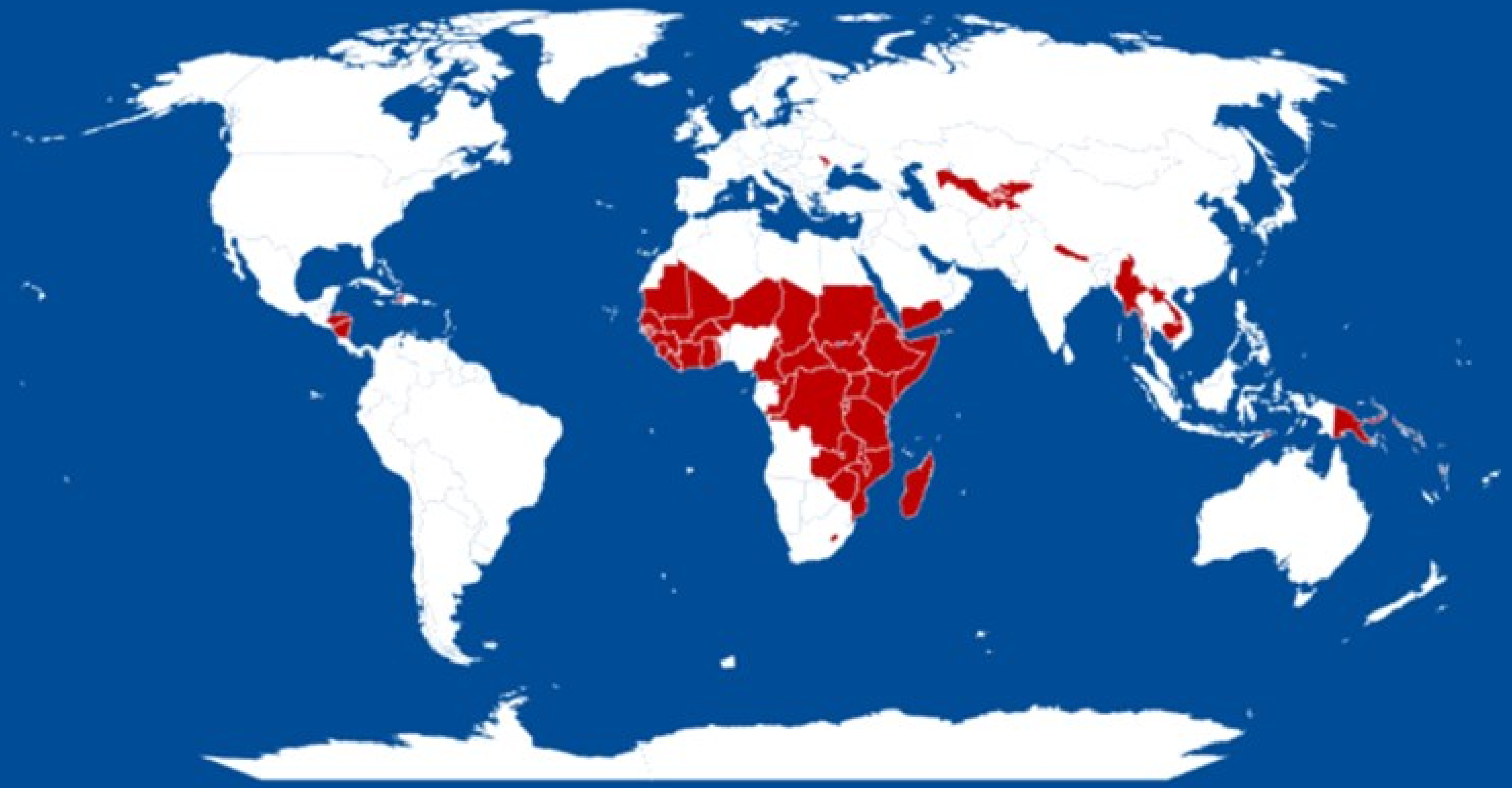


Macroeconomic Developments and Prospects in Low-Income Countries—Latest Findings from the IMF

JANUARY 2023

International Monetary Fund

Context: A Challenging Macroeconomic Environment for LICs

- **Low Income Countries have been disproportionately impacted by the COVID-19 pandemic**:
  - Low number of identified cases, but **strained healthcare system** and **learning losses** from school closures.
  - **Large adverse economic impact**, largely due to **limited policy space** when entering the pandemic and high **vulnerability** to external shocks.
  - **Within-country inequality** increased as disadvantaged groups such as women, youth and workers in the informal economy suffered more from the economic fallout of the pandemic.

- **The macro situation of LICs has further worsened with the spillovers from Russia's war in Ukraine.**

- **Key objectives**: to lay out the latest analysis of the IMF and contribute to the international discussion on:
  - The **quantitative analysis** on the challenges for LICs stemming from the pandemic and the war in Ukraine.
  - The **development challenges** and the associated **financing needs**.
  - The **key policy priorities** for LICs.

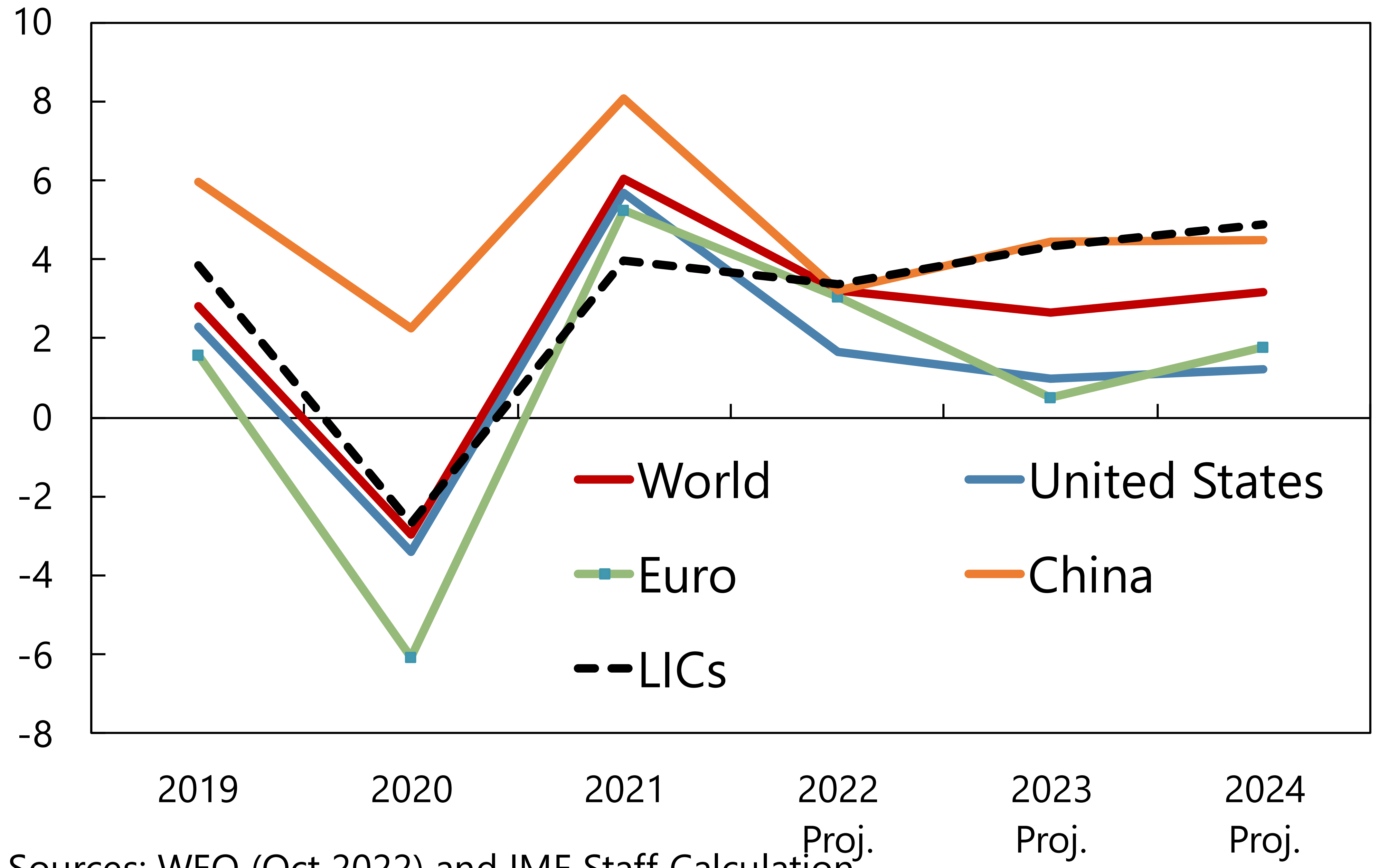
Headwinds to Global Growth Further Delay Income Convergence

Global economy recovery has **weakened in 2022**, with the war in Ukraine, widespread inflation, supply disruptions, tightening of global financial conditions, and the legacy of COVID pandemic being the main factors.

The pandemic and the war in Ukraine have significantly delayed the **convergence** of LICs' income per capita.

Real GDP Growth: Major Economies

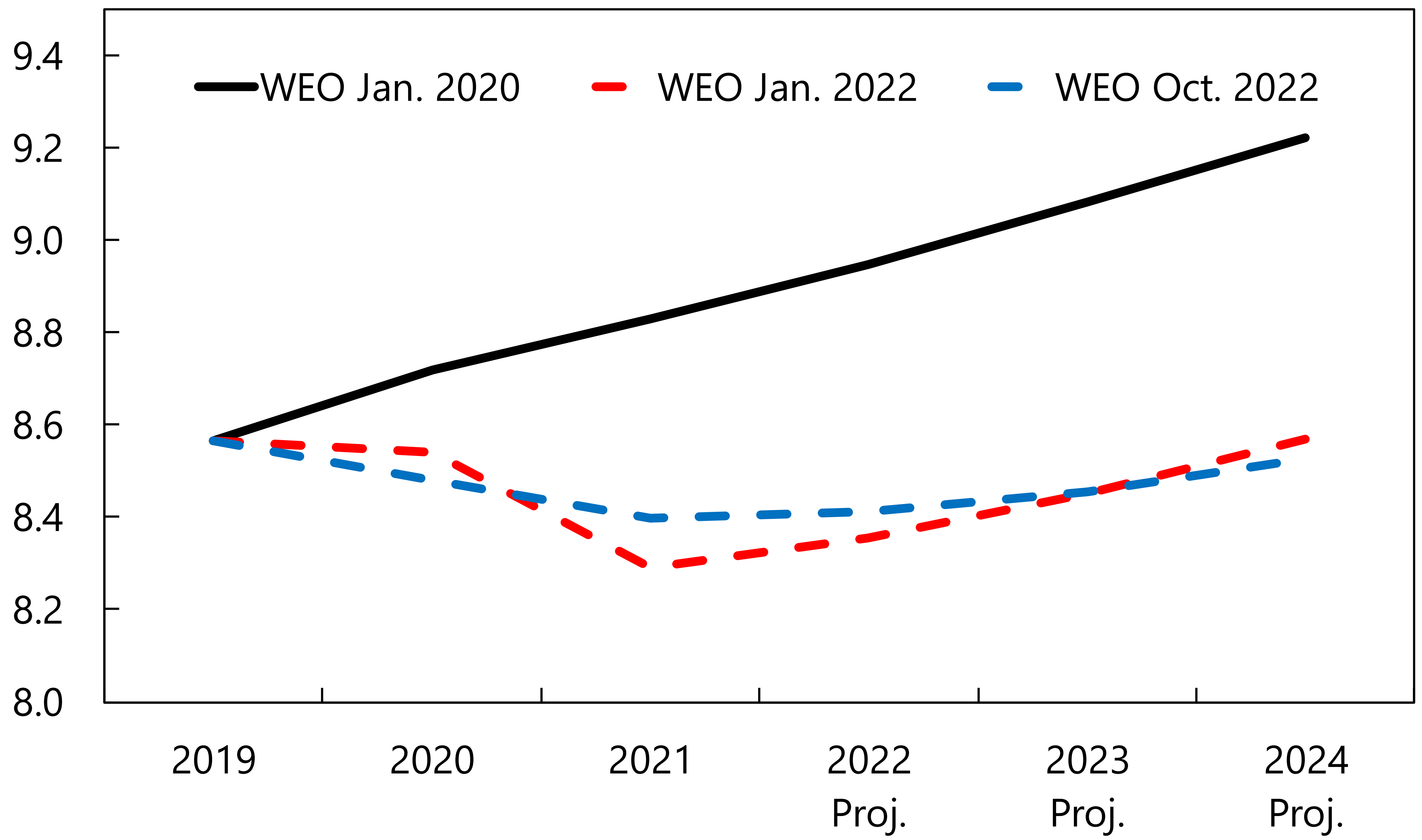
(Percentage Points)



Sources: WEO (Oct 2022) and IMF Staff Calculation

LIC Convergence in Real GDP Per Capita

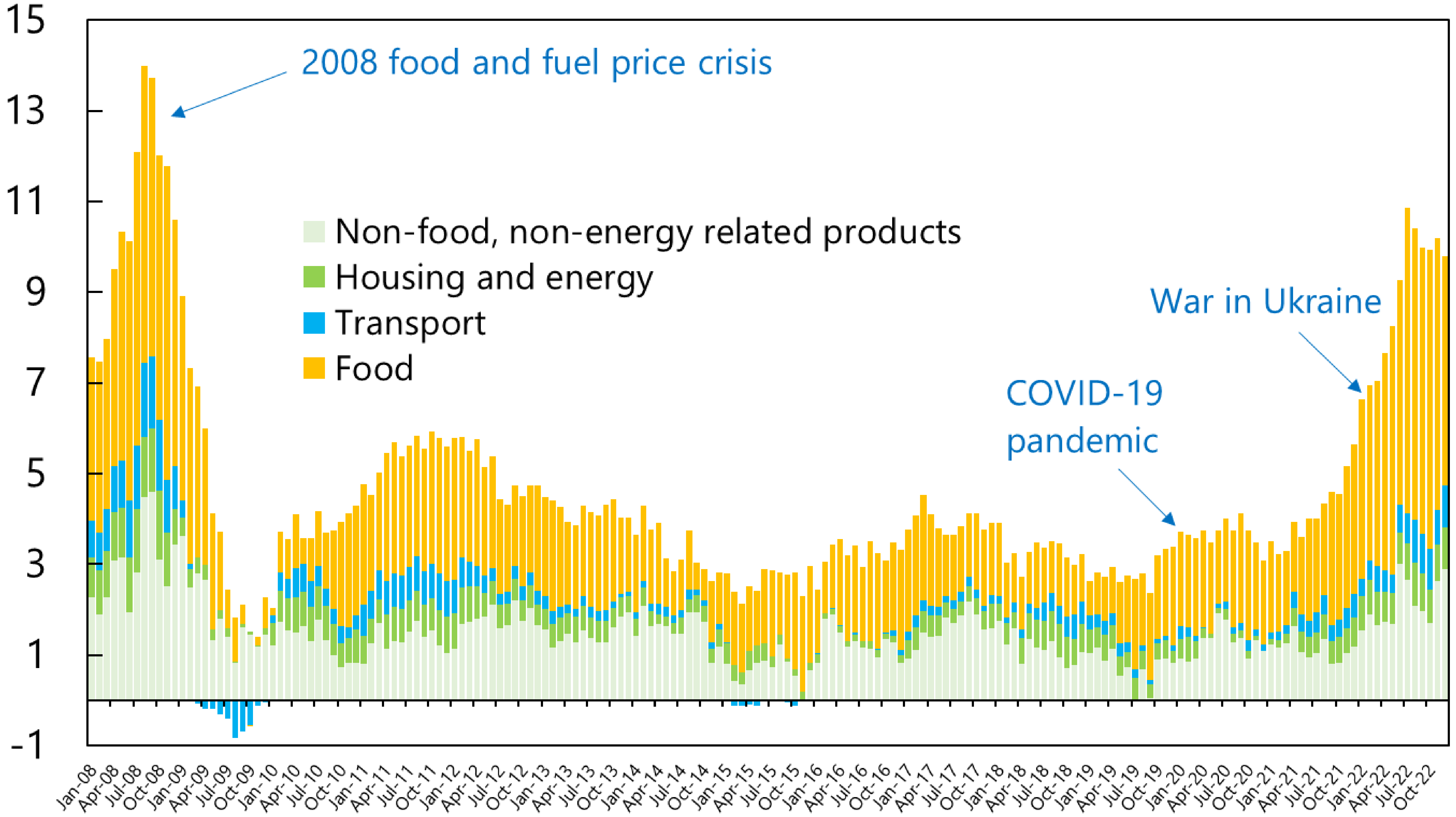
(Percent of AE average)



