

Editorial

Debt, a still debated issue

In emerging and developing countries, debt has become a recurrent theme that pops up whenever financial conditions tighten and/or economic activity slows. The IMF recently published a blog post on the subject with a rather alarming title. Granted, the combined impact of several factors, namely the downward revision of growth forecasts, a stronger dollar and the normalisation/tightening of monetary policies that have been rather accommodating until now, will increase the weight of the debt burden. Yet not very many countries are at high risk of debt distress, and there is little probability that debt will trigger a systemic credit crisis, even though the risk has increased for the most vulnerable countries.

Debt in emerging and developing countries has become a recurrent theme that pops up whenever financial conditions tighten and/or economic activity slows, as is currently the case¹. The major international financial institutions continue to revise downwards their growth forecasts.

■ The slowdown has been confirmed

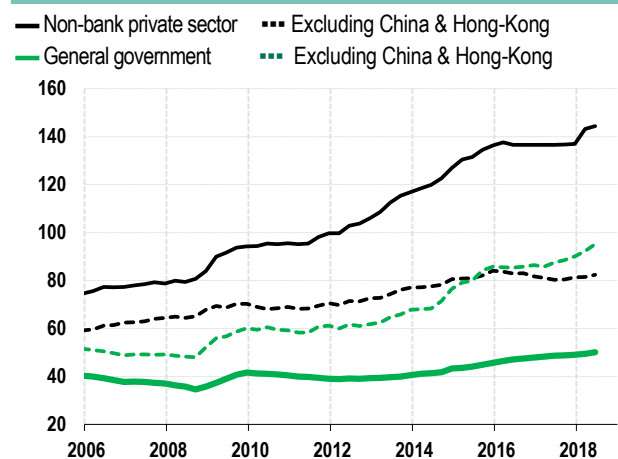
Compared to its June 2018 outlook, the World Bank lowered its growth forecasts for emerging and developing countries as a whole by 0.6 percentage points in 2019 (to 4.2% from 4.8%) and by 0.2 pp in 2020 (to 4.5% from 4.7%). The IMF also revised its 2019 forecast, for the second time, to 4.5%, from 5.1% in June 2018 (which is equivalent to the World Bank's downward revision). In 2020, in contrast, the IMF expects growth to rebound a little more strongly than the World Bank, to 4.9%.

The rather small downward revision of Chinese growth since the mid-2018 outlook (-0.2 pp for the IMF, -0.1 pp for the World Bank) explains only about 10-15% of the revision for the emerging and developing countries as a whole (Chinese GDP accounts for about 30% of the GDP of the emerging and developing countries). The remaining 85-90% can be attributed to the spill-over effects of the Chinese slowdown on the countries of Asia, as well as the painful recovery of the Russian economy despite the upturn in oil prices (see below). We must also factor in the severe slowdowns in South Africa and Mexico, and the recessions in Argentina, Iran, Turkey and Venezuela.

The downward revision of growth estimates for emerging and developing countries as a whole is based mainly on survey data and the usual cyclical indicators (industrial production, exports, and retail sales) which have levelled off or deteriorated since mid-2018. From a more fundamental perspective, these revisions are justified by 1) the slowdown in world trade in 2019, by 0.6 pp compared to the mid-2018 forecasts (for both the IMF and the World Bank), and 2) the tightening of financial conditions, both external (rise in risk premiums, currency depreciation against the USD) and internal (normalisation or tightening of monetary policies, notably for the

¹ The IMF recently published a blog post by Martin Muhselsein and Mark Flanagan with a rather alarming title: "Three steps to avert a debt crisis". Drawing on the IMF database covering 190 countries, the authors focus on emerging market debt. The IIF did the same in its latest update of the Global Debt Monitor entitled "Devils in the details". Lastly, in the World Bank's latest edition of Global Economic Prospects released in January, a chapter is devoted to debt in low-income countries ("Debt in low-income countries: Evolution, Implications and Remedies").

1- Debt in the main emerging countries (% GDP)



Source: BIS

countries whose currencies have come under tense pressure, during summer 2018 like Argentina and Turkey).

