INTERNATIONAL MONETARY FUND

IMF POLICY PAPER

December 2022

MACROECONOMIC DEVELOPMENTS AND PROSPECTS IN LOW-INCOME COUNTRIES—2022

IMF staff regularly produces papers proposing new IMF policies, exploring options for reform, or reviewing existing IMF policies and operations. The following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its December 1, 2022, consideration of the staff report.
- The **Staff Report**, prepared by IMF staff and completed on November 2, 2022, for the Executive Board's consideration on December 1, 2022.

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International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR22/416

IMF Executive Board Discusses Macroeconomic Developments and Prospects in Low-Income Countries—2022

FOR IMMEDIATE RELEASE

Washington, DC – December 8, 2022: On December 1, 2022, the Executive Board of the International Monetary Fund (IMF) discussed the IMF staff paper on recent macroeconomic developments and prospects in low-income countries (LICs). The report also includes in-depth discussion of the role that capacity development on debt management plays in mitigating debt vulnerabilities. The paper defines LICs as those 69 countries eligible for the Poverty Reduction and Growth Trust facilities.[1]

The compound shocks from the pandemic and Russia's war in Ukraine have disproportionally affected LICs. They now face the challenge of resuming income convergence against the backdrop of a weak and uncertain global economic environment.

The strong rebound of growth in 2021 lost momentum in 2022, while inflation is accelerating rapidly. Fiscal deficits widened, thus further exacerbating debt vulnerabilities. Debt sustainability indicators have not yet reached the levels observed on the eve of the Heavily Indebted Poor Countries (HIPC) Initiative, but the shift in creditor landscape toward Non-Paris Club and private creditors brings new challenges for a swift and orderly debt restructuring where and when necessary. While sound policy framework, fiscal consolidation, and decisive action to revitalize growth remain the fundamental solution to sustainable debt, debt restructuring, when necessary, would also help tackle debt vulnerabilities. It will therefore be crucial to make debt restructurings under the G20 Common Framework more effective and timelier.

Capacity development on public debt management (CD) will also play important role in enabling LICs to mitigate debt vulnerabilities and sustainably cover their financing needs. The Fund is well positioned to respond to LICs current and evolving requests for CD that takes account of a more complicated borrowing landscape that has increased costs and risks. Future debt management improvements in LICs will require steadfast commitment on the part of both the authorities and CD providers, including paying more attention to the supportive enabling conditions, such as public debt management institutional arrangements and legal frameworks.

Looking at longer-term challenges, LICs have lost several years of progress towards achieving the Sustainable Development Goals (SDGs). Setbacks have been observed in major indicators, including poverty and education, while LICs are under rising threat from

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[1] The list can be found in Annex I of the report.

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climate change. With greater challenges under more constrained resource envelope, removing structural barriers to sustained and inclusive growth has become ever more important.

The international community and multilateral institutions, including the Fund, have stepped up support to LICs by providing policy advice, financing, and capacity development. However, the financing needs for LIC remains large. Updated estimate on the additional financing needs for LICs to address the legacy of COVID, rebuild external buffers and accelerate income convergence amounts to about $440 billion over the period 2022-26.

On their side, policymakers should confront challenges in both near and long term. They should wield all instruments available concertedly to achieve as best as possible the multiple competing near-term objectives: fighting inflation, protecting the vulnerable, preserving growth, containing debt vulnerabilities and managing financial sector risks. Countries should be mindful of maintaining credible fiscal and monetary policy frameworks. In the meantime, they also should not lose sight of longer-term issues, for instance poverty, inequality, climate change and digitalization. Decisive actions on structural reforms that unleash the growth potential will accelerate LICs' return to the course of income convergence.

Executive Board Assessment[2]

Executive Directors welcomed the opportunity to discuss recent macroeconomic developments and prospects in LICs. They broadly agreed with the staff's assessment and the identified policy priorities. Recognizing the worsening trends in growth, inflation, and in many cases fiscal and external balances. Directors expressed concerns over rising debt vulnerabilities, financial stability risks, and food insecurity. They commended the swift actions taken by the Fund, including the establishment of the food shock window (FSW) under the emergency financing instruments.

Directors concurred with staff that although debt indicators still appear to be lower than the pre-HIPC era, debt vulnerabilities are elevated. They observed that reducing debt over the medium term will require a combination of revenue mobilization, careful prioritization toward social and investment spending, and credible policy frameworks, as well as growth-enhancing structural reforms, including to strengthen governance, institutions, and the business climate. Noting that the evolving creditors landscape brings significant challenges to fast and orderly debt restructurings where needed, Directors emphasized the importance of more effective and accelerated processes for debt restructurings under the Common Framework. Directors also called on the Fund, in close collaboration with the World Bank, to support members on sound debt management and transparency, for which the Multipronged Approach to Address Debt Vulnerabilities provides a reference framework.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summing up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

Directors were concerned about the effects of multiple macroeconomic shocks on progress toward income convergence with advanced economies and achieving the Sustainable Development Goals (SDGs). They stressed that it is important for countries to use all policy instruments available concertedly to address the impact of these shocks in the near-term, while continuing to pursue long-term goals. Directors called on staff to develop more granular advice for LICs on making policy adjustments orderly and smoothly for addressing both near- and long-term challenges, including in areas with increased Fund engagement such as inequality, climate change and digitalization.

Directors were encouraged by the scaling-up of support by the international community. They welcomed the updated estimate of LICs financing needs, while acknowledging the uncertainty surrounding it. Directors commended the Fund for its fast response through the Special Drawing Rights (SDR) allocation and the adaptation of its lending facilities to the shocks, including the Resilience and Sustainability Trust and the FSW. They agreed that it is important to keep the Fund adequately resourced, including by closing the shortfalls in pledges under the ongoing Poverty Reduction and Growth Trust (PRGT) fundraising, while a few Directors also called for the use of internal resources to be considered for the PRGT. More broadly, Directors concurred that increasing the flows of ODA to help meet the financing needs of LICs should remain a prominent objective for the international community. They also emphasized the importance of maintaining an open and rules-based multilateral trade and financial system and avoiding geopolitical fragmentation.

Directors also welcomed the opportunity to discuss the role that public debt management capacity development (CD) plays in enabling LICs to mitigate debt vulnerabilities, particularly after the fundamental changes in the borrowing landscape and sovereign debt structure of LICs during the last two decades.

Directors commended the Fund's efforts, alongside those of other CD providers, to improve public debt management practices in LICs through a variety of CD modalities covering all areas of public debt management. They noted that regional debt management advisors contribute to CD traction by increasing the responsiveness to emerging needs and tailoring, while also facilitating coordination with other CD providers. At the same time, Directors acknowledged that building effective and robust public management practices in LICs takes time. It requires improvements in both technical skills and institutional, legal, and governance arrangements, while being also conditional on the availability of adequate resources, including staffing.

A number of Directors called for future reports on Macroeconomic Developments and Prospects in LICs to be released ahead of Spring and/or Annual meetings to maximize their visibility and potential to impact strategic, policy and resourcing discussions.

November 2, 2022

MACROECONOMIC DEVELOPMENTS AND PROSPECTS IN LOW-INCOME COUNTRIES—2022

EXECUTIVE SUMMARY

Macroeconomic Developments and Outlook

Russia's war in Ukraine and the related fallout have created a challenging external environment for the post-pandemic recovery of low-income countries (LICs). Food and commodity prices linger at elevated level with worsening food security. Global financial conditions tighten as major economies are fighting against inflation. The delay in LICs' income per capita convergence to that of advanced economies (AEs) is expected to last into the medium term.

The war is projected to slow down LICs' recovery from the pandemic. The upside growth surprise in 2021 decelerated in 2022. Inflation, initially driven by the economic recovery, has accelerated rapidly in 2022, heightening food insecurity and increasing risks of social unrest. Current account deficit widened from the low point in 2020, driven by import recovery in 2021, but more by commodity price hikes in 2022.

LICs' fiscal position is increasingly under stress as governments ramped up spending to address the impact of the pandemic and the war in Ukraine, and to protect the vulnerable from high food and fuel prices. As a result, debt vulnerabilities have intensified, with an increasing number of LICs being subject to heightened risks of debt distress, in a complex environment marked by a more diverse creditor landscape. The envisaged medium-term consolidation is subject to an array of downside risks.

While the trends in the macro aggregates of most LIC subgroups is similar to the average LIC, each country group has been affected in different degree by the global shocks. Small developing states experienced by far the largest decline in growth while non-fuel commodity and diversified exporters weathered the shocks relatively better. Fragile and conflict-affected states' growth performance lags behind that of their peers. On the other hand, higher oil prices would support growth in fuel exporters.

The international community and multilateral institutions, including the Fund, stepped up support to LICs in this challenging time, but more needs to be done. An updated estimate indicates that LICs' additional financing needs to resume and accelerate their income convergence with advanced economies would amount to $440 billion for the period 2022-26, broadly unchanged from the 2021 LIC Report which covered the period

2021-25. This estimate does not include an additional $57 billion in financing needs in 2022-23 due to the war in Ukraine.

Policy makers in LICs face challenging trade-offs both in the near term and in the long run. Fighting inflation while preserving growth and protecting the most vulnerable from shocks, as well as maintaining credible policy frameworks to tackle rising debt vulnerabilities, should be at the center of near-term policy objectives. At the same time, structural reforms to unlock growth potential and deal with longer-term issues, including poverty, inequality, climate change, and promote digitalization, will help accelerate income convergence.

Public Debt Management Capacity Development

With elevated debt levels, high gross financing needs, and rising global interest rates, effective public debt management has become more important than ever. For LICs, improvements in public debt management can play a critical role in mitigating debt vulnerabilities. It is important to ensure that debt managers have adequate tools, staffing, and resources to meet these challenges. The Fund can play an instrumental role by providing and facilitating capacity development in these areas. While fiscal policy is the main driver of public debt, effective debt management is essential to help safeguard debt sustainability, reduce economic and financial volatility, encourage development of the financial sector, and support long-term growth and development.

Effective debt management is built on both technical capacity and a strong institutional framework, which requires a clear mandate, resources and political support from government. While the Fund provides CD in all areas of public debt management, in coordination with other debt management CD providers, specific attention should be given by governments on the basic enabling conditions: Governance, Resources, Information and Policy. The Fund is well positioned to respond to LICs requests for debt management CD, including by strengthening the toolkit in core CD areas such as debt management strategies, investor relations, local currency bond markets and debt reporting. In order to support implementation, the number of regional debt management advisors has been increased and the number of online debt management learning courses has been expanded, which will help engage a larger audience in a cost-effective manner, while also improving the quality of CD delivery.

While public debt management CD can, and has, improved LICs' capacity to manage public debt, progress will remain gradual. Debt management achievements come over time, often over years rather than months, and require steadfast commitment on the part of the authorities and the supporting CD providers. Country authorities and CD providers should be prepared, and have contingencies ready, for when interruptions, setbacks, and delays arise.

Approved By
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ANNEXES

Abbreviations and Acronyms

ADB	Asian Development Bank
AE	Advanced Economies
AfDB	African Development Bank
AFRITAC	African Regional Technical Assistance Centre
AFW	AFRITAC West
BLR	Belarus
BOP	Balance of Payments
CARTAC	Caribbean Regional Technical Assistance Center
CC	Creditor Committees
CD	Capacity Development
CF	The G20 Common Framework for Debt Treatments
COMSEC	Commonwealth Secretariat
DMF	Debt Management Facility
DRC	Democratic Republic of Congo
DSA	Debt Sustainable Analysis
DSAx	Debt sustainability analysis massive open online course
DSSI	Debt Service Suspension Initiative
EBRD	European Bank for Reconstruction and Development
ECCU	Eastern Caribbean Currency Union
EM	Emerging Markets
ESG	Environmental, Social, and Governance
FCS	Fragile and conflict-affected States
FDI	Foreign Direct Investment
FSI	Financial Soundness Indicators
HFPS	High Frequency Phone Surveys
HIPC	Heavily Indebted Poor Countries
ICT	Information and Communication Technologies
IEO	Independent Evaluation Office of the IMF
IDA	International Development Association
JDMP	Junior debt managers program
LCBM	Local currency bond markets
LICs	Low-income Countries
MAC	Market Access Countries
MDBs	Multilateral Development Banks
MEFMI	Macroeconomic and Financial Management Institute of Eastern and Southern Africa
MTDS	Medium-term debt management strategy
MTDSx	Medium-term debt management strategy massive open online course
NPC	Non-Paris Club
NPL	Non-performing Loans
ODA	Official Development Aids
PC	Paris Club
PFTAC	Pacific Financial Technical Assistance Centre

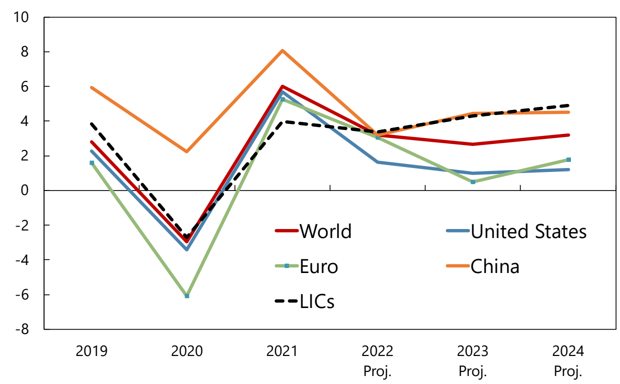
PNG	Papua New Guinea
PPPs	Public-private partnerships
PRGT	Poverty Reduction and Growth Trust
RCF	Rapid Credit Facility
RFI	Rapid Financing Instrument
RST	Resilience and Sustainability Trust
RTAC	Regional Technical Assistance Centers
RUS	Russia
SDG	Sustainable Development Goals
SDS	Small Developing States
SOEs	State-owned enterprises
SRDSF	Sovereign Risk and Debt Sustainability Framework
UKR	Ukraine
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNICEF	United Nations International Children's Emergency Fund
UNWTO	World Tourism Organization
WEO	World Economic Outlook

RECENT DEVELOPMENTS, OUTLOOK, AND POLICY CHALLENGES IN LICS[1]

A. The Global Economic Environment: A Challenging Post-Covid Recovery

1. **Russia's war in Ukraine and the related fallout threaten to derail the nascent post-Covid global recovery.** The strong growth rebound observed in major economies in 2021 is losing steam in 2022, largely reflecting the economic damage from the war in Ukraine and higher than expected inflation (Figure 1). In advanced Europe, the war and associated spillovers disrupt energy supply and put pressures on global energy prices, which weigh on growth prospects. In the U.S., growth is held back mainly due to continued supply chain disruptions and faster withdrawal of monetary support. In addition to the global spillovers from the war, the Chinese economy is experiencing a sharper-than-anticipated deceleration as the Omicron variant strains its zero-COVID strategy and its real estate sector is falling into deeper trouble.

Figure 1. Growth Developments and Prospects[1]



Sources: WEO and IMF Staff Calculations

[1]All figures use simple average unless otherwise specified.

2. **Elevated food and commodity prices, and disruptions stemming from the war in Ukraine, are putting a significant strain on most LICs.** Food and other commodity prices were on the rise before the outbreak of the war in Ukraine on the back of the continued recovery of the global economy, but the war exacerbated this trend (Figure 2). As a consequence, the number of people suffering from food insecurity increased sharply.[2] In addition to high food and oil prices, LICs are also vulnerable to disruptions in fertilizer markets for which Belarus, Russia and Ukraine occupy dominant shares (Figure 3). Supply disruptions for fertilizers this year will weigh on domestic agricultural production in many LICs next year, potentially feeding back to high food prices. Nevertheless, commodity price hike could benefit some LICs, particularly fuel exporters, as export earnings rise. While prices have eased in June-July, they remain significantly above the 2020–21 average and are still historically high, and the outlook remains highly uncertain.

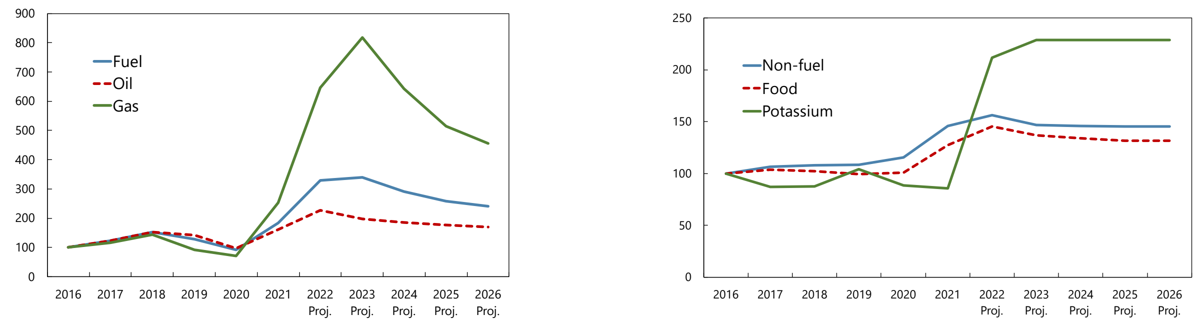
[1] The group of low-income countries is defined in this report as the 69 countries currently eligible to Poverty Reduction and Growth Trust (PRGT) facilities; see Annex I for details.

[2] Rother et al. (2022).

Figure 2. Global Commodity Price Developments

Fuel Commodity (Price Index, 2016 = 100)

Non-fuel Commodity (Price Index, 2016 = 100)

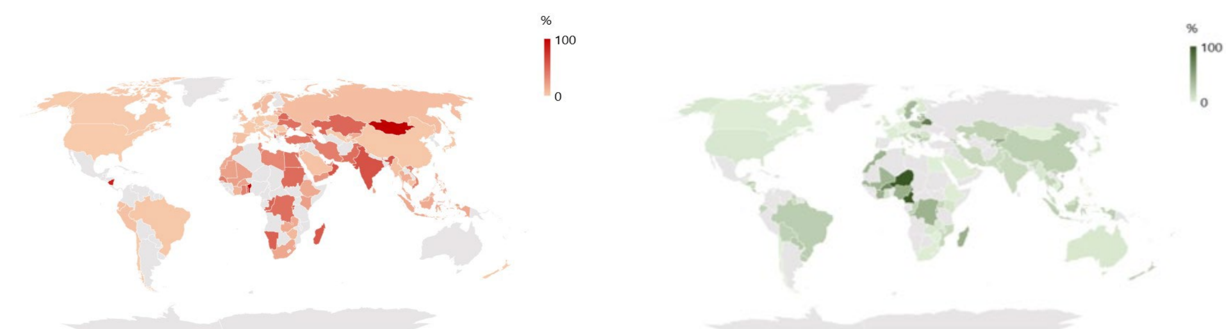


Sources: WEO and IMF Staff Calculations

Figure 3. Exposure to Wheat and Potassium Fertilizer Imports from Russia, Belarus, and Ukraine

Wheat Imports from BLR, RUS and UKR (Percent of Total Imports)

Potassium Fertilizer Imports from BLR, RUS and UKR (Percent of Total Imports)

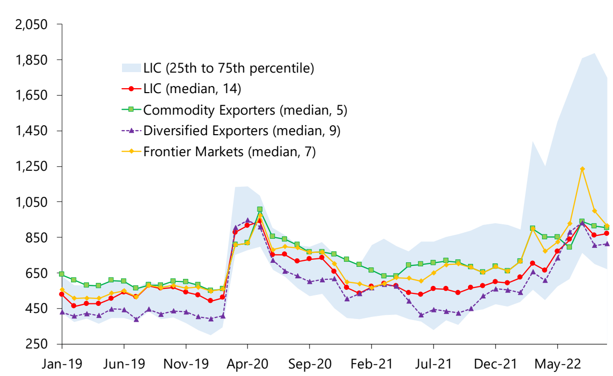


Sources: UN Comtrade and IMF Calculations

3. As major economies fight against inflation, the tightening of global financial conditions reduces the availability of external financing to LICs. Rising inflation in many advanced economies prompted major central banks to raise policy rates sharply and scale back asset purchases. Heightened market uncertainties and monetary policy normalization reduce risk appetite and trigger a flight to quality, as shown by the recent increase in the level and volatility of LICs' sovereign spread (Figure 4). This prompted LICs to scale back issuance plans or explore the path of syndicated loans. Covering budget needs thus becomes

Figure 4. Sovereign Spreads

Sovereign Spreads (Basis Points)



Notes: Number of countries in parentheses
Sources: Bloomberg and IMF Staff Calculations

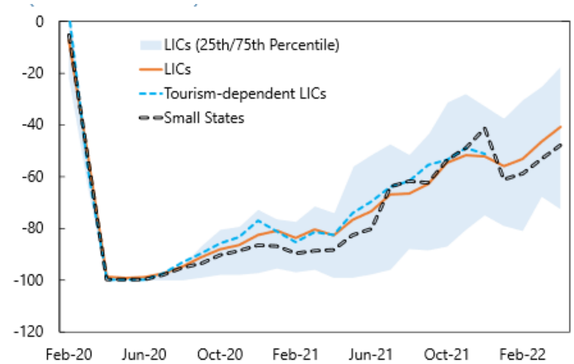
more challenging at a time when fiscal space is much needed. Further, tighter global financial conditions increase the risks of debt distress as financing cost rises and access to external financing shrinks; this also complicates the conduct of monetary policy and exchange rate management.

4. **LICs, particularly small states due to their heavy reliance on the tourism industry, are also confronted to the sluggish recovery in international tourism amid the pandemic and subsequently the war in Ukraine.** Tourism was hit exceptionally hard by the pandemic as many countries resorted to border closures and travel bans to contain the spread of the disease. With the relaxation of travel restrictions, tourist arrivals in LICs have been recovering gradually with about half of the lost ground regained by May-2022; the pace of recovery was also accelerating lately (Figure 5). Though the direct impact of the war on tourism is confined to Europe and Central Asia, the indirect impact is likely to be more pronounced and widespread through the slowdown in global growth and the elevated travel cost due to high energy prices.[3] Tourism, especially in the Asia-Pacific region, suffered also from drop in arrivals due to China's zero COVID policy.

Figure 5. International Arrivals

International Arrivals

(Percent of 2019 Level)



Sources: World Tourism Organization

5. **More broadly, income divergence between advanced economies (AEs) and LICs remains a great concern.** Despite having lower identified caseload, the pandemic has had a profound impact on the economy and labor markets in LICs (Annex II). In the medium term, while real GDP is projected to get close to the pre-pandemic projected level for AEs, LICs will sustain the largest output loss. Together with emerging markets (EMs), their prospects to claw back this loss in the near-term are slim (Figure 6 left panel). While it looks as if the war does not slow down the convergence process on top of the pandemic by much (Figure 6 right panel), it is by and large due to larger than expected contraction in AEs rather than catching up by LICs (Figure 6 left panel). Insofar as vaccination speeds recovery, the delayed vaccination in LICs exposes their population to new emerging variants and subjects the recovery and convergence to even higher risks.[4]

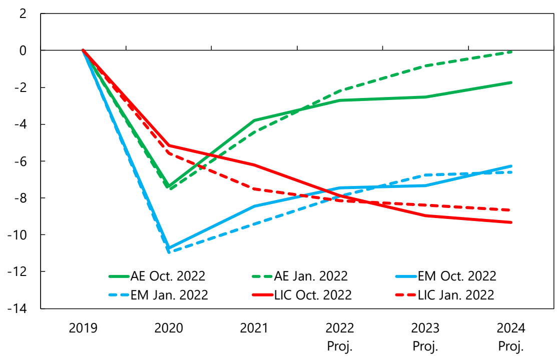
[3] As an example, the number of flights to Moldova was 70 percent lower between February and May compared to 2019 level (UNWTO, 2022).

[4] IMF study finds that vaccination rate is an important determinant of a country's recovery speed (Brussevich, Liu and Papageorgiou, 2022).

Figure 6. GDP Loss and Income Convergence amid the War in Ukraine and the Pandemic

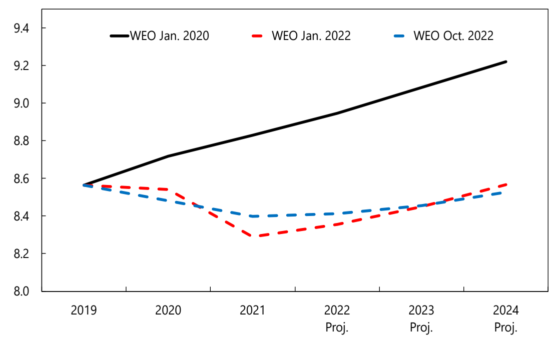
Real GDP Loss

(Percent of Pre-pandemic Projection)



LIC Convergence in Real GDP Per Capita

(Percent of AE average)



Sources: WEO and IMF Staff Calculations

B. Domestic Development in LICs: Navigating Through Unchartered Territory

Key Macroeconomic Trends and Policy Challenges in LICs

Growth and Inflation

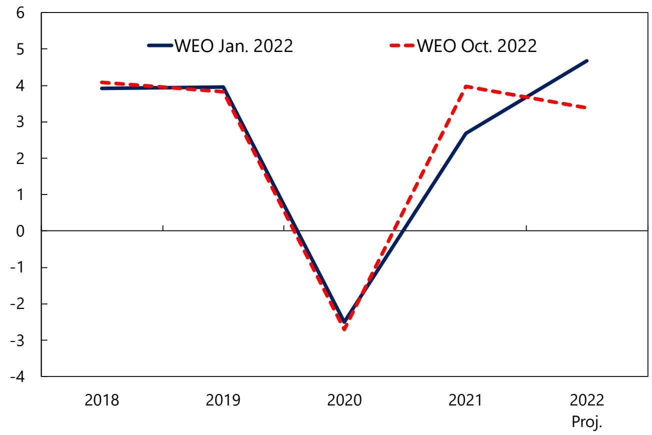
6. The spillovers of the war in Ukraine have slowed down growth in LICs (Figure 7). While the rebound in 2021 turned out to surprise on the upside, the momentum weakened in 2022 as disruptions to trade, high food and energy prices, together with the tightening of global financial conditions undermine the post-Covid recovery in LICs. Real GDP growth in LICs is projected to decelerate in 2022, in contrast to the increasing trend in the January 2022 WEO update. The revision is driven by the materialization of many downside risks, which will continue to exert downward pressure to the projections forward.