Sources: WEO and IMF Staff Calculation

The Food Crisis is Deepening

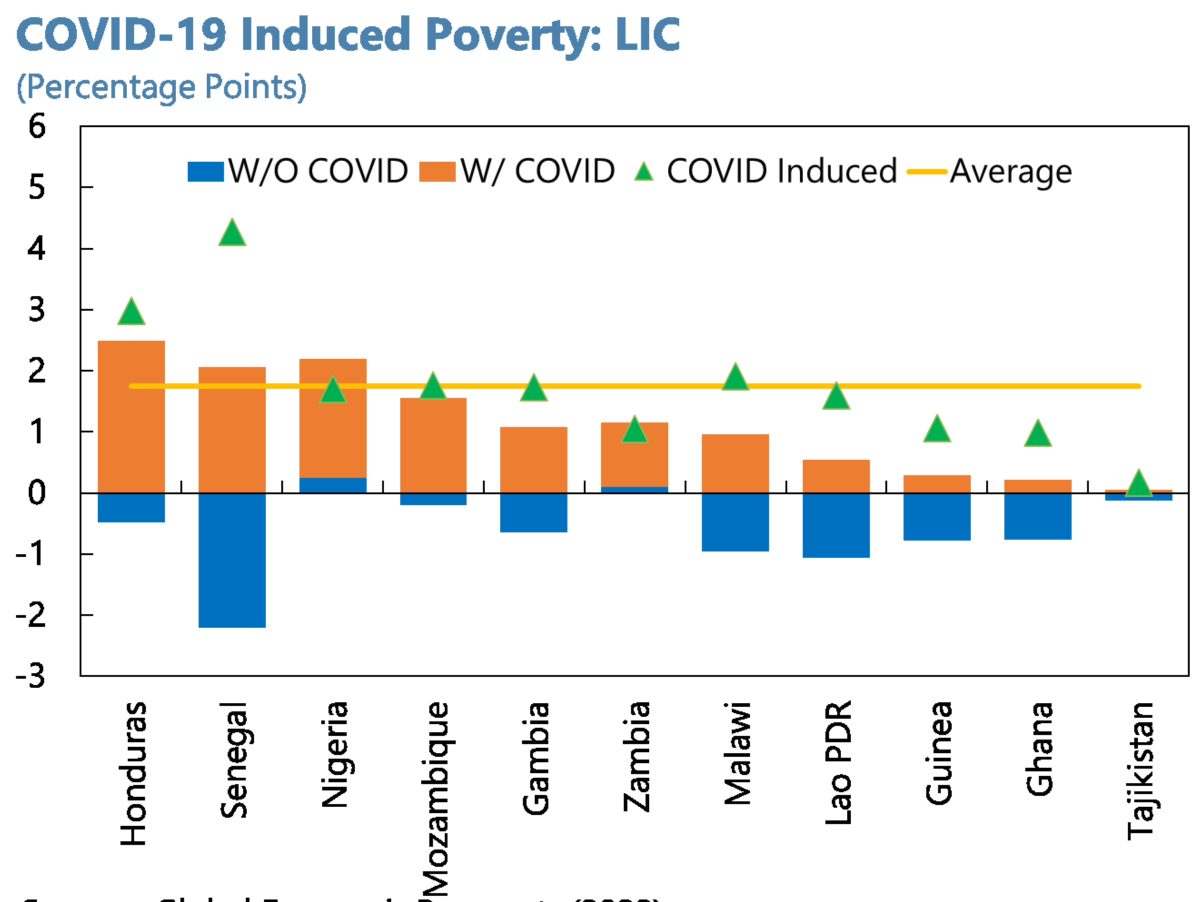
LICs: Contribution to Headline Inflation, Jan 2008 - Dec 2022
(percent)



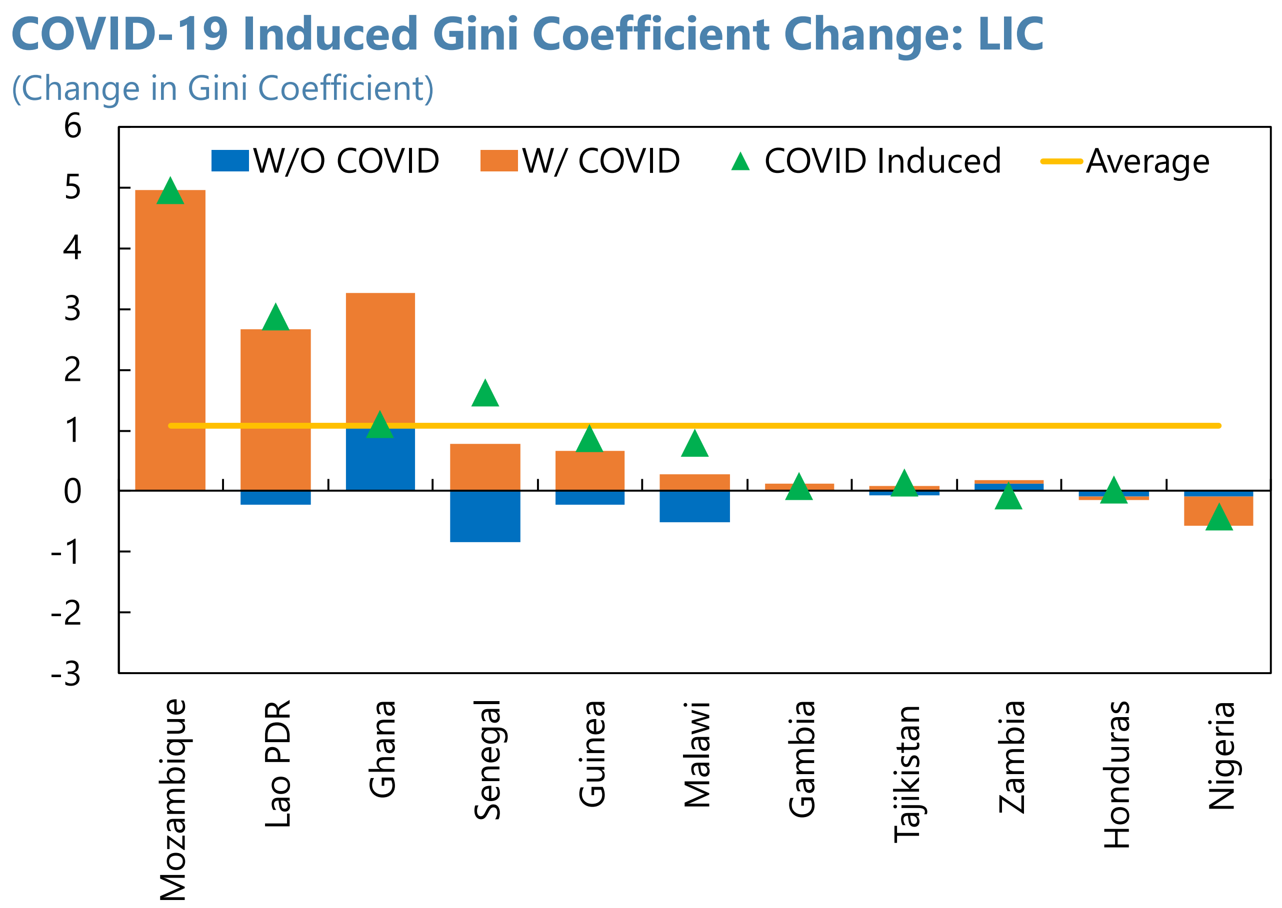
Notes: Contribution to median twelve month inflation rate.
Sources: IMF and staff calculations.

- Due to their high share in consumption basket, high food prices expose vulnerable households to the **risk of hunger**.
- The number of people under acute food insecurity increased **by 200 million** since 2019 (WFP).
- Nearly **670 million** people (**8%** of world population) will still face hunger by 2030 (FAO).
- High food and energy price compounds the risk of **social unrest**, which if left unattended, can lead to protracted income losses.

Obstacles on The Road To Sustainable and Inclusive Growth



Sources: Global Economic Prospects (2022)



Sources: Global Economic Prospects (2022)

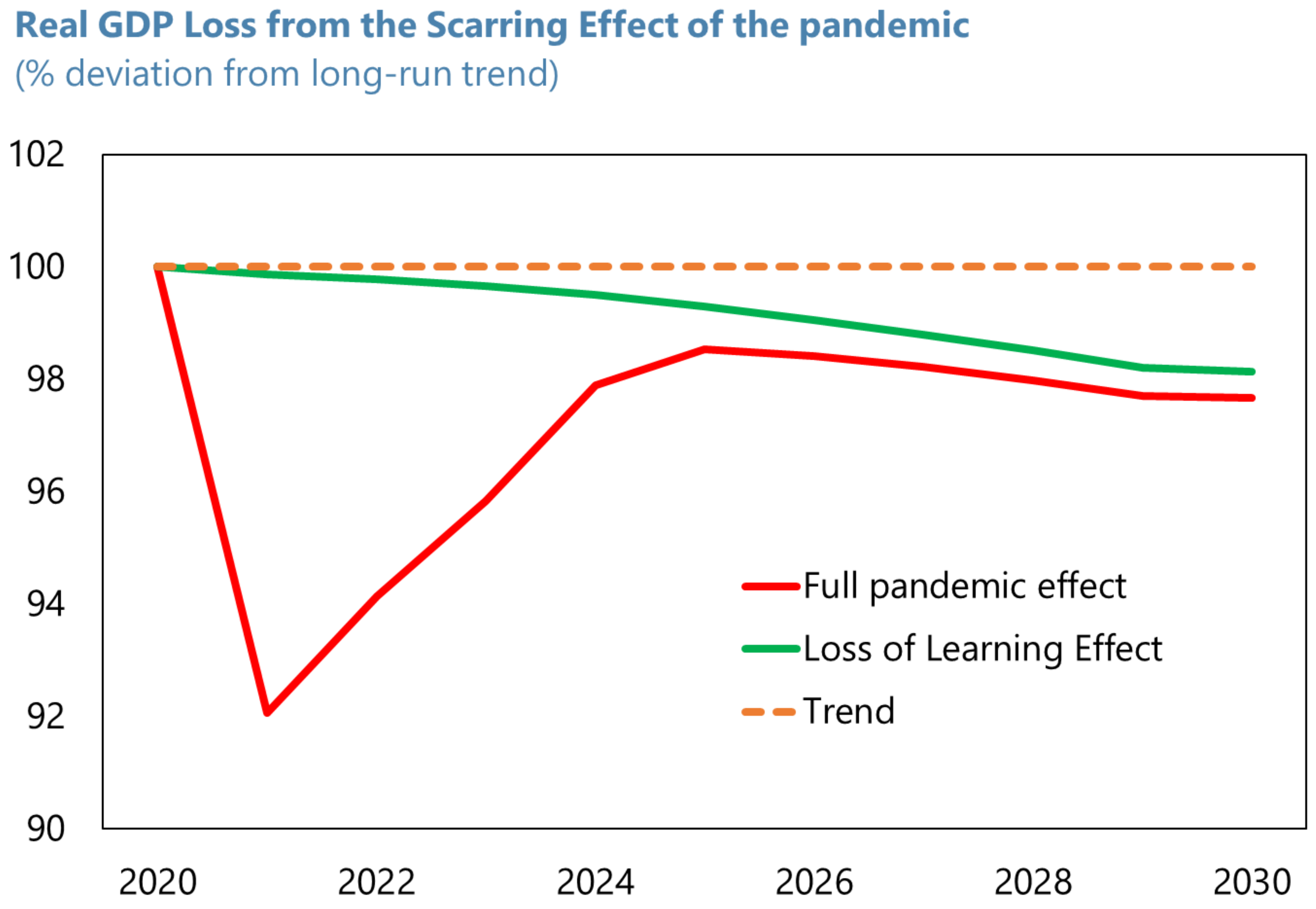
- The pandemic has reversed several years of progress toward achieving the SDGs with the **poverty rate** and **Gini coefficient** having increased since the pandemic.

- **Climate change affects LICs disproportionately.** Droughts, flood and other shocks will worsen **food crisis** in many LICs.

- **School closure** and the associated setback in human capital accumulation will undermine growth, if not addressed.

- Gaps in infrastructure investment and modern regulatory framework remain major challenges for LICs to reap the benefit from **digitalization**.

- **Structural reforms** that unleash the growth potential and strengthen resilience are critical.



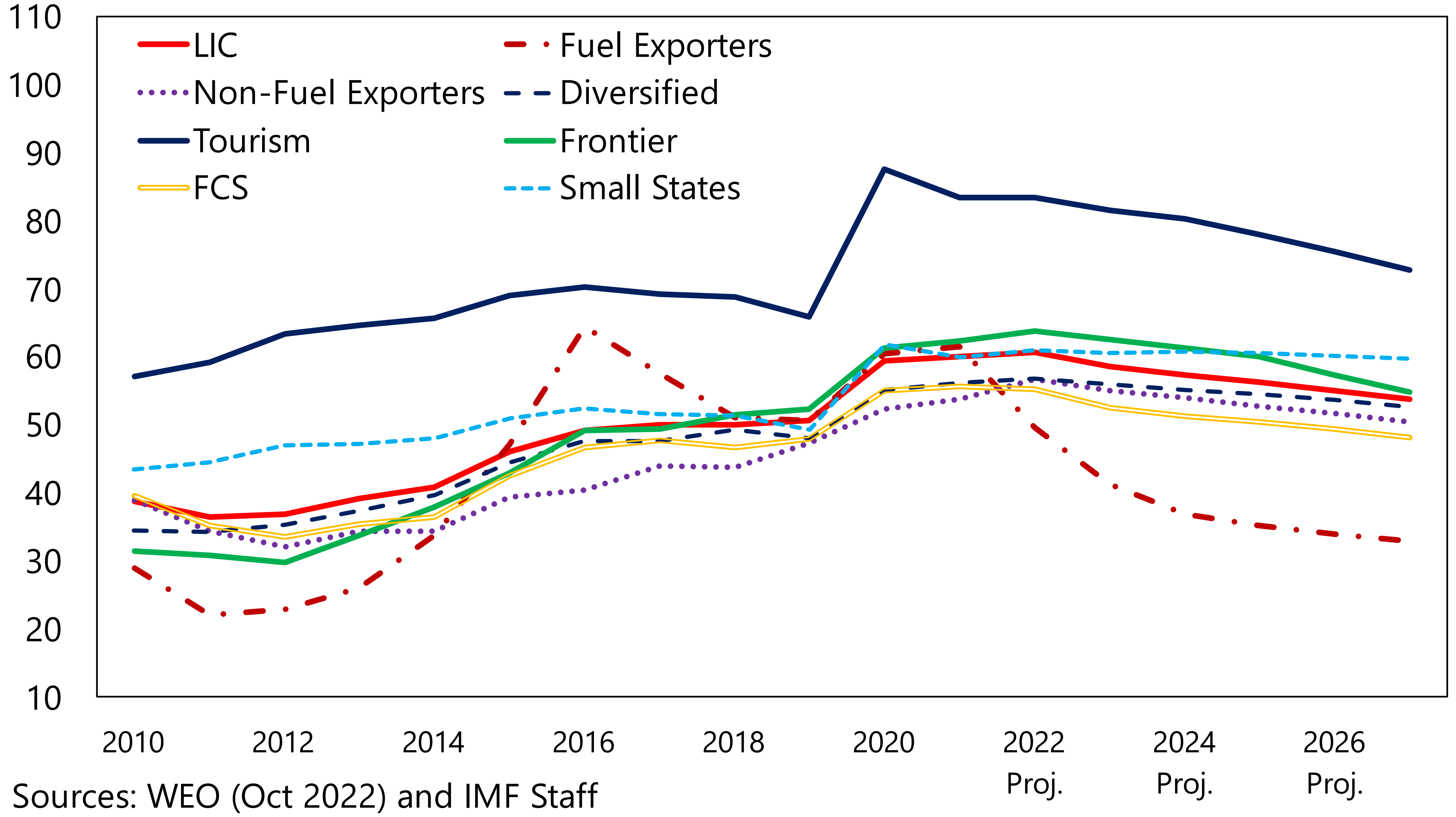
Sources: IMF staff calculations

Heightened Debt Vulnerability Leaves Limited Policy Space

Public debt has increased steadily in the past decade, driven by favorable global financial conditions, weak revenue mobilization, etc., with a **sharp jump** since the pandemic.