■ Private debt is higher, but sustainable

The combined impact of these two factors will increase the weight of the debt burden in the emerging and developing countries. According to the IMF and the Institute of International Finance (IIF), the private non-financial sector in the emerging and developing countries has not deleveraged since the 2008-2009 crisis. This is true but only at the aggregate level as China alone explains the ongoing increase in the private sector debt/GDP ratio in recent years. Excluding China, the ratio has been fairly stable since 2016 (chart 1). Yet even excluding China, private debt is significantly higher than it was before the 2008-2009 crisis (82% of GDP in Q3 2018 vs 64% at year-end 2007). An aggravating factor is that foreign currency debt has increased sharply in recent years, especially excluding China. According to the IIF, in the emerging countries excluding China, foreign currency debt in the non-bank sector (including sovereign debt in foreign currencies) has swelled from 14% to 20% of GDP since 2015, and it is currently higher than the previous peak at the end of the 1990s, prior to the Asian financial crisis.



Debt raises at least two questions. Which countries will face a sharp increase in market debt servicing in the years ahead? Could the increased debt burden trigger a credit crisis?

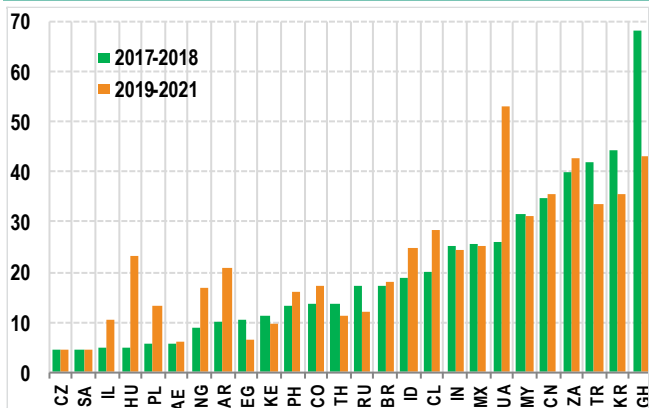
The answer to the first question is that few countries are at high risk of debt distress, even though the aggregate amount of maturing bond debt and syndicated loans is rising year after year; according to the IIF, the annual redemption will average USD 1,949 bn in 2019-2020 (with a peak of USD 2,16 bn this year) compared to a 2017-2018 average of USD 1,639 bn. At the country level, however, if we compare repayments to official foreign reserves at year-end 2018, Ukraine is the only country that stands out for a high and rapidly rising debt ratio (chart 2). Among the countries with a high debt ratio, we must distinguish between those in healthy macroeconomic situations (China, South Korea, Malaysia) and the more vulnerable countries (South Africa, Turkey and especially Ghana), which must be monitored. On the whole, however, the emerging and developing countries are not backed up against a wall of maturing market debt, at least not in the short term.

The response to the second question was recently provided by the economists at the European Central Bank (ECB)². Like most recent academic research on the vulnerability of the emerging countries, they conclude that there is much less risk that a financial shock will trigger a balance of payments crisis or systemic credit crisis than in the past. The vast majority of emerging countries are better armed to cope: adequate external solvency and liquidity, flexible forex regimes, credible monetary policies, and no major mismatches in banks' balance sheets.

By comparing a few basic macroeconomic variables for a selection of 20 emerging countries before the Asian crisis of 1997-1998 with today's figures, the authors only identified three countries that now have a significantly higher probability of experiencing a banking crisis. Unsurprisingly, the three countries are those with the highest external vulnerability: Argentina, Turkey and Ukraine. Argentina and Ukraine benefit from IMF programmes, which for the moment are providing financial stability (sustainable in Ukraine's case, which has been in the programme since 2014). In Turkey's case, the consolidation of public finances and the banking sector in the 2000s have enabled the economy to absorb a series of financial shocks, including the recent increase in the cost of credit risk for banks.

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2- EM bond debt and syndicated loans amortization (% official fx reserves ¹)



¹) Sovereign net foreign assets for the United Arab Emirates
 AE : United Arab Emirates, AR : Argentina, BR : Brazil, CZ : Czech Rep, CL : Chile, CO : Colombia, CN : China, EG : Egypt, GH : Ghana, HU : Hungary, IL : Israël, ID : Indonesia, IN : India, KE : Kenya, KR : South Korea, MX : Mexico, MY : Malaysia, NG : Nigeria, PH : Philippines, PL : Poland, RU : Russia, SA : Saudi Arabia, TH : Thailand, TR : Turkey, UA : Ukraine, ZA : South Africa.

Source: IIF - BNP Paribas

² Livia Chitu and Dominic Quint, *Emerging market vulnerabilities – a comparison with previous crises*, ECB Economic Bulletin – December 2018