7. Inflationary pressures surged on the back of higher food and energy prices and disrupted cross-border production networks, along with accommodative monetary policy and exchange rate depreciation. The global food and energy price increases exacerbated by the war accelerated the buildup of inflationary pressures in LICs, which already started with the economic reopening amid the pandemic. Due to higher share of food in the consumption basket of households in LICs, inflation is driven overwhelmingly by food price hike (Figure 8 upper panel). In the January 2022 WEO, inflation was projected to have culminated in 2021 and to start retreating in 2022. The war has reversed the trend altogether and leads to a sharp increase in projected headline inflation rate in 2022, with persistent higher inflation into the medium term (Figure 8 lower panel). Accommodative monetary policy as can be seen from broad money growth and large currency depreciation may have also contributed to the rising inflationary pressures (Figures 21 and 22, bottom panels).

Figure 7. Growth Developments in LICs

Real GDP Growth: Impact of the War

(Percentage Points)



Sources: WEO and IMF Staff Calculations

8. Food insecurity risks are materializing owing to the combination of the impact of the war and climate risks. LICs are typically net food importers and tend to experience higher pass-through of global to domestic food prices, which expose them to international food price shocks. Moreover, in many LICs, high energy prices have been a key driver of domestic food inflation through their impact on transport and food distribution costs. As a result of the high share of food products in the consumption basket of the poorest households, high food prices leave many vulnerable households at risk of hunger. Beyond this immediate concern, climate change exacerbates downside risks to rainfed agriculture in LICs: a few countries have faced worsening drought conditions with delayed and below-average rainfall (Ethiopia, Somalia, South Sudan, Uganda);[5] others have experienced planting delays because of poor rainfall (Burundi, Madagascar, Malawi, Mozambique).

9. The number of people suffering from food insecurity increased sharply and will remain high in the medium-term. The World Food Programme (WFP) estimates that 345 million people in 82 countries are suffering today from acute food insecurity and are in need of urgent action, an increase of 200 million since 2019. Moreover, as the factors underlying food insecurity are unlikely to disappear any time soon, food insecurity is expected to remain a key global challenge in the coming years. Projections by the International Fund for Agricultural Development (IFAD) and the Food and Agriculture Organization (FAO) suggest nearly 670 million people will still be facing hunger by 2030 – 8 percent of the world population. The World Bank estimates that over the medium-term (until 2028) the number of severely food insecure people will remain high at around 1 billion people in its IDA and IBRD member countries (Annex III).

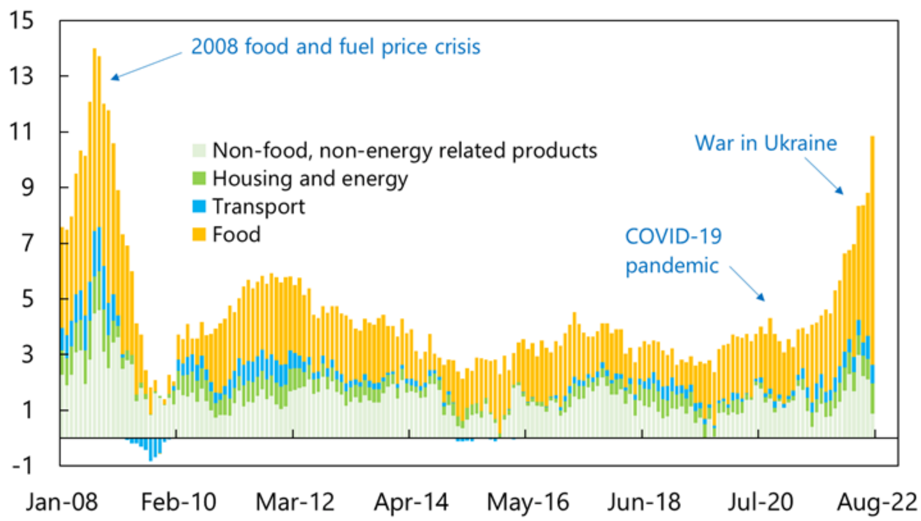
[5] Drought conditions this year extend further to Nigeria, South Sudan, Democratic Republic of Congo, some parts of Kenya, and countries in the Sahel. The four-season drought in the Horn of Africa was recently identified by the World Food Program as the worst global food emergency in 2022.

10. High food prices, combined with soaring fuel prices which compound the risk of social unrest, prompt many governments to take actions. Policy measures to mitigate the impact of the most vulnerable include price freeze, tax exemptions or subsidies. However, they are often untargeted and can disrupt market signals, which could delay the necessary demand and supply adjustments. It is, therefore, important that they are carefully designed to ensure the right incentives while protecting the most vulnerable in a cost-effective way.

Figure 8. Inflation Prospects in LICs

LICs: Contribution to Headline Inflation, Jan 2008 – Jul 2022

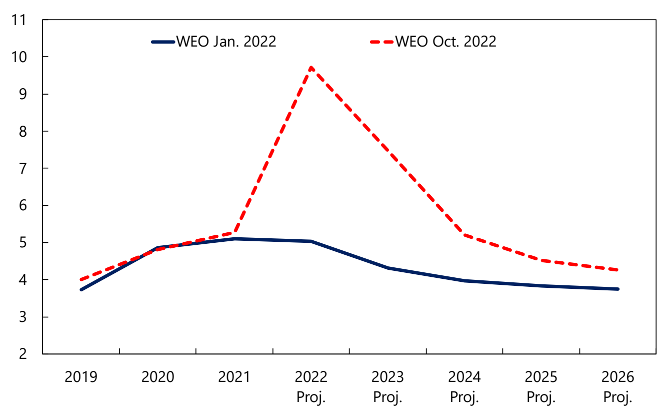
(percent)



Notes: Contribution to median twelve-month inflation rate.

Headline Inflation: Impact of the War

(Percentage Points)



Sources: WEO, International Financial Statistics and IMF Staff Calculations

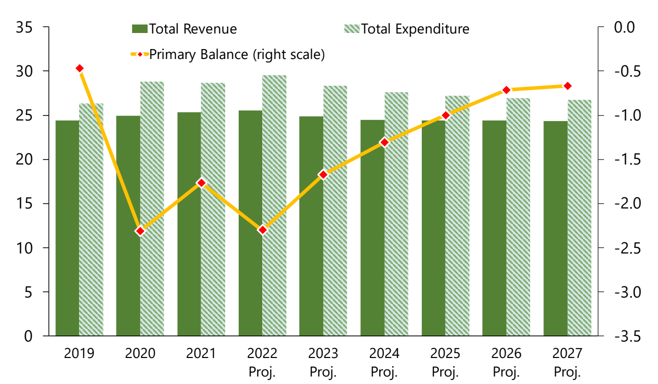
Fiscal Development

11. LICs' fiscal position is projected to remain under pressure in the wake of the war in Ukraine, but could improve from 2023 onwards, supported mainly by expenditure containment (Figures 9 and 10). This follows two consecutive years of fiscal pressures as LICs sought to meet pressing health expenditure needs and provide vital support to the vulnerable during the pandemic, as well as granting tax relief for businesses. The slight improvement in the primary balance observed in 2021 is projected to reverse in 2022, reflecting an uptick in government spending as LICs devote budgetary resources to subsidies and social spending to mitigate the impact of high food and oil prices on the poor. The limited capacity to target the most needed implies that the cost of these subsidies is often much higher than warranted. On the positive side, favorable terms of trade movement owing to higher commodity prices may provide additional fiscal buffers to natural resource-rich LICs. Debt levels soared in many countries, worsening debt vulnerabilities that started building up well before the pandemic and the war, further limiting the policy space for growth friendly expenditure and to deal with shocks (see section *Headwinds from Rising Debt Vulnerabilities*). In the medium term, fiscal restraint is projected to materialize, but this hinges entirely on expenditure consolidation with marginal improvements in tax revenues, thus throwing in doubt LICs' revenue mobilization ambitions, a key component of the 2015 Addis Ababa Action Agenda. Risks are tilted to the downside as slippages from the projected fiscal consolidation would further elevate debt vulnerabilities.

Figure 9. Fiscal Trends in LICs

Revenue, Expenditure and Primary Balance

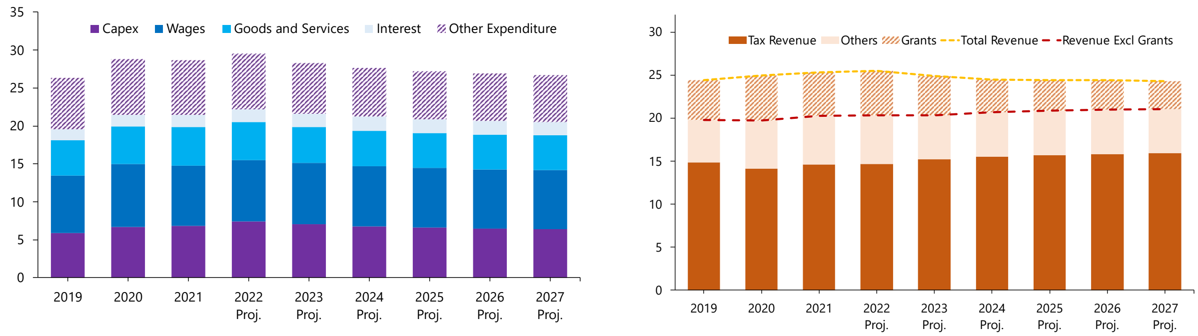
(Average, percent of GDP)



Sources: WEO and IMF Staff Calculations

Figure 10. Components of Revenue and Expenditure

Breakdown of Expenditure (Percent of GDP) | **Breakdown of Revenue** (Percent of GDP)

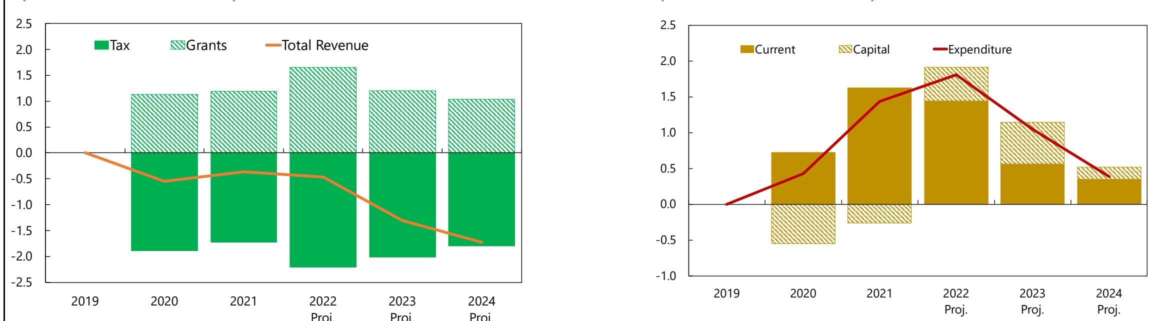


Sources: WEO and IMF Staff Calculations

12. Comparing the level and composition of revenue and expenditure with pre-pandemic projections shows concerning trends. The pandemic and the war together pushed LICs to scale back revenue mobilization ambitions by about 1.5 percent of 2019 GDP over the medium term compared to the pre-pandemic projected level, while grants are higher (Figure 11 left panel). At the same time, governments spent more than they planned to, driven by significant expansion on current spending. On the other hand, capital expenditure was postponed, with the cuts in the past two years being reversed in 2022 onwards (Figure 11 right panel). Though the main driver behind the increase in current spending is due to the pandemic response, past experience suggests that, depending on their nature (e.g., wages, subsidies), clawing back current spending can be challenging, which could jeopardize the much-needed medium-term fiscal consolidation.

Figure 11. Revenue and Expenditure Versus Pre-pandemic Projection (in Real Term)

Revenue and Subcomponents: LIC (Percent of 2019 GDP) | **Expenditure and Subcomponents: LIC** (Percent of 2019 GDP)



Sources: WEO and IMF Staff Calculations

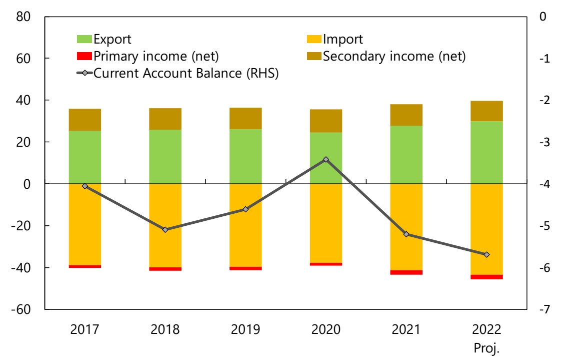
External and Financial Sectors

13. LICs' current account (CA) deficits are expected to deteriorate in 2022 on average, after easing during the pandemic (Figure 12 left panel). The collapse in aggregate demand amid the pandemic led a sharper contraction of imports relative to exports, and together with the softening of oil prices and strong remittances, current account deficits in LICs improved on average in 2020, before starting to widen with the economic reopening. Additional upward pressures on commodity prices due to the war will further deteriorate LICs' external position in 2022, sending the current account path to a weaker position than implied by the pre-war projections (Figure 12 right panel).

Figure 12. External Sector Developments

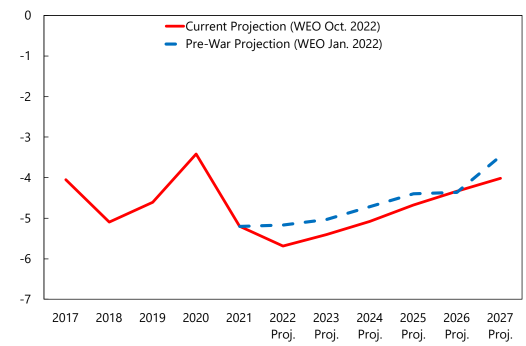
Current Account Decomposition

(Average, percent of GDP)



Current Account Balance: Medium-Term Outlook

(Average, percent of GDP)



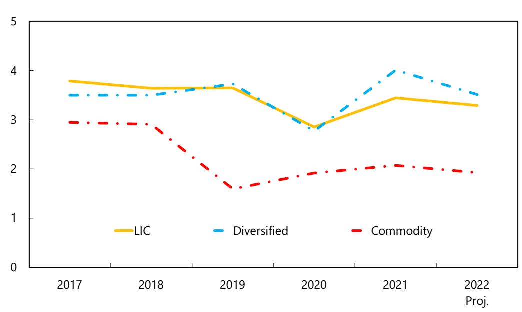
Notes: Exclude small states and Mozambique as outliers.
Sources: WEO and IMF Staff Calculations

14. The resilience of remittances, a silver lining for the pandemic, continued to show strength while foreign direct investment (FDI) remains weak. Remittances contracted in the second quarter of 2020 as the pandemic unfolded but recovered strongly in the second half of the year (Box 1). On the contrary, average FDI in LICs dropped in 2020 to 2.9 percent of GDP from 3.6 percent in 2019 and is projected to remain subdued in 2022. Looking at the period 2017—21, remittances were on average more than twice higher than FDI as a share of GDP in LICs, showing their relatively important role in development financing (Figure 13).

Figure 13. Remittances and Net FDI Flows to LICs

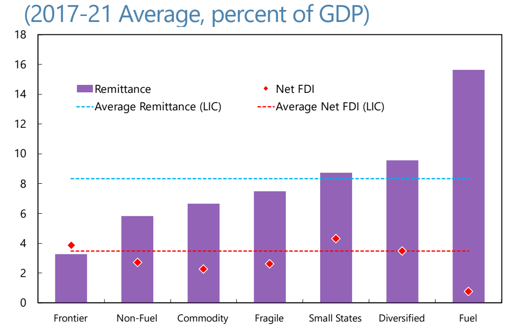
Net FDI

(Average, percent of GDP)



Net FDI and Remittance

(2017-21 Average, percent of GDP)

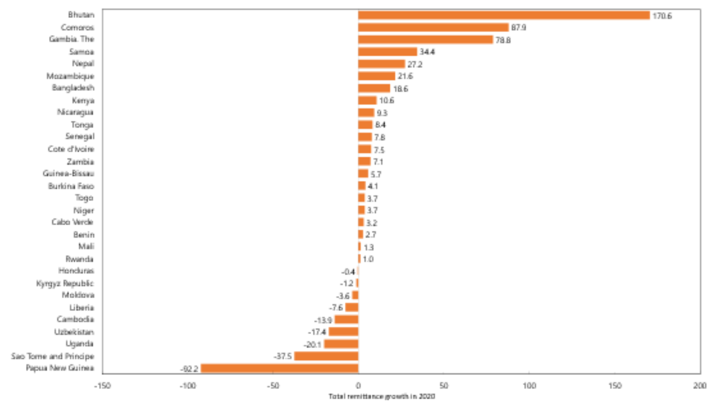


Sources: WEO and IMF Staff Calculations

Box: 1. The Resilience of Remittances: A Silver Lining for the Pandemic

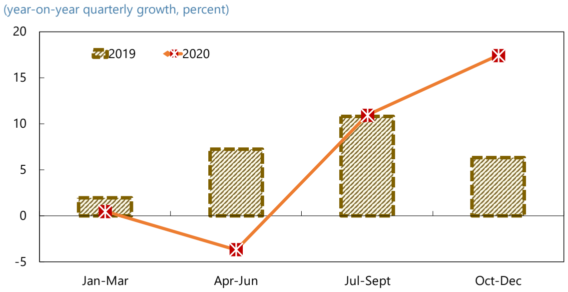
Remittances to LICs proved to be resilient during the COVID-19 pandemic. In a sample of 30 LICs for which quarterly remittances data are available, the average growth of remittance in the period in 2020 relative to 2019 reached 10.7 percent, defying grim forecasts at the onset of the pandemic. Bhutan, Comoros, and Gambia recorded the largest increase in remittances. Despite the decline in some countries, the general trend shows the resilience of remittances during the COVID-19 crisis in providing critical external financing and cushioning shocks in LICs. Remittances also saw strong growth in 2021 supported by robust economic activity and employment levels in many advanced countries.

Change in Inward of Remittances in 2020 Relative to 2019 (percent)



Intra-year dynamic of remittances shows a V-shaped recovery in 2020. Using the same sample of 30 LICs, the year-on-year quarterly growth of remittances clearly displays a contraction in the second quarter of 2020 as the pandemic spread out and containment measures were put in place across the world. This was followed by a sharp recovery of remittances in the rest of the year that surpassed the levels seen in 2019, as migrants stepped up support to their families dealing with the pandemic; informal remittances shifted to the formal channel following travel restrictions; accommodative fiscal and monetary policies in the host countries cushioned growth and preserve jobs; and the use of digital payment services expanded.[1]

Remittance Flows to LICs during the pandemic
(year-on-year quarterly growth, percent)



Unfavorable global conditions weigh on the outlook for remittances in 2022. The forecasted slowdown in growth in many large host countries and lukewarm global economic conditions in the wake of the war in Ukraine will likely lead to more moderate remittance flows in 2022.

[1]Kpodar et al. (2021); World Bank (2021).

15. Foreign reserve coverage is expected to decline marginally in 2022, after holding up well in 2021 propped by the SDR allocation and sustained remittances (Figure 14).[6] The median level of import coverage in LIC is projected to drop to 4.1 months in 2022 from 4.5 months

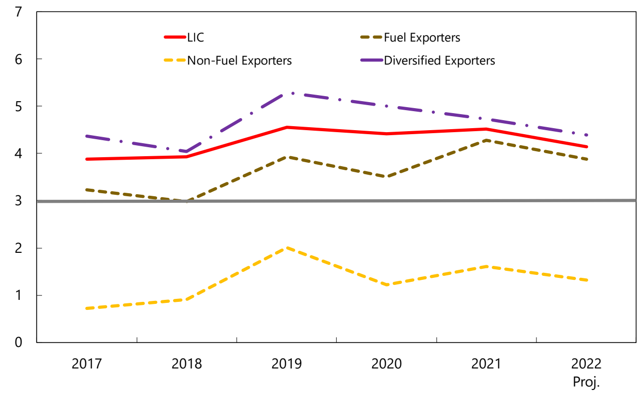
[6] See Box 5 on the use of the 2021 SDR allocations by LICs.

at end-2021, reflecting a widening in the current account. Furthermore, about one-third of LICs are projected to have reserve levels less than the threshold of 3 months of imports in 2022.

Figure 14. Stock of International Reserves

Stock of Reserves

(Median, Months of Prospective Imports)



Sources: WEO and IMF Staff Calculations

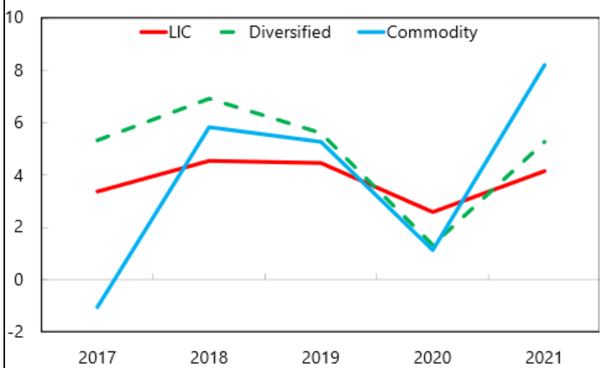
16. Relaxation of macro-prudential policies during the pandemic provided lifeline to many firms in liquidity shortage, but also increasingly exposes LICs to financial sector risks, particularly as countries withdraw pandemic support. After a sharp decline during the pandemic, growth of private sector credit in LICs rebounded in 2021 to pre-pandemic levels (Figure 15). Recent financial sector data are not yet readily available for LICs, making it difficult to assess emerging financial sector stresses. That being said, notwithstanding the decline in profitability, the general pattern of the evolution of Financial Soundness Indicators (FSI) in LICs until end-2020 does not indicate significant financial sector vulnerabilities (Figure 15). While at elevated levels, non-performing loans as a share of total loans only increased modestly in LICs on average from 8.5 percent at end-2019 to 9 percent at end-2020. The situation could deteriorate, however, not only as regulatory forbearance and other exceptional support measures introduced during the pandemic come to an end but also due to global downside risks to growth and financial conditions. The increased likelihood of corporate defaults that may ensue calls for enhancing national corporate insolvency frameworks to mitigate macro and financial stability implications. Moreover, the wider expected current account deficit and weaker reserve coverage are likely to lead to exchange rate depreciation, which in turn could trigger the deterioration in the bank and corporate balance sheets in flexible regime countries with high level of dollarization.

17. Rising domestic public debt (¶22) predominantly held by domestic financial institutions can give rise to risks to financial stability. Sovereign banks' exposure has been on the rise in LICs (Figure 16), notably during the pandemic, due to on-lending to the government. This interconnectedness of banks and sovereigns (the so-called sovereign-bank nexus) could pose challenges to bank's liquidity positions and crowd out private lending, especially when many banks in LICs are state-owned. More importantly, with rising debt vulnerabilities, a deeper nexus makes the banking system and the overall economy vulnerable to macroeconomic shocks.