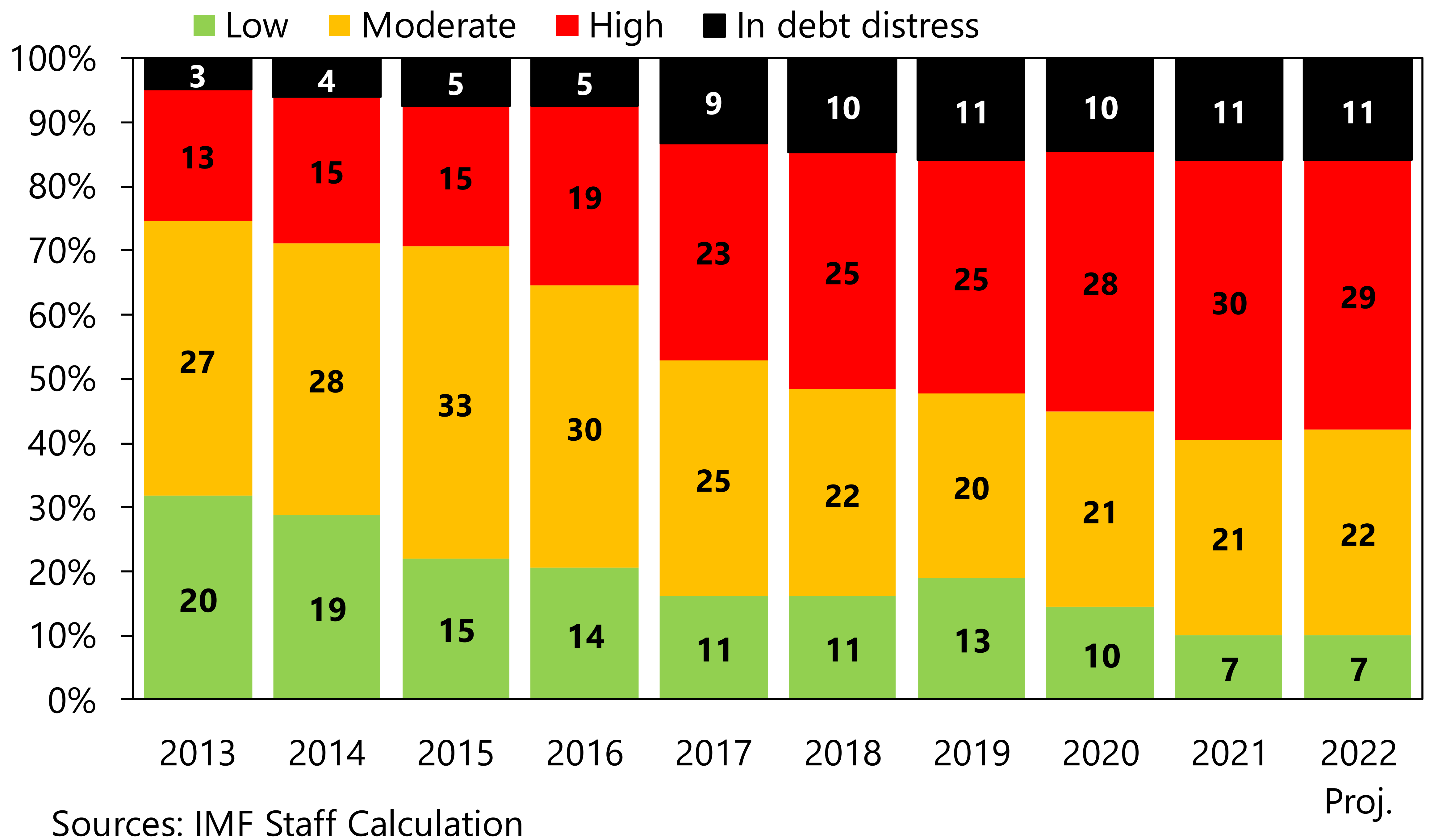
The risk of debt distress has increased steadily in the last decade, with almost **60 percent** of LICs being assessed at high risk of or in debt distress, up from **less than 30 percent** in 2013.

Public Debt, 2016-27
(Percent of GDP)



Sources: WEO (Oct 2022) and IMF Staff

Evolution of Risk of Debt Distress
(Percent of LICs with DSA)



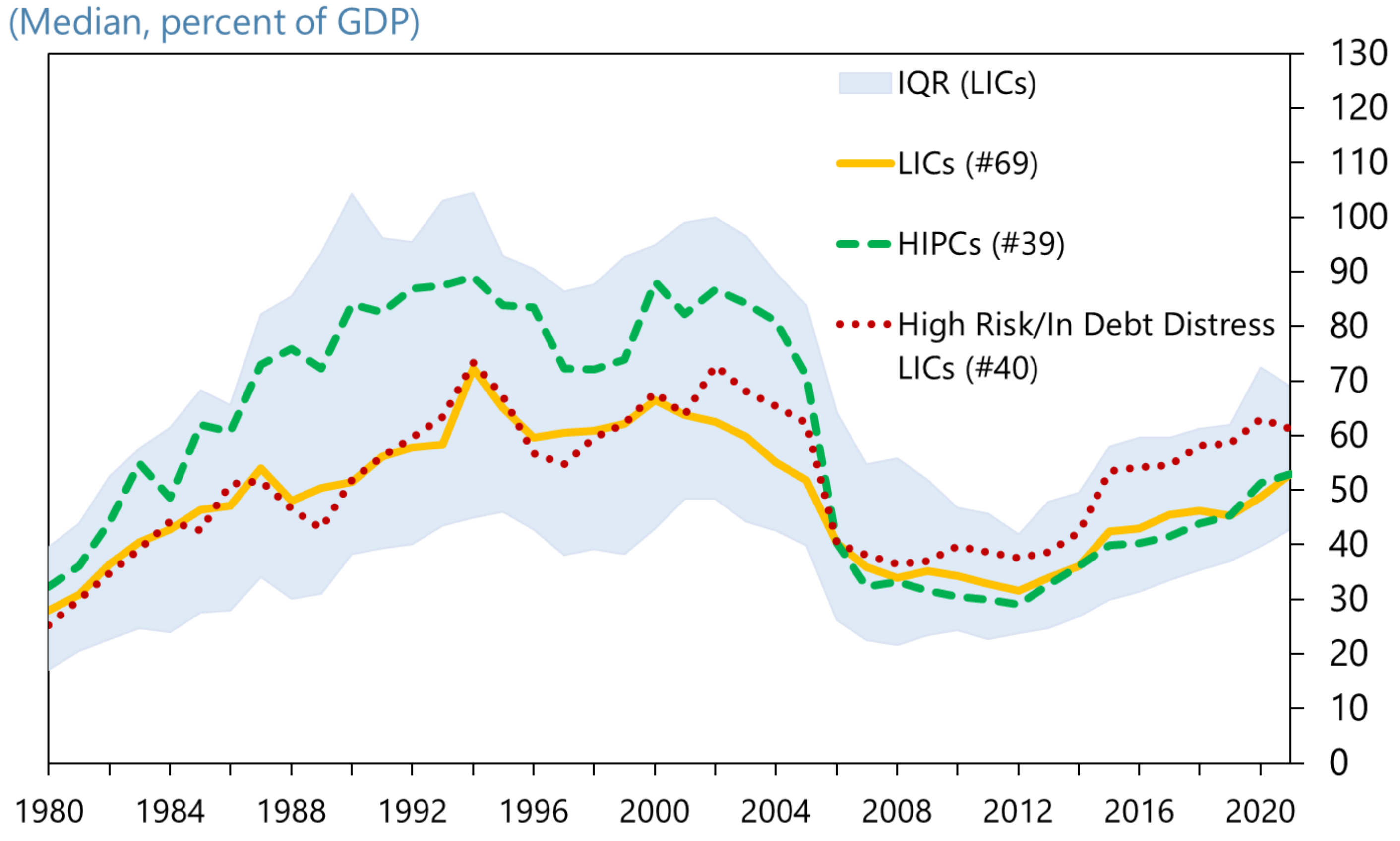
Sources: IMF Staff Calculation

New Challenges Emerge Compared to pre-HIPC Era

Compared to the **pre-HIPC era**:

- **Debt stocks** are not as high.

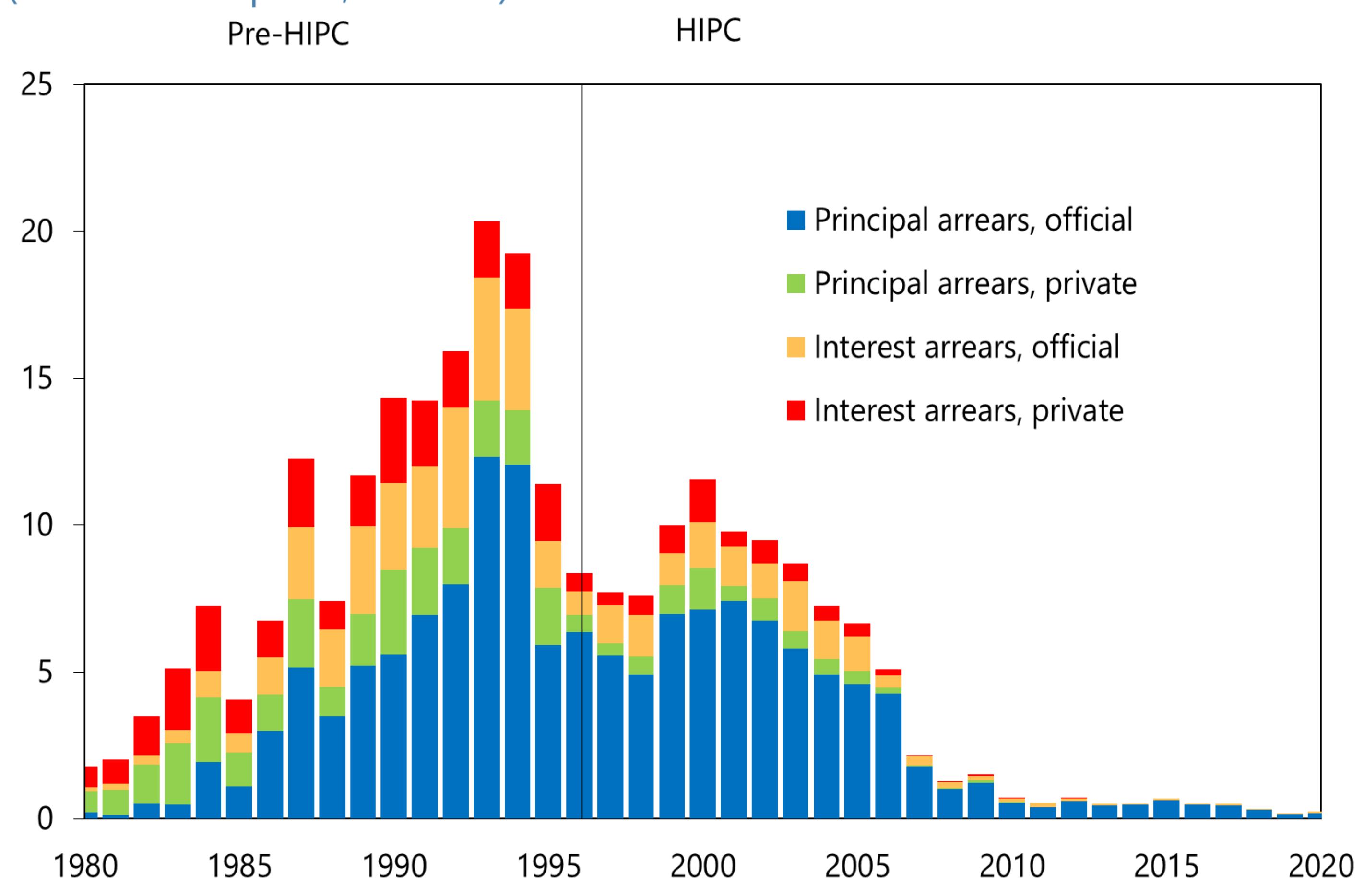
Public Debt-to-GDP Ratio in Country Subgroups
(Median, percent of GDP)



Source: IMF Global Debt Database, IMF WEO and staff calculations

- **Arrears accumulation** also appears to be minimal.

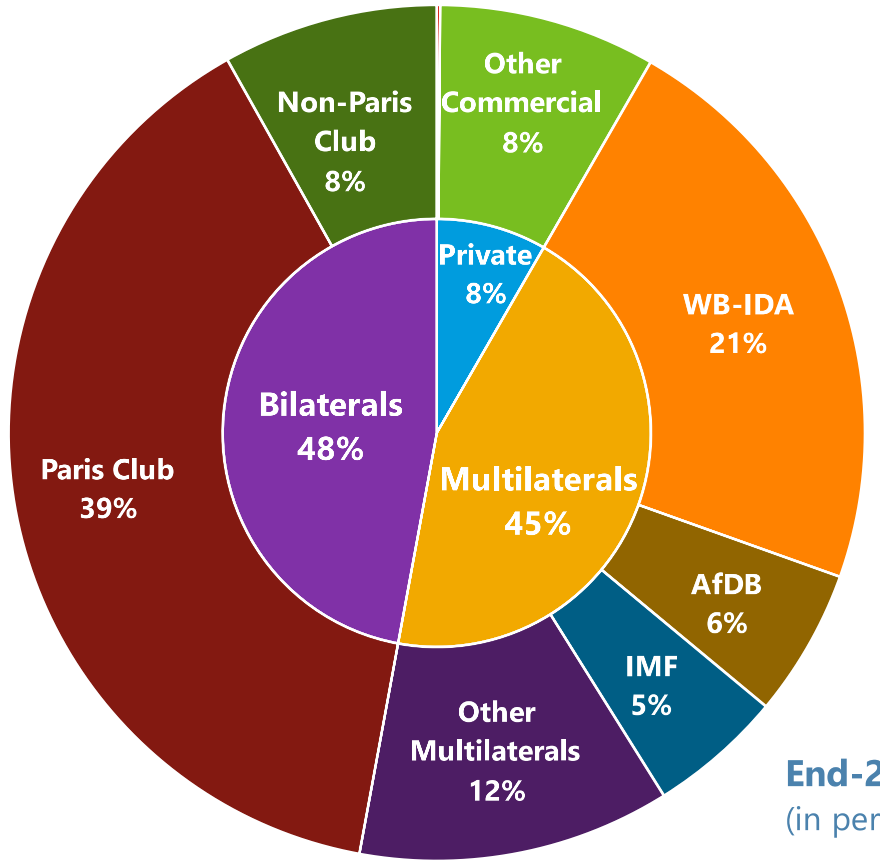
Outstanding Arrears
(Percent of Exports, Median)



Source: WEO and IMF staff calculations

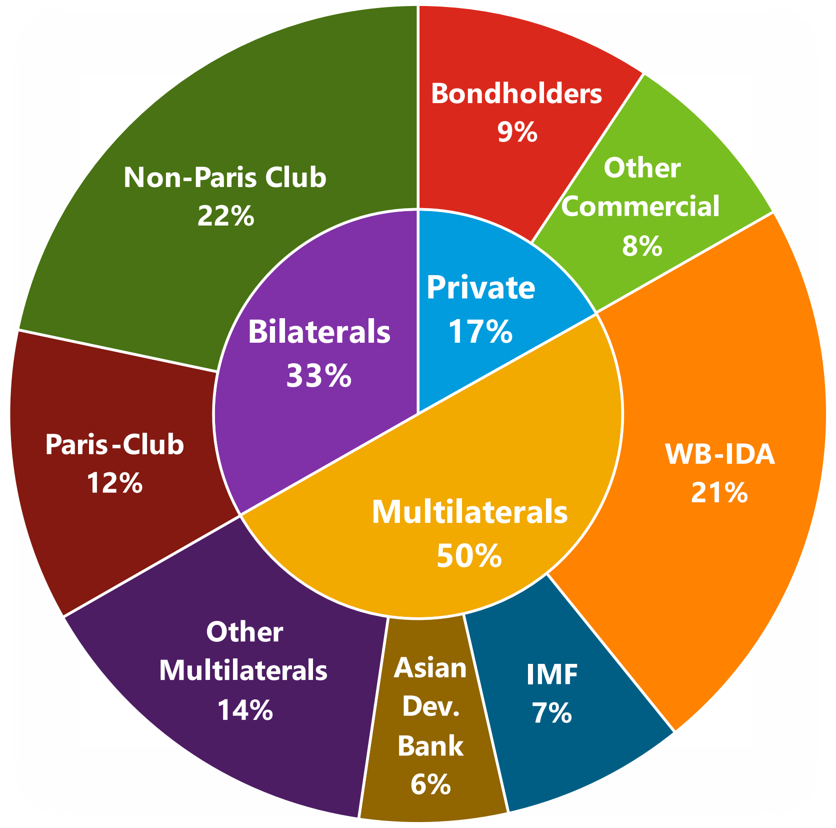
- However, evolving **creditor landscape** with increasing lending from non-Paris Club and private creditors poses new coordination challenges.

