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ALLIANZ RESEARCH

EMERGING MARKETS DEBT RELIEF: KICKING THE CAN DOWN THE ROAD

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EXECUTIVE SUMMARY

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- **The Covid-19 pandemic and related global economic crisis triggered an unprecedented shift in public debt sustainability in the developing world.** Emerging Markets (EMs) and Low-income Developing Countries (LDCs) have been hit harder by the post-Covid debt surge, reflecting their heavy debt-service burden compared to Advanced Economies (AEs). A decade ago, the share of government interest payments in fiscal revenues was nearly the same (on average around 6%) for the three country categories. Since then, the debt-service cost has fallen for AEs (to 4% in 2020), gradually increased for EMs (7.3%) and more than doubled for LDCs (13.7%).

- **Despite the global economic recovery that is already underway (+5.5% in 2021, the fastest recovery in the past 40 years), we expect increased debt distress in EMs and especially in LDCs in the next two years and further sovereign downgrades as well as some defaults.** Low-income countries will need a minimum of USD450bn in order to step up their spending response to Covid-19, to rebuild or preserve foreign exchange reserves and to offset the long-lasting scars of the crisis. In the absence of a comprehensive solution, heavy debt burdens may generate a permanent global divergence between rich and poor countries.

- **Current debt restructuring initiatives will certainly continue to kick the can down the road and are likely to fall short of their objectives.** The IMF's new USD650bn SDR allocation is a step in the right direction but will be no game-changer. The G20/Paris Club Debt Service Suspension Initiative (DSSI) has the merit of including China, for the first time, into a coordinated debt relief initiative. Yet, it will bring only "temporary" relief (i.e. payment deferral without debt cancellation) in 2021 and covers a very small portion of the debt-service burden (excludes EM borrowers and private creditors, for example).

- **The changing creditor landscape of public debt (Eurobond holders, China, India and some Middle Eastern countries) has created a "race to seniority" and increased debt sustainability risks.** This shift from traditional (concessional) to private and commercial debt complicates debt restructuring and leaves less room for debt forgiveness. China's collateralized lending with strategic assets gives it a more senior status, for instance in Angola and Zambia, compared to official international lenders (such as the IMF, World Bank). This creates a race to seniority that complicates debt-resolution negotiations in case of repayment difficulties. So far, when things have gone wrong and repayment difficulties arose, countries have bilaterally engaged in debt-restructuring talks with China behind closed doors (Sri Lanka, Ecuador, Angola, Zambia, Kenya), with barely any disclosure on agreed repayment deferrals (rather than write-offs).

- **The IMF-coordinated "Common Framework" aims at offering the same restructuring terms for all creditors, including private creditors, by following a "case by case" approach.** Coordination, transparency and acceptability will be the main challenges for reaching a satisfactory debt restructuration agreement with all stakeholders. Given the overwhelming share of Eurobond holders, official creditors are currently pushing for private sector involvement in debt restructuring to ensure "fair" burden sharing. Yet, some borrower countries are less inclined to incur losses on private creditors, with the fear of having their sovereign ratings downgraded, which would lead to losing market access. In addition, the success of the initiative hinges on transparent information sharing regarding the stock and conditionality of the debt with China. We believe that the political acceptability of these debt-relief initiatives could be jeopardized should China not take sufficient part in the process. The US and other bilateral creditors may not want to join the initiative if the provided debt relief is used to repay Chinese debt.

- **Overall, we expect neither a fundamental blanket solution nor a tsunami of debt defaults in the near future. The international community is likely to step in to bring the needed liquidity relief in case of stress, without being able to offer an overarching solution.** Debt forgiveness will bring only temporary financial relief to countries without tackling the root causes of unsustainable debt accumulation. In this sense, proposals like the "New Deal" for Africa from the Paris Summit would offer a viable solution through private sector-led growth if countries manage to overcome their structural impediments (i.e. high exposure to commodity cycles, weak fiscal revenue collection, inefficient government spending, corruption and poor governance, low potential growth due to shortfalls in human capital, infrastructure and energy investment etc.).

- **We identify pockets of sovereign debt stress vulnerability for the next two years. The top riskiest 20 EM countries include the heavyweights Egypt, South Africa, India and Brazil, as well as Pakistan.** Our Public Debt Sustainability Risk Score (PDSRS) analyzes sovereign debt dynamics in 61 EMs and 40 LDCs. The countries that we flag as "most vulnerable" have high chances of being next to seek financial support from international lenders, to apply for debt relief/restructuring initiatives or to default on their sovereign debt (i.e. failure to reimburse principal or interest payments in due time). The top 20 riskiest countries include seven economies each from Latin America (Suriname, El Salvador, Costa Rica, Trinidad & Tobago, Panama, Brazil, Argentina) and Africa (Egypt, Zambia, Angola, Tunisia, Ghana, South Africa, Mozambique) and three each from the Middle East (Lebanon, Bahrain, Jordan) and Asia (Sri Lanka, Pakistan, India). However, there is no country from Emerging Europe. The top 20 also includes four of the five countries that defaulted in 2020 (Lebanon, Suriname, Zambia, Argentina).

- **The traditional debt sustainability analysis toolbox may not catch all high-risk economies as some specific factors could suddenly trigger severe liquidity tensions followed by sovereign debt defaults, even if the overall debt metrics appear at acceptable levels** (the example of Ecuador showed this in 2020). Therefore, we pay particular attention to EMs and LDCs with a high annual interest or amortization burden on sovereign debt and/or with a high level of foreign exchange-denominated public debt along with significant exchange rate vulnerability. This adds Bangladesh, the Dominican Republic, Guatemala, Iran, Kenya, Malawi, Nigeria, Uganda, Albania, Kazakhstan, Morocco, Congo DR, Kyrgyzstan, Tajikistan and Uzbekistan to our watch list for debt distress in the next two years.

46%

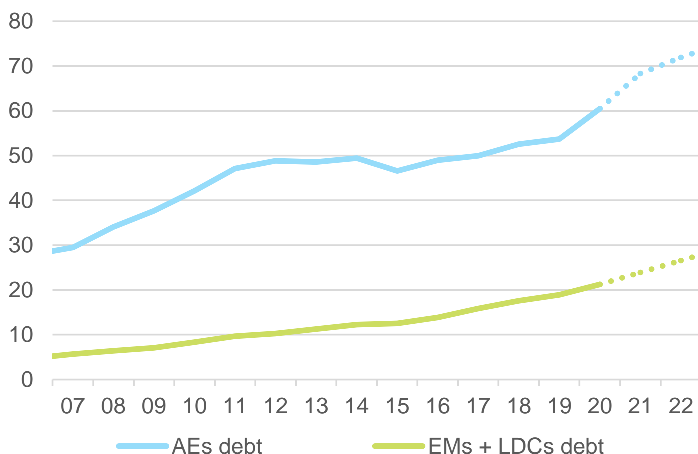
Median debt-to-GDP ratio for Low-income Developing Countries in 2020.