Figure 15. Credit to Private Sector and Non-performing Loans

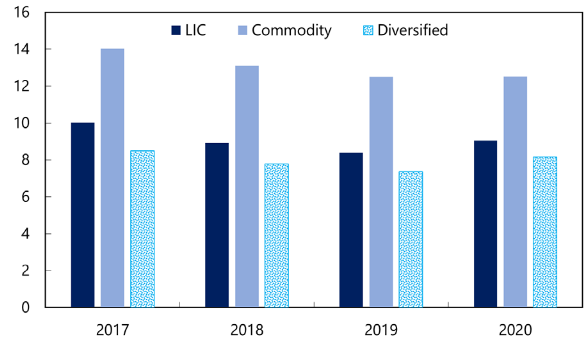
Real Credit Growth

(Median, Percentage growth)



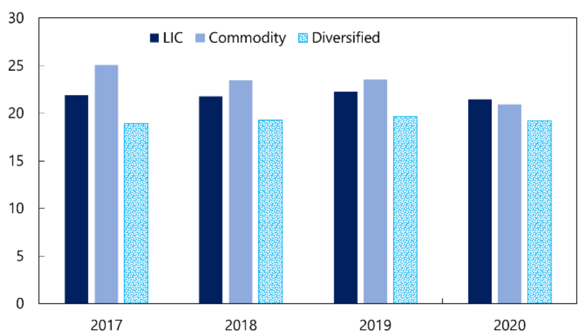
Non-Performing Loans

(Average, Percentage of Total Loans)



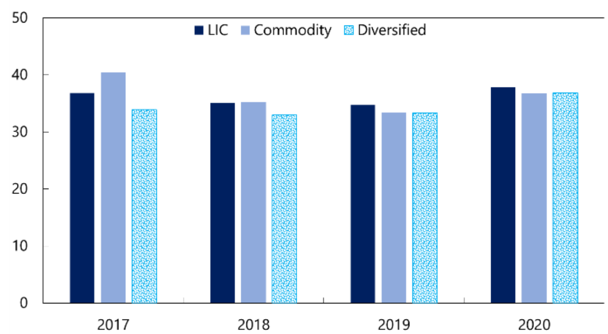
Evolution of Regulatory Capital to Risk Weighted Assets Ratios

(Percent)



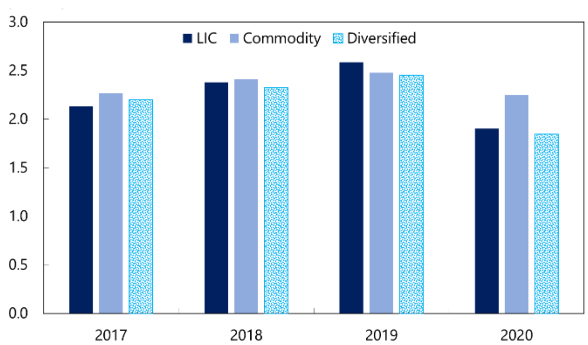
Evolution of Liquid Assets

(Percent of total assets)



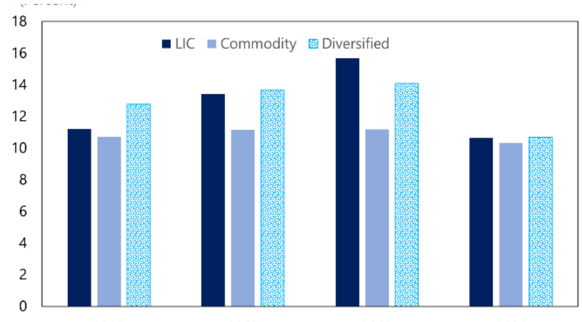
Evolution of return on Assets

(Percent)



Evolution on Return on Equity

(Percent)

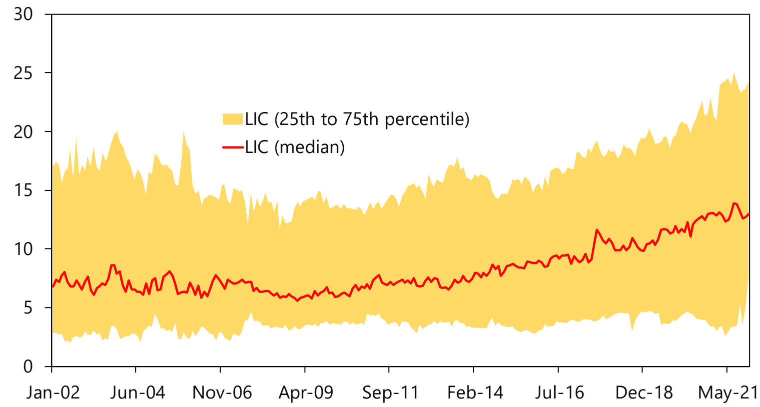


Sources: Financial Soundness Indicators, International Financial Statistics and IMF Staff Calculations

Figure 16. Sovereign Banks' Exposure

Ratio of Claims on Central Government to Banking Institutions' Assets

(Percentage Points)



Sources: International Financial Statistics

Headwinds from Rising Debt Vulnerabilities

18. Public debt has risen steadily during the last decade, with a further increase in 2020-21 due to the pandemic (Figure 17). Higher external borrowing following low interest rates, high investment needs, limited progress in domestic revenue mobilization, and often-constrained public financial management capacity have been the key contributing factors.[7] Despite the scaled-up support from the international community, eroded fiscal buffers and limited access to financial market severely constrained LICs' response to the pandemic. These constraints led to a large output loss, which in turn further elevated debt-to-GDP ratios.

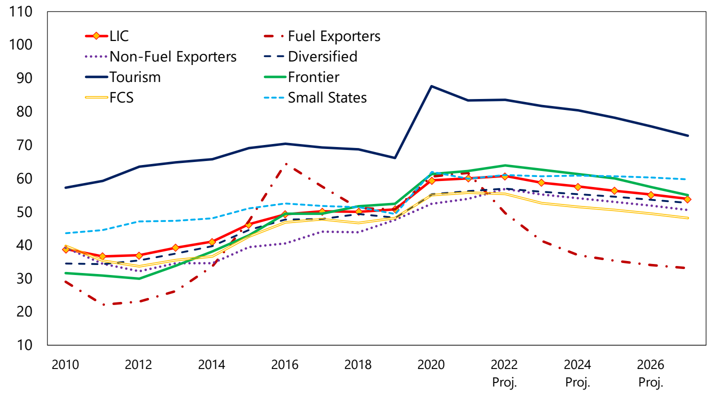
19. The slowdown in growth due to the war in Ukraine threatens to derail LICs' plan to curb public debt. The projected decline in public debt in LICs in the medium-term, mirroring the post-Covid spending consolidation, is subject to high uncertainty as the full impact of the war is yet to unfold. Failure to maintain the consolidation path and put public debt in a decisive downward path will intensify existing debt vulnerabilities. The evolution of recent DSA assessments shows that as of end 2021, almost 60 percent of LICs were assessed at high risk of, or already in debt distress, up from 30 percent in 2015 (Figure 17 middle panel). In the same vein, debt burden indicators—such as the external debt service-to-export ratio and total interest payment-to-revenue (excluding grant) ratio—were on the rise over the course of last decade and are projected to remain elevated in the medium term (Figure 17 bottom panel). With the debt service suspension initiative (DSSI) having expired and interest rates on the rise, LICs will find it increasingly difficult to service their debts and borrow at reasonable costs, particularly as the composition of their debt, historically dominated by concessional loans, has shifted to more borrowings on commercial terms.

[7] Chabert, Cerisola and Hakura (2022).

Figure 17. Public Debt Developments in LICs

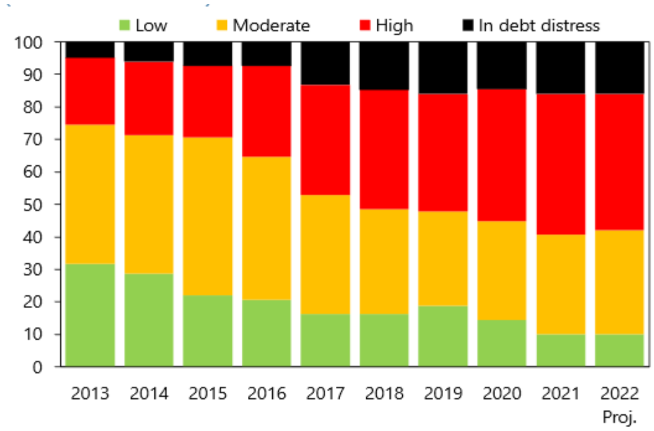
Public Debt, 2016-27

(Percent of GDP)



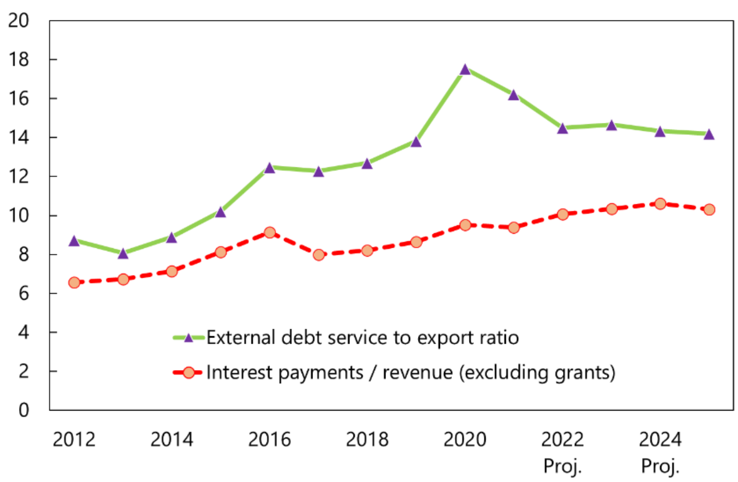
Evolution of Risk of Debt Distress

(Percent of LICs with DSA)



Debt Service Indicators

(Percent)



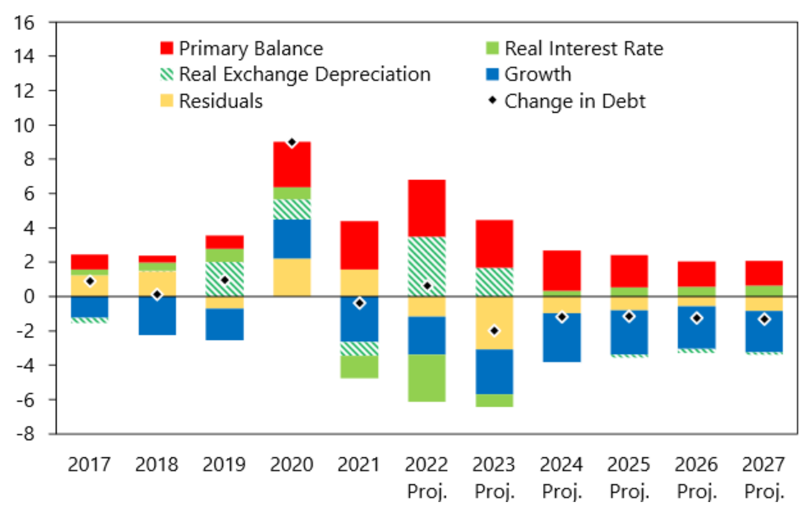
Sources: WEO and IMF Staff Calculation

20. The decline in public debt in the medium-term hinges on fiscal consolidation and sustained growth recovery (Figure 18). The decomposition of debt dynamics shows that high primary deficit and growth contraction were the main contributors to rising debt levels in 2020 as well as a large residual component, capturing below-the-line pandemic support. In 2022, the expected large real exchange rate depreciation, reflecting a strong dollar, adds to the primary deficit pushing up the debt, while economic growth and the decline in real interest rate act as countervailing forces. The impact of real interest rate reflects the prevailing high inflation worldwide; with inflation projected to increase more than the average nominal interest rate, it helps contain the increase in public debt-to-GDP ratio in 2022. In the medium term, primary deficit is expected to continue driving debt level up, albeit at a declining rate, with rebounded growth being the offsetting factor. Nonetheless, the projection of debt-to-GDP ratio is subject to significant downside risks. Uncertainty from the war in Ukraine could negatively affect the debt trajectory: weakening global demand may hamper growth, whereas higher commodity prices may put pressure on fiscal consolidation efforts as governments provide vital support to vulnerable households. Tighter global financial conditions and flight to quality also elevate the rollover risk for LICs due to private creditors and bondholders rebalancing their portfolios. Fiscal consolidation that is not growth-friendly also poses significant risks to the debt trajectory through the fiscal multiplier effect, while failure to undertake critical structural reforms could result in lower than projected growth, thus exacerbating debt vulnerabilities.

Figure 18. Decomposition of Debt Dynamics[1]

Driver of Debt Dynamics: LIC

(Percent of GDP)



[1]Sudan, owing to large currency depreciation and ongoing debt restructuring under HIPC initiative is excluded.

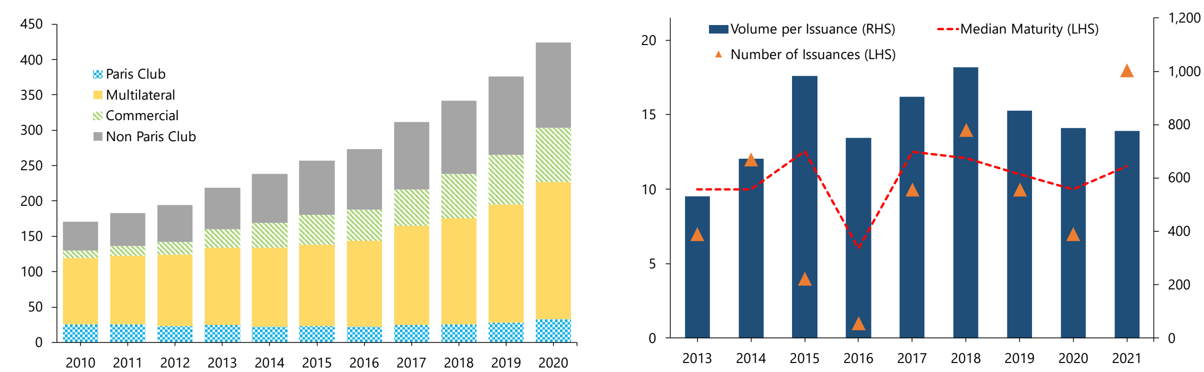
Sources: WEO and IMF Staff Calculation

21. Even though debt burdens are lower compared to the situation that triggered the Heavily Indebted Poor Countries (HIPC) Initiative, debt vulnerabilities are elevated, with the evolving structure of external debt creating new challenges, calling for a more effective and

accelerated implementation of the Common Framework to facilitate delivering debt relief. A comparison of the external debt burden indicators of HIPCs in the mid-1990s with today's LICs already in or at high risk of debt distress indicates that debt burdens are lower today than where they were on the eve of the HIPC initiative (Annex IV). Arrears accumulation, which was widespread among LICs in the 1990s, appears to be not as much of an issue among LICs today as well. The main difference today relates to the transformed financing landscape, which has created new challenges for effective creditor coordination in debt restructuring processes. By the end of 2020, the creditor landscape for LICs had rebalanced. The share of total external debt to Paris Club (PC) official bilateral creditors fell from 39 percent in 1996 to 12 percent in 2020, while that to Non-Paris Club (NPC) official bilateral creditors rose from 8 percent to 22 percent.[8] The share of multilateral debt declined from 55 percent in 2010 to 46 percent in 2020, but remains high. In addition, the share of private creditors in total external debt doubled from 8 to 16 percent through LICs' issuance of marketable bonds (Figure 19 and Annex IV). The more complex creditor landscape makes debt restructuring processes more difficult: indeed, while the share of debt owed to non-traditional creditors has risen, mechanisms to ensure coordination among creditors have not evolved in parallel, in particular for official bilateral creditors. An important objective of the G20 Common Framework (CF) is to bring together PC and NPC creditors to increase their cooperation and facilitate needed debt treatments. The implementation of the CF, however, remains challenging. An effective and timely implementation of the Common Framework is required to restore stability and the conditions for sustainable growth for many vulnerable countries (Box 2).

Figure 19. Debt Composition by Creditor and Trends in Issuance of Marketable Debt by LICs

Total Debt Stock by Creditor (Billions of USD) | **Issuance of Marketable Debt** (Years and Millions of USD)



Sources: World Bank and IMF.

8 The chart representing Paris Club loans consist of loans due to all 22 current Paris Club members. Changing the perimeter to account for the year creditors joined the PC does not significantly affect the figures.

Box 2. The G20 Common Framework[1]

The international sovereign debt restructuring architecture typically relies on negotiated outcomes based on norms and practices that have evolved over many years. The G20 Common Framework (CF) represents a breakthrough in expanding the aforementioned negotiation process by including major non-Paris Club creditors to LICs. However, effective delivery of debt treatments has been difficult and the uptake in the number of countries requesting debt treatment under the CF has remained low. Many of the implementation challenges come from the novelty in the process, which may improve over time, based on the experience accumulated in the first cases. Improvements in the timeline and clarity in the process are urgently needed, however, to ensure the CF can deliver its potential.

The IMF and the World Bank have identified four priorities to improve CF implementation. These four priorities include: (i) quicker and more efficient processes through clear and time-bound steps in the implementation of the CF; (ii) the introduction of a debt service standstill provided by the official bilateral creditors for the period of the negotiation, to immediately address the liquidity needs of countries requesting a treatment, with no penalty interest; (iii) greater clarity on how official bilateral creditors will enforce and evaluate the comparability of treatment to private creditors; and (iv) the expansion of coordinated debt treatments to non-CF eligible countries with debt vulnerabilities. Fostering trust among creditors will be critical to make further progress on the CF.

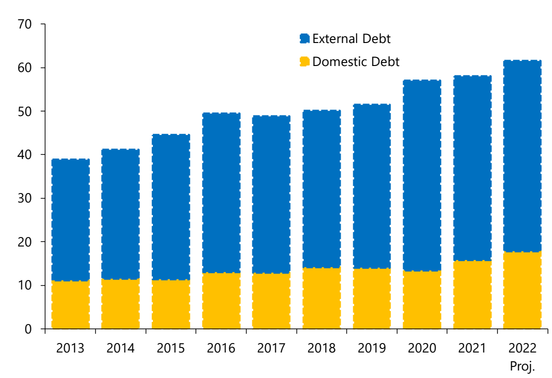
[1]Georgieva and Pazarbasioglu (2021); Chabert, Cerisola and Hakura (2022); IMF and World Bank (2022).

22. **Similar to external debt, domestic debt level has also been on the rise.** As domestic financial and bond markets develop (Chapter 2, ¶59 and ¶67), for supporting financial inclusion among other goals, financing from domestic sources in LICs has kept up pace with the external sources, with the domestic debt ratio increasing from 11 percent of GDP to 15 percent of GDP in 2021 (about 25 percent of total debt). Domestic financing has many benefits, including less rollover and currency risks. On the downside, it exposes a country to the risks of fiscal dominance and of crowding out private sector financing. Since most domestic debt is held by banks, it has also financial stability implications, and can be a significant source of fiscal risk, including when debt needs to be restructured (IMF, 2021d). For many countries, domestic debt also appears to have higher average cost than external debt, particularly concessional debt.

Figure 20. Domestic and External Debt

Domestic and External Debt

Percent of GDP



Sources: World Bank and IMF.

23. Besides fiscal consolidation, and debt restructuring when necessary, sound debt management remains a critical tool to address debt vulnerabilities.[9] The IMF-World Bank Multipronged Approach to Address Debt Vulnerabilities (MPA) provides a reference framework to support this objective, through a comprehensive approach organized around four pillars: (i) strengthening debt transparency; (ii) strengthening countries' capacity to manage debt; (iii) applying accurate debt analysis tools; and (iv) strengthening International Financial Institution (IFI) policies. Building capacity is an essential part of this approach (see more details in Chapter 2). The IMF and World Bank are developing customized advice to address debt and fiscal risks and adapt the modalities of capacity development delivery. They are also supporting more comprehensive borrower reporting to international statistical databases, and strengthening IFIs' policies on debt reporting and data dissemination. In addition, the IMF and World Bank are also enhancing their outreach to creditors and debtors, including in the implementation of the Common Framework. In the meantime, the IMF is providing analytical and policy support through the release of new analytical tools and policies. Most notable are the recent reviews of the IMF's sovereign risk debt sustainability framework for market access countries which provides a clearer signal on sovereign debt risks (IMF, 2021c), the Debt Limits Policy (IMF, 2020) and the IMF's Lending into Official Arrears and Lending into Arrears policies (IMF, 2022e).

LICs as a Group Conceal Significant Heterogeneity

24. LIC subgroups categorize countries according to institutional characteristics and export structure. The classification by institutional characteristics encompasses fragile and conflict-affected states (FCS), small developing states (SDS), and frontier markets (Figure 21), while the classification by export structure includes fuel, non-fuel commodity, diversified exporters and tourism-dependent LICs (Figure 22).[10] There is, however, a significant overlap across the subgroups. For instance, over 50 percent of LICs are FCS, whereas non-fuel commodity and diversified exporters each contains 40 percent of LICs. The FCS subgroup consists of disproportionately non-fuel commodity exporters; and for tourism-dependent countries, all but one (Cambodia) are SDS. In contrast, only five countries are fuel exporters with widely varying domestic environments.

25. Beneath the broad averages, there are significant variations in the macro picture across LIC subgroups. Most subgroups share similar trends in the macro aggregates with the overall group (as discussed in Section *Key Macroeconomic Trends and Policy Challenges in LICs*), reflecting the broad-based nature of the pandemic and war shocks; the heterogeneity mainly lies in the magnitude of the impact of the shocks. One exception is the elevated oil prices that have had contrasting effects on the fiscal and external position of fuel exporters relative to the rest of LICs.[11]

[9] IMF and World Bank (2022)

[10] The detailed country sample is included in Annex I.

[11] For each LIC subgroup, the subsequent paragraphs only focus on macro aggregates that show marked differences with the average of all LICs and that of other subgroups.

Fragile and Conflict-Affected States[12]

26. Unsurprisingly, FCS growth performance lags behind that of most LIC subgroups, but will experience narrower primary and current account deficits in 2022 (Figure 21). Institutional weakness, political uncertainty, domestic conflict, and poor security situations magnify the adverse impact of the pandemic and the war on FCS, with growth projected to be more modest in 2022 and in the medium term than for the average LIC. This trend is worrisome as failure to generate strong growth and create enough jobs could delay the exit from fragility and put these countries at a significant risk of falling further behind the rest of the world. FCS are especially vulnerable to the ongoing food crisis as 72 percent of the FCS fall into the group of low-income food deficit countries defined by the FAO. While FCS are projected to record smaller primary deficit than the average LIC, this reflects more tighter financing constraints. On the other hand, though their current account deficit is expected to deteriorate in 2022 mainly due to the commodity price shock, it will remain smaller than that of the average LIC, partly driven by limited international trade and high dependency on remittances and aid flows.

Small Developing States and Tourism-Dependent Countries

27. Reflecting their high vulnerability to exogenous shocks, SDS exhibit the worst macroeconomic performance across LIC subgroups (Figure 21). The abrupt stop in international travel due to the pandemic, and the clouding prospects for its recovery due to the war, exacerbate pre-existing challenges associated with remoteness, smallness of the economy, and heightened exposure to climate change and natural disasters. Real GDP growth is projected to be the lowest among LICs in 2022, after recovering from the largest decline during the pandemic. The fiscal and external positions are also expected to deteriorate sharply in 2022, and remain elevated in the medium term due to high commodity prices, protracted recovery in tourism activities, and anemic growth. On the bright side, while rising in 2022 before declining in the medium term, inflation will remain relatively contained thanks to the peg regime in three-quarters of SDS. Considering the large overlap between tourism-dependent countries and SDS, the macro-picture for the former subgroup broadly mimics that of the latter (Figure 22).

Frontier Markets

28. Growth in frontier market LICs, while being flattened in 2022 due to the impact of the war and the tightening of financial conditions, is projected to remain above that of other LICs (Figure 21). Frontier LICs were able to tap the global financial market to provide stronger fiscal support to their economy during the pandemic; their primary deficits and the increase in debt were the largest in 2020. This led to the smallest decline in growth in 2020 among all subgroups. Though their recovery is also projected to slow down with the outbreak of the war and headwinds from the tighter financial conditions, growth is projected to be more robust than in the average LIC from 2022 onwards. Together with fiscal consolidation, it will drive down debt level faster than in other

[12] This report uses the IMF list of 42 FCS in effect since 2019. The Fund will transition to a new FCS list in 2022 after adopting the methodology for FCS classification used by the World Bank.

LICs. The faster consolidation is driven by a combination of factors, including the loss of market access for many frontier market LICs and large currency depreciation.

Diversified Exporters

29. Growth in diversified LICs is set to be on par with the overall LIC group average in 2022, although they stand out by the resilience of their economy during the pandemic (Figure 22). With the war in Ukraine, projected growth in diversified exporters is expected to remain subdued in line with the average LIC. Nevertheless, they have weathered the pandemic relatively well: they nearly avoided negative growth in 2020 and observed a strong recovery in 2021. Thus, the cumulative output loss is smaller than a typical average LIC in 2020-22. While other macro-aggregates behave similarly to the average LIC, inflation in diversified LICs is forecast to be marginally higher at peak in 2022 and in the medium term as high openness to trade amplifies the transmission of food and fuel price shocks. The current account deficit is also projected to deteriorate more in 2022 for diversified LICs.

Non-Fuel Commodity Exporters

30. Non-fuel commodity exporters are expected to experience similar growth than the average LICs in 2022, but with a narrower, although weakening current account (Figure 22). Although they have weathered the pandemic better than average LICs, similar to diversified LICs, growth in non-fuel commodity exporters is projected to stagnate in 2022 despite favorable terms of trade. Current account deficit is projected to widen in 2022 due to the food and energy price shock, but their current account deficit will remain smaller than the other LICs, except fuel exporters. A notable trend in non-fuel commodity exporters is the rapid currency depreciation, which is expected to continue in 2022, mirroring the lagged effect of the strong growth in broad money in 2020-21 as a response to the pandemic coupled with the appreciation of the US dollar more recently.