End-1996: Distribution of LIC Creditors
(in percent of total PPG debt stock)



Sources: World Bank IDS and staff calculations

End-2020: Distribution of LIC Creditors
(in percent of total PPG debt stock)

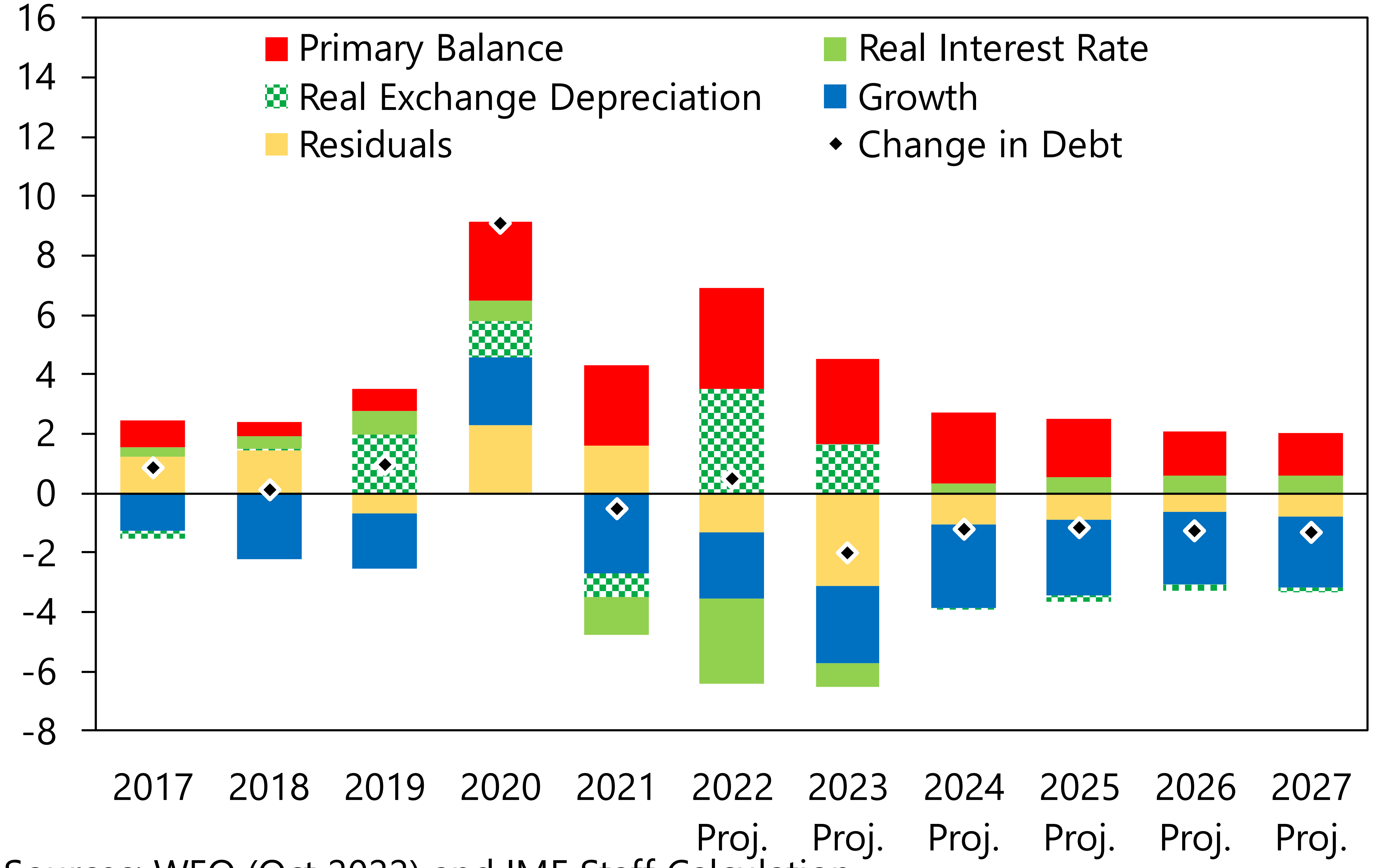


Sources: World Bank IDS and staff calculations

Sustainable Growth and Fiscal Restraint are Critical

The projected debt dynamics reveals critical policy actions that can create the necessary **policy space** for sustainable development while **keeping debt sustainable**.

Drivers of Debt Dynamics: LICs
(Percent of GDP)



Sources: WEO (Oct 2022) and IMF Staff Calculation

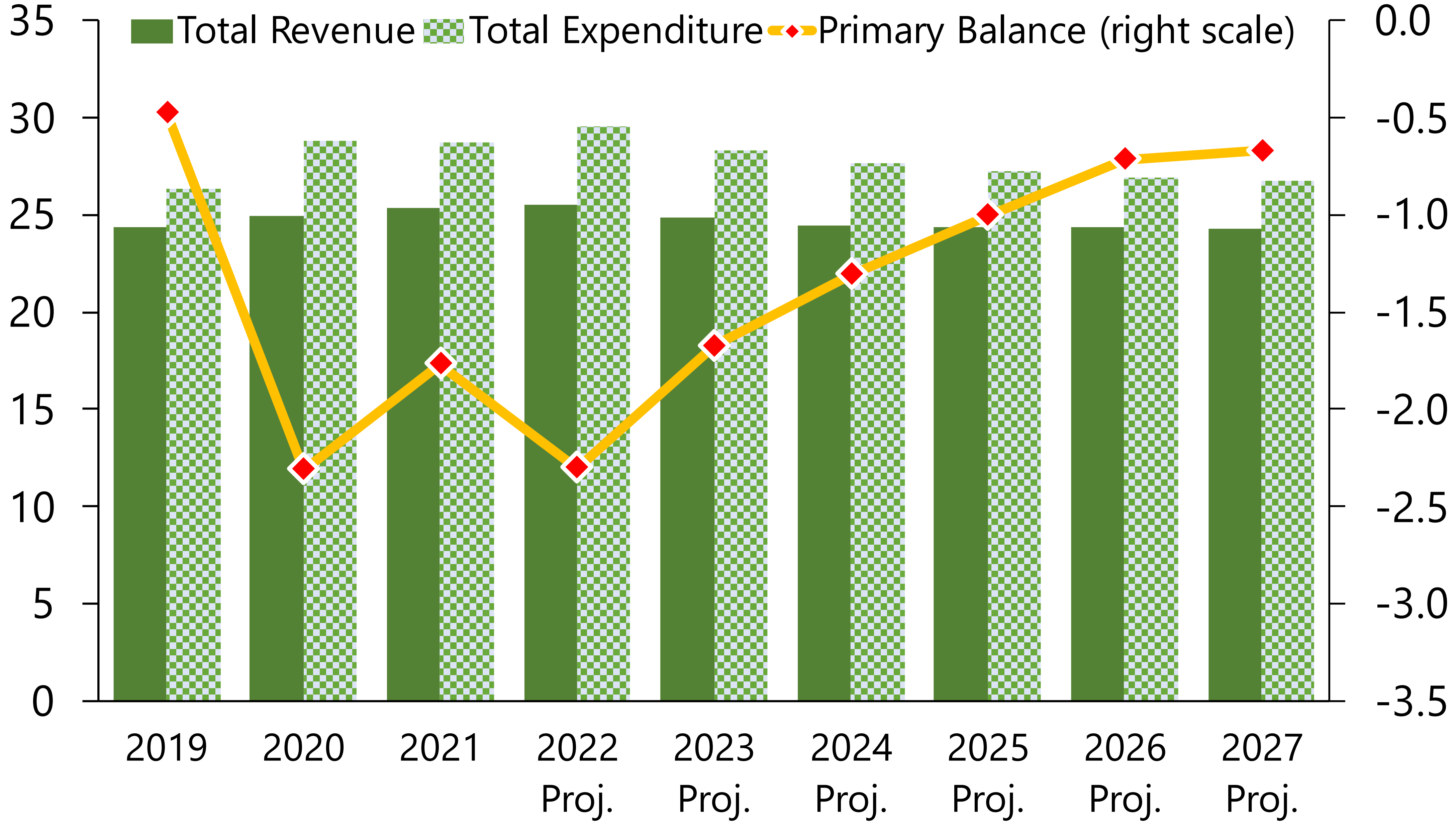
- Sound policy framework with **solid growth** and responsible **fiscal deficit** remains the fundamental path to sustainable debt.
  - Effective **growth-friendly investment** and decisive actions on **structural reforms** can help unlock growth potential.
  - **Fiscal consolidation** is needed to contain debt accumulation pressure.
- Improvements in **public financial management** including **public debt management** can help mitigate debt vulnerabilities.
- Accelerating the processes of the **G20 Common Framework** is key to delivering **debt relief** where needed.

Fiscal Space under Stress with Consolidation subject to Risks

The war and the pandemic strained LICs' fiscal positions; with depleted fiscal space, sizable **fiscal consolidation** is needed in the medium-term while **spending pressure** continues to be high.

Revenue, Expenditure and Primary Balance

(Average, percent of GDP)



Sources: WEO (Oct 2022) and IMF Staff Calculation

- Is the expected consolidation path credible? **Downside risks** are significant.
  - The expected consolidation is to be achieved predominantly through expenditure cut rather than **revenue mobilization**.
  - How can the necessary room for growth-enhancing **investment** and **social spending** be protected? Can the consolidation be achieved while limiting its macroeconomic impacts?
  - More efforts on revenue mobilization are needed, alongside adequate international support.

Public Debt Management Capacity Development

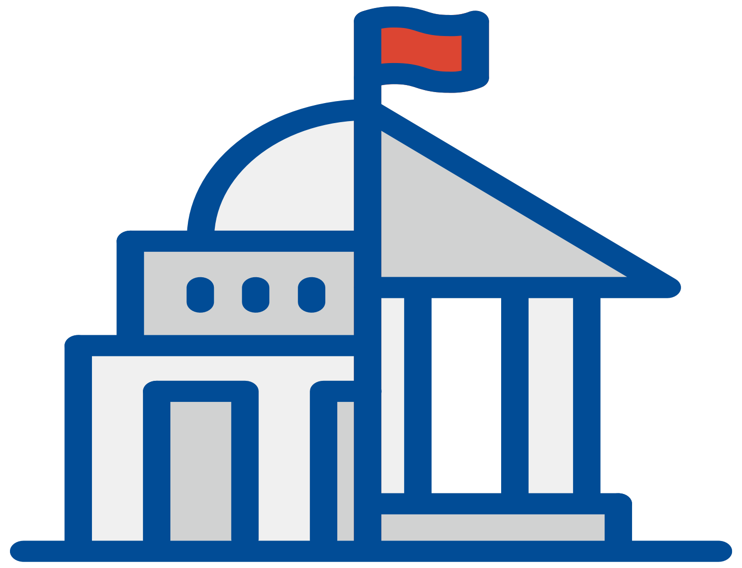
- **The fundamental changes in the borrowing landscape and sovereign debt structure of LICs and the risks they pose** to LICs' debt sustainability further underscore the importance of improving debt management practices in LICs.

- **The Fund, in coordination with other debt management Capacity Development providers, is well positioned to respond** to both LICs' current and evolving requests for debt management CD.

- **Public debt management capacity development in LICs must be seen as a long-term endeavor**, requiring steadfast commitment from both authorities in LICs and CD providers.