GROWING INEQUALITIES AND VULNERABILITIES

The Covid-19 sanitary crisis triggered an unprecedented increase in public debt all around the world. Global public debt was already increasing before the Covid-19 crisis on the back of the commodity price slump in 2015 and weak growth momentum in most Advanced Economies (AEs, see Figure 1): The worldwide debt-to-GDP ratio rose from 60% in 2007 to 83% in 2019. Then, with Covid-19-related spending and the drying-up of international revenues adding to mounting debt pressures, the global debt-to-GDP ratio jumped to 96% in 2020. Comparing median public debt (as a share of GDP) among different country classes, we find that in 2020 Emerging Markets (EMs) nearly caught up with the 67% ratio of AEs. As for Low-income Developing Countries (LDCs) – which structurally have greater debt intolerance[1] – the median debt-to-GDP ratio climbed to 46% in 2020 (see Figure 2).

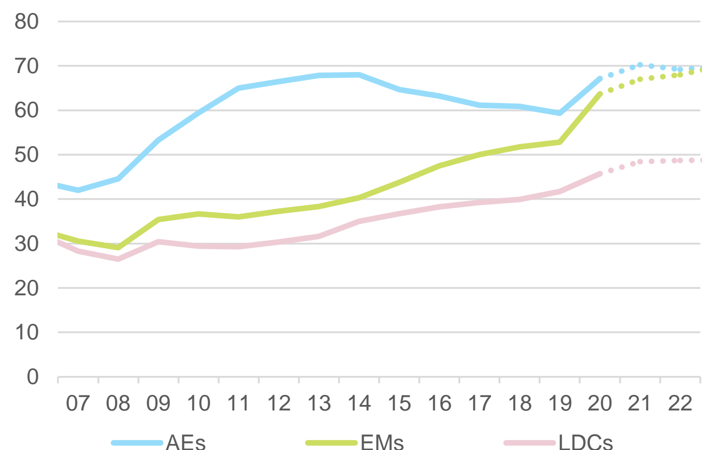
Excess global liquidity did not bring lower borrowing costs to all. Despite accommodative financing conditions at the global level, all countries did not enjoy low borrowing costs. A comparison of the median effective interest rate (the average rate on the entire stock of a government's debt) since 2015 reveals that the borrowing cost almost halved from 2.7% to 1.4% for AEs and fell from 4.8% to 3.6% for EMs. However, it rose from 2% to 2.9% for LDCs (see Figure 3). In fact, financing conditions have been less supportive for many EMs and especially LDCs because of their higher exposure to changing investor sentiment, exchange rate fluctuations and greater risk premiums. The interest rate differential between advanced and other economies is likely continue to widen further in the next two years, on the back of continued accommodative policies in AEs and higher inflationary pressures in the developing world.

Figure 1: Government debt (USD trn)



Sources: IMF, Euler Hermes and Allianz Research forecasts

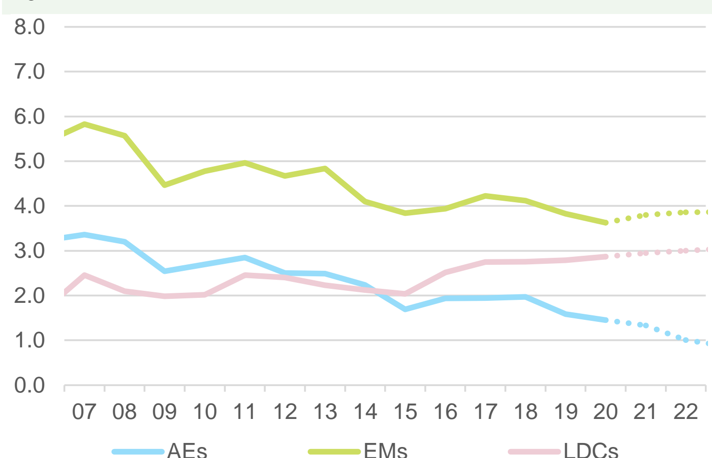
Figure 2: Median government debt-to-GDP ratio (%)



Sources: IMF, Euler Hermes and Allianz Research forecasts

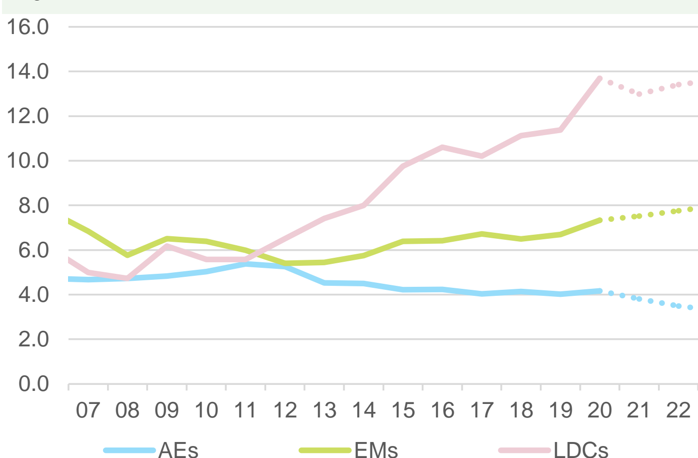
[1] Debt-intolerant countries tend to have severe fiscal and financial weaknesses such as a poor fiscal revenue base and underdeveloped financial sectors. Moreover, high inflation and a "serial sovereign default" record also deteriorate the tolerance to debt. Literature (https://www.jstor.org/stable/1209144?seq=1) shows that "safe" indebtedness thresholds for highly debt-intolerant countries could be surprisingly low at around 15-20% of GDP.

Figure 3: Median effective interest rates on public debt (%)



Sources: IMF, Euler Hermes and Allianz Research forecasts

Figure 4: Government interest payments (% of revenues)



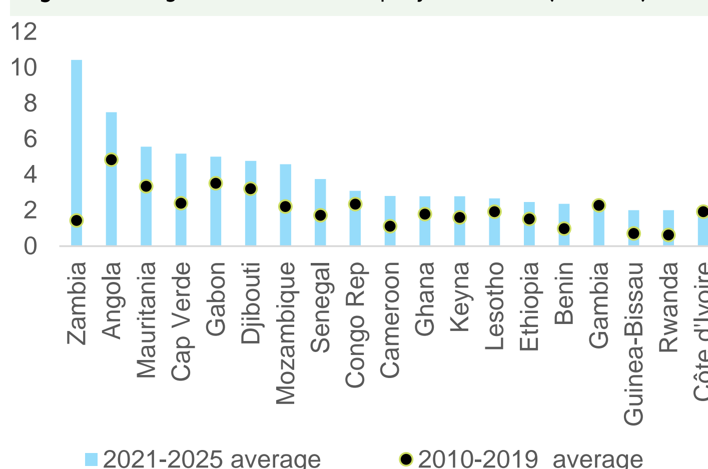
Sources: IMF, Euler Hermes and Allianz Research forecasts

There is a growing divide in the debt-service burden built up over the past decade between advanced and other economies. Even though debt volumes increased in AEs, historically low interest rates have enabled them to keep their debt-service burden constant since 2015. In contrast, higher interest rates and rapidly rising government debt levels in EMs and LDCs have fueled their interest-service costs. Figure 4 illustrates that a decade ago, the share of government interest payments in revenues was nearly the same, on average around 6%, for the three country categories. Since then, the debt-service cost has fallen for AEs (to 4% in 2020), gradually increased for EMs (7.3%) and more than doubled for LDCs (13.7%).