Fuel Exporters

31. Unsurprisingly, fuel exporters stand to benefit from higher energy prices. Unlike other LIC subgroups, the growth recovery started in 2021 is projected to continue in 2022, albeit at a slower pace, but reaching a level above that of the pre-pandemic period. Strong oil export revenue will also help maintain the current account broadly balanced in 2022, while boosting reserve coverage. Nonetheless, the perceived benefits from higher energy price, can be rather limited in practice, due to aging oil fields and weak extractive investment which constrains production expansion (Chad and South Sudan), depleting oil reserves (Timor-Leste) and high fuel subsidies.

32. The high heterogeneity within the fuel exporter subgroup and the small size of the subgroup (5 countries) calls for a closer look at individual countries. For instance, inflation pressure is exceptionally high in Yemen and South Sudan, including due to domestic conflicts, rapid currency depreciation, and a very high share of imported foods in the consumption basket of households. Both countries also face severe currency depreciation and excessive money growth. The other three countries (Timor-Leste, Chad, and Republic of Congo) all have fixed exchange rate, and as a result, have experienced better performance on the inflation front. On the fiscal side, Timor-Leste persistently runs large primary deficit due to its large sovereign wealth fund. Yemen has moderate primary deficits since 2019, while the other three countries, unlike most LICs, have all accumulated primary surpluses over the same period. Public debt is expected to decline in all fuel exporters except Timor-Leste going forward, supported by higher oil prices and debt restructuring in the case of the Republic of Congo.

C. Longer-Term Issues

33. The pandemic reversed several years of progress towards achieving the Sustainable Development Goals (SDGs), which is now under further threat due to the war in Ukraine. Beyond the humanitarian losses associated to the Covid pandemic, the ensuing recession and disruption to global economic recovery pushed millions into extreme poverty and shrank government resources, hampering the provision of basic services. As the pandemic affected disproportionally the poorest households, informal workers, women, and youth, it has triggered a major setback to poverty and inequality reduction. The spillovers of the war in Ukraine, in particular the related food and energy shocks, add to the setback. Some close to 70 million people have been pushed into extreme poverty ($1.90/day) during the pandemic (IMF, 2022f). The UNDP anticipates that globally, the human development index has also dropped, with much of its socio-economic impacts being expected to have fallen upon LICs. Both indicators suggested that as of 2021, the developing world has lost about 5-years progress in poverty reduction and human development.

34. The pandemic has increased poverty and inequality, albeit with some variations among countries (Figure 23). World Bank (2022b; Chapter 4) and Narayan et al. (2022) combine pre-pandemic household surveys with the high frequency phone surveys (HFPS) conducted during the pandemic for 23 EMs and 11 LICs to estimate the probability of experiencing an income loss for households with certain characteristics (age, education, sector of employment, etc.). The size of income loss is calibrated such that the aggregation of the simulated income changes is consistent with those observed in national income account. The results show that the pandemic has led to higher poverty and income Gini coefficient, and more in LICs than in EMs. While it is unsurprising that the impacts were generally moderate—with the corresponding increases in Gini coefficients to be 0.6 (EMs) and 1.0 (LICs)—as inequality is in general slow-moving, the impact on certain countries can be rather significant: 2.9 for Laos and close to 5 for Mozambique.

35. In addition, pandemic school closure risks having a long-lasting impact on human capital accumulation, thus undermining long-term growth in LICs. Across the world, school closures during the Covid-19 pandemic exacted a heavy toll on children and young people in full-time education.[13] The impact has been particularly severe in developing countries where school closures lasted twice as long on average than in advanced economies; a larger proportion of the population, and hence of the future labor force, were exposed to closures; and the capacity of

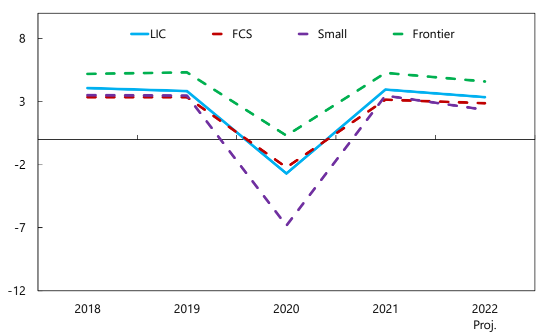
[13] IMF (2022a) notes that at least 1.6 billion students across the world experienced significant disruption to their schooling in 2020 and 2021 (UNESCO, UNICEF and World Bank, 2022), with early evidence from some G-20 countries identifying significant falls in standardized test outcomes.

school systems to support remote learning was weaker.[14] Simulations from a general equilibrium model suggest that the output loss in the long-run can be sizeable for LICs, and that reversing these hysteresis effects requires significant investment in education, for which financing support from the international community is paramount (Box 3).

Figure 21. Main Macroeconomic Indicators by Structural Characteristics

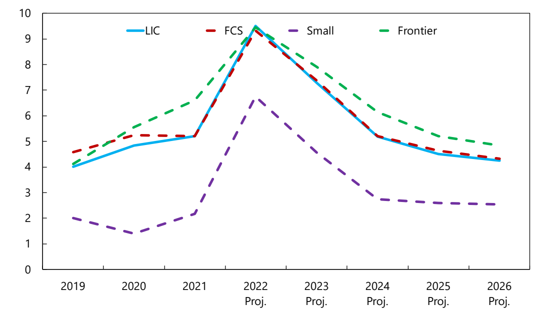
Real GDP Growth:

(Percentage Points)



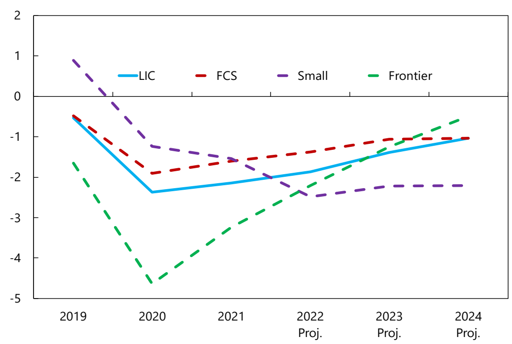
Headline Inflation:

(Percentage Points)



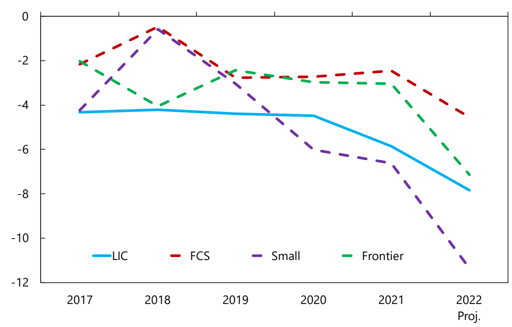
Primary Deficit

(Percent of GDP)



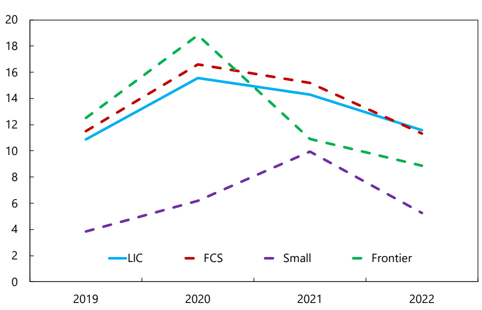
Current Account Deficit

(Percent of GDP)



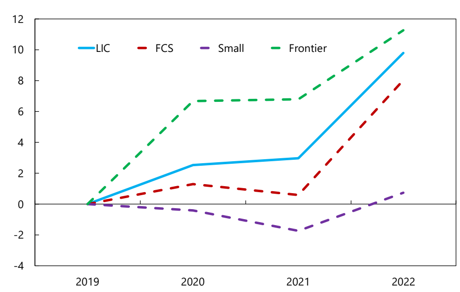
Broad Money Growth Rate

(Percentage Points)



Currency Depreciation

(Percent Change to 2019 Level)



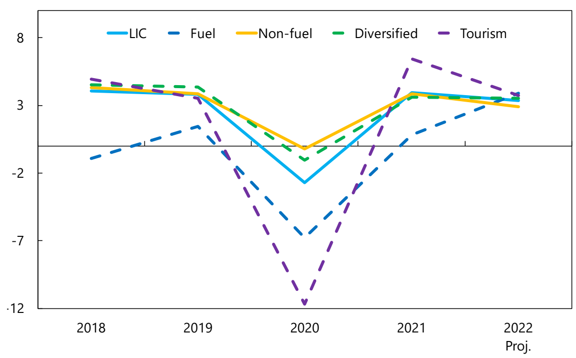
Notes: Figures exclude Sudan, South Sudan, Yemen and Zimbabwe for monetary indicators (headline inflation, broad money growth and exchange rate dynamics) due to hyper-inflation, and Kiribati and Timor-Leste for primary deficit due to their reliance on sovereign wealth fund. Nominal exchange rate with 2019 level normalized to one is used.
Sources: WEO and IMF Staff Calculation

[14] Goldberg and Reed (2020), York et al. (2021), IMF (2021b) and Agarwal (2022).

Figure 22. Main Macroeconomic Indicators by Export Structure

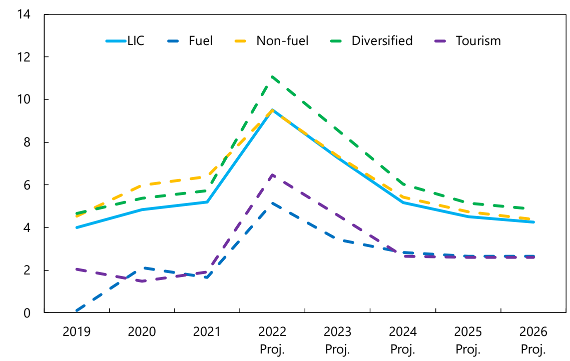
Real GDP Growth:

(Percentage Points)



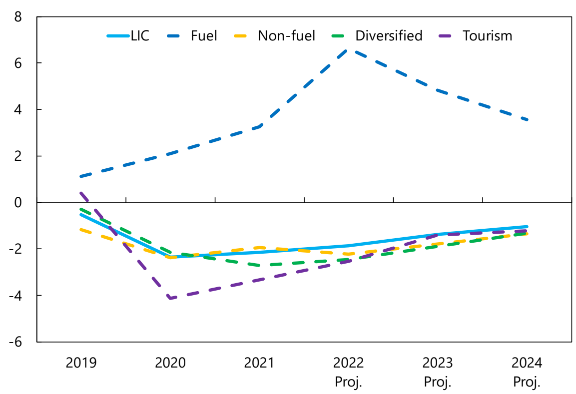
Headline Inflation:

(Percentage Points)



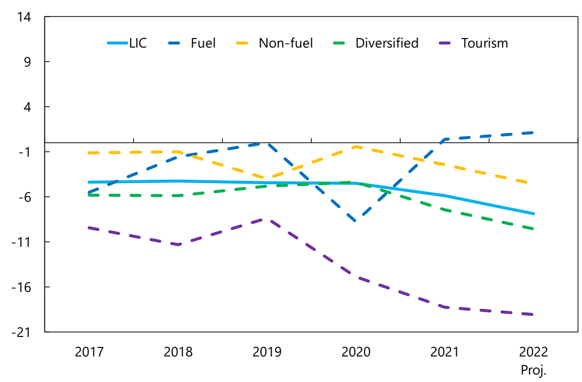
Primary Deficit

(Percent of GDP)



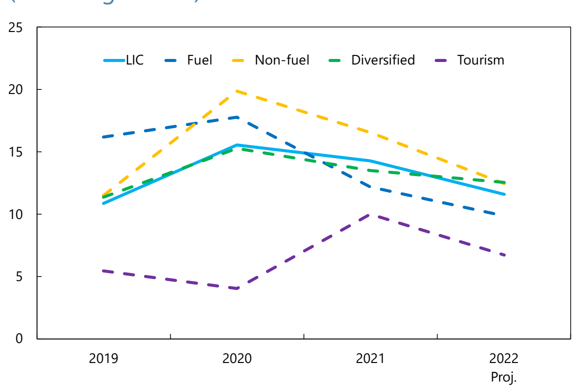
Current Account Deficit

(Percent of GDP)



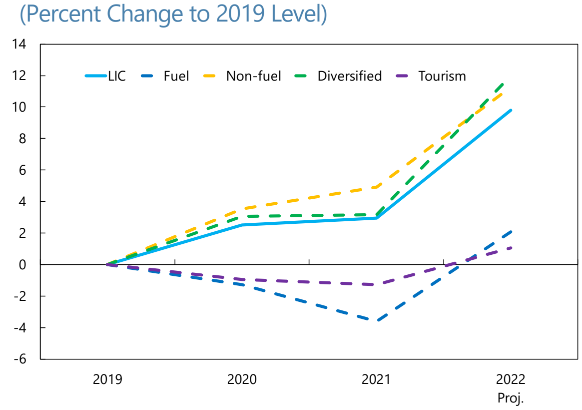
Broad Money Growth Rate

(Percentage Points)



Currency Depreciation

(Percent Change to 2019 Level)



Note: Figures exclude Sudan, South Sudan, Yemen and Zimbabwe for monetary indicators (headline inflation, broad money growth and exchange rate dynamics) due to hyper-inflation, and Kiribati and Timor-Leste for primary deficit due to their reliance on sovereign wealth fund. Nominal exchange rate with 2019 level normalized to one is used.
Sources: WEO and IMF Staff Calculation

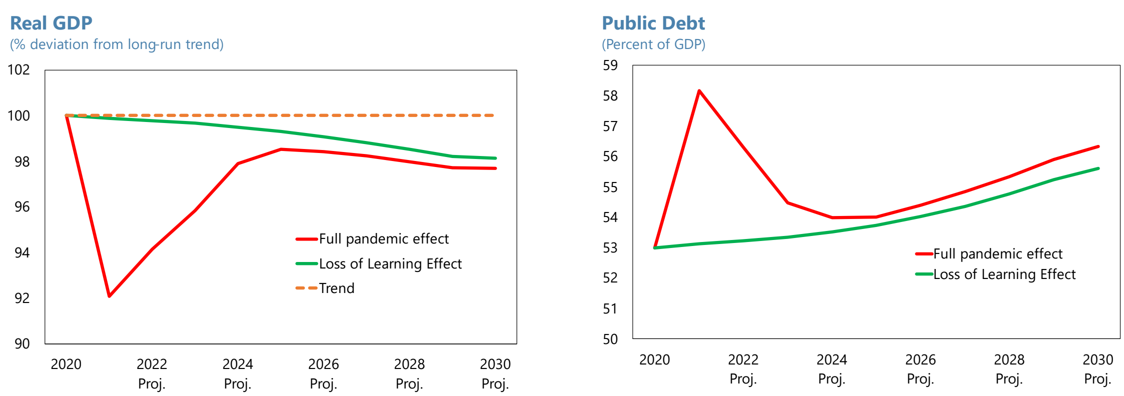
36. Climate change adds to LIC challenges. Higher frequency and intensity of droughts, floods, and other climate shocks affect all countries, whatever their income level, but impact more specifically LICs as their limited fiscal and policy space constrain their capacity to prevent or address such events. Climate change exacerbate further fragilities in many LICs, while the efforts to build resilience, including to shift towards climate-resilient agriculture (adaptation) or promote renewable energy (mitigation), are facing intense budget constraints.

Box 3. Loss-of-Learning and The Post-Covid Recovery[1]

An increasing volume of evidence suggests that the loss of learning due to school closures during the pandemic is likely to have long-lasting effects on schooling outcomes in later childhood as well as on health, lifetime earnings and productivity.[2,3] The broader macroeconomic impacts of this erosion of human capital remain far from clear, as do the appropriate policy responses. Buffie *et al.* (2022) embed estimates of loss-of-learning effects in a variant of the Debt Investment Growth (DIG) model calibrated for a typical LIC to explore the legacy effects of the Covid-19 crisis and the prospects for purposive post-crisis recovery.[4] The model simulates the disastrous direct short-term economic impacts wrought by the pandemic, as well as how the scarring of human capital affects productivity and growth in the medium and long run.

The box figure shows the simulated path of output and public debt under a baseline scenario in which the government attempts to ride out the pandemic *without* fundamentally changing the stance of domestic public policy. Unsurprisingly, the "full pandemic effect" shows in the short-run a sharp contraction in output coupled with a jump in the public debt-to-GDP as the tax base collapses. Nonetheless, output recovers within a few years before stabilizing around 2-3 percent below its pre-pandemic level. Isolating the effect attributable solely to the loss-of-learning, shows a high degree of negative persistence if these effects are left unaddressed. The output loss due to the loss-of-learning, while marginal in the short-run, widens over time as the current generation enters the workforce and experiences depressed earnings, to the point where the loss-of-learning effect accounts almost entirely for the "Full pandemic effect" in the long run. The simulation also suggests that rural and informal sector households are disproportionally affected by the loss of learning, implying that income inequality could rise.

Scarring Effect of the Pandemic
Simulated Output Loss and Debt Path due to the loss of learning in LICs



Box 3. Loss-of-Learning and The Post-Covid Recovery (continued)

Reversing these hysteresis effects before they become deeply embedded requires significant investment in education. An investment program needs therefore to combine shorter-term remedial investment targeted at those cohorts directly exposed to the shock with sustained medium-term investments designed to improve the technological capacity and resilience of the education, public health, and training systems.

A "fighting back scenario" in which basic and secondary education spending is scaled up—financed by external concessional financing and domestic revenue mobilization— helps rebuild lost human capital and bring output back to pre-pandemic level, but public debt rises above the baseline scenario level. In reality, external concessional finance may well be limited, particularly with high debt vulnerabilities in many LICs, thus confronting policymakers with an acute trade-off between rebuilding human capital and limiting domestic financing pressures. The support of the international community is, therefore, critical to help LICs to alleviate the aggregate welfare cost associated with the pandemic and its adverse distributional effects.

[1] Prepared by Christopher Adam.

[2] Psacharopoulos et al. (2021) estimate the annualized losses in national income due to the effect of pandemic-related school closures on labor productivity and expected lifetime earnings to range from around 0.5 percent of GDP in high-income countries to 2.8 percent of GDP in low-income countries. These estimates, based on Mincerian earnings equations, assume an average rate or return to education of 8%; a working life of 45 years for the affected cohorts; and pandemic-related loss-of-schooling equivalent to one-third of a full school year.

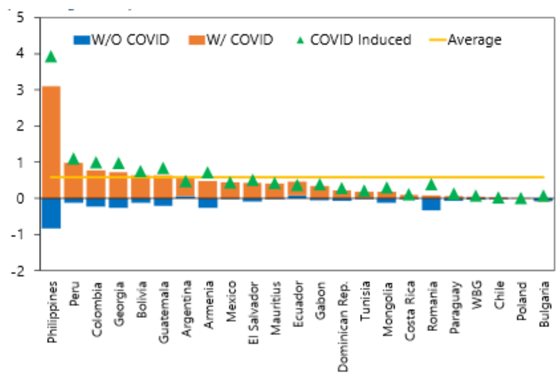
[3] IMF (2022a), focusing solely on the advanced economies in the G-20, use a general equilibrium model to suggests loss of learning effects could reduce long-run output by as much as 3% relative to pre-pandemic levels, while at the same time driving up inequality.

[4] The Covid-19 shock is characterized as the composite effects of: the direct productivity effects of domestic lockdown measures; the deterioration in external conditions reflecting the loss of export revenues as a result of deteriorating terms of trade, the collapse of global travel and tourism, and the slowdown in FDI and remittance; and the effects of school closures. See Buffie et al. (2022) for full details of the model, its base calibration and the characterization of the Covid-19 shock.

Figure 23. Simulating the Poverty and Inequality Impact of the Pandemic

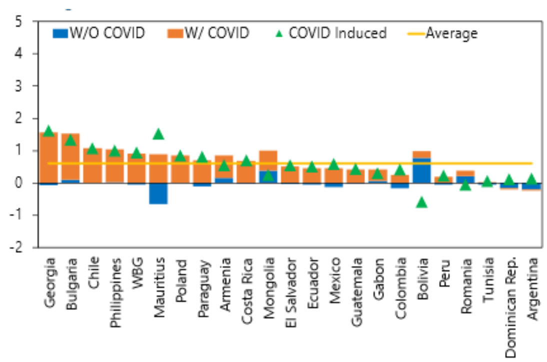
COVID-19 Induced Poverty: EM

(Percentage Points)



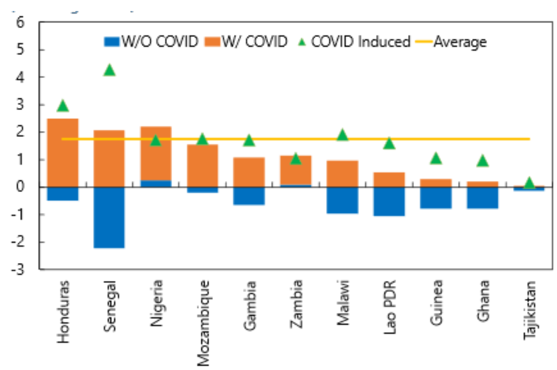
COVID-19 Induced Gini Coefficient Change: EM

(Change in Gini Coefficient)



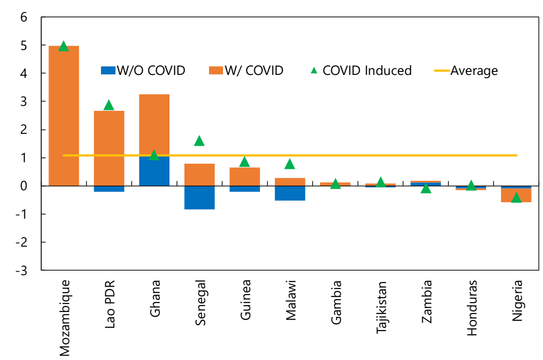
COVID-19 Induced Poverty: LIC

(Percentage Points)



COVID-19 Induced Gini coefficient Change: LIC

(Change in Gini Coefficient)



Sources: World Bank (2022b) and Narayan et al. (2022)

37. Elevated debt and challenging global environment intensify the urgency of structural reforms to unlock growth potential and resilience in LICs. Ambitious yet realistic reform agenda to boost competitiveness, increase public investment efficiency, promote private sector development, improve governance and inclusiveness, foster diversification, and ultimately increase growth potential and resilience is critical. Such reforms are of particular importance to FCS which consistently trail behind other LICs. While structural reforms should be implemented overarchingly, policies geared towards improving distributional aspects of macroeconomic adjustments are especially important to mitigate the impact on the vulnerable and contain risks of political instability and social unrest (Box 4).

Box 4. Structural Reform Priorities in FCS[1]

FCS are generally plagued by weak institutional capacity, poor governance, heightened security risks, and often unstable political environments. These challenges are often compounded by high vulnerability to macroeconomic and climate shocks and low policy buffers. As a result, the policy space for reforms and increase trade-offs between short and long-run policy objectives. In addition, fragility and conflict spillovers emanating in FCS threaten the economic stability in neighboring countries and regions.

Recognizing these challenges, the Fund has approved its first FCS Strategy to provide robust, well-tailored, and longer-term support to its most vulnerable members. The objective is to help FCS achieve macroeconomic stability, strengthen their resilience, and promote sustainable and inclusive growth to exit fragility. Notwithstanding the heterogeneity across countries, the FCS Strategy identifies a set of cross-cutting reform priorities that are typically important, where tailoring to country circumstances and capacity constraints often represent the centerpiece. These include:

- **Fiscal policy.** Fiscal policy should include the following components: (i) defining an appropriate fiscal framework; (ii) securing tax and customs revenues that can be administered easily; (iii) strengthening core PFM systems to enable FCS to meet their basic spending needs efficiently; and (iv) reinforcing transparency and accountability. Efforts to tackle corruption simultaneously with revenue and expenditure policy reforms are essential to build effective fiscal institutions. Furthermore, strategies also need to balance wage and security-related expenditures with social and growth-enhancing spending.
- **Debt management (see also Chapter 2).** Borrowing decisions need to be anchored at a coherent and robust medium-term debt management strategy. The capacity in debt sustainability analysis, as well as improving basic policies and procedures, including for debt transparency should be strengthened. As FCS' capacities increase, the goal is to develop domestic debt markets.
- **Exchange rate and monetary policies.** Related policies include (i) the mix of policies to achieve stability under their exchange rate regime; (ii) policies to help achieve price stability in view of the close link between inflation and poverty.
- **Financial sector policy.** Developing capacity for supervising and regulating the banking sector and the relevant nonbank financial intermediaries (including for AML/CFT reasons) is critical. FCS can benefit the most from financial inclusion facilitated by digital money and fintech. It is important to develop institutions that facilitate the provision of banking and payments services as sustainable financial deepening can be an important driver of growth. Digital money can help lower costs of doing business, spurring innovation, competition, and market integration.

Policies geared towards improving distributional aspects of macroeconomic adjustments are especially important to contain risks of political instability and social unrest. Reform measures can focus on safeguarding social outcomes through social spending and protecting vulnerable households. Essential cohesion-building initiatives addressing inequalities, including targets for poverty reduction (e.g., spending on health, education, and social protection) should be incorporated in policymaking. Similarly, the distributional impacts of revenue mobilization need to be carefully calibrated so as not to worsen inequality.[2] In this regard, capacity in progressive taxation should be strengthened when possible.

