

# The IMF Is Digging Deeper Into Its Pockets

High debt costs are placing more demands on the IMF.

By Vaibhav Tandon



Just last year, the International Monetary Fund (IMF) was working overtime to provide relief to economies affected by COVID-19. With the virus-related shock moving into the past, the world's lender of the last resort remains in high demand, this time over rising debt distress. Global debt rose by 28 percentage points to 256% of gross domestic product in 2020. This was the largest one-year debt surge since World War II, justified by the need to protect lives and

livelihoods. However, a perfect storm of high inflation, rising interest rates, the stronger dollar and unsustainable debt is now threatening to engulf vulnerable emerging markets (EMs). While **EMs** were more resilient in the run up to the pandemic, with increased reserves and smaller trade deficits, those buffers have diminished rapidly. As a result, many developing economies are staring at turbulent times. More than 60% of low-income countries, defined as economies eligible to access the IMF's Poverty Reduction and Growth Trust, and over 25% of EMs are in or at risk of debt distress. Markets are pointing to a level of strain not seen in three decades.

Sovereign dollar bonds of several economies in Bloomberg's EM Sovereign Dollar Debt Index have been trading at a spread of over 1000 basis points or more over U.S. Treasuries. Countries like Sri Lanka, Pakistan, Lebanon, Ghana and Ukraine have either already defaulted or are struggling to repay their debt obligations. According to a **study** by Boston University, 55 of the world's poorest economies face debt repayments of \$436 billion over the next six years.

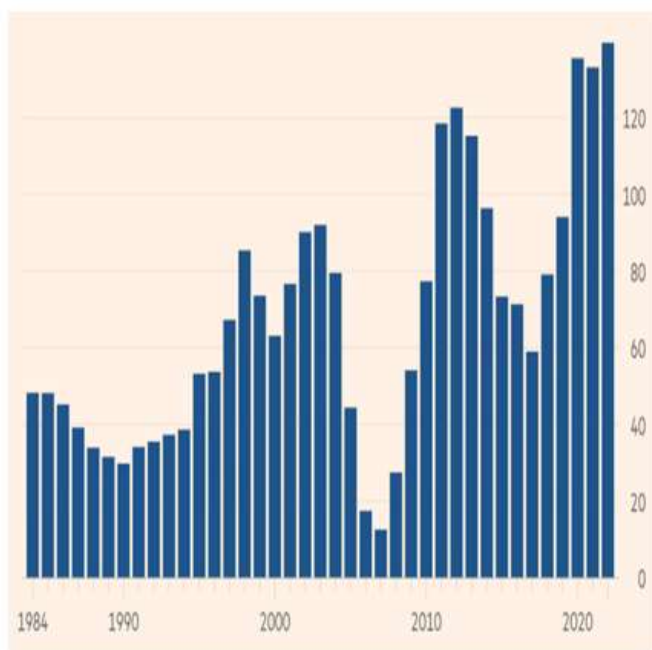
As a result, the IMF — a body with the resources, mandate and a global reach — is becoming more involved in bailing out countries facing distress than it has in recent history. The value of its emergency loans has climbed to a record level; the Fund has disbursed \$140 billion in 44 separate programs thus far in 2022 with another \$128 billion in loans agreed.

The numbers have raised concerns about the IMF's capacity to provide further support. While the Fund's capacity to offer concessional (zero interest rate) financing to low-income economies is limited, its emergency-lending toolkit is quite substantial. With a capacity of \$1 trillion, up from \$400 billion over a decade ago, the IMF has enough financial firepower to deal with the needs of struggling economies. It is also making efforts to expand its lending capacity, which includes the recently established Resilience and Sustainability Trust and the Food Shock Window.

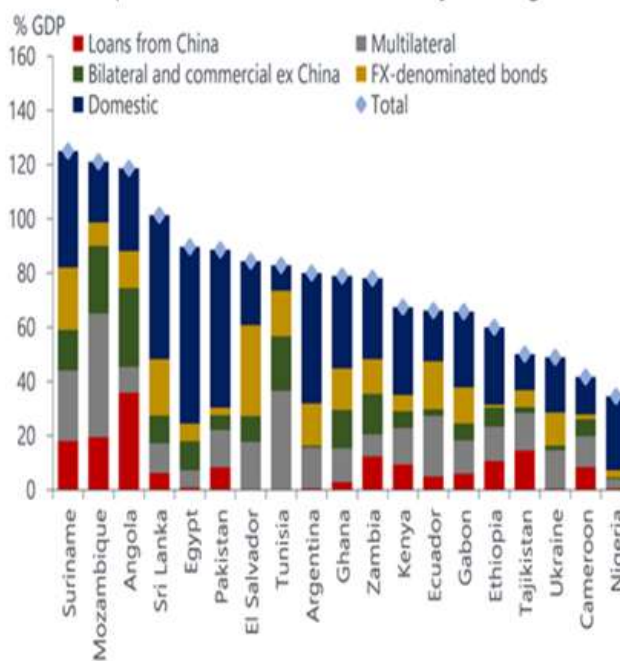
Multilateral loans are an important part of rescue packages for countries afflicted by stress. But that help comes with conditions attached, often a source of criticism of institutes like the IMF. Loans require unpopular measures such as reducing public spending, raising taxes and cutting subsidies for essentials. The IMF is also seen as interventionist for its public criticism of economic policies of national governments, like in case of the **U.K.** and **Mexico**.

**IMF bailouts have hit a record high this year amid rising debt distress.**

IMF Lending (Loans disbursed, \$ Billion)



Debt composition in economies afflicted by sovereign stress



Sources: FT, IMF, Oxford Economics

Multilateral institutions are not the only source of sovereign funding. China has emerged as a major lender to smaller economies, offering loans at more lenient terms or adjustable interest rates. Chinese public and private lenders accounted for 12% of Africa’s \$696 billion external debt in 2020. According to the World Bank, of the \$35 billion debt-service payments due this year by the world’s poorest economies, around 40% is owed to China.

This shift has given rise to resolution and transparency problems. Last November, the **World Bank** reported that 40% of low-income countries have not published any data about their sovereign debt since 2020. According to **AidData**, debts stemming from Chinese lending are significantly higher than estimated by credit rating agencies and international organizations. This boom in **obscured liabilities** has led to an increase in unrecorded debt restructuring and defaults. Chinese banks, which are the lenders instead of the government, don’t have a history of taking losses on external credit. This has made debt workouts more difficult. Though Beijing was initially reluctant to allow debt reductions, it has agreed to provide relief to 23 African nations. China’s ability to deliver more relief will be challenged by its own domestic **woes**. There is a **growing** clamor for the IMF to develop new unconditional ways of providing financial assistance to struggling states. This is not entirely misplaced given the current economic environment. But without any strings attached, the Fund risks aggravating the very problem that landed the borrowers at its doorstep.

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