On top of this, Covid-19 added to already increasing interest burdens. The spread between AEs' and LDCs' debt-service costs widened in particular in 2020, to 9.5pp from 7.4pp in 2019, and is forecast to remain so in the next few years. The recent rise in the interest rate burden is particularly striking in debt-ridden African countries such as Zambia, Angola and Mozambique but also Senegal (see Figure 5).

Many emerging and low-income countries could be trapped in a low-growth-high-debt loop after Covid-19. Because of limited fiscal space and a structurally weak revenue base, most developing countries could not engage in large-scale fiscal stimulus to spur post-Covid-19 growth and ensure debt sustainability down the road. In contrast, a growing debt-service burden, all-time high external funding gaps as well as weak export revenues and remittances have forced some countries to cut government spending while the sanitary crisis is still ongoing. Yet, this abrupt contraction of government spending in highly indebted countries may became counter-productive by putting a break on the economic recovery, feeding into social tensions and political instability, hence raising further their risk premiums.

Figure 5: Average cost of debt service per year in Africa (% of GDP)



Source: French Development Agency, Euler Hermes, Allianz Research

CURRENT DEBT RESTRUCTURING INITIATIVES WILL CONTINUE TO KICK THE CAN DOWN THE ROAD

The developing world could have more than USD550bn in financing needs in the medium run. The IMF estimates that low-income countries need around USD200bn to step up their spending response to Covid-19, including for vaccinations, and to rebuild or maintain foreign exchange reserves. An additional USD250-350bn would be required to accelerate convergence with AEs and offset the long-lasting scars of the crisis. In the absence of a comprehensive solution, heavy debt burdens may generate permanent global divergence between rich and poor countries. Moreover, a global recovery that leaves low-income countries behind could fuel humanitarian crises, increasing refugee flows and contributing to the rise of terrorism and violence. In addition, disorderly sovereign defaults in EMs and LDCs may create a domino effect that could destabilize financial stability across the globe.

None of the initiatives currently on the table will bring sufficient support to cover the funding gaps of the developing world. In addition, it is still not clear how to include Eurobond holders and China into the restructuring talks.

The new USD650bn SDR allocation of the IMF will be no game-changer. The new USD650bn allocation of the IMF currency, Special Drawing Rights (SDR), will bring limited oxygen to countries in need of liquidity. These new SDRs are good news as they will add up to countries' international reserves, hence improving liquidity positions and support credit worthiness. In addition, they can be exchanged for hard currency to finance imports or budget spending with the approval of the IMF. The new allocation will improve the international reserves of EMs such as Turkey, South Africa, Nigeria, Argentina, Pakistan and Sri Lanka by around 10-20%.

However, the country allocation of SDRs has followed the same rules since the 1970s, according to which the SDRs are distributed in proportion to members' quotas. Needless to say, rich countries will receive the bulk of new SDR allocation (around 67%) while the USD650bn SDR allocation would provide only USD21bn in liquidity support to LDCs and USD212bn to other EMs (excluding China). The African continent will receive only USD34bn whereas its financing gap until 2023 is estimated at around USD300bn. For comparison, the IMF's concessional lending provided about USD13 billion in emergency financing only in 2020.

In the recent Paris Summit, French President Macron called for AEs to donate or lend their SDRs to other countries in need, namely USD65bn as SDRs for Africa. Nevertheless, at present, such mechanisms that would compel rich countries to transfer their SDRs to poorer countries free of cost do not exist. And amid the exit from the sanitary crisis and ahead of elections (Germany and France), political priorities are likely to shift towards domestic issues. In view of the implementation complexities and diverging incentives of AEs, we believe this initiative has limited chances to provide a quick and significant solution to the continent's looming liquidity needs.

The G20/Paris Club Debt Service Suspension Initiative (DSSI) covers a very small portion of the debt service burden but at least has the merit of bringing China into the restructuring talks. The DSSI already provided USD6bn in debt-service relief for 45 countries (out of over 70 eligible countries) in 2020 and is expected to deliver up to USD7.3bn of additional debt-service suspension through June 2021. As the scope of the initiative was not extended to EMs, countries such as Tunisia or Gabon could not benefit. The expected USD7.3bn relief with official creditors covers a very small portion of the debt-service burden of intermediate income (over USD420bn) and eligible countries (USD42bn) in 2020 (estimations of the IMF and the World Bank). The main motivation of this initiative was to bring a "temporary" liquidity relief from debt payments to official creditors. It had the merit of bringing together, for the first time, China, G20 and Paris Club official creditors in a coordinated debt relief initiative. However, as the participation of private creditors was only on a voluntary basis, none of them participated in the initiative.

A changing creditor landscape leaves little room for debt forgiveness

The Common Framework intends to bring a "case by case" solution for debt restructuring. Based on a case by case approach, the IMF-coordinated Common Framework aims at reaching debt re-profiling and restructuring agreements under the same conditions for all creditors. The initiative has the ambitious goal of extending the scope of relief beyond the limited debt deferral available under the DSSI to ensure "fair" burden-sharing across all creditors, including the private sector. The G20 launched the "Common Framework for Debt Treatments beyond the DSSI" in November 2020, with Chad becoming the first country to join in January 2021, followed by Zambia and Ethiopia.

The shift from traditional (concessional) to private and commercial debt complicates debt restructuring. The Common Framework aims at offering the same restructuring terms to all stakeholders. The main challenges for its successful implementation relate to coordination, transparency and acceptability. To ensure coordination of different stakeholders, the debt-negotiation talks would need to bring together (perhaps around the same table) official creditors (international organizations or state representatives), bondholders and new creditors from EMs. Importantly, the success of the initiative would require information sharing with full transparency on the stock and conditionality of the existing debt. It may be difficult to convince China and its creditors to disclose this kind of strategic information. Another complication relates to China's collateralized lending with strategic assets: In these loans, China enjoys a more senior status compared to international organizations such as the IMF, the World Bank and other development banks. The collateralized debt creates a "race to seniority" of official stakeholders that complicates debt-resolution negotiations in case of a default or debt distress (for example Zambia and Ethiopia). Moreover, loans from private Chinese banks generally have cross-default clauses, which also make them difficult to restructure. The acceptability of these debt-relief initiatives in AEs could be jeopardized if China does not take a sufficient part in the process[2]. Reaching a common debt-restructuring agreement with all creditors may also be challenging from the borrower's viewpoint: Some bond issuers may not want to default on bonds or international banks' loans as they would fear the negative impact on their sovereign ratings. On the other hand, official creditors would push for including private lenders into bailouts to ensure "fair" burden sharing.

Market access fears: seeking debt relief is a double-edged sword for credit ratings. Despite the relief that debt restructuring brings for public finances, not all countries are eager to ask for it. The risk of credit rating downgrades and/or a deterioration in market reputation has prevented highly indebted countries like Kenya and Ghana[3] from joining the initiative to reschedule private sector liabilities. As expected, the initiatives to include private creditors into debt-relief schemes qualifies as a "selective default", as seen in the example of Ethiopia. The country's sovereign rating was downgraded to "substantial risk" by rating agencies following the announcement that it would seek debt relief under the new G20 Common Framework.