Box 4. Structural Reform Priorities in FCS (concluded)

The pace and timing of macroeconomic adjustment and structural reforms should be calibrated to the political and social context. For example, while a full-fledged reform agenda is necessary to achieve macroeconomic stability and sustainability, the reform and adjustment need to be well-sequenced and prioritized, taking into consideration the ownership and public support, as well as the severe capacity constraint. This is crucial in pivotal moments, when macroeconomic policy advice can allow for short-term, feasible objectives to show early success and help build public support for initiatives that further advance a more comprehensive reform agenda. When external support, tailored technical assistance, and government ownership align, structural reforms aimed at strengthening economic fundamentals over the long run are more likely to succeed.

[1] For further details, see IMF (2022b).
[2] See for instance Peralta-Alva et al. (2018) and IMF (2019, Chapter 2).

38. Digitalization presents tremendous opportunities, but also comes with challenges. The Covid-19 pandemic has demonstrated how countries can leverage information and communication technologies (ICT) to build resilience amid exogenous shocks and keep business running while limiting the spread of infections (e.g., Kenya and Rwanda were particularly successful in developing tracing technologies). More broadly, ICTs constitute a tremendous tool to support development, make public services more efficient and transparent, prevent corruption and enhance financial inclusion by fostering access to individuals, as well as financing for small and medium enterprises. However, significant challenges need to be addressed to fully reap the benefits of ICTs. This is true, in particular in Sub-Saharan Africa, where only 28 percent of the population has access to internet. Significant investments in ICT infrastructure and access to reliable electricity remain key priorities for LICs.

D. Multilateral and International Support

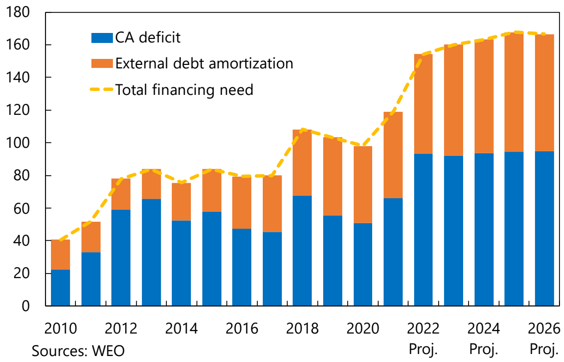
39. LICs' financing needs remain large. External financing needs increased dramatically as LICs were hit by a series of shocks (Box 5). In line with the findings of the 2021 LIC report, estimates suggests that an additional $170 billion would be needed to help LICs address the legacy of COVID and rebuild external buffers and further about $270 billon additional spending would be needed for LICs to catch up with EMs' average spending to GDP ratios by 2026.

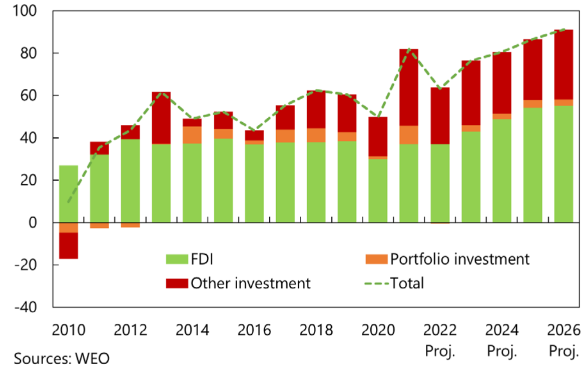
Box 5. LICs' External Financing Needs

Based on the October 2022 WEO projections, LICs' gross external financing needs are projected to increase from $103 bn in 2019 to $167 bn in 2026 (Box Figure). External financing needs are expected to increase on the back of higher current account deficits and rising external debt amortization. LICs as a group are highly exposed to global food prices, particularly the price of wheat, as well as other commodity prices (e.g., oil price), which are expected to remain high throughout the year and into 2023. Direct trade and remittance linkages add a further layer of disruptions in a number of LICs. The average current account deficit in 2022-26 is more than 60 percent higher than the pre-pandemic level. The average annual amount of external debt service falling due in 2022-26 is about twice as much as the pre-pandemic average (2010-19). Tighter global financial conditions and elevated volatility could constrain LICs' ability to finance BoP

Box 5. LICs' External Financing Needs (continued)

needs and roll over external debt.





LICs need to boost well-designed spending to address the legacy of COVID and support pandemic preparedness, accelerate development efforts, and build adequate external buffers. Our current estimates of additional financing needs for the period 2022-26 update the estimates provided in the 2021 LIC report for the period 2021-25.[1] These financing would enable LICs to:

- Address remaining gaps in vaccine distribution, support pandemic preparedness policies and health systems. This is proxied by matching LICs' COVID-related spending to EMs' average spending response to COVID in each year over 2022-26, subject to a minimum of the nominal spending level projected pre-pandemic.
- Build external buffers by ensuring all LICs' reserves are at least equal to a minimum reserve threshold, which would help them to improve their credit worthiness and market access, and more broadly secure a more resilient recovery.
- Step up investment spending to reach development targets. This is proxied by increasing LICs' spending to GDP ratio in every year to get closer to the EM average by 2026.

Overall LIC's financing need is estimated at $440 billion over the medium-term, of which $170bn to help LICs address the legacy of COVID and rebuild external buffers.[2] Over 2022-26, additional financing needs in LICs would support filling remaining gaps in vaccine distribution and pandemic preparedness ($150 billon) as well as build external buffers ($20 billion). About $270 billion additional spending would be needed for LICs to catch up with EMs' average spending to GDP ratios by 2026. This would help LICs accelerate convergence towards AEs provided public spending is of high quality, productive, and cost-effective. Overall, LIC's additional financing needs would amount to about $440 billion in our baseline scenario, close to the estimate of $450 billion in the 2021 LIC report.[3] In an adverse scenario of slower recovery, additional

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

Box 5. LICs' External Financing Needs (concluded)

financing needs could increase by about $100 billon.

The external financing needs driven by the war in Ukraine are significant but subject to considerable uncertainty. The impact of the war, however, would vary significantly across countries given the heterogeneity among LICs. First, oil importers would experience significant deterioration of current account balances, while oil exporters would benefit. Second, many LICs both export and import agricultural goods, and the net impact of higher food prices depends on the composition of their trade. Overall, LICs' BoP needs are estimated at $57 billion over 2022-23. About $43 billion can be met with the drawdown of reserves, while the residual financing needs are $14 billion.

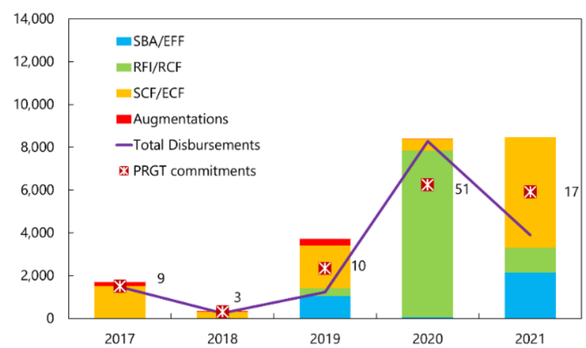
[1]IMF (2021a).
[2] The war in Ukraine is projected to have a limited impact on medium-term additional financing needs. Therefore, a separate estimate of the short-term financing needs directly stemming from the war is provided in the last paragraph.
[3]Our baseline estimates show a decrease in COVID-related financing needs compared to 2021 estimates as most needs were concentrated in the first year. On the contrary, development-related financing needs have increased slightly, suggesting a widening gap between LICs and EMs. Shorter-term financing needs arising from Russia's invasion of Ukraine would add to these estimates.

40. The Fund has stepped up its support to LICs in this challenging time. With the increased access limits, Fund lending to LICs surged in 2020 as LICs sought financial assistance to respond to the pandemic—the bulk of it through the emergency financing instruments during the peak of the crisis. With the situation normalizing progressively, Fund financing shifted in 2021 to multi-year lending arrangements. In July 2021, the Fund increased by 45 percentage points the normal limits on access to concessional financing and eliminated hard limits on access for the poorest countries allowing more concessional support to LICs (Figure 24). Furthermore, the August 2021 SDR 456.5 billion SDR allocation—of which SDR 14.7 billion went to LICs—provided additional liquidity to cope with the impact of the pandemic (Box 6). The voluntary channeling of SDRs from countries with strong external positions to countries most in need is expected to amplify the benefits of the SDR allocation through the scaling up of the Poverty Reduction and Growth Trust (PRGT) and the operationalization of the newly established Resilience and Sustainability Trust (RST)—which will supplement an Upper Credit Tranche-quality IMF-supported program—that would help address longer-term structural challenges.[15] The recent creation of a new, time-bound "food shock window" under the Fund's emergency instrument (¶41) will also help LICs facing urgent BoP needs associated with the global food crisis. Given the critical role of the Fund in supporting LICs through the current crisis and in the post-pandemic decade and beyond, the PRGT must be adequately resourced. In this context, it is crucial to close the shortfalls in

Figure 24. The IMF's Lending Support to LICs

PRGT and GRA commitment to LIDCs

(Millions of SDRs)



Source: IMF Staff Calculations

[15] For more details on the RST, please refer to IMF (2022c).

pledges under the ongoing fundraising and achieve the fundraising targets—endorsed by the Board in July 2021 and reaffirmed in April 2022 (IMF, 2022d)—timely.

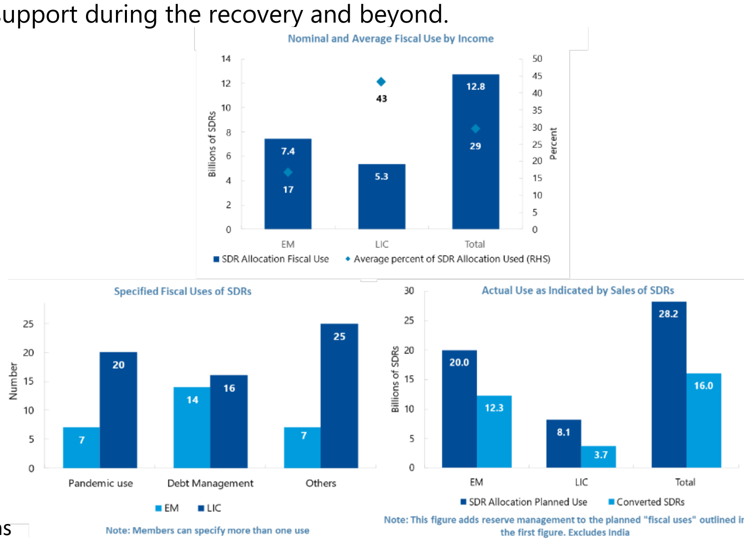
Box 6. How Have LICs Used Their 2021 SDR Allocations So Far?

In August 2021, the IMF issued a historic SDR 456.5 billion general allocation of special drawing rights (SDRs) of which LICs received about SDR 14.7 billion. The primary objective was to bolster member countries' reserves and provide them with additional liquidity to cope with the COVID-19 crisis. The SDRs, allocated in proportion to countries' quota shares, are fairly large for many LICs relative to the size of their economy, representing on average 2.8 percent of 2020 GDP. The SDR allocation provided additional policy space for LICs (e.g., by boosting reserve and the related reserve adequacy indicators). As unconditional reserves, SDRs could be used for priority spending to fight the pandemic, reduce debt, and support reserve management operations.

Central Banks received the SDR allocation in most LICs. About 62 percent of LICs decided that the central bank is the beneficiary of the SDR allocation while 16 percent of the countries chose the Ministry of Finance (MoF). After receiving the SDRs, almost one-third of LICs kept them as part of international reserves and the rest decided to use the SDRs for either budget or BoP financing purposes.

As of end-June 2022, LICs have used or planned to use SDR 5 billion for budget outlays (about a third of their total allocation). Key fiscal uses of SDRs include pandemic response, debt management and other uses such as public investment and social spending. As a share of individual country's GDP, the use of SDRs for fiscal purpose was sizeable in some LICs, reaching above 3 percent of GDP in countries like, Liberia, Zimbabwe, and South Sudan. Looking at the actual use as reflected by SDR sales data, LICs' total sales during August 2021-June 2022 amounted to SDR 3.7 billion.

LICs will also benefit from channeling of the SDR allocation through the Resilience and Sustainability Trust (RST) and Poverty Reduction and Growth Trust (PRGT). The RST will channel SDRs from countries with strong external positions providing LICs with affordable financing to address longer-term structural challenges and support prospective BoP stability. SDR channeling is also expected to help mobilize additional resources for the PRGT by about SDR 20-35 billion projected to be channeled in the coming years. This will help close the resource gaps created by pandemic-related concessional financial support to LICs and the expected support during the recovery and beyond.



Source: IMF Staff Calculations

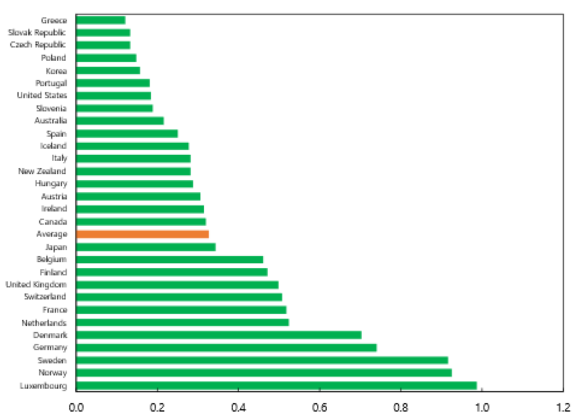
41. The IMF Executive Board approved on September 30, 2022, a new, temporary "food shock window" to help member countries facing urgent BoP pressures associated with the global food shock and where a UCT-quality program is not feasible or not necessary. The time-bound window–available for 12 months from the date of its establishment–provides low-access emergency financing for urgent BoP needs associated with acute food insecurity, the rising costs of food and fertilizer imports, or, for food exporters, substantial cereal export shortfalls. It will help affected LICs to cope with the global food shock and mitigate its impact on the most vulnerable.

42. Official development aids (ODA) increased to a record level in 2021, but still remained far from the 0.7 percent of GNI ODA target (Figure 25). ODA rose to a new peak of USD 178.9 billion in 2021, up by 4.4% in real terms from 2020, as donors stepped up their support to developing countries and help them grapple with the COVID-19 crisis. As a share of combined donors' GNI, however, ODA was 0.33 percent in 2021, unchanged from 2020, still well below the 0.7 percent ODA target. In 2020, ODA to LICs went up by 25 percent to USD 85.4 billion reflecting increased support related to the COVID-19 pandemic. In the current context of increasing military and refugee-related expenditures in many donor countries in response to the war in Ukraine, there are risks of a possible crowding-out of ODA to LICs. While there is no evidence yet on the relation between military expenditure and ODA, in-donor-country refugee-related spending counts toward donors' development aid target. As a result, an increase in refugee-related spending in donor countries may potentially divert aid away from LICs.

Figure 25. ODA to LICs

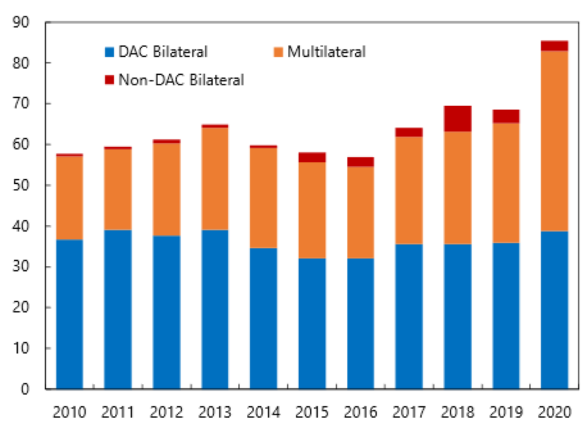
ODA grant

(Percent of GNI, 2021)



Net ODA Received by LICs

(Percent of GDP)



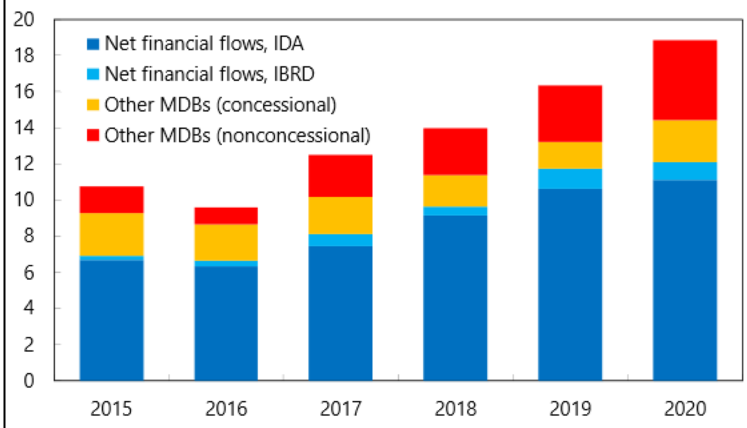
Source: OECD

43. Similarly, MDBs scaled up significantly their financing to LICs in 2020-21 in response to the COVID-19 crisis (Figure 26). During the period between April 2020 and December 2021, MDBs' approved commitments to the world's poorest countries totaled about USD 100 billion, of which USD 66 billion had been disbursed. In December 2021, an advanced replenishment of the World Bank's IDA20 was announced, representing a $93 billion financing package that will provide grants and highly concessional loans to help LICs recover from the impacts of the pandemic, tackle climate change and respond to development challenges.

Figure 26. MDB Financing to LICs

MDBs' Financing to LICs

(USD Billions)



Sources: WDI, WEO and IMF Staff Calculations

E. Conclusion and Policy Issues

44. LICs were already stretched before the Covid pandemic, and shocks stemming from the pandemic and the war in Ukraine only makes their challenges more daunting. Though the rebound in 2021 was stronger than previously anticipated, LICs face a global environment with fragile growth, widespread inflation pressure, crippling supply disruptions and drying international liquidity—all of which happen while the pandemic still lingers around. The war aggravates these challenges while also casting exceptional uncertainty to the path forward. With exhausted policy spaces due to the pandemic and rising debt vulnerabilities, policymakers are left with few options and little room for maneuver.

45. LICs face challenging policy trade-offs both in the near term and in the long run. Fighting inflation, supporting the post-pandemic recovery, and protecting vulnerable households and firms from shocks using fiscal, monetary and exchange rate policies, while at the same time maintaining credible policy frameworks, are the main near-term objectives. Countries need also to prepare their medium-term fiscal framework to adapt to tighter international financial conditions. At the same time, structural reforms to address long term issues such as poverty, inequality, climate change and to promote digitalization, remain key drivers for income convergence to developed economies.

46. Fiscal policy needs to protect the most vulnerable from the spillovers from the war in Ukraine and preserve investment that are critical to long-term growth, while safeguarding debt sustainability. With debt hitting a record-high level, countries must design their short-term fiscal policies within a credible medium-term strategy and framework. They also need to gradually build back fiscal buffers in preparation for future shocks. This requires careful scrutiny and prioritization of future spending plans, coupled with increasing efforts in domestic revenue mobilization—in particular through progressive taxation—and enhancement in debt management capacity. With growing challenges for monetary authorities, fiscal measures that protect the vulnerable from the cost-of-living squeeze must be counteracted by other measures to maintain the overall fiscal envelope so as not to fuel further inflation. For countries without established social safety net, building capacity on the basis of existing programs is more desirable. While distortive price control should be avoided in general, in some occasions second-best policy measures may be a necessary expedient but should be phased out as soon as possible.

47. For LICs that may benefit from higher energy and food prices as net exporters, building buffers for bad times is critical. While higher commodity prices can generate sizable windfalls for commodity-exporting countries, the gains could be consumed by energy and food subsidies if these are not contained and well targeted. It is important to take advantage of the positive terms of trade shocks to rebuild policy buffers, particularly in LICs with elevated debt vulnerabilities. In the meantime, these countries also need to manage the impacts from more volatile commodity prices.

48. Addressing risks to debt vulnerabilities through sound policy frameworks remains utmost important. LICs can prevent debt crises through fiscal restraint, effective public financial management, sustained growth, transparency, sound debt management and responsible borrowing. Specific policy actions should be calibrated to the nature and magnitude of debt vulnerabilities. Countries at low risk of debt distress need to continue fiscal restraint while continuing pro-growth spending. Those at medium risk of debt distress have relatively smaller fiscal space to deal with shocks, but where possible, would need to continue building buffers. Countries with high risk of debt distress face a difficult tradeoff between fiscal consolidation and the need to address development needs and tackle the food crisis. Where needed, countries may seek preemptive debt restructuring to free up fiscal space. Other preemptive maturity managing tools that countries can use include debt reprofiling operations, swaps, or other liability management operations. Countries facing solvency or liquidity constraints should restructure their debt, including through Common Framework where relevant.

49. Monetary authorities must exert a delicate balancing between growth and inflation. Despite the high rate of inflation, sluggish recovery and tight fiscal space make monetary support all the more important in LICs. To navigate the trade-offs, central banks will need to act resolutely to bring inflation back to target, in particular when inflation expectation is at the risk of de-anchoring, defend a credible policy framework underpinned by strong central bank independency and clear communication, while avoiding over-tightening that may induce recession and disorderly adjustment in financial markets. At the same time, they also need to guard the economies against financial sector risks from higher interest rates and consequences of other macro-prudential relaxations during the pandemic. Tenser trade-off also emerges with high domestic debt exposure, which magnifies the fiscal and debt vulnerabilities from interest rate hikes.

50. Elevated debt vulnerability, heightened inflation-growth trade-off and global financial tightening require careful and appropriate use of exchange rate policies, where relevant. For countries with pegged exchange rate, monetary and fiscal policies need to be consistent with maintaining the credibility of the peg and supporting reserves. For countries with flexible arrangement, while exchange rate depreciation may help absorb trade shocks and buffer the effects of global financial tightening, large exchange rate movement may expose fiscal and financial sectors to external risks, exacerbate inflationary pressures, and worsen the trade-off monetary authorities face. The trade-off can be especially acute for countries facing capital outflows and with weak external positions. Interventions to smooth exchange rate volatility could thus help stabilize domestic economies and contain financial risks. Countries, however, need to be mindful of their reserve buffers and not use such policies to support unsustainable policies or substitute necessary macroeconomic adjustment.

51. Meanwhile, decisive policy actions are needed to address long-term challenges posed by poverty, inequality, economic diversification, digitalization, climate change and food security. Governments need to strengthen social protection systems, improve public services provision, and promote financial and labor market inclusion to tackle rising inequality. Efforts are also needed to build resilience, including to shift towards climate-resilient agriculture and renewable energy. Governments should improve public spending efficiency in green infrastructure, reforming energy subsidies, and incentivizing private sector to implement adaptation and mitigation measures. Significant investments in ICT infrastructures and access to reliable electricity remain key priorities for LICs to reap the benefits from digitalization. Strengthening governance and institutions would finally help build better business practices and enable the private sector to thrive.

52. The global food and energy shock calls for continued coordinated international actions to support LICs. The international community needs to continue and deepen its actions to address the food and energy shock and ensure the availability of food, agricultural inputs and energy, including by reducing protectionism and export restrictions, exploring the use of food and energy stockpiles and reserves, and facilitating accessibility of flexible, urgent, and sufficient funding and relief from debt servicing where appropriate. Enhancing food production and distribution and investing in climate-resilient agriculture are critical. Increasing the flows of ODA to LICs remains also a key priority. More broadly, the international community must also strengthen cooperation by maintaining an open and rules-based multilateral trade and financial system to support long-term growth and avoid fragmentation.

PUBLIC DEBT MANAGEMENT CAPACITY DEVELOPMENT

A. Introduction

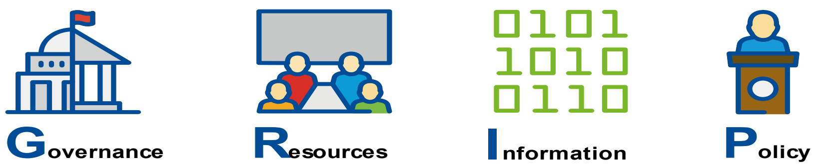
53. Capacity Development in public debt management can play an important role in helping LICs to mitigate debt vulnerabilities. Public debt managers are typically tasked with covering the financing needs of the sovereign at the lowest cost subject to an acceptable degree of risk over the medium to long term. Best practice suggests that the way to do this is by establishing and executing a debt management strategy, and identifying and monitoring debt-related fiscal risks, linked to the composition of debt (interest rate, currency, and rollover risks) and exposure to contingent liabilities arising from on-lending and guarantees to State-owned enterprises (SOEs) and public-private partnerships (PPPs).[16] Although fiscal policy is the main driver of public debt levels and public debt vulnerabilities, effective debt management is an important element of a LICs' toolkit of prudent macroeconomic policies aimed at safeguarding debt sustainability, by reducing economic and financial volatility, and supporting sustainable financial sector development and hence, supporting overall growth and development. Ineffective debt management can generate significant fiscal costs, unduly expose countries to changing market conditions, and weaken crisis preparedness. Debt management capacity development is designed to support LICs in their quest to design and implement an effective strategy for managing their debt portfolio and deliver effective debt management operations.