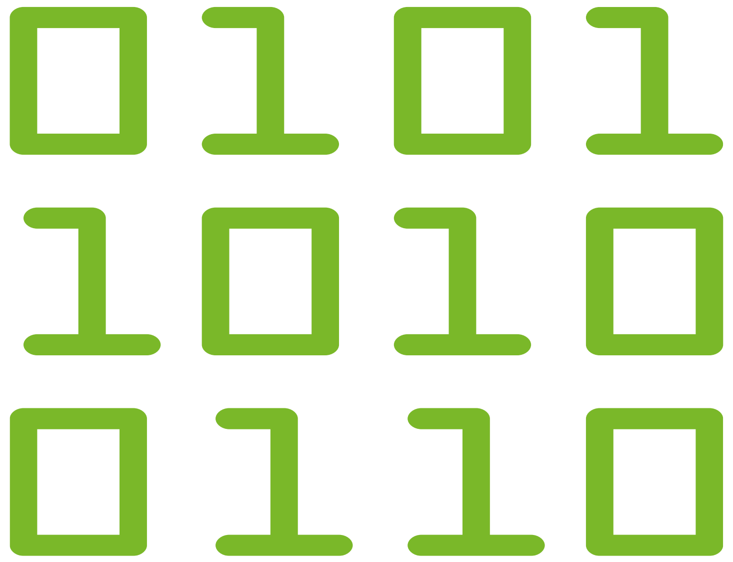
Enabling Conditions for Effective Public Debt Management

- Getting a GRIP on Public Debt Management



Governance

Resources



Information

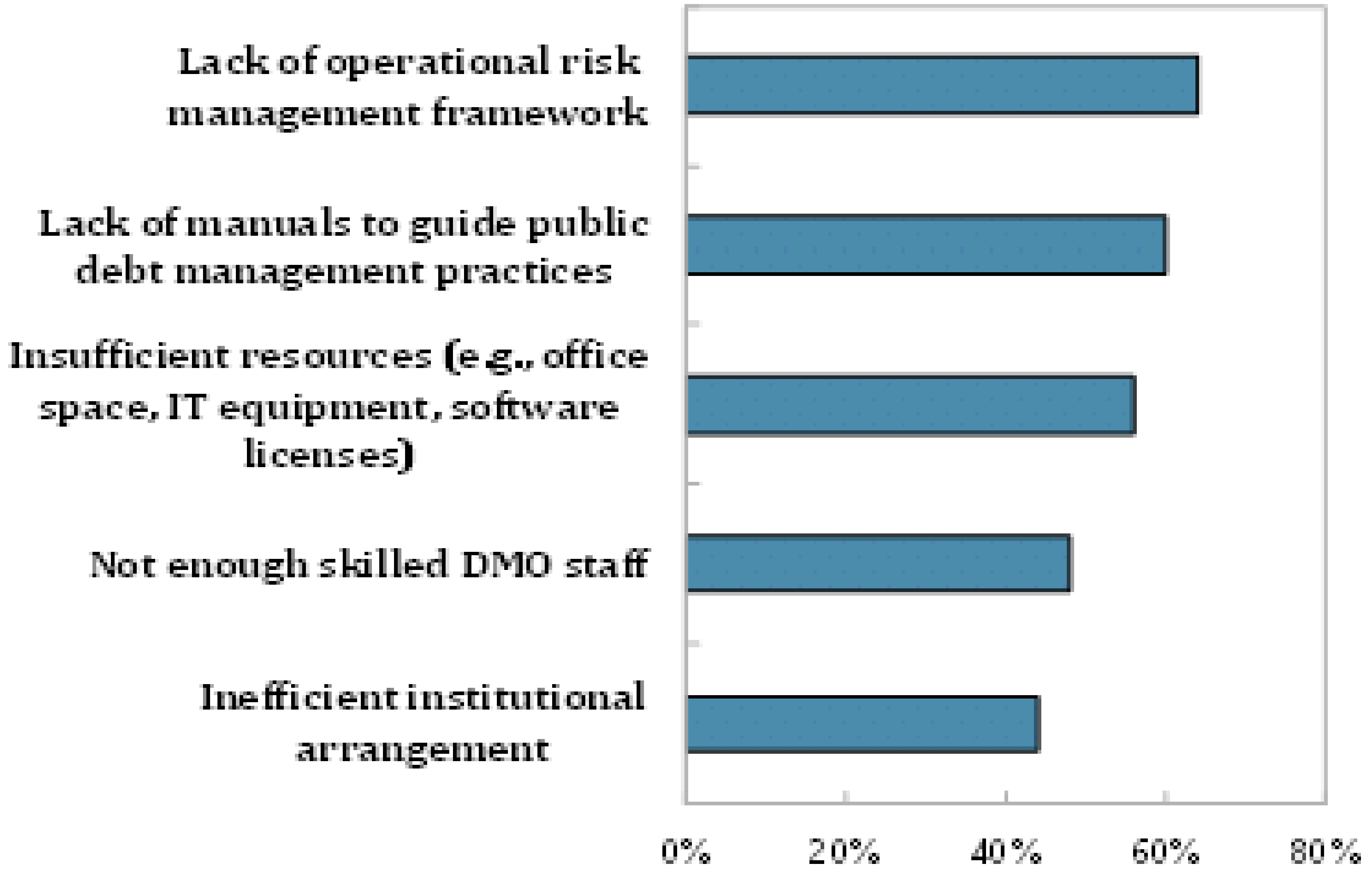
Policy

- **Legal and governance framework**
- **Human and physical capital**
- **Data collection**
- **Consistency with macroeconomic framework**

LIC Survey: Challenges in Debt Management– Main Obstacles

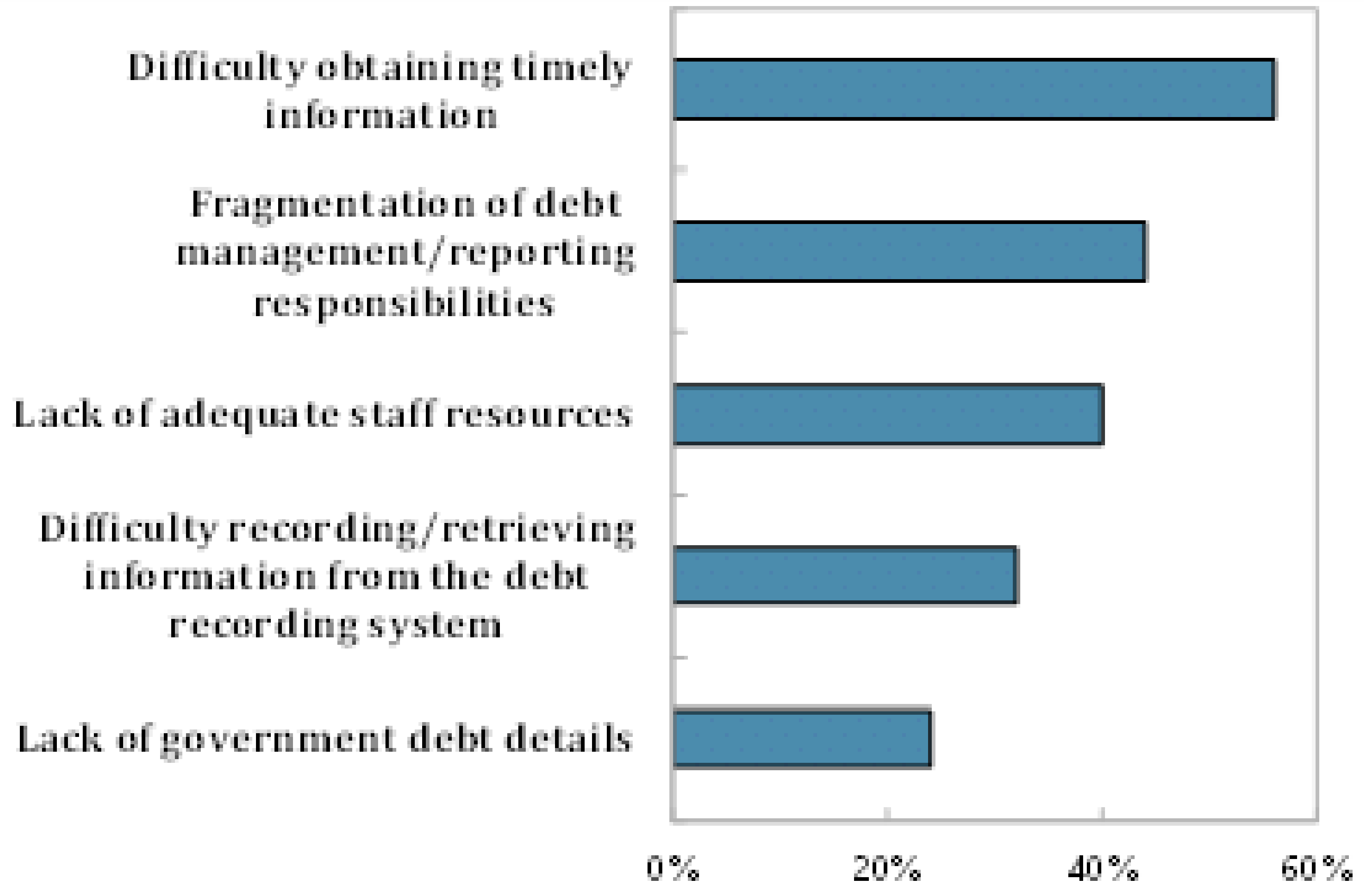
Challenges in Debt Management

(Share of respondents)



Debt reporting and monitoring

(Share of respondents)

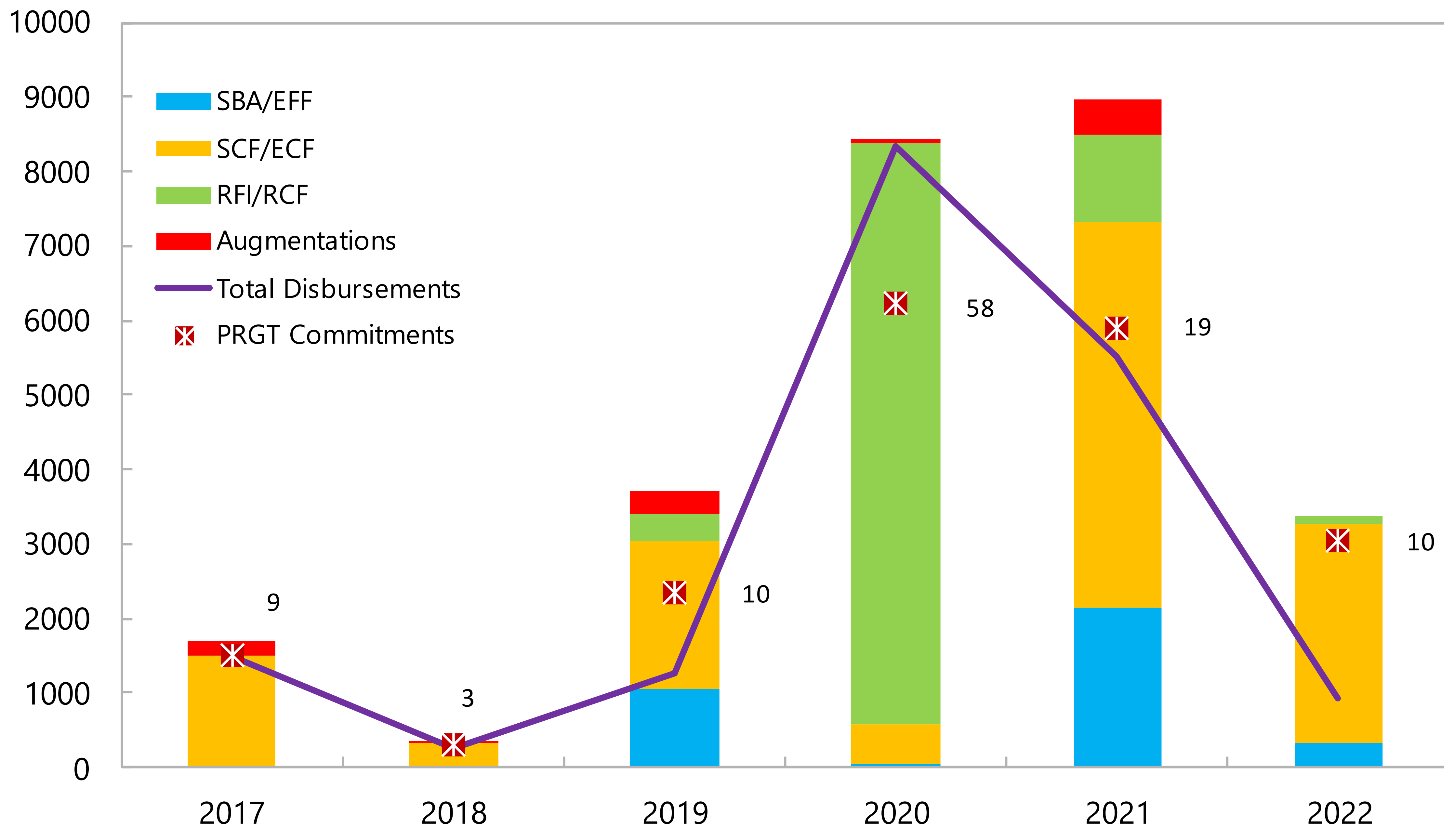


The Fund Participated Swiftly to the Int'l Support to LICs

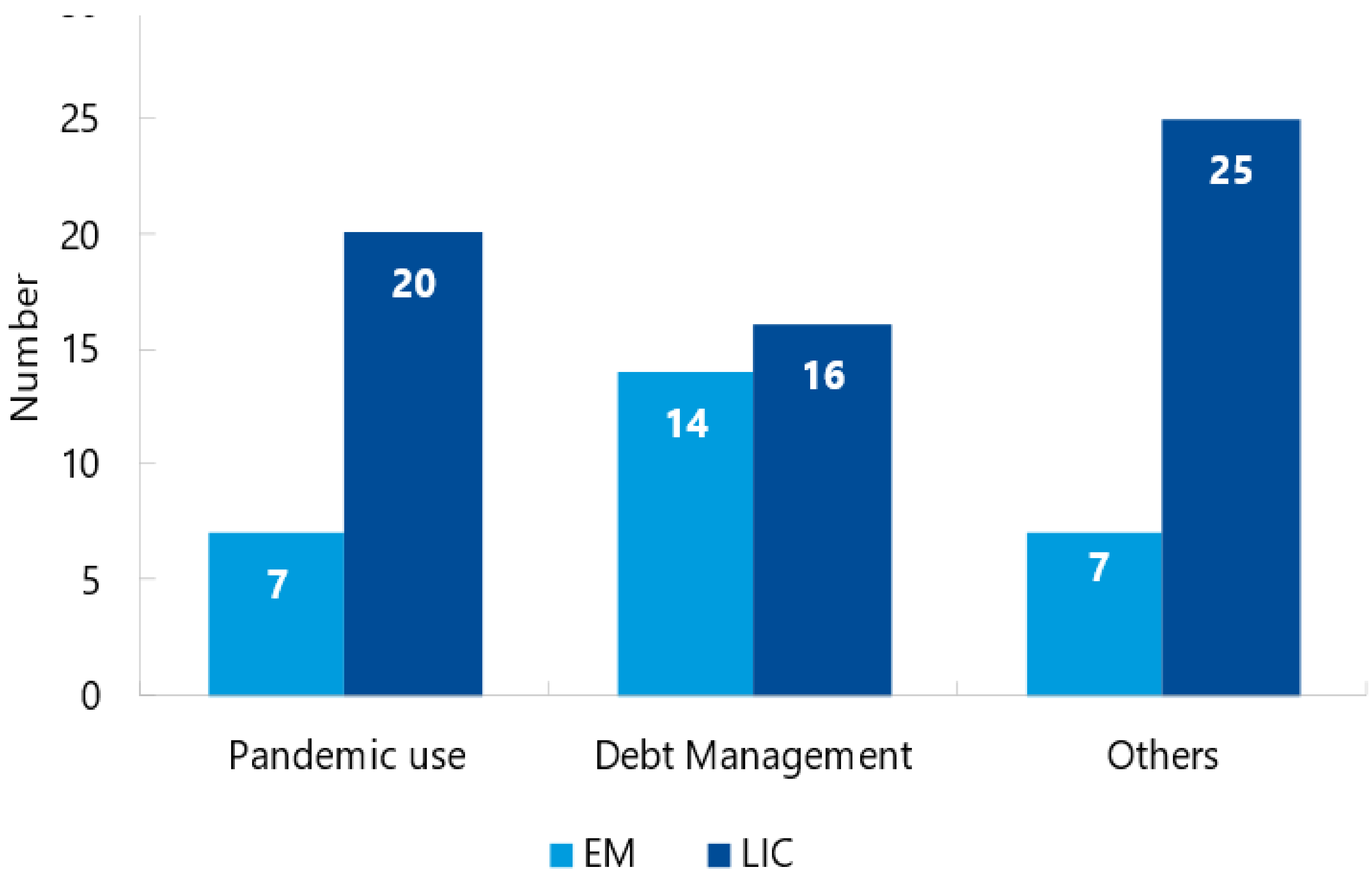
- Lending to LICs through **emergency financing instruments** surged in 2020, with lending gradually shifting toward **multi-year arrangements** afterwards.
- IMF lending facilities also evolved, including higher PRGT access and the establishment of the RST and food shock window.

The historic **SDR allocation** of USD 650 billion in 2021 provided additional liquidity to LICs, with about a third of the total allocation being used for **budget support**.