In the current international setting, we do not expect a comprehensive solution to be reached in 2021 to offer a way out for debt-ridden countries. Even so, debt forgiveness tends to bring only temporary relief while promoting private-sector-led growth could be the long-lasting solution. In the past, the IMF-World Bank Heavily Indebted Poor Countries (HIPC) Initiative and multiple Paris Club agreements have showed that debt forgiveness brings only temporary financial relief to countries, without tackling the underlying reasons of unsustainable debt accumulation, a trend that is echoed in the literature[4]. Therefore, most sovereign debt default episodes have been preceded by on average two debt restructurings within the same decade.

Since 2012, the HIPC initiative has provided partial or full debt relief to 39 countries. However, most of these countries piled up new debt quickly thereafter. In most of Africa, the countries' indebtedness tripled in just 13 years after the debt cancellation in 2006. The root causes of unsustainable debt accumulation in most developing countries arise from a long list of structural factors: high exposure to commodity cycles, weak fiscal revenue collection, inefficient government spending, corruption and poor governance, low potential growth due to shortfalls in human capital, infrastructure and energy investment and finally high borrowing and debt-servicing costs because of high risk premiums. In this sense, proposals like the "New Deal" for Africa from the Paris Summit would offer a viable solution to debt accumulation. The initiative aims at reallocating productive resources towards high-value added industrial sectors and setting the stage for a private-sector led growth model. Obviously, the successful implementation of this type of policy may take time and requires overcoming the structural obstacles listed above.

Overall, we expect neither a fundamental blanket solution nor domino debt defaults in the near future. The international community will step in to bring the needed liquidity in times of stress, without being able to offer an overarching solution to growing debt unsustainability. Despite the global economic recovery that is already underway (+5.5% in 2021, the fastest recovery in the past 40 years), we expect increased debt distress in EMs and especially in LDCs in the next two years and further sovereign downgrades as well as some defaults. Yet, we do not expect a continued strong wave of rating migrations going ahead (2020 registered record numbers of more than 30 sovereign downgrades by both Moody's and Fitch). The debt relief and restructuring initiatives on the table (IMF, G20, Paris Club, China in some cases) – while being far from a comprehensive, far-reaching and sustainable solution – should help a number of countries to avoid default in the next few years. In the next sections, we will identify the main pockets of vulnerability.

[2] Janet Yellen, the US secretary of the treasury, expressed in June 2021: *"We would be very concerned to see the resources that are provided to these countries [with debt relief initiatives] used to repay Chinese debt. That would defeat the purpose of the programmes."*

[3] Some market access countries did not prefer asking for debt relief under the Common Framework as this would trigger a downgrade and put in danger their continued market financing which comes, unlike official loans, without policy conditionality.

[4] For more information please see "External sovereign debt restructurings: Delay and replay" (https://voxeu.org/article/external-sovereign-debt-restructurings-delay-and-replay).

MEET THE TOP 20 EMS AT RISK

Fiscal vulnerabilities depend on both the level and composition of government debt. We analyze the sustainability of sovereign debt in 101 countries – 61 EMs and 40 LDCs.[5] We calculate a Public Debt Sustainability Risk Score (PDSRS) for these markets in order to identify the most vulnerable ones that could be next in line to seek financial support and/or a debt restructuring or relief, or which may default on their sovereign debt. We apply a number of hard data combined with some forward-looking indicators based on our macroeconomic scenario.

The top 20 countries with the least sustainable public debt according to our analysis include seven economies each from Latin America and Africa and three each from the Middle East and Asia, though none from Emerging Europe (see Figure 11 in the Appendix for the complete scoreboard of our analysis). The top 20 ranking also include four of the five countries that defaulted in 2020 – Lebanon, Suriname, Zambia and Argentina.

Importantly, the top 20 riskiest include the heavyweight EMs Egypt, South Africa, India and Brazil, as well as Pakistan, which are all included in the MSCI Emerging Market Index. India, Brazil and South Africa are expected to post large post-Covid-19 annual fiscal deficits that will certainly add to their already high public debt burdens. Yet, these heavyweights should be able to avoid default in the next two years as most of their debt is domestic and they enjoy manageable debt maturity structures. India should also experience solid nominal GDP growth in the medium term, which should help contain the debt-to-GDP ratio. However, Egypt's debt metrics are a cause for serious concern, as they include a high level of foreign exchange denominated public debt (39% of the total) and maturing public debt accounting for 15% of GDP in 2021-2022 (among the highest in our country sample). Moreover, the country's interest payments account for 40% of revenues, with an effective interest rate reaching 10%. Meanwhile, Pakistan continues to face strong debt distress: The country had an IMF Extended Fund Facility (EFF) program in place before Covid-19 that was disrupted by the pandemic and then paused for a year while it got support from the IMF's Rapid Financing Instrument (RFI) and G20 debt suspension.

Sri Lanka is another Asian country with debt sustainability concerns. An IMF Extended Fund Facility (EFF) expired in 2020 and discussions on a RFI have not been completed to date due to disagreements over policy requirements from the IMF. To ease the liquidity tensions, the Sri Lankan authorities have concluded a USD1.5bn currency swap with China in the meantime.

Regarding Africa, we have furthermore identified Angola, Tunisia, Ghana and Mozambique as highly vulnerable countries. Their debt-to-GDP ratios are exceeding 80% after the Covid-19 shock. Angola's debt is currently at unsustainable levels but the country will benefit from the G20 DSSI until the end of 2021 and has negotiated with China USD6.2bn in debt relief at the horizon of 2023. Angola lost market access in 2018 and received in June 2021 the final tranche (USD0.7bn) of the USD4.5bn facility (Emergency Assistance and EFF) agreed with the IMF. The Fund assesses the debt of Mozambique as in distress while the country continues to accumulate external debt service arrears, particularly on the "hidden loans" contracted with some international banks. The stock of external arrears on public and publicly guaranteed external debt service is above 10% of GDP. Ghana will face important rollover risks in 2022-2023 but the country was able to quickly return to Eurobond markets in early 2021. Finally, Tunisia's public debt soared to over 90% of GDP after the pandemic due to the collapse of the tourism sector. While striking a deal with the IMF appears to be the only way out, political paralysis – a power struggle between the president, the prime minister and the fragmented parliament – has made it impossible to reach a loan agreement

[5] We have followed the classification of EMs and LDCs in the latest IMF Fiscal Monitor from April 2021 and added 21 EMs that are not included in the Fund's publication. Our sample of 101 EMs and LDCs together with all AEs – which are not part of our analysis – account for 98% of global GDP.

before summer. The country may need additional bilateral loans, potentially from the Middle East, to cover its short-term financing needs. However, as a young democracy, should a liquidity crisis materialize, Tunisia is likely to benefit from the financial support of the international community.