54. As noted in Chapter 1, the borrowing landscape and sovereign debt structure of LICs have fundamentally changed during the last 15 years. The composition of public debt in LICs has migrated from traditional multilateral and Paris Club borrowing towards non-Paris Club bilateral and commercial creditors, including through a large increase in the volume of domestically issued debt. These new sources of fiscal deficit financing have allowed LICs to limit exposures in their debt portfolios to currency risk and more generally to manage rollover risk (e.g., by issuing longer-term bonds domestically and bonds with non-bullet principal repayment features in international markets). At the same time, international bond market issuance has increased borrowing costs (when compared with external multilateral and bilateral loans) and raised the exposure of countries to changes in market sentiment from foreign investors. These developments underscore the importance of improving debt management practices in LICs. To maintain investors' interest in their bonds and narrow the information gap between borrowers and a large group of investors and stakeholders (including credit rating agencies), LIC sovereign debt managers are called upon to engage in more formal "investor relations" functions, including greater relationship building and information sharing than before.

[16] See the IMF/WB Revised Guidelines for Public Debt Management (2014). The *Guidelines* also outlines the essential building blocks of debt management, including, objectives and coordination; transparency and accountability; institutional framework; debt management strategy; and risk framework.

55. Effective public debt management relies on set of enabling conditions. For simplicity, these conditions can be grouped in four different, but mutually reinforcing, dimensions, which lay the foundation for developing and implementing effective debt management: governance, resources, information, and policy (box 7).

Box 7. Getting a GRIP on Public Debt Management



Governance. Robust sovereign debt management starts with adequate legal and institutional arrangements and authority for debt management activities, consistent with best practice. A comprehensive public debt management law, which clearly delineates responsibilities, including reporting requirements, is essential to providing the legal and institutional architecture for a debt management office to operate effectively.

Resources. The debt management office needs to have adequate human and physical capital to undertake its role effectively. Resources allocated to public debt management should be commensurate with the nature and complexity of the current (and expected) debt portfolio.

Information. For a debt management office to fulfill its tasks effectively, it must have ongoing access to all relevant data and information. This may include data collection from multiple parts of government, making it critical that the debt manager has the authority to request this information. Likewise, it must have the necessary capacity to record and manage debt data effectively.

Policy. Debt policy should ensure consistency with the overall macroeconomic framework through appropriate coordination mechanisms with fiscal and monetary authorities. Moreover, debt management policy should be supported, and approved, by the highest levels of government and legislature.

56. Debt managers need fluid access to key data and decision makers (Figure 27). For example, in terms of information, debt managers need full and timely information of the sovereign debt portfolio. Public debt managers cannot effectively manage a debt portfolio whose size and fundamental characteristics (interest rates, currency denominations and time to maturity) are unknown or not well documented. Moreover, it is impossible for public debt managers to adhere to basic principles of sound portfolio risk management—risk identification; assessment and quantification; mitigation; and reporting and monitoring—in the absence of comprehensive information of the fundamental characteristics at the instrument and portfolio level.

Figure 27. Key Debt Management Activities

57. The medium-term debt management strategy (MTDS) framework, developed by Fund and Bank staff for capacity development purposes, helps public debt managers to meet their financing need at the lowest cost subject to an acceptable degree of risk. The framework allows debt managers to set medium-term goals or "benchmarks" for the public debt portfolio that reflect the government's preferences regarding cost-risk trade-offs. Annually, the debt manager implements the debt strategy by developing and following a borrowing plan (consistent with achieving the debt strategy targets) through issuance of debt in the domestic and foreign market. An annual borrowing plan also includes short-term cash management considerations to manage the government's in-year liquidity needs. Additionally, debt managers need to monitor the government's exposure to contingent liability risks that can create new debt.

58. Such contingent liability risks may include central government loans and guarantees to the state-owned enterprises, public-private partnerships, and power-purchase agreements. The Fund has significant expertise and provides capacity development in the legal frameworks underpinning the contingent liabilities as well as recent fiscal risk tools developed by the Fund can be used to monitor this risk. These include the fiscal risk portal that provides a toolkit and reflects lessons learned and complements Fund's work on fiscal transparency and fiscal risk assessments.

59. The numerous technical and institutional elements needed to develop an efficient and robust public debt management framework may take considerable time to take hold. Consequently, public debt management capacity development in LICs has to be seen as a long-term endeavor**.** Furthermore, starting conditions vary widely among LICs; thus, building up debt management capacity in some countries, e.g., fragile and conflict affected states (FCS), can be particularly challenging. The large variance in initial conditions requires debt management capacity building to be applied flexibly while preserving and adhering to sound debt management practices.

60. Building effective debt management in the absence of a supporting and enabling legal, governance and institutional framework is difficult. Improving technical debt management capacity is necessary but not sufficient to create effective debt management frameworks and practices. It requires strong support from legal, governance and institutional arrangements. Shortcomings in these areas often stymie efforts to build efficient public debt management operations even when progress has been made in improving technical capacity. Many LICs have fragmented debt management institutional arrangements that segment information, dilute accountability, prevent developing debt management expertise, and require complex coordination mechanisms among different debt management entities.

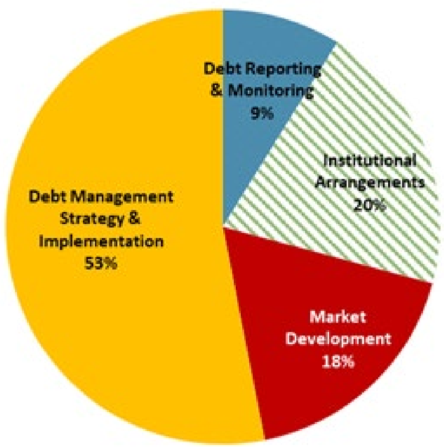
61. The chapter is structured as follows: Section B describes the scale and scope of recent CD on public debt management as well as the key tools and methodologies. Section C presents the results of the survey LIC debt managers on their priorities and outlines how IMF CD can respond to evolving needs. Section D provides concluding remarks.

B. The Fund's Approach to Public Debt Management CD

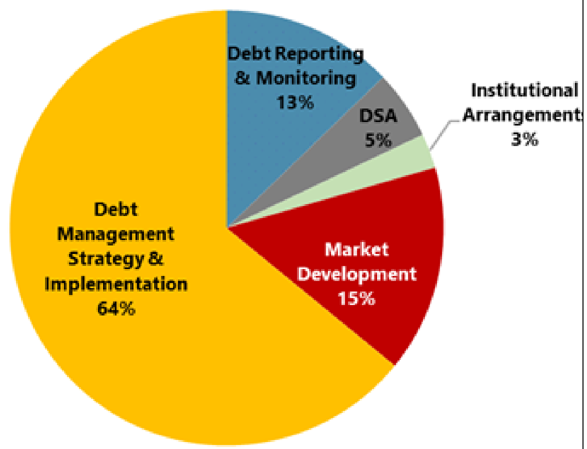
62. The IMF delivers capacity development to LICs in all areas of public debt management. The bulk of CD on public debt management has focused on the technical aspects of debt portfolio management, but it has also covered CD on legal and institutional aspects of debt management (Figure 28). Of the four core areas depicted in Figure 28—institutional arrangements, debt strategy formulation and implementation, market development, and debt recording—the bulk of delivery has been on debt management strategies. The Fund also provides CD on legal frameworks, strengthening public debt management frameworks, public debt securities and related tax issues, as well as training courses in these areas. Related to debt management TA, the Fund provides supporting CD on fiscal risks including: (i) assessing countries' risk exposure and its potential impact on public finances; (ii) evaluating the adequacy of fiscal risk management framework, practices, and institutional capabilities; (iii) developing action plans for improving risk management processes/practices; (iv) strengthening institutional capacity to better analyze and manage fiscal risks; and (v) enhancing disclosure on fiscal risks by developing comprehensive fiscal risk statements and encouraging country authorities to publish them.

Figure 28. Selected IMF Debt Management Capacity Building Delivery to LICs FY2018–22

Types of TA Delivered 2018-22

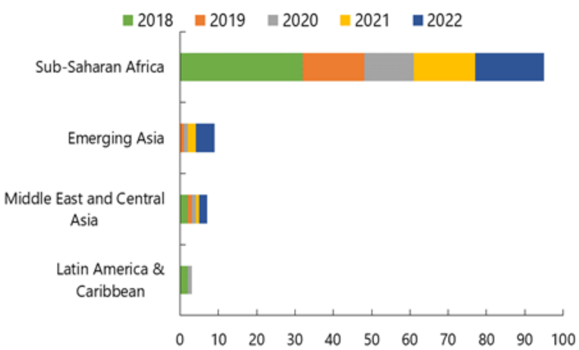


Types of Training 2018-22



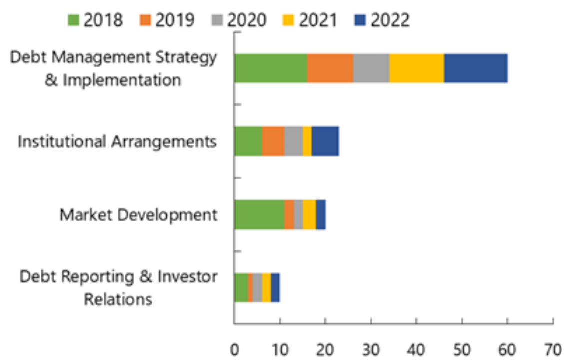
LICs: TA Delivered by Region

(Number of missions)



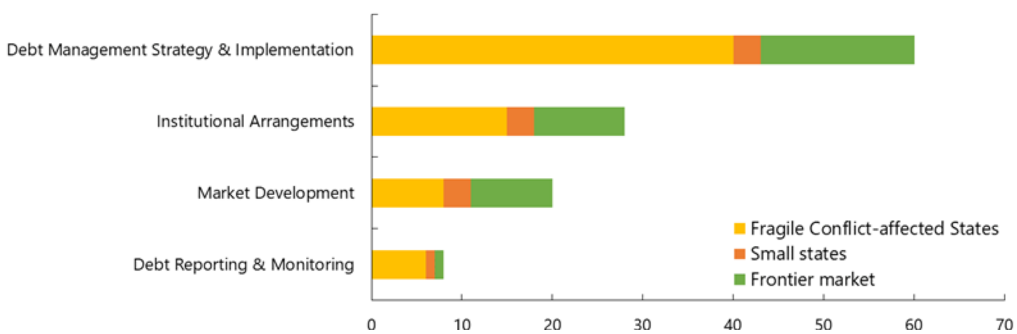
LICs: Type of TA delivered

(Number of missions)



LICs: Type of TA Delivered FY2018-22

(Number of missions)



63. The Fund's approach to CD on debt management is underpinned by several key principles; key among these is that CD activities must be rooted in specific demand from member countries. The Fund's CD activities are anchored in the Articles of Agreement, which allow the Fund to perform "financial and technical services" consistent with the Fund purposes to members countries on request. Unlike members' obligations to the Article IV consultation and engage with staff on bilateral surveillance discussions, CD is a voluntary form of engagement that has to be requested by a member country.

64. Subject to this demand driven approach, the Fund adjusts the types of CD, their frequency of delivery, and other modalities of support to the different characteristics of the CD recipient. In the area of public debt management, those characteristics relate to the creditor landscape, institutional arrangements, and initial debt management capacity**.** For LICs with limited human and technical capacity, and at an early stage in their development of a debt management framework (such as some FCS and smaller economies), CD provided often focuses on the foundational aspects of debt management, including developing and implementing policies and procedures, as well as improving institutional co-ordination. In other LICs, CD can be targeted in areas such as local currency bond market development, international capital market issuance, and investor relations.[17]

65. In recent years, delivery of debt management CD to LICs has been enhanced by a network of regional advisors located in Regional Technical Assistance Centers (RTACs). The number of regional debt management advisors has increased from two to five since the outbreak of the Covid-19 pandemic, with new advisors in the Caribbean (2020), Pacific Islands (2021) and in East and Southern Africa (2022) adding to existing support in Francophone West and Central Africa (Box 8). In areas with shared regional characteristics, such as members of a currency unionor where there are a larger number of FCS, delivery of CD and training with the support of a dedicated advisor, focused on building country-specific plans for CD, has delivered positive outcomes in improving capacity in debt management.

[17] See Annex for examples of CD across a heterogeneous set of LICs.

Box 8. The Role of Regional Debt Management Advisors in CD Delivery

Regional debt management advisors increase the benefits of delivering and coordinating CD from the field. Located in members countries, regional advisors help the Fund to be responsive to emerging authority needs, including tailoring CD to regional challenges and providing sustained on-the-ground support, hence contributing to CD traction.

Regional debt management advisors have been stationed in AFRITAC West and AFRITAC Central for almost a decade, and their experiences illustrate both successes and challenges of those in African regions. First, the regional advisors work has helped strengthen capacity in the preparation and implementation of medium-term debt management strategies in some countries. Second, their CD has supported the efficacy of domestic/regional financing through improvements in the predictability and transparency of auctions, harmonization of issuance practices, and development of a secondary market convention for government securities for WAEMU countries. Third, the regional advisors have been instrumental in improving the organizational structure of debt offices by developing internal procedures manuals and improving coordination between institutions with debt management responsibilities, and between debt and cash managers in both AFRITAC West and AFRITAC Central. And fourth, CD from regional advisors has contributed to improving the quality of public debt information and reporting and strengthening capacity for risk analysis. These achievements, however, have come over time, with frequent interruptions, setbacks, and delays.

In the Caribbean, attention to regional challenges has been pivotal in the work of the successive regional debt management advisors. The four LIC countries in the ECCU—Dominica, Grenada, St. Lucia and St. Vincent and the Grenadines—have benefitted from this approach. Given the limits to their absorption capacity, the integration of training and technical assistance modalities has been critical to CD delivery in the ECCU. One successful example of this capacity-building approach was the junior debt managers program (JDMP), which delivered in-depth training to a cohort of country officials over the course of a year (2016-17). The reintegration of JDMP participants into their respective debt management units boosted skill levels in those offices, allowing some participants to assume leadership positions, as for example, in Saint Vincent and the Grenadines, where the debt management unit is headed by a JDMP graduate.

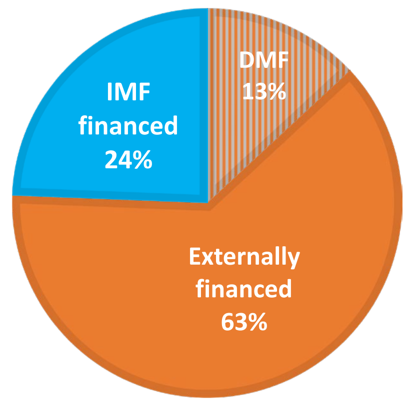
The April 2022 online seminar on debt-for-climate swaps is another example of CD addressing regional challenges. Like most Caribbean economies, Dominica, Grenada, Haiti, St. Lucia and St. Vincent and the Grenadines are highly vulnerable to climate-related risks, with implications for their fiscal and debt positions. The seminar responded to interest from Caribbean countries in innovative instruments for mobilizing or redirecting financing for climate-related objectives while keeping debt at sustainable levels.

The work of the regional debt management advisor in the Pacific islands commenced in 2021 and was initially impacted by Covid-19. Nevertheless, taking advantage of virtual delivery modalities, several CD activities and a regional training workshop have been delivered. The program has concentrated on country engagement and needs assessments to develop tailored CD country programs. The programmatic approach builds the foundation for good debt management practice and allows for the absorption of technical assistance where country resources are constrained. Given the infancy of debt management in the region, assistance focused on establishing a sound foundation to debt management, including institutional arrangements and debt transparency.

66. The bulk of CD in debt management provided by the Fund is financed by external resources (Figure 29). The Debt Management Facility (DMF), administered jointly by the World Bank and the IMF, is an integral component of these external resources and provides vital coordination across bilateral, multilateral and regional CD providers. In addition, many development partners have financed a number of regional projects, including the five regional debt advisors in Francophone West and Central Africa, the Caribbean, the Pacific, and in East and Southern Africa (Box 9).

Figure 29. Debt Management CD by Funding Source

(FY22)



Box 9. Other Providers of Debt Management CD

Capacity development in debt management is not the sole purview of the IMF—a range of multilateral development banks (MDBs), regional institutions and other entities provide CD across the full range of issues in debt management.

The **World Bank** is one of the IMF's major partners in the delivery of CD in debt management, with significant collaboration across all topics, funded mainly through the DMF.

Other MDBs, including the **African Development Bank** (AfDB), the **Asian Development Bank** (ADB), and the **European Bank for Reconstruction and Development** (EBRD) provide CD on debt management to their member countries.

The two providers of debt recording systems, the **Commonwealth Secretariat** (COMSEC) and **UNCTAD**, provide training and technical support on the use of their statistics and records systems, and on related issues.

In Africa, the **Macroeconomic and Financial Management Institute of Eastern and Southern Africa** (MEFMI) and the **Western African Institute for Financial and Economic Management** provide substantial technical assistance and training on debt management in their respective regions, often in collaboration with the Fund and Bank.

67. In 2013, the IMF began offering online courses in debt management. Online courses offer a scalable, low-cost means to deliver training on core concepts in debt management. In addition to training on debt sustainability analysis (DSAx), in 2020, the IMF created a new stand-alone online course on the MTDS framework and tool (MTDSx).[18] This online course will serve as a prerequisite for in-person training and technical assistance on MTDS, thereby allowing in-person CD

[18] Prior to 2020, the MTDS content was combined with the debt sustainability analysis content in one course.

to focus more on advanced concepts and strategy. These courses are available in English and are currently being translated into other languages, which will be particularly beneficial for FCS. The IMF plans to expand the suite of online courses to respond to the growing demand for training in several aspects of debt management, including on legal, governance and institutional arrangements, investor relations, and local currency bond market development.

68. One of the major challenges in delivering effective CD is unmet enabling conditions for debt management. This slows the pace at which countries can make improvements in their debt management frameworks. The negative impact of these limitations on the effectiveness of debt management strategy and implementation manifests itself through various channels. Mapping to the GRIP framework (Box 7 above), these can include:

- **Legal and governance framework.** While several LICs have received CD on how to design a medium-term debt management strategy, weak legal and governance arrangements often prevent the formulated and published debt strategy from driving borrowing decisions and managing the risks of the debt portfolio. For this reason, effective debt management strategies that follow recommendations from Fund CD are often not implemented.

- **Data recording.** Shortcomings in debt recording is common in LICs and create difficulties for debt management offices. Often, debt management offices in LICs are made responsible for managing only a fraction of total public debt, sometimes without knowledge about the terms and conditions of other public debts that have been contracted by other government entities (oftentimes in the same ministry as the debt management office).

- **Human resources.** Inadequate staffing and high turnover of skilled staff is common and poses serious problems for debt management offices in LICs. These human capital and staffing related challenges reduce the effectiveness of CD and slow the progress that LICs can make in improving their debt management. High turnover in staff can significantly affect debt management capacity, often stall reform momentum, and divert scarce resources to onboarding and training of new staff.

- **Institutional arrangements.** Many LICs have fragmented debt management institutional arrangements that limit accountability, slow the development of a center of debt management expertise, and often require additional coordination mechanisms to manage the involvement of various stakeholders. This often results in "second-best" institutional solutions that limit efficacy of debt management.

69. Annex V provides five illustrative examples of providing debt management CD in LICs. The cases were drawn to provide a diversity of experience, geographic coverage, and lessons learned. For Somalia, a FCS working towards the HIPC completion point, there was a need to coordinate the work of CD providers, strengthen institutional arrangements, and improve debt reporting. In Papua New Guinea, CD sequencing was required so that the issues of fragmented legal and institutional frameworks were addressed before progress could be made on the original request to improve public debt recording and reporting. In Guinea, debt management reforms and associated CD were stalled due to political instability, but continued dialogue with the debt management office allowed CD to resume and eventually resulted in the legal and regulatory changes necessary for the first local currency treasury bond to be issued. In the Eastern Caribbean Currency Union, CD highlighted the advantages of taking a coordinated regional approach to debt management CD, with the support of a reliable bilateral partner that could provide sustained medium-term financial support to the national debt managers and the development of the regional local currency bond market. Finally, the Democratic Republic of Congo, thanks to efforts led by the AFRITAC regional debt management advisor, benefitted from CD to reintroduce treasury bills after a 30-year hiatus of government securities in the domestic market. The Democratic Republic of Congo engagement highlighted the benefits of a regional advisor who could build sufficient trust and 'buy-in' from the authorities and provide more frequent support.

C. Aligning Debt Management CD Delivery to LICs Capacity Gaps

Priorities Identified by Low-Income Countries

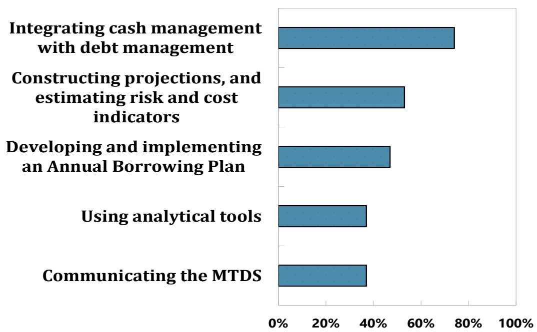
70. The evolving debt management CD needs of LICs will require the Fund to remain nimble in responding to emerging requests. While the IMF is well positioned in this area, risks relate to the sustainability of external financial support for Fund-delivered CD, as well as the ability to attract a sufficient number of high-quality debt management experts to meet the growing demand of requests across a range of topic areas.

71. A survey of LIC debt management offices undertaken for this paper that examined current debt management challenges found that the development and implementation of debt management strategies, as well as domestic market development, were the broad areas where the Fund's CD can help (Figure 30).[19] Most notable areas of challenge were in the integration of cash and debt management, and in the implementation of annual borrowing plans. This is consistent with other challenges revealed by the survey, including issues with issuing benchmark government bonds, and engaging in liability management operations to manage the redemption profile. There is a strong desire to deepen the investor base generally and to support the development of the local debt market.

[19] The survey, conducted in May 2022, was sent to all 69 LICs covered in this report. The response rate was forty percent. The five top responses are displayed.

Figure 30. LIC Survey Results: Challenges in Debt Management: Areas Fund CD Can Help

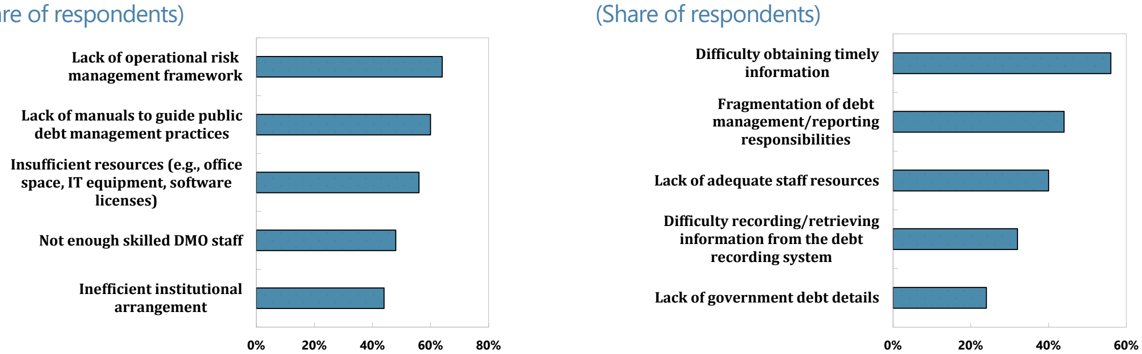
Debt Management Strategy (Share of respondents) | **Primary and Secondary Market** (Share of respondents)



72. **In the survey, LIC debt managers also suggest that insufficient resources and inadequate information flows undermine effective debt management (Figure 31).** Debt managers noted that resourcing, both in terms of staffing and physical/IT equipment, and institutional arrangements surrounding data recording, monitoring, and receiving debt data (including from other parts of government) are among the main impediments to effective debt management. Resource constraints are more evident among fragile and conflict-affected states and small and developing states.