PRGT and GRA commitments to LICs
(Millions of SDRs)



Specified Fiscal Uses of SDRs

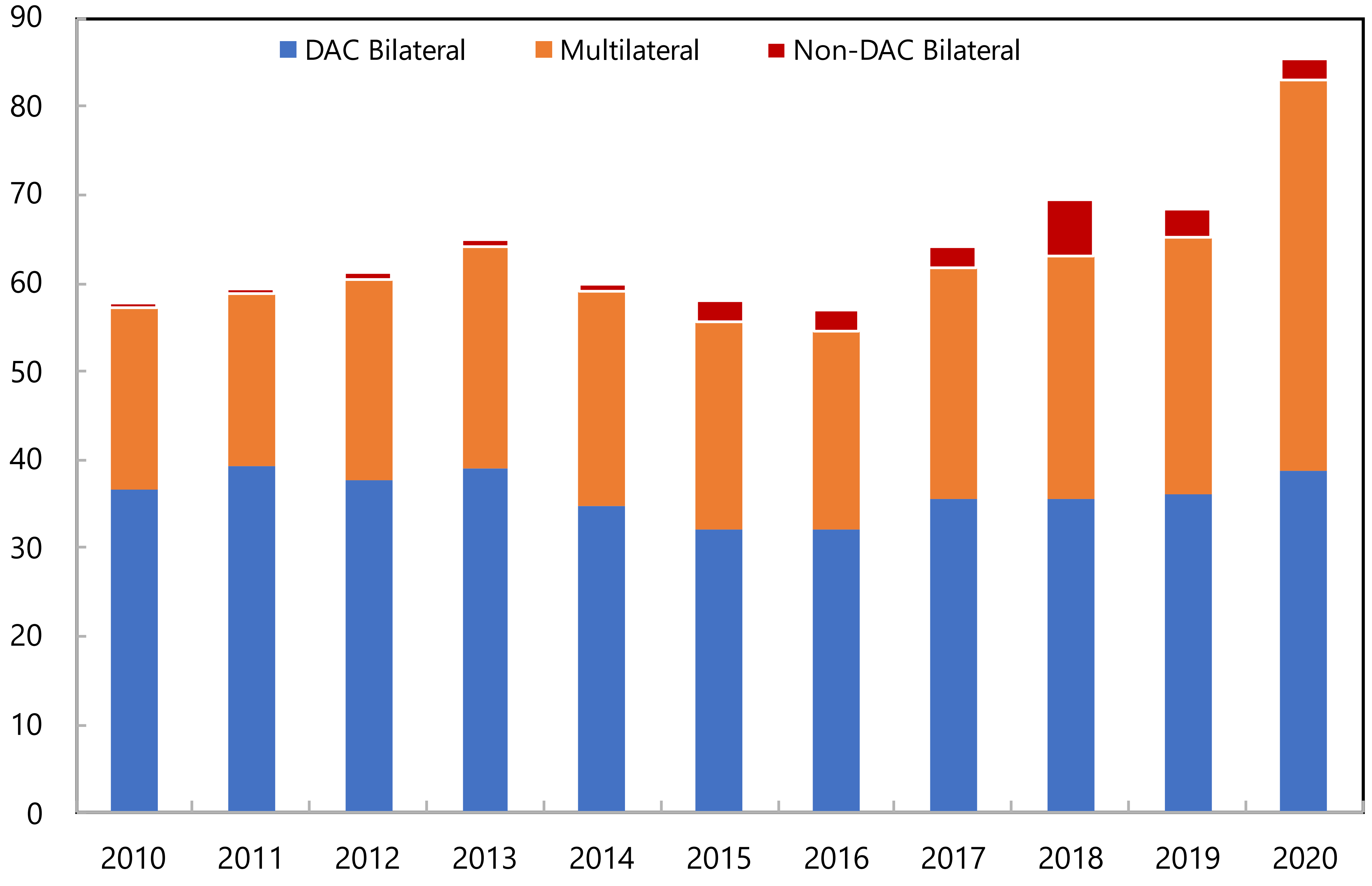


Together with Other Institutions

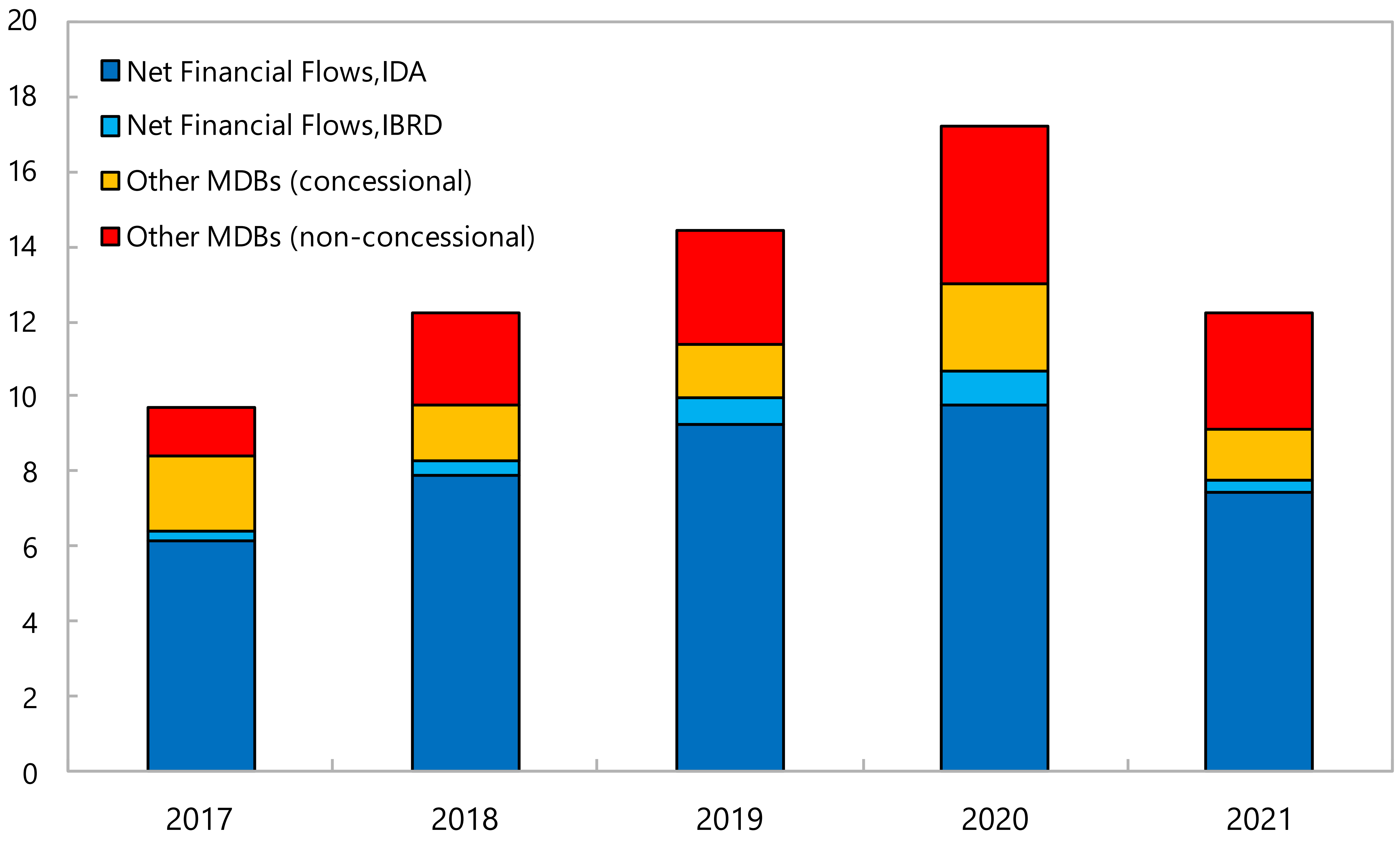
Official development assistance increased to record level, mainly through multilateral channels, but still fall short of the 0.7 percent GNI target.

MDBs scaled up significantly their financing to LICs, including a $93 billion financing package from the World Bank's IDA20 replenishment.

Net ODA Received by LICs
(Billions of USD)



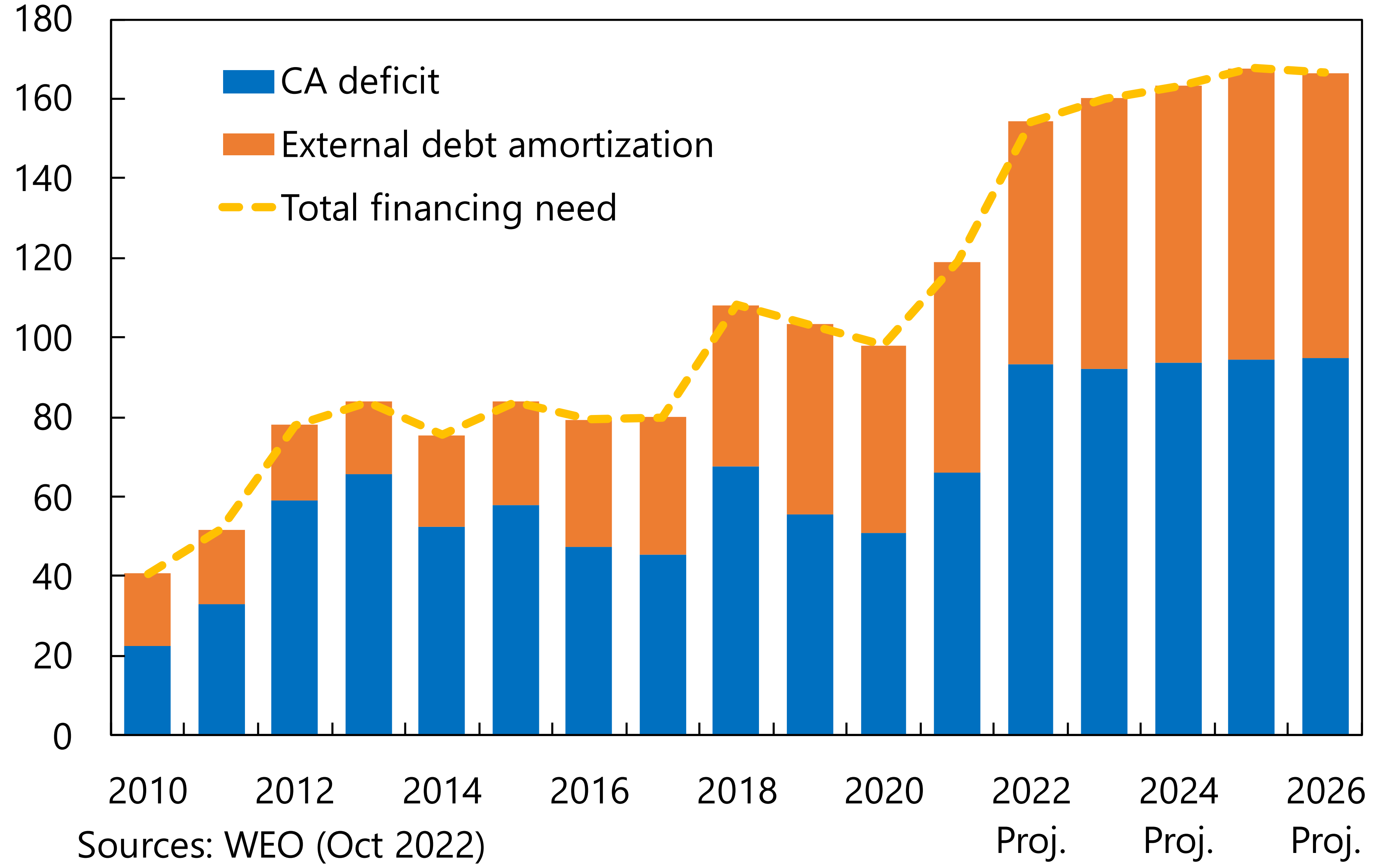
MDBs' Financing to LICs
(Billions of USD)



Source: OECD

However, LICs Financing Needs Remain Large

LICs' Gross External Financing Needs
(Billions of USD)



Sources: WEO (Oct 2022)

LICs' Additional Financing Needs under Baseline Scenario (USD bn)

	2022	2023	2024	2025	2026	Total
Additional spending needs:						
Covid spending	32	37	25	27	27	150
Reserves accumulation	3	4	4	4	4	20
Investment spending	14	40	58	71	83	267
Total additional financing needs:						
Baseline	49	82	88	103	114	436

- **Estimate of LICs' financing needs to offset the 2020-22 shocks is elevated:**
  - External gross financing needs are projected to increase under the medium-term baseline scenario.
  - Additional financial needs (on top of those in the baseline) to address the legacy of COVID, rebuild buffers and return to the pre-COVID income convergence path are sizeable (≈ USD 450 bn over 5 years).
  - The fallout of the war in Ukraine adds to the needs, with an overall estimate of ≈ USD 60 bn, subject to high uncertainty and variations among LICs.

- **The international community, including the Fund, responded swiftly to support LICs, but more needs to be done.**

The Situation Requires Concerted Use of All Policy Instruments

- **LICs' development challenges were already high before the pandemic, with the shocks making the challenges even more daunting:**
  - **External environment** is weaker, including fragile growth, inflation pressure, supply chain disruptions and tightening global financial conditions. Exceptional **uncertainty** surrounds the path forward.
  - **Domestic situation** is more challenging, with high demand, limited space and very complex policy trade-offs.

- **LICs need to address imminent near-term challenges while not losing sight of long-term goals:**
  - **Near term:** fighting inflation, addressing debt vulnerabilities, supporting recovery and protecting the vulnerable from shocks using **fiscal**, **monetary** and **exchange rate policies**, while maintaining credible policy frameworks.
  - **Long term: structural reforms** to address poverty, inequality, climate change and to promote digitalization, as key ingredients for development and income convergence.

- **The global food and energy shocks, and large financing needs in LICs call for coordinated international actions to support LICs to ensure the availability of:**
  - Food, agricultural inputs and energy, including by action on trade restrictions and strong coordination between key international organizations (WTO, WFP, FAO, World Bank, IMF, etc.).
  - Adequate financing, both through multilateral and bilateral channels, including higher flows of ODA and debt relief where needed.

… Including Fiscal Policy

- The **priorities** of fiscal policy should be to protect the vulnerable, build back buffers, and preserve investment, while safeguarding debt sustainability.

- Fiscal policy should be calibrated in coordination with monetary policy to keep inflation under check and not make the **monetary trade-off** more costly.

- Commodity exporters should **rebuild policy buffers** from the positive terms-of-trade shocks while managing the risks from **volatile commodity price**.

- **Sound policy framework** remains the utmost effective tool to address debt vulnerabilities.

… Monetary and Exchange Rate Policies

- Monetary authorities must strike an appropriate **balance** between growth and inflation.
- They also need to guard the economies against **financial sector risks**.
- **Exchange rate** and **capital flow management** policies should be carefully calibrated to a country's external pressure and exchange rate regime.
- While temporary capital flow management measures can be useful to stabilize the economy, they should not be used to support **unsustainable policies** or substitute for **necessary adjustment**.

… and Structural Reforms

- Decisive policy actions are needed to address **long-term challenges** posed by poverty, inequality, economic diversification, digitalization, climate change and food security.
    - Strengthening **social protection system** including better public services provision would improve economic inclusion to tackle poverty and inequality.
    - Implementing **adaptation and mitigation measures** will help build climate resilience and relieve food insecurity.
    - Significant investments in **ICT infrastructures** and access to reliable **electricity** remain key priorities for LICs to reap the benefits from digitalization.
    - Strong **governance and institutions** are necessary for social cohesion, revenue mobilization and private sector development.

- The **pace and timing** of macroeconomic adjustment and structural reforms need to be carefully calibrated to each country's economic, political and social context.