In the Middle East we have Bahrain and Jordan in the top 20 riskiest list. Bahrain already ran out of fiscal policy buffers in 2017 and has since "survived", thanks to financial support from Saudi Arabia and the UAE, without which it would be in default. Jordan's public debt trajectory had deteriorated already before Covid-19 – and got a boost through the latter – owing to a combination of many years of low growth and high fiscal deficits amid a rapidly growing population. Yet, an IMF support package and ongoing aid from the GCC should help Jordan to avoid a debt default or restructuring in the next two years.

El Salvador, Costa Rica, Trinidad & Tobago and Panama are additional Latin American countries on the debt sustainability watch list. All have a worrisome debt trajectory and relatively high interest obligations, though near-term maturing public debt is not an immediate concern.

Meanwhile, Ecuador is not in the top 20 riskiest anymore. Following its sovereign default last year it completed a USD17bn debt restructuring in August 2020, which has postponed its amortization payments to 2026. Moreover, Ecuador's debt metrics are rather mixed and not overall weak (see Figure 11 in the Appendix). Nonetheless, the fully-dollarized country[7] defaulted last year as it could not serve debt falling due. This example shows that a multi-factor analysis of public debt sustainability such as our PDSRS may not identify all countries at risk of a debt default or restructuring as in some cases one or a few factors alone could trigger severe liquidity shortages that may lead to a default. Thus, in the following section, we look at some specific factors that may threaten debt sustainability.

[6] We derive the Pubic Debt Sustainability Risk Score (PDSRS) from a set of eight indicators: public debt (% of GDP), Covid-19 debt shock (increase in public debt-to-GDP ratio in pp), FX public debt (% of total public debt), maturing public debt in the next two years (% of GDP), fiscal balance (% of GDP), government interest payments (% of fiscal revenues), effective interest rate (interest payments in % of public debt at the end of previous year), and the interest rate-growth differential (pp). To make the data comparable across indicators, each of them was rescaled from 0 to 100, with 0 denoting the highest risk and 100 the lowest. Then the PDSRS was calculated as the average of the indicators, thus also ranging between 0 and 100.

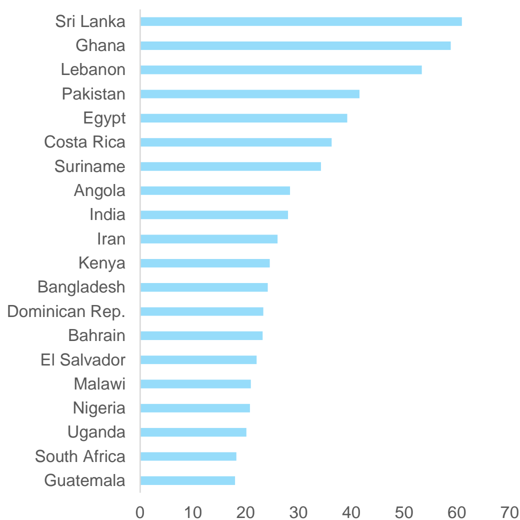
[7] For more information on Ecuador's debt distress episodes, please see "Twenty years of official dollarization in Ecuador: a blessing or a curse?" (https://www.afd.fr/sites/afd/files/2020-09-04-23-15/official-dollarization-ecuador.pdf)

THE DEVIL IS IN THE DETAILS

A heavy interest burden may cause debt distress for Bangladesh, the Dominican Republic, Guatemala, Iran, Kenya, Malawi, Nigeria and Uganda even if their overall debt loads appear manageable. These eight countries have interest payments falling due that range between 18% and 26% of government revenues in 2021-2022, which puts them among the top 20 countries in our sample of 101 EMs and LDCs with regard to this metric (see Figure 6). The first nine in the list and three other countries were already identified by our PDSRS in the previous section as highly vulnerable with regard to debt sustainability.

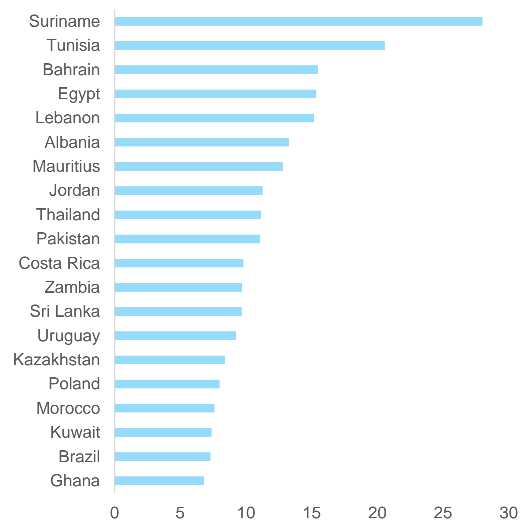
An unfavorable public debt maturity structure poses significant refinancing risk for Albania, Kazakhstan and Morocco in the next two years despite an apparently manageable overall debt burden. Figure 7 shows the 20 countries in our sample with the highest level of maturing sovereign bonds in relation to expected GDP in 2021-2022. Eight of them were not among the riskiest top 20 identified by our PDSRS in the previous section. Among them are Thailand, Uruguay, Poland, Mauritius and Kuwait, which should be able to roll over that debt, thanks to favorable market access or resuming government revenues from recovering trade and tourism activity. However, Albania, Kazakhstan and Morocco may experience difficulties to do so owing to high borrowing costs that reflect weaker sovereign ratings.

Figure 6: Government interest payments 2021-2022 (% of revenues)



Sources: IMF, Euler Hermes and Allianz Research forecasts

Figure 7: Maturing sovereign bonds in 2021-2022 (% of GDP)

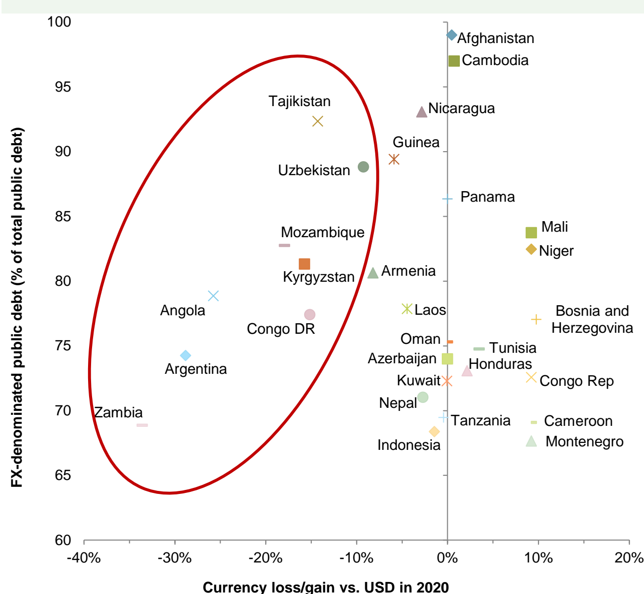


Sources: Refinitiv, Euler Hermes and Allianz Research forecasts

A high level of foreign exchange-denominated public debt can also trigger debt distress, especially if it comes along with significant exchange rate vulnerability. Figure 8 shows the 30 countries in our sample of 101 EMs and LDCs with a share of FX-denominated public debt in total debt above two thirds, which puts debt sustainability for all of them on an insecure footing. If we also take the economies' exchange rate vulnerability (here measured by the change of the currencies vs. the USD in 2020) into account, then the eight encircled countries in the chart appear to be the most vulnerable in this context. These include Congo DR and three Central Asian LDCs (Kyrgyzstan, Tajikistan, Uzbekistan) that are not in the riskiest top 20 identified by our PDSRS. However, these sovereigns do not have access to global financial markets. Hence their debts include significant shares of multilateral and bilateral loans, with the latter often subject to market conditions, i.e. relatively high interest rates, which can create further problems. We will investigate this in more detail below.

