Reducing Low-Income African Country Debt Risks in a Post-COVID-19 era

OUR WEBINAR WILL START SHORTLY ...
MFW4A WEBINAR SERIES

- G8 initiative launched in October 2007

- Common platform for the harmonization and facilitation of financial sector development and knowledge sharing in Africa.

- Donor partners, African governments the private sector, and other financial sector with the aim of unleashing the full potential of Africa's financial sector in order to drive economic development and reduce poverty across the continent.

"Reducing Low-Income African Country Debt Risks in a Post-COVID-19 era"

- MFW4A PRESENTATION
  HOUSEKEEPING
  INTRODUCING SPEAKERS
  POLICY PAPER FINDINGS
  EXTERNAL CONTRIBUTION
  DISCUSSION
  CONCLUSION
Our work program encompasses three inter-linked strategic pillars:

- **Financial inclusion**
  - Digital finance
  - Agriculture finance
  - SMEs finance

- **Long-term finance**
  - Capital markets
  - Pension systems
  - Housing finance

- **Financial stability and regulation**
  - Community of African Banking Supervisors (CABS)

**Knowledge Management and Advocacy**

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Today’s session is scheduled to last 1 hour including Q&A

To ensure the highest quality of experience, all participants will be muted

QUESTIONS can be submitted via the “Chat” or “Q&A”

For Live questions / Comments. Click on “Raise Hand” icon to speak (Lower Hand and mute after)

Slides and a recording of this presentation will be circulated to registered participants within 72-hours following the webinar
They will also be available on MFW4A.ORG.

Message the organizers for any issues

Don’t forget to fill out the survey that appears automatically after the session


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Speakers

Ugo Panizza  Professor of International Economics and Pictet Chair in Finance and Development The Graduate Institute Geneva

Michael Atingi-Ego  Executive Director Macroeconomic And Financial Management Institute Of Eastern And Southern Africa (MEFMI)


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Main Message

1. Low-income countries, already facing significant challenges, now face a dramatic worsening of debt sustainability and the possibility of a widespread debt crisis because of the Covid-19 pandemic.

2. These countries are sensitive to external shocks partly because a large proportion of their debt is held in foreign currency and widespread devaluation of their own currencies can make their debt situation much worse.

3. The ability to borrow long term, internationally, in local currency could significantly reduce borrowing risks for low-income countries, but they would need help from multilateral institutions to do so.
High risk of debt distress is back...

Figure 8. Evolution of Risk of External Debt Distress
(Share of countries with LIC DSAs)

- Low
- Moderate
- High
- In debt distress

<table>
<thead>
<tr>
<th>Year</th>
<th>Low</th>
<th>Moderate</th>
<th>High</th>
<th>In debt distress</th>
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- LIEs Applying LIC-DSA: 73%
- Low-Income Developing Countries (LIDCs):

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- LIDCs: 44%

Source: LIC DSA Database as of End-October 2019.
Note: 69 out of 76 LIEs applies the LIC DSA, LIDCs constitute 59 countries (57 LICs).

Source: IMF (2020)
...and budget deficits are only part of the story

Figure 5. Debt Decomposition 1/
(Cumulative change in percentage points of GDP)

Source: IMF (2020)

See also: The Unexplained part of public debt (Campos, Jaimovich and Panizza, 2013)
Increase in the debt-to-GDP ratio with a 20% currency depreciation

Source: Own simulations based on estimates by Panizza and Taddei (2020)
Composition of public debt in low-income countries

Currency composition of PPG external debt

Composition of Public debt

Source: Panizza and Taddei (2020)
What is to be done?

• Better and safer domestic debt management, but it’s not enough. The IFIs need to play a role.
• Four possible options:
  1. Multilaterals accept the currency risk themselves
     – Problematic for non-concessional lending, probably possible for IDA
  2. Multilaterals borrow from local capital markets and on-lend
     – Bad idea
What is to be done?

3. Multilaterals borrow abroad and on-lend in local currency (Eichengreen, Hausmann and Panizza, 2002)
   - The multilaterals would need to be careful in matching their assets (single-currency loans) and liabilities (indexed loans).

4. Multilaterals outsource currency risk by hedging lending through another institution
   - Hedging products could be particularly interesting for regional development banks with limited internal diversification capacity, but could also allow global institutions, such as IDA, to experiment with local-currency lending in a limited subset of countries.
   - The Currency Exchange Fund (TCX), backed by a large number of multilateral and national development finance institutions, has a long history of providing hedging instruments for currencies that lack them in commercial markets.
Challenges

• Moral hazard
  – Not really an issue IMHO

• Pricing
  – Fair pricing is key

• Domestic political economy
  – Need to build a risk evaluation culture
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Ugo Panizza
The Graduate Institute Geneva

Based on joint work with Jesse Griffiths and Filippo Taddei

Michael Atingi-Ego  Executive Director  Macroeconomic And Financial Management Institute Of Eastern And Southern Africa (MEFMI)
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CONCLUSION

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