Thank you

Background Slides

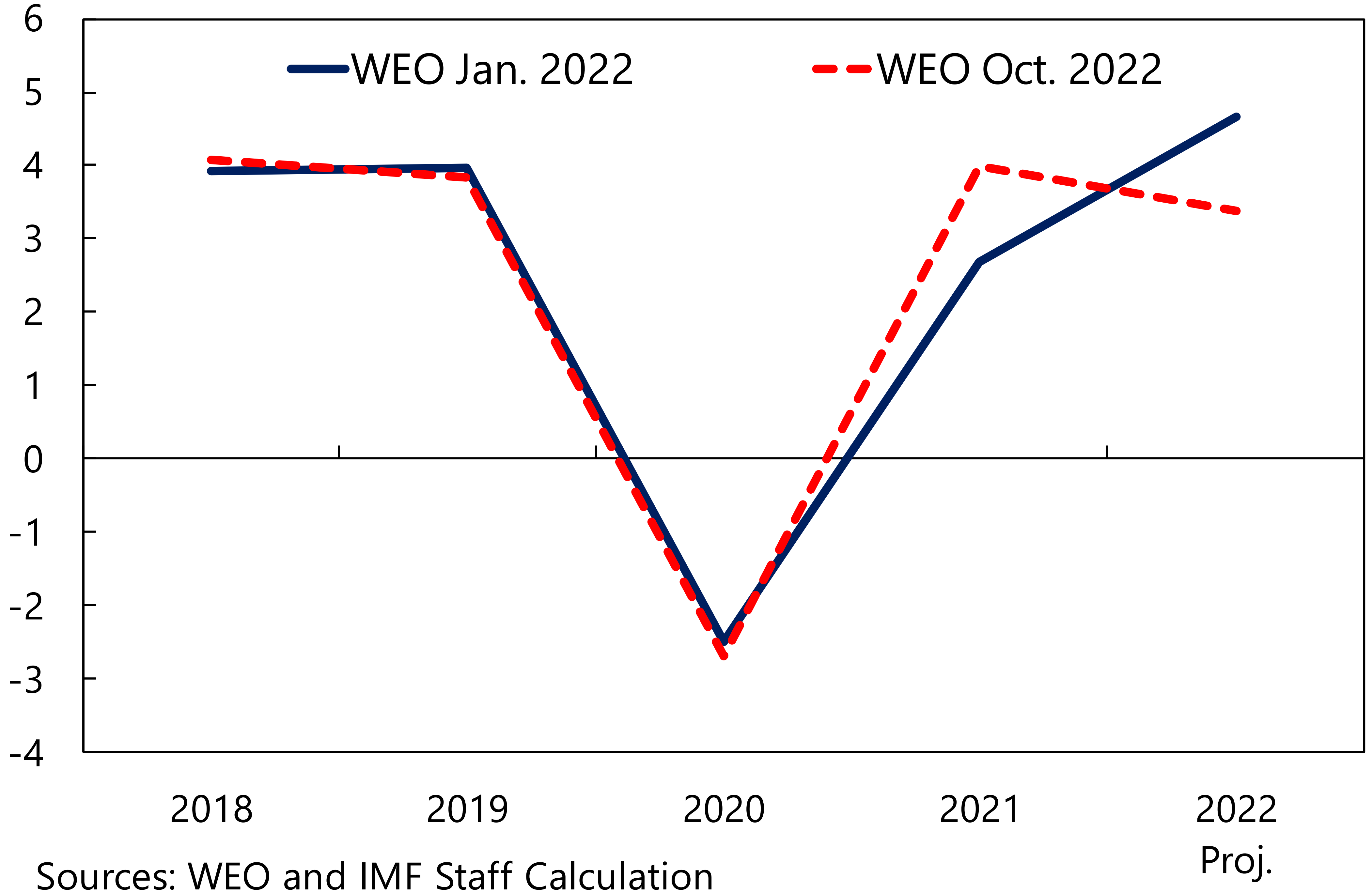
The War Has led to Weaker Growth and Higher Inflation in LICs

Growth in 2022 was projected to be stronger than 2021 before the war, but lost momentum.

Inflationary pressures intensified on the back of high global food and energy prices, accommodative monetary policy and currency depreciation.

Real GDP Growth for LICs: Impact of the War

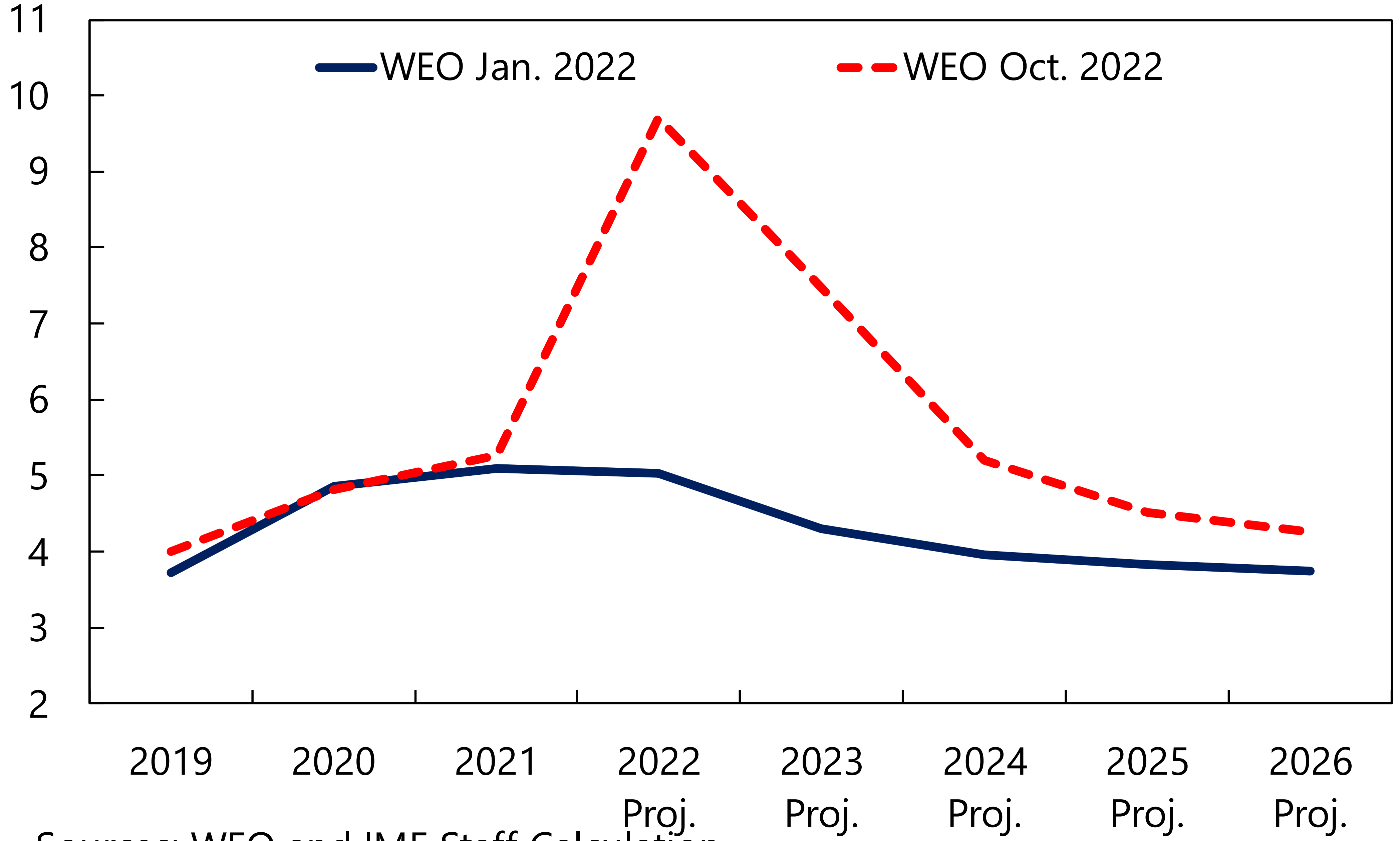
(Percentage Points)



Sources: WEO and IMF Staff Calculation

Headline Inflation for LICs: Impact of the War

(Percentage Points)



Sources: WEO and IMF Staff Calculation

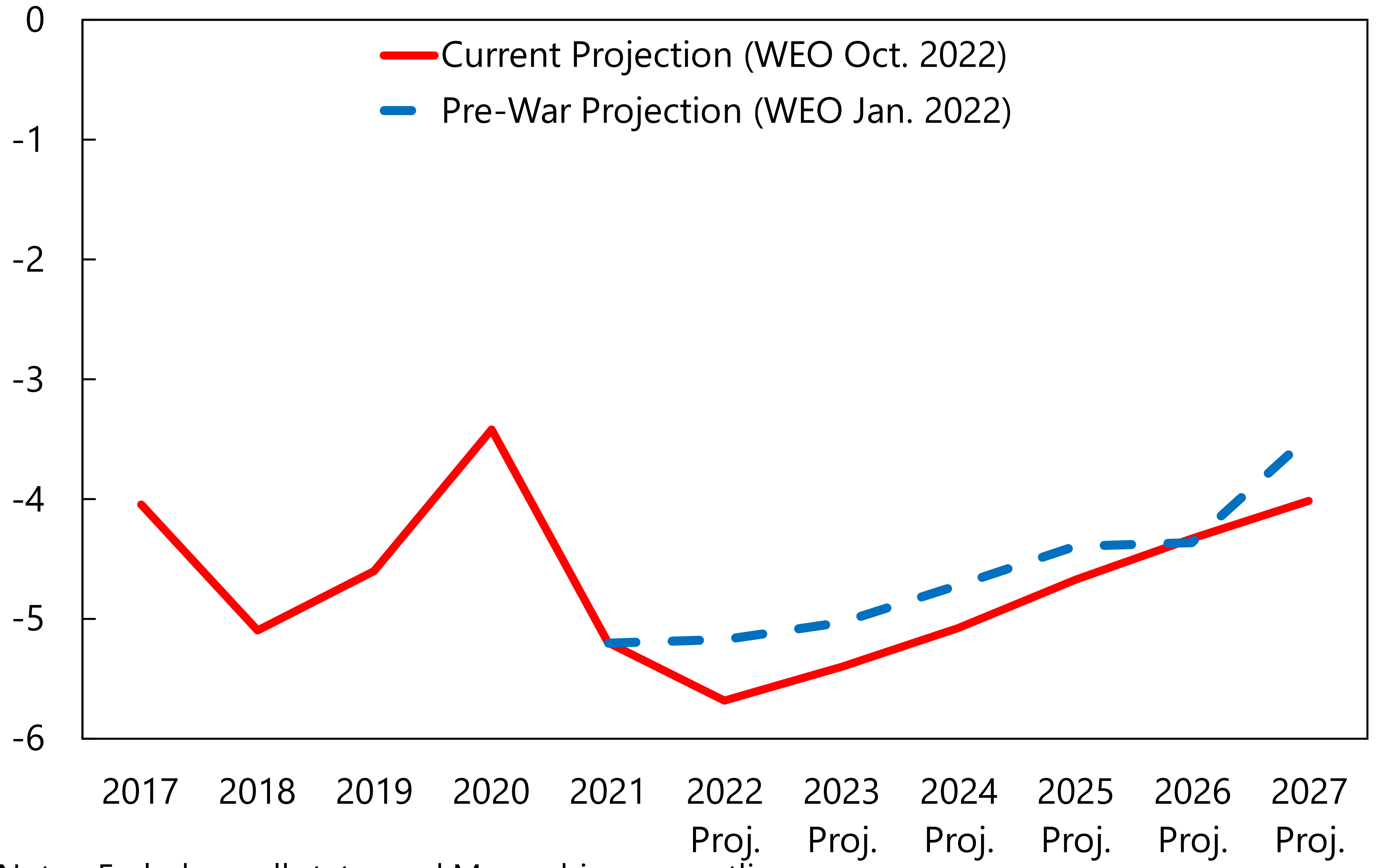
Note: Excluding Sudan, South Sudan, Yemen and Zimbabwe.

External Imbalances and Financial Sector Risks Are Building Up

The **current account deficit** is expected to have deteriorated in 2022 due to upward pressures on commodity prices.

Current Account Balance: Medium-Term Outlook

(Average, percent of GDP)

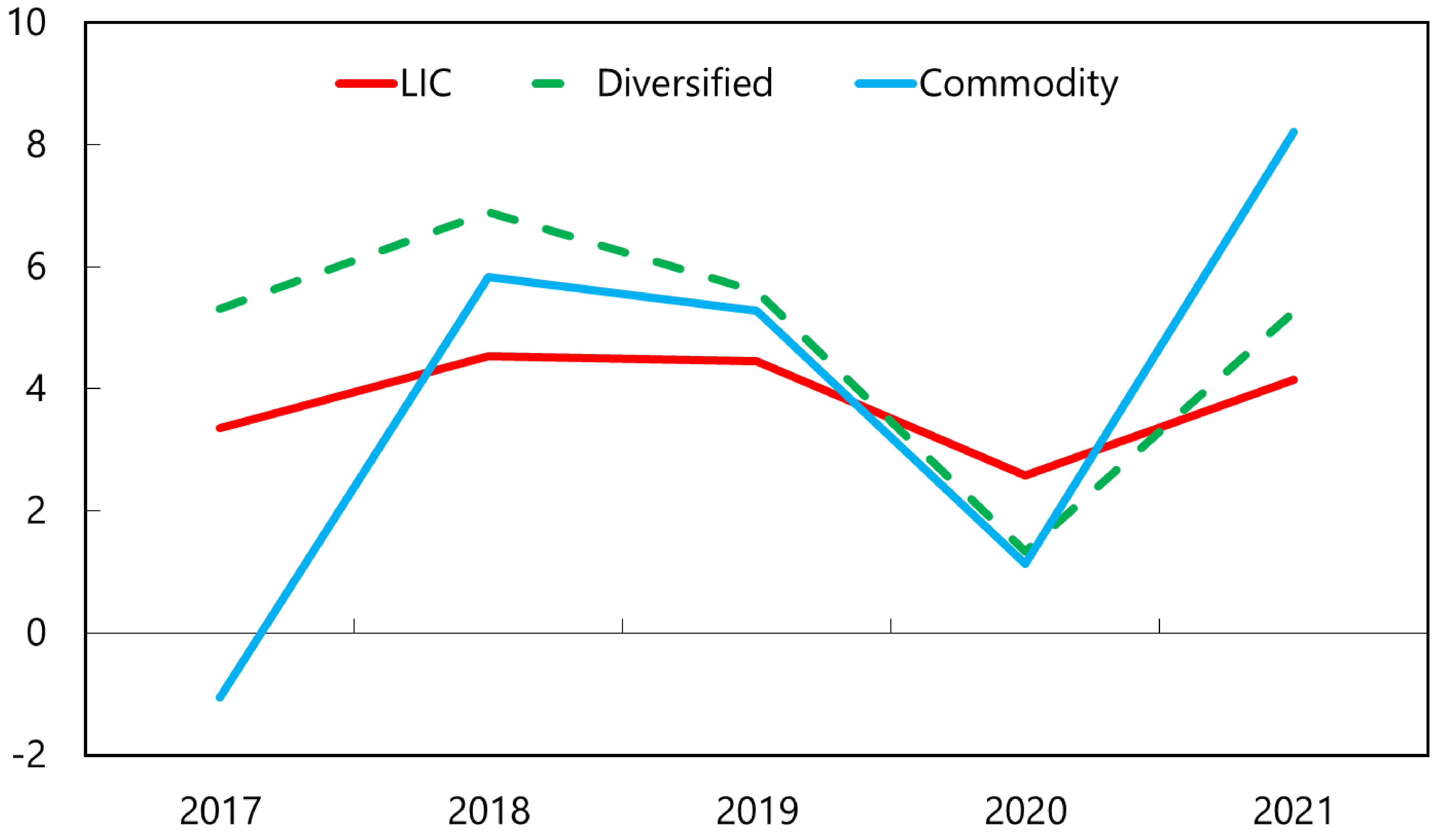


Notes: Exclude small states and Mozambique as outliers
Sources: WEO and IMF Staff Calculations

Credit to private sector rebounded in 2021. Relaxation of macro-prudential policies during the pandemic provided lifeline to many firms in liquidity shortage, but may have led to a build-up in financial sector's vulnerabilities.