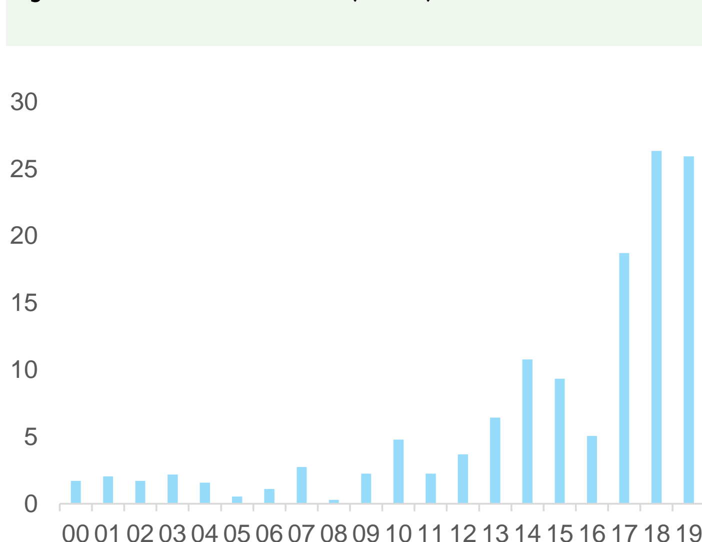
Watch out for the debt owed to commercial creditors and to China! The creditor landscape of public debt has considerably changed for EMs and LDCs. Excess liquidity and the search for yield in AEs have enabled some developing countries to issue Eurobonds for the first time. Over the past decade, new private (Eurobond holders) and official (essentially China but also India and some Middle Eastern countries) lenders have emerged. The change in creditor identity has been especially striking in Africa (Figure 9) where the share of commercial creditors in the external debt stock has more than doubled in the last two decades – from 17% in 2000 to 40% at the end of 2019. At least 21 African countries accessed international capital markets between 2000 and 2020. On the continent, Eurobond issuances have been led by Egypt (USD31bn), South Africa (USD30bn), Ghana (USD12bn), Nigeria (USD12bn) and Angola (USD8bn).

Figure 8: Share of FX-denominated public debt to total debt and exchange rate vulnerability



Sources: Refinitiv, Euler Hermes and Allianz Research forecasts

Figure 9: Africa Eurobond issuances (USD bn)



Sources: African Development Bank, Euler Hermes and Allianz Research estimates

This growing share of private and commercial debt has become an additional source of vulnerability. Increased reliance on Eurobond emissions expose EMs and LDCs to shifts in investor sentiment[8] and sudden capital outflows. In addition, these markets' debt tends to be of short maturity, which increases the rollover risk when market conditions are tight. In the same way, EMs and LDCs are more exposed to a "taper tantrum", an abrupt tightening of monetary conditions in developed countries that could change investment appetite for riskier assets[9]. This vulnerability was visible amid the Covid-19 shock: while 15% of AEs have had their credit ratings cut since 2020, the share of downgrades for EMs and developing economies reached 40%[10]. Moreover, the normalization of the sovereign spreads from all-time highs in March-April 2020 has been slow and only partial in EMs and LDCs (in comparison to AEs)[11].

[8] African debt, for example, tends to be highly exposed to shifts in market sentiment and herd behavior. Lacking comprehensive information on individual markets, international investors may lump all African bonds into one asset class. This would lead to the mispricing of African sovereign risk due to discriminatory behavior by international investors, irrespective of macroeconomic fundamentals (see for example https://www.afdb.org/sites/default/files/documents/publications/wps_no_331_mispricing_of_sovereign_risk_and_investor_herding_in_african_debt_markets.pdf).

[9] For more details on this topic, see our recent report *Taper Tantrum in 2021-22: Beware of the TUCKANS*.

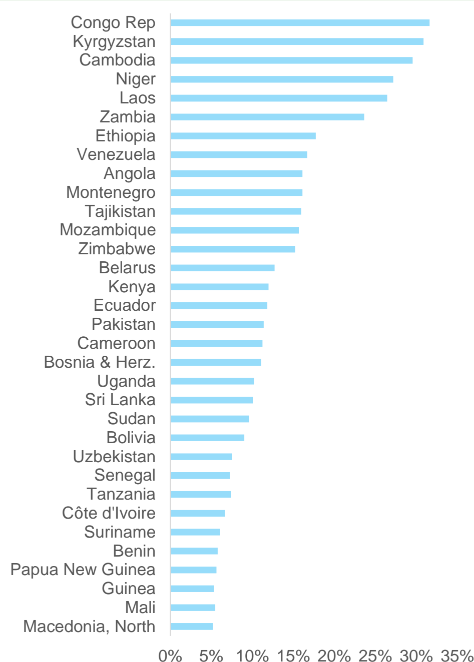
[10] "Bond returns in sovereign debt crises: The investors' perspective" (https://voxeu.org/article/bond-returns-sovereign-debt-crises-investors-perspective).

[11] In Africa, for example, despite growing financing needs to fight the pandemic, Eurobond emissions only resumed at the end of 2020 in Côte d'Ivoire (USD3.5bn), Benin (USD3.5bn) and Ghana (USD3bn). The region is expected to issue USD15bn Eurobonds in 2021, let by Nigeria, South Africa and Kenya.

China is the new game in town. In line with China's "strategic" objectives and the Belt and Road Initiative, mostly resource-intensive EMs and LDCs from all over the world have been increasingly borrowing from China. The country has emerged as a new major lender to the developing world via an increasing share of commercial loans, collateralized loans[12] granted by the Exim and the Chinese Development Bank[13]. In contrast to foreign aid or lending from official creditors, there is no systematic reporting on China's overseas commercial lending exposure. Hence, it is hard to have a transparent reading on loan terms, associated interest rates and collateralization conditions of debt owed to China. Figure 10 provides estimates for 33 countries out of our sample of 101 whose external debt to China exceeds 5% of GDP. It is led by the Republic of Congo (32%) and contains 17 African countries in total, reflecting the continent's outstanding position as the largest recipient of Chinese funding, with the debt stock owed to China exceeding USD150bn. Currently the share of China in the total debt stock of Africa is estimated at 21%, vs. just 3% for France for example[14]. Many of the countries currently in debt distress or classified as being at high risk of debt distress also have high exposure to Chinese loans, including Kyrgyzstan, Zambia, Angola, Tajikistan, Mozambique, Ecuador, Pakistan, Sri Lanka, Uzbekistan and Suriname (see Figure 10).

