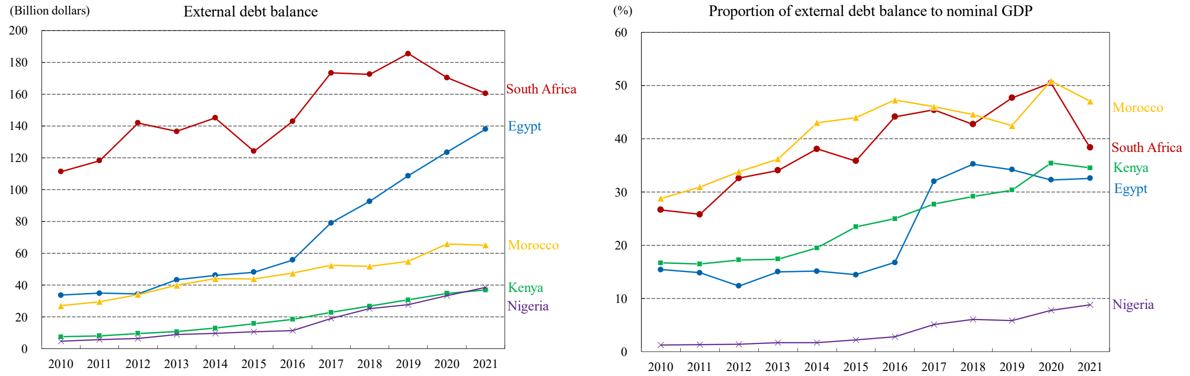
Furthermore, in November 2022, an agreement was reached on the treatment of Chad's debts under the common framework of the G20 and the Paris Club, which was mentioned earlier, representing the first case agreed upon under that framework. In this case, it was agreed that if a fund shortfall occurred because of factors such as a crude oil price fall, negotiations would be held again on the treatment of the debts. In addition, although Egypt has not defaulted as of now, the COVID-19 crisis steeply reduced its tourism-related revenue and the deterioration of the Ukraine situation dealt a heavy blow to the procurement of food by Egypt, which depends heavily on Russia and Ukraine for food imports. The level of Egypt's foreign currency reserves declined 24.7% compared with 2019 to 34.0 billion dollars (as of the end of 2022). To rebuild its economy, Egypt has agreed to receive loans totaling 3 billion dollars from the IMF over a period of three years and 10 months.

Below, we will look at the level of debt risk in Egypt and other major countries for which the data is available, including Nigeria, South Africa, Morocco, and Kenya, based on specific economic indicators.

(A) Outstanding balance of external debts

The outstanding balance of external debts are increasing as a trend. In 2021, the outstanding balance was particularly large in South Africa (160.5 billion dollars) and Egypt (137.9 billion dollars), but in other countries under analysis, the level was less than half that in those two countries (Figure I-1-4-29: left-side figure). The ratio of external debts to GDP in Egypt, which was around 15% in 2010, rose above 30% in 2021. The ratios of external debts in Morocco and South Africa rose from the higher 20% range in 2010 to 47% and 38%, respectively, in 2021 (Figure I-1-4-29: right-side figure).

Figure I-1-4-29. Changes in outstanding balance of external debts and those in ratio of external debts to nominal GDP in five major countries in Africa



Source: Statistics on countries and regions stored in the CEIC.

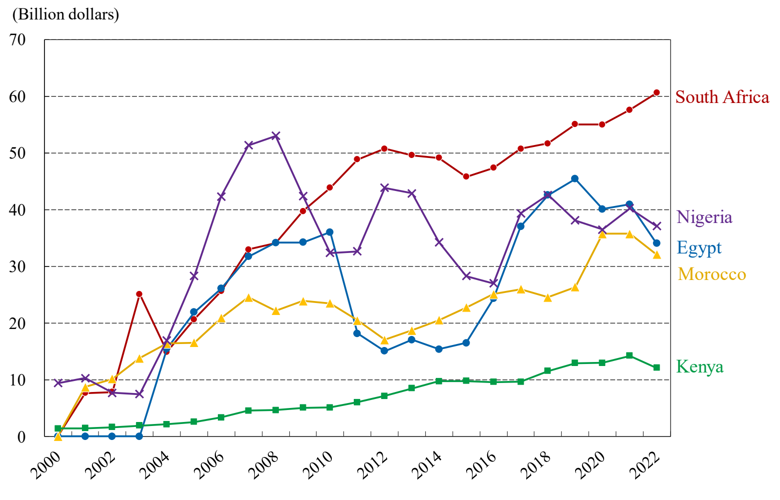
(B) Share of foreign currency-denominated debts

The share of foreign currency-denominated debts in overall external debts was only around 55.3% in South Africa. The relevant data for other African countries under analysis are not available from the World Bank. However, generally speaking, as trust in the currencies of emerging and developing countries is lower than that in the U.S. dollar, which is an international reserve currency, it is difficult for those countries to issue bonds or take in loans in domestic currency terms, a situation that leads to a larger share of foreign currency-denominated debts. Therefore, it should be kept in mind that if U.S. policy interest rates are raised, funds may flow out of emerging countries, resulting in an increase in the burden of repaying foreign currency-denominated debts by inducing currency depreciation and that a further fund outflow may occur if concerns among investors grow in response to that situation.