Real Credit Growth

(Median, Percentage growth)



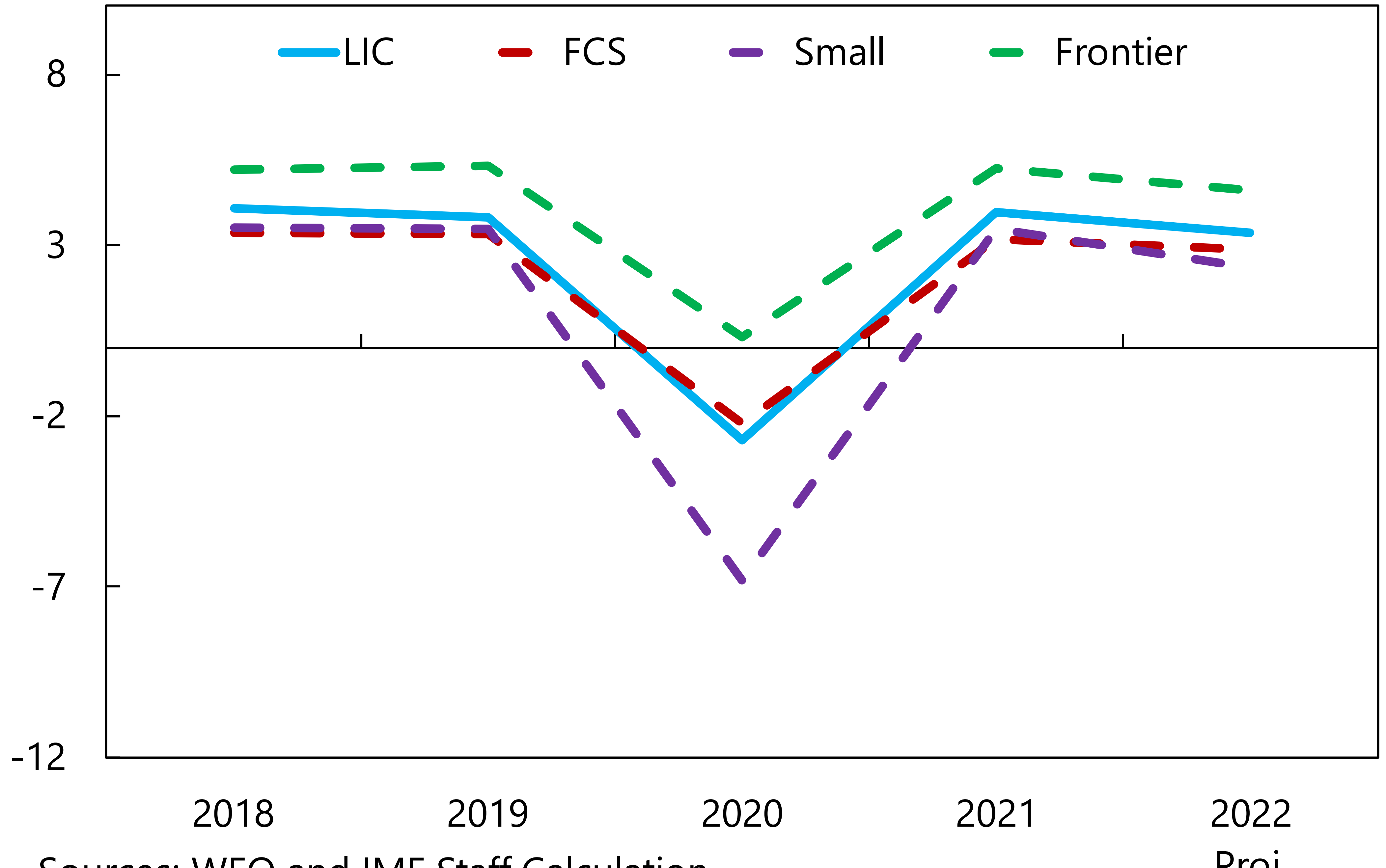
Sources: International Financial Statistics; IMF Staff Calculations

Marked Differences Can Be Seen in LIC Subgroups

Small states were hit the hardest while **frontier markets** countries weathered relatively well. Growth recovery in **FCS** is expected to be more protracted.

Real GDP Growth

(Percentage Points)

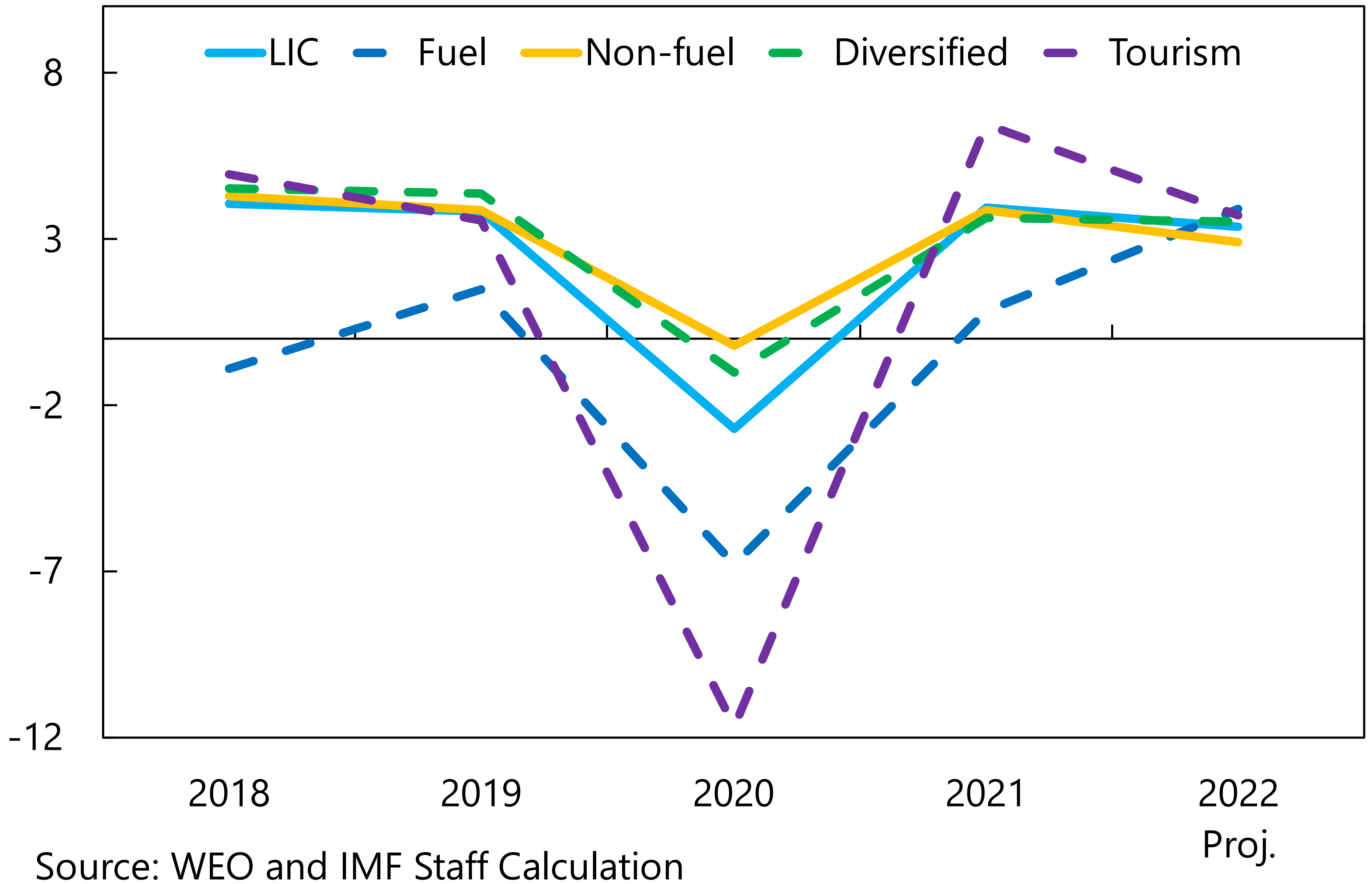


Sources: WEO and IMF Staff Calculation

Tourism-dependent countries saw the largest loss in growth with more **diversified economies** being more resilient; Growth in **fuel exporters** is projected to remain robust, supported by high crude oil prices

Real GDP Growth

(Percentage Points)



Source: WEO and IMF Staff Calculation

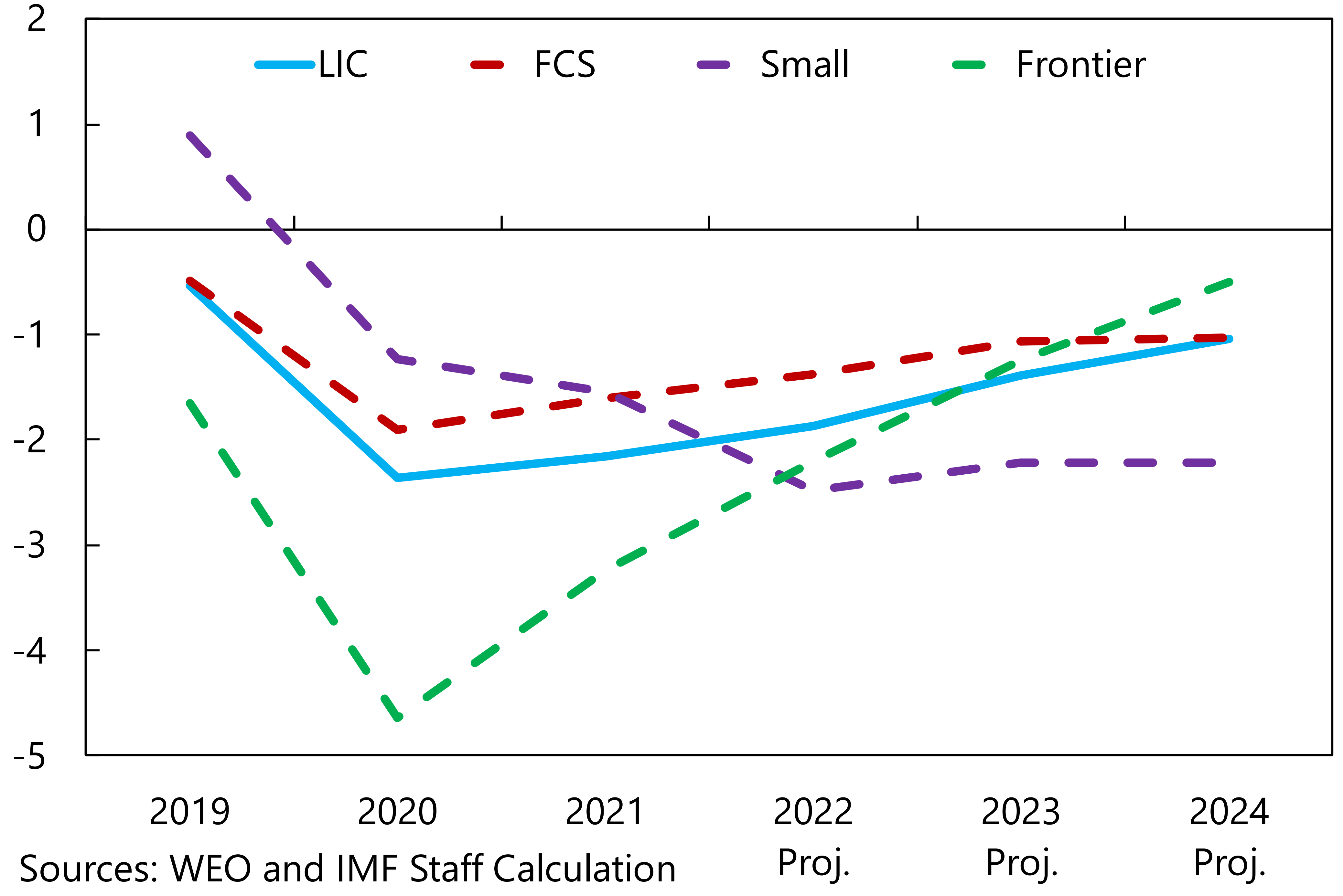
Heterogeneity in LICs' Fiscal Position

Fiscal position continues to be under pressure for **small states**; **frontier markets** were able to mobilize the largest financing with the deficits being expected to close rapidly.

Tourism-dependent countries once again saw the biggest pressure, while the hike in commodity price allows **fuel exporters** to run fiscal surplus.

Primary Deficit

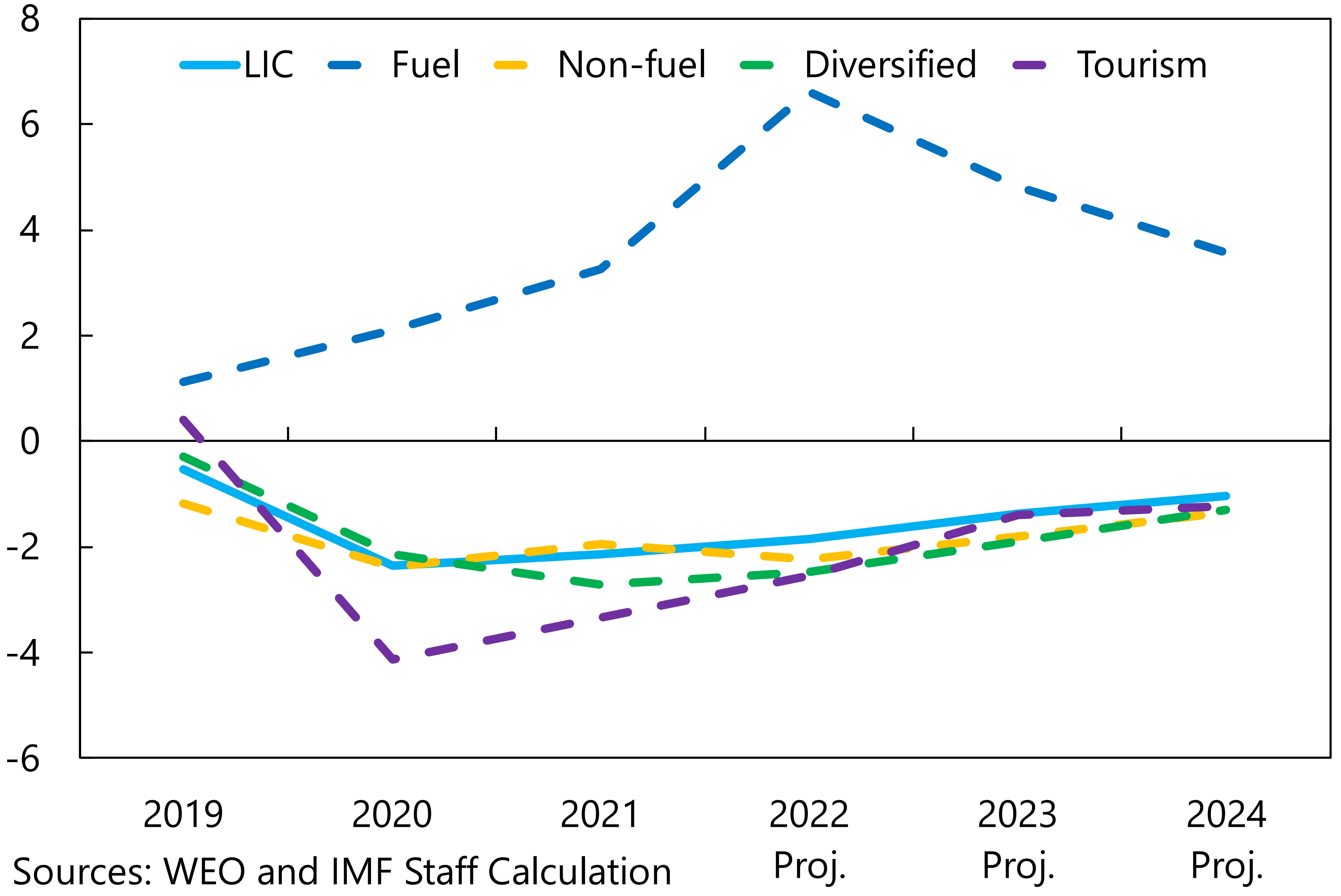
(Percent of GDP)



Sources: WEO and IMF Staff Calculation

Primary Deficit

(Percent of GDP)



Sources: WEO and IMF Staff Calculation