Borrowing from China certainly helped many countries to bridge the infrastructure gap (Ethiopia, Kenya, Zambia) but also made it possible to finance infrastructure projects that were deemed unviable by other creditors (Montenegro). In other cases, Chinese lending gave short-lived breathing room to governments when public finances went out of control (Ghana, Ecuador, Argentina). Substantial commercial loans to Argentina (currency swap), Ecuador and Angola illustrate China's willingness to lend even to highly risky sovereign borrowers. In contrast to the IMF's lending practices, Chinese loans are increasingly assimilated to commercial debt, hence they do not ask for conditionality related to "good" fiscal discipline or to taking on additional foreign debt. However, from a debt-sustainability perspective, such conditionality would prevent the risk of excessive indebtedness and sovereign default. Although the concessional lending of Eximbank is active in Africa, Chinese loans do not systematically offer preferential terms. Interest rates on commercial loans can be aligned with market conditions, as reflected by high effective interest rates to Latin America. When things go wrong and repayment difficulties arise, countries bilaterally engage debt-restructuring talks behind closed doors (Sri Lanka, Ecuador, Angola, Zambia, Kenya) and with barely any disclosure on agreed repayment deferrals (rather than write-offs).

Figure 10: External debt to China (% of GDP)



Sources: Horn et al. (2019), Euler Hermes and Allianz Research estimates

[12] Debt-Collateralized sovereign debt refers to a sovereign loan that is secured by existing assets or future receipts owned by the government. The collateral could be commodities, future export revenues, or infrastructure use (such as electricity). In principle, the lender can take control of the collateral if the loan is not repaid. Yet, the physical seizure of commodities and/or assets will be hard to implement in an international context.

[13] For more information on Chinese lending, see our recent report *Emerging markets: heading for a China-less-recovery?*

[14] The cost of debt service to China is estimated at 25% (USD50bn) of the total debt service cost in Africa, with Angola (53%) and Ethiopia (42%) having the highest shares in the period 2021-2025 (compare https://www.afd.fr/fr/ressources/soutenabilite-dettes-afrique).

APPENDIX

Figure 11: Public Debt Sustainability Risk Score (PDSRS)

Rank	Country (from high risk to low risk)	**Public Debt Sustainability Risk Score (0 = high risk; 100 = low risk)**	Total Public Debt (% of GDP) max(2020;2021)	Covid-19 Debt Shock (increase in public debt-to-GDP ratio) 2020	Foreign Exchange-denominated Public Debt (% of total public debt) 2020	Maturing Public Debt (% of GDP) 2021-2022	Fiscal Balance (% of GDP) 2021-2022	Interest Payments (% of fiscal revenues) 2021	Effective Interest Rate (interest payments in % of public debt at the end of previous year) 2021	Interest Rate - Growth Differential (%) 2016-2020
1	Lebanon	**0.0**	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2	Suriname	**3.7**	0.0	0.0	17.6	0.0	0.0	0.0	11.7	0.0
3	Sri Lanka	**8.8**	0.0	0.0	32.4	35.6	0.0	0.0	2.7	0.0
4	Bahrain	**10.5**	0.0	0.0	0.0	0.0	0.0	0.0	47.5	36.9
5	Egypt	**14.1**	13.1	67.3	32.5	0.0	0.0	0.0	0.0	0.0
6	Zambia	**15.9**	0.0	0.0	0.0	35.4	0.0	20.5	71.1	0.0
7	Angola	**16.2**	0.0	14.7	0.0	86.0	0.0	0.0	28.5	0.0
8	El Salvador	**16.9**	10.7	0.0	0.0	100.0	0.0	0.0	8.5	16.2
9	Tunisia	**16.9**	18.1	15.6	0.0	0.0	14.3	43.4	44.2	0.0
10	Pakistan	**17.1**	18.3	89.0	3.3	26.2	0.0	0.0	0.0	0.0
11	Jordan	**20.3**	9.2	29.8	0.0	25.0	0.0	21.1	37.3	40.1
12	Costa Rica	**21.5**	36.9	24.7	75.4	34.6	0.0	0.0	0.0	0.1
13	Ghana	**22.8**	26.5	5.9	55.1	54.7	0.0	0.0	0.0	40.2
14	South Africa	**25.3**	23.7	0.0	100.0	63.7	0.0	13.4	1.9	0.0
15	Trinidad and Tobago	**28.3**	51.0	17.7	38.7	100.0	0.0	18.8	0.0	0.0
16	Panama	**29.1**	53.1	0.0	0.0	77.2	0.0	45.8	46.1	10.7
17	India	**29.8**	8.1	0.0	100.0	79.0	0.0	0.0	2.7	48.8
18	Brazil	**29.9**	0.0	30.5	100.0	51.3	0.0	22.2	35.4	0.0
19	Mozambique	**30.4**	0.0	0.0	0.0	100.0	0.0	53.4	77.8	12.3
20	Argentina	**33.1**	0.0	35.9	0.0	66.4	55.3	54.4	53.1	0.0
21	Oman	**33.3**	8.6	0.0	0.0	63.8	0.0	85.6	72.3	36.3
22	Mexico	**33.5**	50.9	29.1	40.1	55.3	60.0	26.3	6.2	0.0
23	Malawi	**33.9**	35.6	89.5	29.8	68.2	0.0	0.0	0.0	47.9
24	Uganda	**34.2**	69.7	43.5	0.0	80.9	0.0	1.1	4.7	73.6
25	Philippines	**36.8**	66.5	20.3	38.2	61.5	0.0	37.5	19.1	51.1
26	Colombia	**36.9**	48.9	15.2	36.1	82.3	19.2	57.2	36.5	0.0
27	Venezuela	**37.0**	0.0	0.0	20.9	75.2	0.0	100.0	100.0	0.0
28	Indonesia	**38.3**	82.7	47.1	0.0	89.6	0.0	22.1	16.4	48.2
29	Uruguay	**38.5**	43.6	76.4	0.0	38.4	34.4	60.8	48.4	5.8
30	Turkey	**38.5**	86.6	72.2	0.0	81.7	0.0	67.4	0.0	0.0
31	Montenegro	**38.7**	0.0	0.0	0.0	66.0	24.3	79.3	66.9	72.8
32	Armenia	**38.8**	49.7	14.1	0.0	86.1	38.9	37.2	32.4	52.0
33	Ukraine	**40.1**	52.1	20.1	0.0	54.7	18.6	63.8	11.6	100.0
34	Georgia	**40.1**	50.7	0.0	0.0	78.4	0.4	79.6	70.5	41.5
35	Dominican Republic	**40.2**	43.9	0.0	53.2	100.0	67.5	0.0	29.9	27.1
36	Kenya	**40.3**	39.9	65.3	30.4	74.2	0.0	0.0	12.7	100.0
37	Papua New Guinea	**41.0**	72.1	39.0	45.0	92.0	26.8	14.9	28.0	10.3
38	Mauritius	**41.7**	19.4	76.0	97.5	14.5	0.0	46.1	61.3	18.6
39	Morocco	**43.0**	31.0	23.9	84.6	49.3	0.0	56.4	53.5	45.4
40	Gabon	**43.2**	36.9	21.3	50.1	100.0	30.0	27.0	42.2	37.9
41	Benin	**43.5**	55.7	0.0	27.4	82.4	54.0	19.7	17.5	91.6
42	Congo Rep	**44.7**	0.0	0.0	0.0	100.0	100.0	71.8	75.8	9.7
43	Albania	**45.0**	29.8	45.8	18.3	11.5	14.3	73.7	66.6	99.9
44	Paraguay	**45.1**	91.9	37.7	35.2	82.7	25.0	59.0	25.7	3.6
45	Laos	**46.2**	41.5	44.7	0.0	92.0	0.0	28.3	63.4	100.0
46	Bangladesh	**46.4**	78.3	66.4	23.7	87.9	0.0	0.0	15.0	100.0
47	Rwanda	**46.6**	43.7	33.4	0.0	84.2	0.0	70.0	63.5	77.9
48	Yemen	**46.7**	14.2	55.8	50.2	100.0	0.0	53.0	100.0	0.0
49	Guatemala	**47.3**	94.0	61.2	16.6	100.0	46.3	11.0	6.0	43.6
50	Nigeria	**47.4**	91.0	59.6	100.0	85.9	10.0	1.1	31.9	0.0