Figure 31. LIC Survey Results: Challenges in Debt Management: Main Obstacles

Challenges in Debt Management (Share of respondents) | **Debt reporting and monitoring** (Share of respondents)



New Demands for Public Debt Management CD

73. **Implementing debt management strategies is an area in which demand for CD has increased.** In recent years Fund debt management CD has focused more heavily on translating a published debt strategy into an implementable plan through the use of a new joint Fund-Bank Annual Borrowing Plan Tool (APBT). The ABPT also allows for the integration of cash management considerations. A good cash management system provides the government with several benefits,

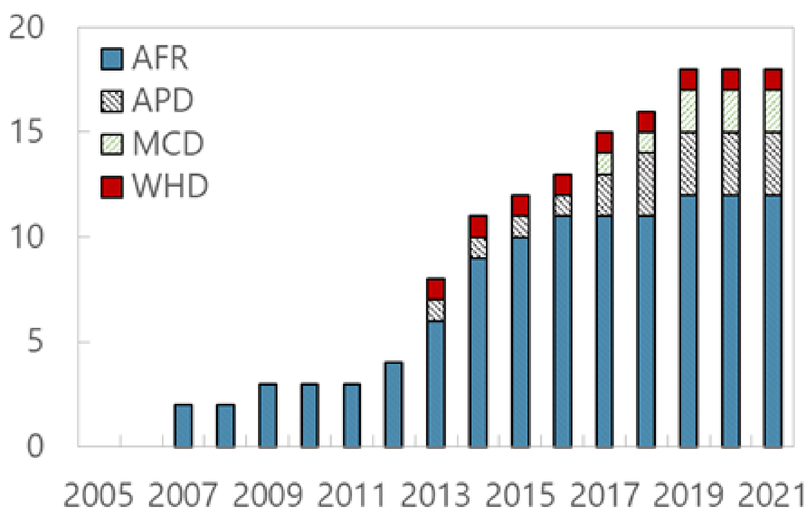
including timely payments; reduction in short-term borrowing costs; and avoidance of expenditure arrears.[20]

74. The recent publication of the joint Fund-Bank framework on local currency bond market development **will facilitate a structured approach to market reforms in LICs.[21]** Some LICs have made progress in developing their local currency government bond markets, but much more needs to be done for the majority of this group. Besides the local currency bond market's contribution to meeting the government's borrowing needs and serving as a mitigant to the exposure to direct foreign currency risk in the public debt portfolio, its development offers a set of wider benefits that can contribute to both economic development and macroeconomic and financial stability. The IMF is now working to increase awareness of the new framework as a means to deliver integrated CD in this area for LICs.

75. Developing investor relations capacity is receiving more attention as more LICs are accessing international markets (Figure 32). Recently the IMF has published a working paper on sovereign investor relations[22] and delivered new training in this area. These will be used to develop an online training course in response to the growing demand for this activity.

Figure 32. LICs with Eurobond Issuance by Region

(Cumulative number of countries)



Sources: Dealogic, BondRadar and IMF Staff

[20] See, "How to Build Cash Management Capacity in Fragile States and Low-Income Developing Countries", FAD, How to Notes, Note 22/01.

[21] See the IMF/WB Guidance Note for Developing Government Local Currency Bond Markets (2021). The Guidance Note outlines the key building blocks for developing debt markets, assess development stage and reforms.

[22] Knight and Northfield (2020). Sovereign Investor Relations: From Principles to Practice.

76. Going forward, the range and type of debt securities issued by LICs are expected to increase, creating both challenges and opportunities for LIC debt managers and new sources of demand for CD. Environmental, Social, and Governance (ESG)-based borrowing presents LICs with a potential new pool of financing that can be accessed to meet their developmental policy objectives. However, issuing new instruments such as green bonds can be challenging for countries with capacity constraints. ESG financing will also create a need for new CD modalities to ensure that the principal tenets of sound debt management are observed. Meanwhile, incorporating state-contingent clauses in debt securities is another innovation that can generate increased demand for CD.[23] While not used widely, these type of clauses in securities can be useful for some LICs, particularly small island economies, where debt challenges are often related to environmental disasters.

Supporting Implementation

77. Decisions and financial support from high levels of government are critical to many public debt management reforms. Importantly, finding solutions to the problems of inadequate staffing, antiquated IT equipment, and legal frameworks are beyond the authority of the debt office. In this regard, delivering more technical CD is unlikely to solve the problem; rather, change needs to be sought through different avenues. For example, country authorities (and Fund country teams) can play a pivotal role in disseminating the main findings and recommendations of CD missions on debt management. Moreover, debt management institutional weaknesses and resourcing issues can be flagged during bilateral discussions with Fund staff to raise the profile of these deficiencies; such discussions are often the first step in securing the will and resources for debt management.

78. As part of the Fund's response to the recent IEO evaluation of the IMF and Capacity Development, discussions with the authorities, including in the context of Article IV consultations, should more consistently raise and prioritize debt management deficiencies and CD needs when these issues are macro-critical.[24] For example, for a county with large financing needs and limited capacity or experience in managing heavy volumes of maturing debt, country reports could highlight the benefits of designing and implementing a debt strategy, including adding realism to the financing projections that underpin the LIC-DSA. In a similar vein, if the macro-critical debt management weakness is related to debt reporting, transparency, or coverage, there could be an elaboration of the issue, a follow up on any previous recommendations (if any), or a view of how debt management CD can assist in making improvements.

D. Concluding Remarks

79. Although fiscal policy is the main driver of public debt levels, debt management plays a useful role in mitigating debt vulnerabilities in LICs. While the core responsibilities of the debt management office remain largely unchanged, the borrowing landscape and sovereign debt

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[23] The Role of State-Contingent Debt Instruments in Debt Restructurings, IMF 2020.

[24] The IMF and Capacity Development. IEO, 2022.

structure of LICs have changed fundamentally in the past two decades. The triple shocks of COVID-19, a global inflation spike and the conflict in Ukraine further complicate an already challenging environment for LICs. Ineffective debt management risks additional fiscal costs, unduly exposes the sovereign to changes in market sentiment, and weakens crisis preparedness. The goal of public debt management CD is to support LICs in creating effective debt management frameworks.

80. Effective debt management relies fundamentally on enabling legal, governance, and institutional frameworks, which require support from high levels of government. Consequently, along with CD to improve analytical capacity and to train staff, there should be a renewed emphasis on improving the legal and governance framework that underpin debt management. Improved legal, regulatory, and governance frameworks, along steadfast implementation, would expedite reforms and help to overcome current challenges related to segmented information, insufficient authority, and inadequate resourcing.

81. Elevated debt levels and evolving economies in LICs have implications for the Fund's CD on debt management. With increased debt levels and vulnerabilities in most LICs, there is an opportunity to raise the profile of debt management in bilateral discussions and economic reports (both within the Fund and among the authorities). The Fund will also need to remain nimble given changing CD needs by investing in the necessary staffing and analytical research, including ESG, state-contingent debt and sovereign asset-liability management. While currently well-positioned, it will be important for the Fund to continue to work towards securing the necessary professional and financial resources to meet LICs needs over the medium-to-long term.

82. While the IMF's CD is multi-faceted, the Fund cannot and should not attempt to meet all demand for debt management CD requests of LICs, and it is important for CD providers to coordinate. The DMF provides critical coordination across several bilateral, multilateral, and regional CD providers, in order to avoid duplication and quicken the pace of reforms. The expansion of regional advisors in the RTACs has also proven useful in coordinating debt management CD delivery and follow-up work.

83. The Fund's provision of debt management CD is well-positioned to meet the demand from LICs and is sufficiently responsive to new areas of CD needs. Established core CD areas, such as the design of MTDS, continue to support LICs in developing robust borrowing strategies. At the same time, the Fund has been prepared to respond to increased demand for CD to support the authorities in growing areas of interest, such as the implementation of annual borrowing plans, integration of cash and debt management, local debt market development, and investor relations. With the help of the regional debt management advisors, the IMF aids countries with the implementation of CD recommendations, including those related to institutional arrangements and enabling conditions.

84. Over time, public debt management CD has improved the capacity of LICs to manage public debt. Improvements can be seen in all aspects of debt management, from the implementation of public debt management strategies to developing local currency bond markets to improvements in debt management frameworks. That said, these achievements have come over time, with frequent interruptions, missteps, delays, and setbacks. In this regard, debt management CD should be undertaken and assessed over a time horizon of years, not months, and its success relies heavily on strong political support from the authorities as well as efficient coordination across the multitude of debt management CD providers.

Annex I. Country Classification

Annex 1. PRGT-Eligible Country Groups

All Countries (69)	By Export	By Structural Characteristics
Afghanistan		
Bangladesh	**Fuel (5)**	**FCS (36)**
Benin	Chad	Afghanistan
Bhutan	Congo, Republic of	Burundi
Burkina Faso	South Sudan	Central African Republic
Burundi	Timor-Leste, Dem. Rep. of	Chad
Cabo Verde	Yemen	Comoros
Cambodia		Congo, Republic of
Cameroon	**Non-Fuel (27)**	Cote d'Ivoire
Central African Republic	Afghanistan	Democratic Republic of the Congo
Chad	Benin	Djibouti
Comoros	Burkina Faso	Eritrea
Congo, Republic of	Burundi	Gambia, The
Cote d'Ivoire	Central African Republic	Guinea
Democratic Republic of the Congo	Cote d'Ivoire	Guinea-Bissau
Djibouti	Democratic Republic of the Congo	Haiti
Dominica	Eritrea	Kiribati
Eritrea	Guinea	Liberia
Ethiopia	Guinea-Bissau	Madagascar
Gambia, The	Kiribati	Malawi
Ghana	Lao P.D.R.	Maldives
Grenada	Liberia	Mali
Guinea	Malawi	Marshall Islands
Guinea-Bissau	Mali	Micronesia, Fed. States of
Haiti	Marshall Islands	Myanmar
Honduras	Mauritania	Papua New Guinea
Kenya	Papua New Guinea	São Tomé and Príncipe
Kiribati	Sierra Leone	Sierra Leone
Kyrgyz Republic	Solomon Islands	Solomon Islands
Lao P.D.R.	Somalia	Somalia
Lesotho	Sudan	South Sudan
Liberia	Tajikistan	Sudan
Madagascar	Tuvalu	Tajikistan
Malawi	Uzbekistan	Timor-Leste, Dem. Rep. of
Maldives	Zambia	Togo
Mali	Zimbabwe	Tuvalu
Marshall Islands		Yemen
Mauritania	**Diversified (28)**	Zimbabwe
Micronesia, Fed. States of	Bangladesh	
Moldova	Bhutan	**Small States (19)**
Mozambique	Cambodia	Bhutan
Myanmar	Cameroon	Cabo Verde
Nepal	Comoros	Comoros
Nicaragua	Djibouti	Djibouti
Niger	Ethiopia	Dominica
Papua New Guinea	Gambia, The	Grenada
Rwanda	Ghana	Kiribati
Samoa	Haiti	Maldives
São Tomé and Príncipe	Honduras	Marshall Islands
Senegal	Kenya	Micronesia, Fed. States of
Sierra Leone	Kyrgyz Republic	Samoa
Solomon Islands	Lesotho	São Tomé and Príncipe
Somalia	Madagascar	Solomon Islands
South Sudan	Micronesia, Fed. States of	St. Lucia
St. Lucia	Mozambique	St. Vincent and the Grenadines
St. Vincent and the Grenadines	Myanmar	Timor-Leste, Dem. Rep. of
Sudan	Nepal	Tonga
Tajikistan	Nicaragua	Tuvalu
Tanzania	Niger	Vanuatu
Timor-Leste, Dem. Rep. of	Rwanda	
Togo	São Tomé and Príncipe	**Frontiers Markets (10)**
Tonga	Senegal	Bangladesh
Tuvalu	Tanzania	Cote d'Ivoire
Uganda	Togo	Ghana
Uzbekistan	Tonga	Kenya
Vanuatu	Uganda	Mozambique
Yemen		Papua New Guinea
Zambia	**Tourism (10)**	Senegal
Zimbabwe	Cabo Verde	Tanzania
	Cambodia	Uganda
	Dominica	Zambia
	Grenada	
	Maldives	
	Samoa	
	São Tomé and Príncipe	
	St. Lucia	
	St. Vincent and the Grenadines	
	Vanuatu	

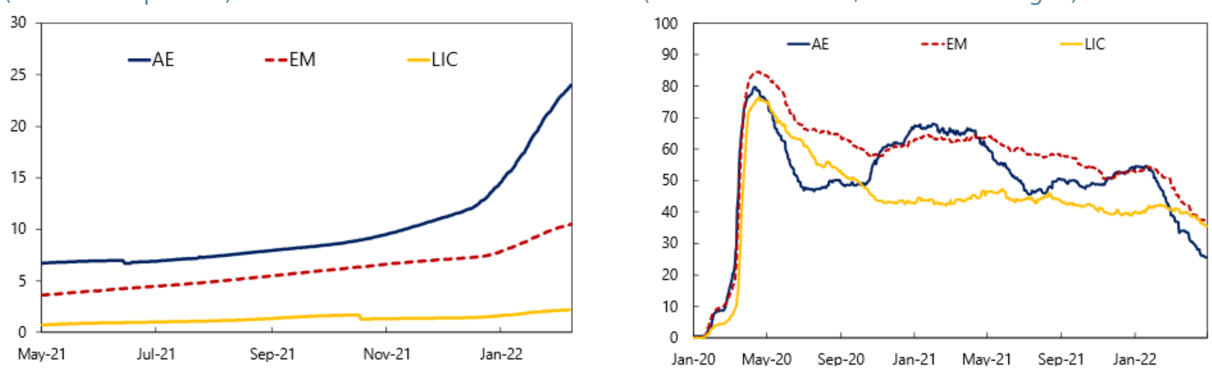
Annex II. The Impact of COVID-19 on LICs

The pandemic has affected the progress on poverty reduction and human development in LICs significantly. Despite a relatively low number of identified cases, the economic impact from the pandemic and containment measures is sizable in LICs, due to their economic structure, capacity constraint in public health sector and limited fiscal space. Macro-level shocks reach households mainly through massive disruptions in labor markets. Women, less educated and urban workers as well as those in informal sector were the most affected. While employment bounced back with the economic reopening, income, however, remained below pre-pandemic level. Further, slow vaccination progress exposes populations in LIC to new variants.

1. **The COVID-19 pandemic has placed a heavy toll on LICs despite lower identified cumulative cases (Figure II.1 left panel).** The pandemic stretched the capacity of LICs' health systems heavily. Besides having inadequate resources to treat COVID patients, non-COVID related deaths may also have been on the rise as the fight against the pandemic disrupted routine health care.

Figure II.1. Trends in COVID-19 Incidence and Lockdown Measures

COVID-19 New Infections (Percent of Population) | **Stringency Index** (Scaled from 0 to 100, weakest to strongest)



Sources: Johns Hopkins University
Note: small fluctuations are due to country coverage difference at different point in time.

Sources: Oxford University

2. **Like most countries in the world, LICs introduced strong containment measures at the early stage of the outbreak of the pandemic which impaired severely the function of labor market (Figure II.1, right panel).** The lockdown measures were relatively stringent early on and remained stronger than AEs until fall 2020. These measures reduced sharply individual mobility: at the peak of the lockdown in April 2020, mobility related to retail activity was down by more than 40 percent. When combined with health concerns, this led to decreased ability and willingness to work by workers. Labor demand by firms were also dampened, as firms' production processes were disrupted.

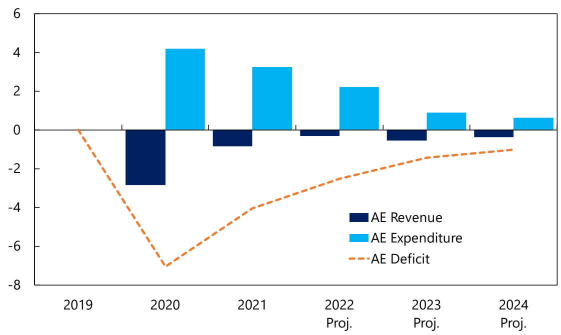
3. **LICs entered the pandemic with meager fiscal space, which impaired their ability to respond as strongly as AEs and EMs to the pandemic shock.** Measured in changes to pre-

pandemic projection (January 2020 WEO), the revenue shortfalls were larger and more persistent for LICs than EMs and AEs (Figure II.2). However, limited access to financial markets and external financing more broadly forced LICs to absorb the revenue shortfalls by limiting expenditure in 2020, unfortunately at the time when fiscal spending was the most needed. As such, though LICs also introduced ample economic support measures, the scale was not on par with AEs and EMs. Together with constraints in administrative capacity and heightened economic hardship, LICs were also not able to sustain the use of lockdown measures.

Figure II.2. Fiscal Stance and Policy Support

Fiscal Stance: AE

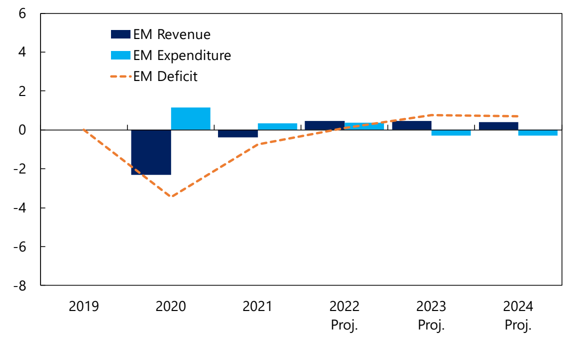
(Percentage Points Change from Pre-pandemic Projection)



Sources: WEO and IMF Staff Calculations

Fiscal Stance: EM

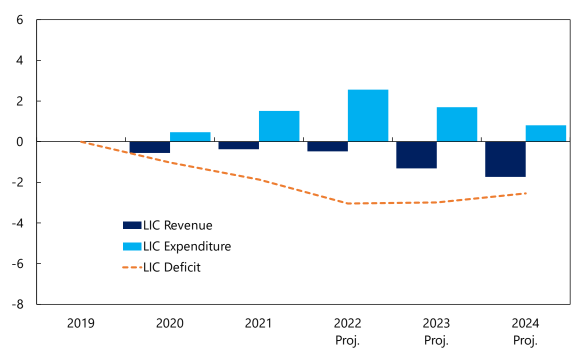
(Percentage Points Change from Pre-pandemic Projection)



Sources: WEO and IMF Staff Calculations

Fiscal Stance: LIC

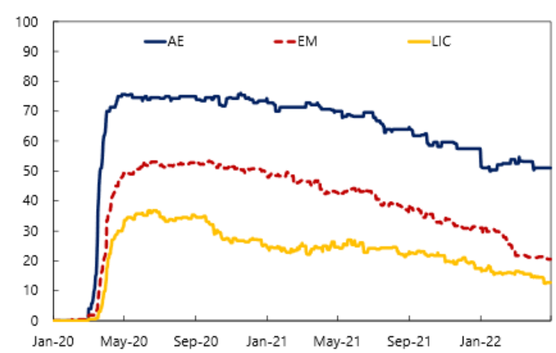
(Percentage Points Change from Pre-pandemic Projection)



Sources: WEO and IMF Staff Calculations

Economic Support Index

(Scaled from 0 to 100, weakest to strongest)



Sources: Oxford University

4. **At the sectoral level, industrial and services sectors saw larger decline in economic activity than agricultural sector.** From April to July, among the several LICs covered by the World Bank's High Frequency Phone Survey (HFPS), the shares of respondents stopped working are 13 percent for agriculture, 26 percent for industry and 28 percent for services (Khamis et al., 2020).[1]

[1] The indicators are calculated from varying group of countries due to difference in coverage. The largest sample includes Burkina Faso, Djibouti, Ethiopia, Ghana, Honduras, Kenya, Laos, Madagascar, Malawi, Mali, Myanmar, Papua New Guinea, Solomon Island, South Sudan, Tajikistan, Uganda, Uzbekistan, Zambia, Zimbabwe.

One notable example of services sector is tourism. The tourism sector is also characterized by low-skill intensity and a high degree of informality, which is due in part to its seasonality, combined with weak regulations and enforcement. It also hires disproportionately women and lower-wage migrant workers from neighboring countries.

5. **At the individual level, young, urban, and low-skilled workers saw the largest drop in employment, with gender differences being particularly pronounced.** Unequal impacts of the pandemic at the sectoral level explains largely the age, region, and skill difference (Kugler et al., 2021). The gender difference was driven by three factors: 1) care and domestic responsibilities fell more on women; 2) sectors that employed larger share of women—e.g., travel, accommodation, and other services—were more affected by the pandemic; and 3) women were also more likely to stop working than men even within the same sector.

6. **Another angle to view the long-lasting damage that pandemic left to the economic fabric is through its impact on informal sector.** ILO (2020a) estimated that in LICs, about 77 percent of the people working in informal sector were significantly impacted by lockdown and physical distancing measures introduced at the beginning of the pandemic. Informal sector jobs often have less potential for teleworking, even more so in LICs due to infrastructure constraints; working environment also tends to be worse, which exaggerates the health risks workers face (Brussevich, Dabla-Norris and Khalid, 2020). While the immediate income loss was the most direct impact, it also undermined food security as informal food markets play an essential role both as a source of food and where smallholder farmers sell their products. Informality was likely expanded during the pandemic because of forced closure and sales of productive assets by formal micro, small and medium enterprises, especially so in countries with weak social protection system (ILO, 2020b). On the positive side, informality could have cushioned employment loss in the formal sector.

7. **Along the time dimension, early in the pandemic, work stoppage, partial payment, involuntary job changes and loss of income were common in many countries.** From April to July, among the several LICs covered by the World Bank's High Frequency Phone Survey, 28 percent of respondents reported stopping work, 13 percent of wage workers reported having received partial or no payments, 9 percent of workers switched their jobs and 63 percent of all respondents suffered from income losses (Contreras-Gonzalez et al., 2020). Other sources of income, for instance those from family businesses, also decreased significantly. As an example, farming and non-farm business income losses were reported by respectively 41 and 85 percent (Ethiopia), 73 and 84 percent (Malawi) and 60 and 90 percent (Uganda) of respondents.

8. **Later, as the lockdown measures were gradually lifted, employment recovered substantially in the second half of 2020.** Employment gains were larger for sectors and population with larger initial job losses, including the informal sector. The process, however, came to a halt from 2020 Q4 onwards; ILO (2022) estimated that for LICs, there is a persistent gap in working hours of around 5 percent compared to pre-pandemic levels. Moreover, despite the recovery in employment, a large number of households still suffered from income loss. This suggests that the rebound in employment was not sufficient to offset shortage in income from other sources.

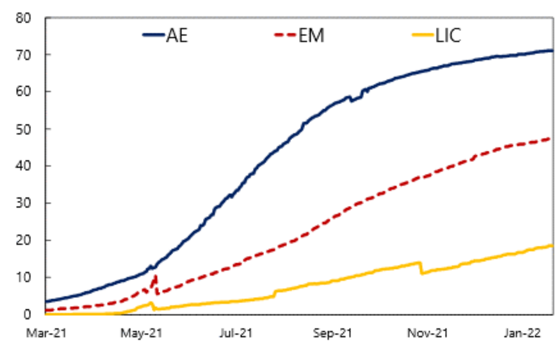
9. To support households and mitigate the impacts of the pandemic, an important component of the policy response by LICs and developing countries more generally are fiscal policies targeting labor market (Luciana et al., 2021). The most widely used labor market policies were those that increase firm liquidity and labor regulatory flexibility. To improve firm liquidity, most governments prioritized temporary tax relief and reductions in social security contributions, followed by credit facilities, guarantees and various loan payment facilities. Cash transfers programs targeting economically active persons gained increased popularity during the pandemic, as they were the main vehicle governments resorted to reach workers not protected by social insurance schemes, such as informal and self-employed workers. For example, Burkina Faso introduced cash transfers targeting informal workers such as fruit and vegetable vendors. Notably, a majority of such programs are new initiatives as opposed to expansion of existing programs, which reflects partly the limited social protection capacity of LICs prior to the pandemic.

10. One critical vulnerability going forward for LICs is their lagging vaccination progress. Barely more than 10 percent population in LICs have been fully vaccinated to date (Figure II.3). In fact, most countries were not able to meet the global agenda of vaccinating 40 percent population by end-May of 2022. People in LICs thus face elevated vulnerability to new variants, which threatens the post-pandemic recovery, especially when previous waves have almost exhausted the policy space they have. In addition, while the direct health impacts of past waves of COVID in LICs are lower than in AEs, possibly due to LICs' younger demographic profile, the same may not be true for future waves. As such, relatively high levels of vaccine hesitancy in many LICs can be especially risky. Support from the international community, including by helping LICs secure funding for vaccine purchases and building up distribution, testing and treatment capacity, continues to be important.

Figure II.3 Progress in Vaccination

COVID-19 Vaccination

(Percent of Population)



Sources: Johns Hopkins University
Note: small fluctuations are due to country coverage difference at different point in time

Annex III. Food Insecurity and Policy Responses to Surging Food and Fuel Prices

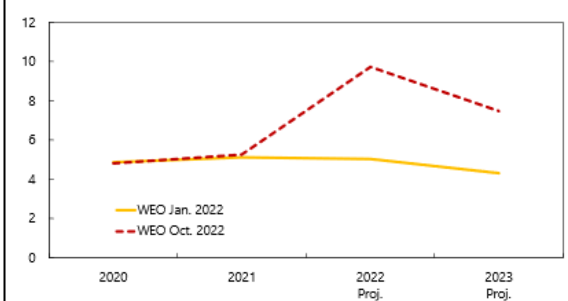
1. **The war in Ukraine, compounded with other factors, is severely threatening the recovery of low-income countries from the pandemic.** The setback is severe and varies across the heterogenous group of LICs. The war is likely to have a protracted impact on commodity prices, while most LICs have little policy space to buffer the new shock. Although some commodity exporters could benefit from revenue windfall, a large number of LICs, with limited or no fiscal space, would suffer deeply.