(C) Foreign currency reserves

For developing countries whose economic fundamentals are weak, holding a sufficient level of foreign currency reserves serves as a precaution against a rapid outflow of funds and a currency depreciation. As shown in Figure I-1-4-30, the level of foreign currency reserves is increasing as a trend, but in Egypt and Nigeria, the level sometimes declined steeply. As for the IMF's ARA, which was mentioned earlier, the ARA index was lower than the appropriate range (1.0-1.5) in each of the countries disclosing the data, namely Morocco (0.91), South Africa (0.78), and Egypt (0.39). As those countries' vulnerability to external shocks continues to be high, a further buildup of foreign currency reserves is required.

Figure I-1-4-30. Changes in level of foreign currency reserves in major countries in Africa

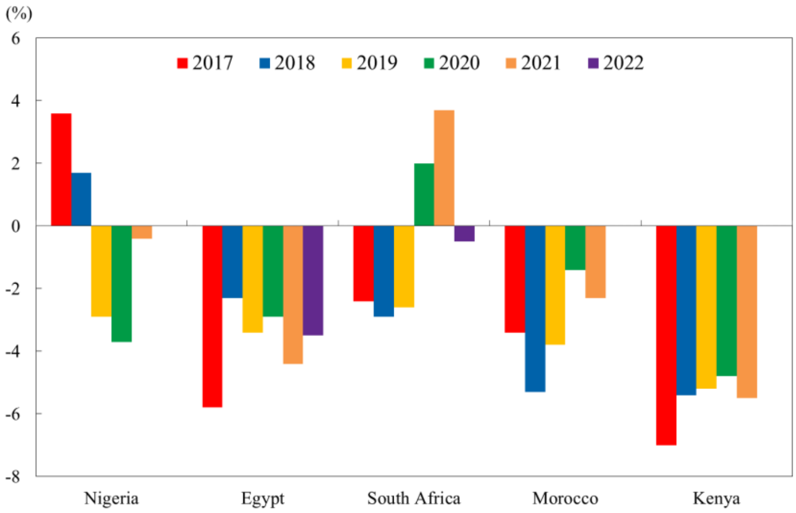


Source: Statistics on countries and regions stored in the CEIC.

(D) Current account balance

According to Figure I-1-4-31, which shows the capacity to earn foreign currencies in terms of the ratio of the current account balance to nominal GDP, South Africa turned to surplus in 2020, but other countries under analysis have chronically been in deficit. In particular, Kenya (-5.5% in 2021) and Egypt (-3.5% in 2022), recorded a large deficit against the backdrop of import price rises for fuels, fertilizers, and foods.[28] The main industries of Africa are agriculture and mining, which are susceptible to fluctuations of international prices, and many African countries import energy and foods. An expansion of current account deficit creates pressures for outflows of investment funds and raises the inflation rate through currency depreciation. Attention should be paid to a possible increase in the burden of debt repayment.

Figure I-1-4-31. Ratio of current account balance to nominal GDP in five major countries in Africa



Source: Statistics on countries and regions stored in the CEIC.

Above, we provided an overview of the status of debt risk in individual countries in each region. Once a country has defaulted due to failure to reduce debt risk, it becomes difficult to raise new funds because of the loss of trust in international financial markets. In addition, if it becomes difficult to ensure the supply of necessities due to inability to make payments for imports, ordinary people's lives and companies' production activity become unstable.

Furthermore, it should be kept in mind that a debt crisis in emerging and developing counties has the risk of raising the global inflation rate by generating spillover effects on agricultural products, which are those countries' main export items. That is because foreign currency shortages make it difficult to purchase fertilizers and materials, and delays in the growth of agricultural products and reduced harvest tend to lead to higher international prices due to concerns over a possible steep fall in export volume.

Amid the slowdown of the growth of the global economy, there is increasing risk from expanded debts in emerging and developing countries, where there is a lack of industries that form the basis of the capacity to earn foreign currencies. Therefore, international organizations, such as the IMF and the World Bank, are requesting cooperation from the developed countries that are the creditors.

[28] World Bank, "Africa's Pulse, No. 27, April 2023."