2. **Prices for food, which accounts for a significantly higher share of disposable income in LICs compared to emerging market and advanced economies, have surged.** Since early 2020, prices of wheat and corn have almost doubled. In sub-Saharan region, around 85 percent of wheat supplies are imported. Higher fuel and fertilizer prices also affect domestic food production and transportation. Research indicates that LICs are more subject to supply shortages especially if their fertilizer costs significantly increase. These factors contribute to serious food insecurity concerns, with the impact being disproportionately severe on the poor.

Figure III.1. Average Inflation Rate

Average Inflation Rate

(Year of Year percent change)



Source: WEO and IMF Staff Calculation

3. **Higher oil prices will substantially increase the cost of oil imports for net importers, worsen their trade imbalances, and raise transport and other consumer costs.** Oil exporters (such as Nigeria), however, would benefit from higher crude prices.

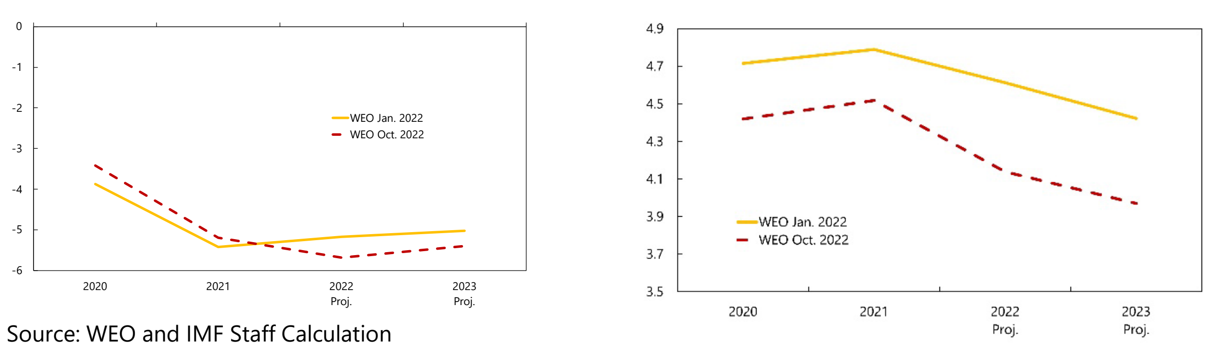
Figure III.2. External Sector Development

Current Account Balance

(Average, percent of GDP)

Stock of Reserves

(Average, months of import)



Source: WEO and IMF Staff Calculation

4. As a consequence, the number of people suffering from food insecurity skyrocketed and will remain high in the medium-term. The World Food Programme (WFP) estimates that 345 million people in 82 countries are suffering today from acute food insecurity and are in need of urgent action, an increase of 200 million since 2019. Moreover, as the factors underlying food insecurity are unlikely to disappear any time soon, food insecurity is expected to remain a key global challenge in the coming years. Projections by International Fund for Agricultural Development (IFAD) and Food and Agriculture Organization/ (FAO) suggest nearly 670 million people will still be facing hunger by 2030 – 8 percent of the world population. The World Bank estimate that over the medium-term (until 2028) the number of severely food insecure people will remain high at around 1 billion people in its IDA and IBRD member countries.

5. Governments are taking actions to help mitigate the pressures on the vulnerable, safeguard food security, and contain risks of social unrest. Many countries have announced measures, including price freeze, tax policies and provision of subsidies or transfers. For example, some countries announced a temporary reduction or suspension of import duties on food and on containers to alleviate the rise of shipping costs, and some countries announced support to vulnerable households through targeted cash transfers. Some governments provided subsidies, transfers and financing to producers and importers in the energy and food sectors. Some authorities resorted to trade bans on the export of staple food.

6. These policies, however, need to be tailored to country-specific circumstances and designed in a way that protects the poor and meanwhile preserve appropriate market incentives and contain costs within the existing fiscal envelope.[1] The following principles could help LICs achieve their objectives:

- Targeted and direct support to vulnerable households. Countries with strong social safety nets could use targeted and temporary cash transfers to low-income and vulnerable groups. Countries without strong social safety nets can expand existing social programs (for example, public transportation and school feeding programs) to provide relief to vulnerable households.

- Governments with existing energy or food subsidies should gradually pass-through international prices to retail prices especially if social safety nets are not well developed or timely expansion is not feasible.

- International cooperation and external financing are critical for LICs to address the food and energy crisis.

[1] See Fiscal Monitor (forthcoming, October 2022)

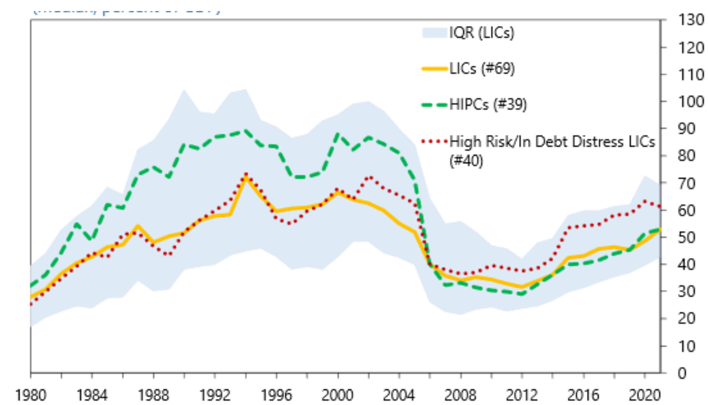
Annex IV. Debt Vulnerability Today and in Pre-HIPC Era[1]

1. The current debt situation in many low-income countries bears important parallels and differences with the debt situation of the mid-1990s that triggered the heavily indebted poor countries (HIPC) Initiative. A comparison with the situation in the mid-1990s shows that today's median debt of low-income countries is still lower. More precisely, a comparison of the median debt-to-GDP ratios of the heavily indebted poor countries of the mid-1990s with the latest debt-to-GDP ratios of low-income countries that are currently assessed to be in debt distress or at high risk of debt distress indicates that, though debt levels are high and rising rapidly, they remain below the levels observed on the eve of the HIPC initiative in the mid-1990s (Figure IV.1). Similarly, for the other key debt burden indicators—PPG external debt-to-GDP ratio, PPG external debt-to-export ratio, PPG external debt-service-to-export ratio—debt levels today for countries assessed to be in debt distress or at high risk of debt distress are below the levels observed on the eve of the HIPC Initiative in the mid-1990s (Figure IV.2).

Figure IV.1 Public Debt-to-GDP ratio in PRGT-Countries

Public Debt-to-GDP Ratio in Country Subgroups

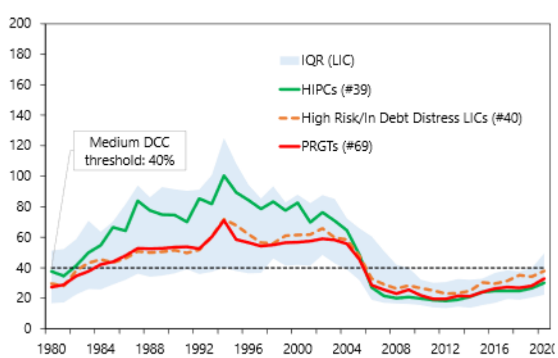
(Median, percent of GDP)



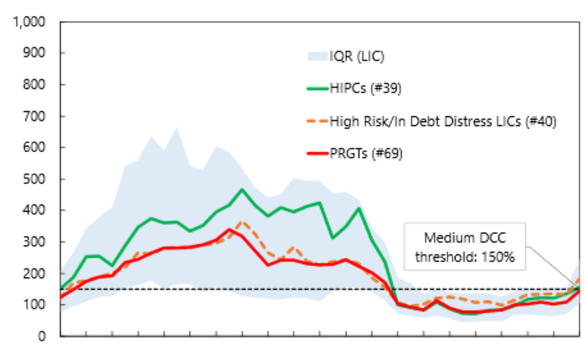
Source: IMF Global Debt Database, IMF WEO and Staff Calculations

Figure IV.2 Main Debt Indicators in PRGT-Countries

PPG External Debt-to-GDP Ratio



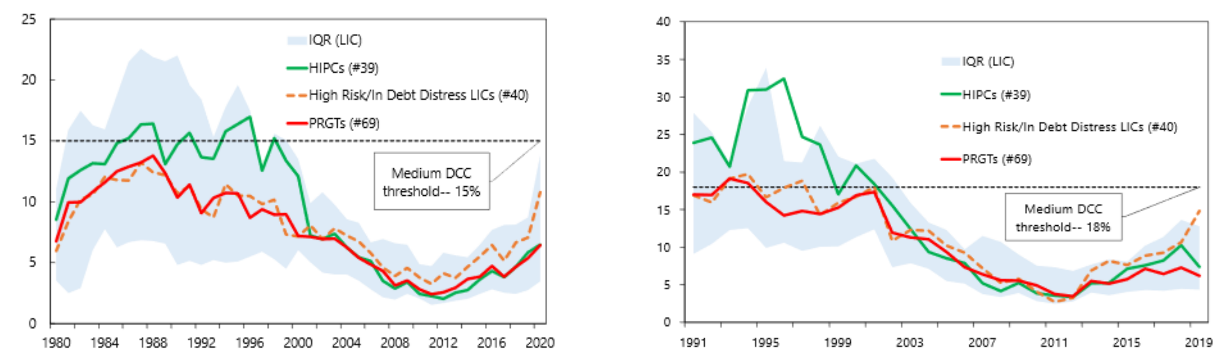
PPG External Debt-to-Exports Ratio



[1] Prepared by Chuku Chuku. Research assistance was provided by Prateek Samal.

Figure IV.2 Main Debt Indicators in PRGT-Countries (concluded)

PPG External Debt Services-to-Exports Ratio **PPG External Debt Services-to-Revenue Ratio**



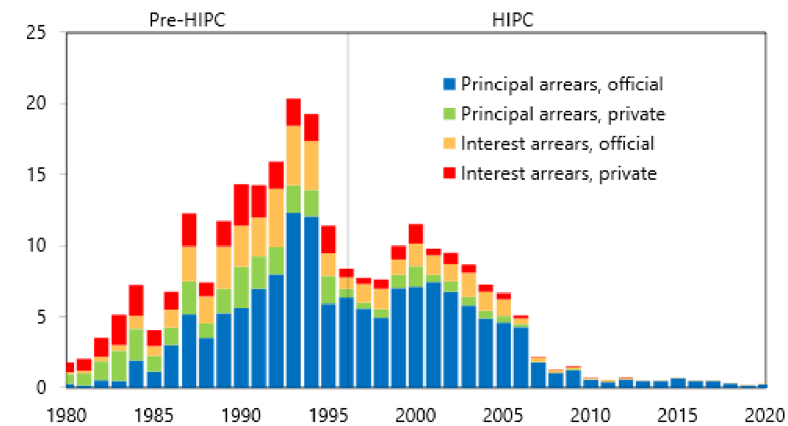
Sources: World Bank IDS and Staff Calculations

2. Relatedly, arrears accumulation, which was widespread among LICs in the 1990s, does not appear to be as much of an issue among LICs today as it was on the eve of the HIPC initiative. Although this could partly be explained by the G20 Debt Service Suspension Initiative (DSSI) that granted beneficiary countries temporary relief on their debt service obligations amid the COVID pandemic shock in 2020 and 2021, arrears accumulation on principal and interest payments to both official and private creditors have remained minimal following the HIPC/MDRI debt relief (Figure IV.3).

Figure IV.3 Outstanding Arrears in PRGT-countries

Outstanding Arrears

(In Percent of Exports, median)



Sources: World Bank IDS WDL and Staff Calculations

3. The financing landscape for low-income countries has transformed significantly since the mid-1990s in ways that create new challenges for effective creditor coordination in debt workouts. The composition of the creditor base of LICs shifted away from traditional Paris Club (PC) and official creditors toward non-Paris Club (NPC) official creditors and commercial creditors. Before the HIPC Initiative in 1996, for example, PC creditors accounted for 39 percent of LICs' external debt while NPC accounted for only 8 percent, with private creditors accounting for 8 percent of the total debt. However, by the end of 2020, the composition had rebalanced in significant ways, with PC creditors now accounting for only 12 percent, while the share of NPC creditors almost tripled to 22 percent, and private creditors doubled their holdings to 17 percent of total PPG debt to LICs (Figure IV.4).

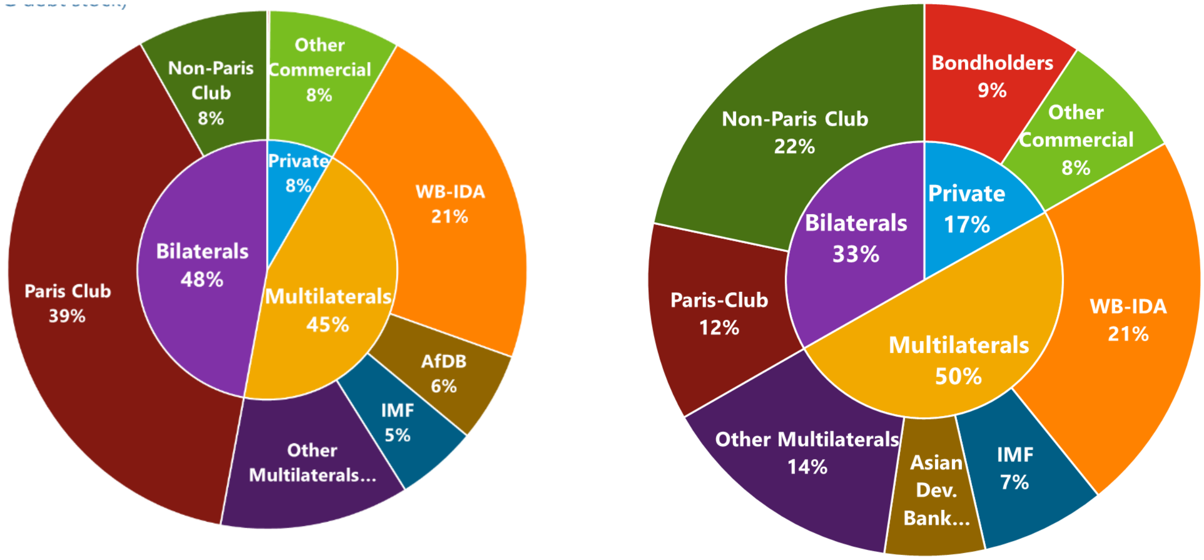
Figure IV.4 External Creditors Landscape

End-1996: Distribution of PRGT Creditors

(In percent of total PPG debt stock)

End-2020: Distribution of PRGT Creditors

(In percent of total PPG debt stock)



Sources: World Bank IDS and Staff Calculations

4. Overall, judging by the levels of the debt burden indicators using the Fund's current LIC-DSA toolkit, the debt situation today in low-income countries remains relatively more benign compared to the situation on the eve of the HIPC Initiative. Widespread accumulation of arrears is not an issue today, and although 40 out of 69 PRGT-eligible LICs are in debt distress or at high risk of debt distress, the related stresses on solvency and liquidity indicators are less severe than they were during the pre-HIPC era. However, if current trends persist, debt vulnerabilities in LICs could reach levels comparable to the pre-HIPC period in the medium term. Countries that face a rising risk of debt distress would benefit from steadfast implementation of policies recommended in the context of IMF surveillance or IMF-supported programs to reduce debt vulnerabilities. Countries whose debt becomes unsustainable should consider whether a debt treatment is needed to restore debt sustainability, including through the G20 Common Framework, and actively engage with their creditors.

5. Looking ahead, the transformed debt landscape in LICs portends challenges to make the international architecture for sovereign debt resolution more efficient and effective. For one, the rebalancing of creditors away from traditional and official lenders to non-traditional lenders (both official and private) have important implications for the ease of creditor coordination today compared to the mid-1990s when Paris Club lenders, private banks and the multilaterals where the major creditors. Initiatives such as the G20 Common Framework can help bring the various groups of creditors together to deliver the required debt relief for eligible LICs.

Annex V. LIC Debt Management Capacity Development Case Studies

1. While not exhaustive, the case studies below attempt to provide some insights into best practices for ensuring the effectiveness of public debt management CD. Some cases highlight how debt management CD can have many providers, and without efficient communication and coordination between them, there is a risk of duplication and waste. Other cases highlight how debt management improvements in LICs, especially fragile states, are not going to be a smooth process and consequently CD providers need to be prepared for setbacks, course corrections, and should support regular communication as a means to overcome these obstacles. Finally, some of the cases emphasize the importance of having an up-front commitment to the reforms, without which even the best plans will achieve little. It is crucial to be transparent about timelines for fundamental debt management and market reforms, where the results are likely to show in years rather than months. Nevertheless, all the cases highlight the importance of the recommendations in the recent IEO's report on the IMF and Capacity Development, which stress the need to reinforce measures to promote CD ownership, including with tighter integration with Fund surveillance and tailoring to country circumstances.[1]

A. Somalia: Debt Management Reform Plan and HIPC Completion Point Triggers

2. The Federal Government of Somalia requested technical assistance to support the development of a debt reform plan and creation of a regular debt bulletin. Improvements in debt management capacity and debt transparency are critical to preparing the country for a post-HIPC normalization of relations with the international community. Moreover, improvements in debt reporting are a completion point 'trigger' for Somalia under the HIPC initiative.

3. Based on consultation with the authorities and other CD providers, in particular the African Development bank, a joint World Bank-IMF mission provided CD focusing on three key areas: (i) the legal framework for debt management; (ii) the institutional framework for debt management; and (iii) debt recording, reporting, and monitoring.

4. The CD supported the preparation of a comprehensive debt reform plan, with a timebound set of recommendations to be implemented broken down in the three main areas (e.g. legal framework, institutional framework, and debt recording/reporting/monitoring) and a timeline for follow-up capacity development support for the authorities. The mission emphasized the importance of coordination amongst CD providers, considering that in Somalia there are multiple external partners providing critical CD support on debt management. The mission also emphasized the limitations of virtual missions and the additional challenges fragile and conflict

[1] The IMF and Capacity Development. IEO, 2022.

affected LICs may have in fully participating in a mission virtually, including connectivity issues and security challenges.

B. Papa New Guinea: Debt Reporting

5. Papua New Guinea (PNG) is relatively advanced for the Pacific region in debt management, utilizing both loan financing and an active domestic debt market. CD for debt reporting and monitoring has been undertaken on a regional and country basis within the Pacific region through the Fund's capacity development center for the Pacific (PFTAC). Unfortunately, the wider challenges within the institutional arrangements for debt management in PNG created a barrier to the implementation of the CD. To assist in overcoming this bottleneck, additional bilateral capacity development on institutional arrangements was organized for PNG.

6. Capacity Development was provided to PNG to review the institutional arrangements for debt management, specifically the organizational structure. The CD highlighted weaknesses within the institutional arrangements that would make achieving effective debt management operations and the implementation of the debt transparency CD difficult. Those weaknesses included a fragmented legal framework, isolated and limited knowledge in the use of the debt recording and reporting system, lack of resources resulting in a clouded organizational structure for debt management, increasing responsibilities outside of specified debt management roles, and the absence of a risk management and compliance framework.

7. The capacity development assisted the authorities in developing a list of reforms necessary to improve the institutional arrangements around debt management as well as in devising an implementation plan. A key lesson was that the underlying context, including the structure of debt management, can provide useful insights into the implementation risks that will arise.

C. Guinea: Developing Local Debt Markets

8. AFRITAC West (AFW) provided capacity development support to the Guinean authorities to develop and implement a reform plan for the domestic government securities market. Local currency bond markets (LCBM) can play a critical role in the financing of key fiscal expenditures and the development of the local financial system. In Guinea, the goal was to move to issuances of T-bills through auctions.

9. AFW provided support in 2020-21 to the authorities in reviewing the legal and regulatory framework for government securities in Guinea. Unfortunately, the military coup of 2021 brought LCBM reforms to a halt and put the project on hold.

10. In 2022, AFW resumed support to the authorities, which helped the Guinean Treasury to set up its first 5-year treasury bond auction in April 2022. One key lesson from this CD is that progress in LIC debt management is not linear, and CD providers should be prepared for setbacks, delays, etc., when providing support to fragile LICs. Another key lesson is the benefits of perseverance and maintaining contact with DMOs during periods of heightened uncertainty.

D. Eastern Caribbean Currency Union (ECCU): Debt Management Improvements and Climate Swaps

11. The Eastern Caribbean Currency Union (ECCU) is an example of building capacity in government debt management through a coordinated regional approach, sustained over many years. The original impetus for IMF support in this area was the launch of the regional government securities market (RGSM) in the early 2000s, which created the need to bring a more systematic and market-oriented approach to debt recording and reporting. Capacity-building has taken place in the ongoing context of large financing needs, elevated debt levels, limited sources of financing (in particular on concessional terms), and vulnerability to macroeconomic shocks, natural disasters, and, increasingly, climate change. An additional consideration is stretched human resources, high turnover, and the technical infrastructure for debt management. The debt management units in ECCU countries are very small, and in some cases functional responsibilities are fragmented, with implications for the capacity to absorb technical assistance and implement reforms.

12. Following an initial period of ad hoc headquarters-led technical assistance, an intensive program of capacity-building began in 2013. This support was made possible through financial support from the government of Canada. A successful component of the capacity-building during this period was the junior debt managers program (JDMP), which delivered in-depth training to a cohort of country officials over the course of a year, in collaboration with the World Bank, the Commonwealth Secretariat, and the Eastern Caribbean Central Bank (ECCB), each of which contributed modules in their respective areas of comparative advantage. Although concluded four years ago, the JDMP continues to pay dividends in the region. The integration of JDMP participants in their debt management units boosted skill levels in those offices. Some participants have taken leadership positions, as in St. Vincent and the Grenadines, where the debt management unit is headed by a JDMP graduate.

13. The years between 2018 and 2020 were a period of lessened but ongoing engagement, primarily through headquarters staff. A successor program, also funded by Canada, was launched in late 2020 and has enabled the deployment of a new long-term expert, with backstopping and additional expertise at the headquarters level. This latest phase of capacity-building has been fully integrated into CARTAC, thereby facilitating relationships and cross-fertilization between debt management and CARTAC's macroeconomics and public financial management work program.

14. The April 2022 online seminar on debt-for-climate swaps is another example of CD addressing regional challenges. The seminar responded to interest from Caribbean countries in innovative instruments for mobilizing or redirecting financing for climate-related objectives while keeping debt at sustainable levels. The seminar drew on country experiences (both in the region and elsewhere) and also recent IMF policy work on this topic.[2] A panel consisting of capital market advisers, country representatives, and IMF staff discussed the practical steps, preconditions, and challenges for executing debt-for-climate swaps.

15. Progress has been substantial, especially in developing strategies to raise financing and manage the stock of debt over the medium term. Nearly all ECCU countries are now able to identify and quantify key risks in their debt portfolios. They are able to prepare strategies that take those risks into account, along with the availability and relative costs of financing from different national, regional, and external sources, without requiring significant technical assistance, as was the case earlier.

16. **Some key lessons can be drawn from the ECCB debt management capacity development experience.** First, a reliable, bilateral partner that can commit to supporting a multi-year CD agenda for a region is important. Second, there is a benefit to taking a regional approach to CD in certain contexts, such as in the case of a currency union. This regional approach has also facilitated specialized training and seminars that are of particular interest to the region, such as debt-for-climate swaps. Finally, there are advantages to better coordinating CD support, in this case through the explicit integration of the new regional expert and CARTAC.

E. Democratic Republic of Congo: Re-Introduction of Treasury Bills and Bonds

17. The Democratic Republic of Congo (DRC) is a highly dollarized economy with several debt management challenges, including a lack of diversified sources of funding for the budget. Since 1991, domestic debt issuances were discontinued because demand for government securities dried up. The discontinuation of government securities issuances forced the government to rely on non-marketable domestic borrowings and impeded the development of a local financial market. In the mid-2010s, the authorities identified the resumption of government securities issuance as a key debt management priority.

18. AFRITAC Central supported the authorities in resuming government securities issuance after a suspension of nearly 30 years. A roadmap for issuance resumption was prepared in February 2015 and was later endorsed by the authorities. The successful introduction of a 3-month nominal Treasury bill in October 2019 marked an important milestone in the diversification of funding sources for the government of DRC**.** However, due to the limited supply of local currency and the COVID-19 pandemic, Treasury bill issuance has not materialized as planned after a few strong months. In 2020 and 2021, AFRITAC Central worked with the authorities to design a new financing instrument: dollar-indexed Treasury bills and bonds denominated in local currency.

19. While more CD will likely be requested as the authorities continue implementing their roadmap for DRC's local bond market, several key lessons are notable. The previous missions

[2] Debt-for-Climate Swaps: Analysis, Design, and Implementation. IMF WP/22/162 (August 2022)

highlighted the importance of securing buy-in from the authorities, in this case through the establishment of a working group composed of the right mix of senior staff and technical experts. Second, coordination with the central bank and other stakeholders to adjust reserve requirements was instrumental in supporting the fledgling market. Finally, it is important to be transparent about the timelines required for fundamental debt management and local bond market reforms, because the results are more likely to show up over several years, rather than several months.

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