(continued on next page)

Rank	Country (from high risk to low risk)	**Public Debt Sustainability Risk Score (0 = high risk; 100 = low risk)**	Total Public Debt (% of GDP)	Covid-19 Debt Shock (increase in public debt-to-GDP ratio)	Foreign Exchange-denominated Public Debt (% of total public debt)	Maturing Public Debt (% of GDP)	Fiscal Balance (% of GDP)	Interest Payments (% of fiscal revenues)	Effective Interest Rate (interest payments in % of public debt at the end of previous year)	Interest Rate - Growth Differential (%)
			max(2020;2021)	2020	2020	2021-2022	2021-2022	2021	2021	2016-2020
51	Peru	**48.9**	87.1	20.7	30.1	82.7	35.2	68.5	36.6	30.3
52	Qatar	**49.7**	40.3	36.7	0.0	62.6	100.0	84.2	66.1	7.8
53	Croatia	**49.8**	15.7	0.0	49.2	58.6	53.7	90.1	67.1	63.7
54	Hungary	**49.8**	26.0	0.7	48.5	60.8	15.6	93.3	75.8	77.6
55	Kyrgyzstan	**50.3**	33.4	0.0	0.0	100.0	16.1	92.3	85.0	75.3
56	Macedonia, North	**51.9**	65.7	29.3	0.0	60.8	22.7	90.4	67.3	78.8
57	Malaysia	**51.9**	46.3	31.1	78.4	63.5	0.0	70.0	72.2	53.8
58	Côte d'Ivoire	**53.2**	81.1	79.3	0.0	100.0	0.0	40.6	32.1	92.9
59	Romania	**53.5**	66.2	20.0	19.4	77.6	0.0	87.8	56.8	100.0
60	Ecuador	**53.7**	46.5	12.8	0.0	100.0	100.0	92.0	78.1	0.0
61	Sudan	**53.7**	0.0	0.0	98.8	100.0	31.1	100.0	100.0	0.0
62	Bolivia	**54.7**	43.6	30.4	26.9	100.0	0.0	83.3	73.7	79.3
63	Belarus	**54.8**	68.8	53.0	0.0	95.7	44.3	86.3	52.0	38.3
64	Myanmar	**54.8**	78.3	76.5	36.3	76.9	0.0	43.8	41.9	84.8
65	Senegal	**57.9**	46.9	85.0	0.0	86.0	36.1	55.3	53.7	100.0
66	Burkina Faso	**59.5**	74.2	87.8	0.0	81.8	20.0	69.0	43.3	100.0
67	Poland	**60.0**	57.2	20.7	51.2	46.7	35.7	100.0	84.9	84.0
68	Niger	**60.9**	72.3	50.2	0.0	100.0	12.9	82.7	68.9	100.0
69	Algeria	**61.1**	46.9	21.9	100.0	87.3	0.0	100.0	100.0	32.6
70	UAE	**61.2**	53.2	50.8	0.0	94.1	53.5	100.0	85.5	52.8
71	Uzbekistan	**61.3**	87.0	43.4	0.0	100.0	52.8	100.0	100.0	7.5
72	Guinea	**61.8**	68.6	0.0	0.0	100.0	65.2	81.5	79.3	100.0
73	Azerbaijan	**62.1**	100.0	75.6	0.0	95.6	71.9	100.0	53.5	0.0
74	Tanzania	**62.1**	86.1	99.5	0.0	93.1	69.9	38.4	28.1	82.1
75	Iran	**62.4**	73.4	100.0	100.0	100.0	0.0	0.0	25.9	100.0
76	Nepal	**62.8**	80.4	39.0	0.0	100.0	0.0	97.3	85.6	100.0
77	Haiti	**63.1**	65.2	55.5	0.0	100.0	47.0	99.4	90.8	46.8
78	Nicaragua	**63.1**	71.1	59.2	0.0	100.0	74.3	98.2	84.3	17.6
79	Mali	**63.2**	79.1	93.1	0.0	85.1	5.7	82.2	60.5	100.0
80	Madagascar	**63.9**	78.6	79.5	0.0	100.0	0.0	77.9	82.1	93.2
81	Serbia	**64.3**	59.5	62.7	0.0	76.2	82.5	90.4	54.1	88.9
82	Vietnam	**64.5**	76.3	78.3	29.5	94.4	0.0	69.5	68.2	100.0
83	Ethiopia	**65.0**	52.7	74.7	0.0	100.0	2.9	89.9	100.0	100.0
84	Tajikistan	**65.2**	71.9	66.6	0.0	100.0	58.3	94.9	82.2	47.8
85	Moldova	**66.3**	87.7	53.5	0.0	100.0	20.7	99.2	69.3	100.0
86	Honduras	**66.5**	68.6	35.2	0.0	100.0	64.2	100.0	90.0	73.9
87	Saudi Arabia	**68.1**	92.8	35.7	21.9	90.5	4.3	100.0	99.5	100.0
88	Cameroon	**68.4**	77.7	85.8	0.0	100.0	48.6	73.2	67.9	94.3
89	Kuwait	**68.9**	100.0	100.0	0.0	50.8	0.0	100.0	100.0	100.0
90	China	**69.5**	47.1	38.8	100.0	81.5	0.0	97.3	91.3	100.0
91	Bosnia and Herzegovir	**70.2**	85.1	60.1	0.0	100.0	58.8	100.0	74.4	83.2
92	Chad	**70.4**	74.3	75.2	25.0	100.0	100.0	86.8	76.7	25.3
93	Zimbabwe	**72.1**	14.1	0.0	99.3	100.0	100.0	100.0	100.0	63.0
94	Kazakhstan	**72.7**	100.0	50.5	37.3	44.1	70.5	100.0	100.0	78.8
95	Thailand	**72.9**	64.4	38.6	100.0	25.7	54.8	100.0	100.0	100.0
96	Chile	**75.6**	89.3	66.1	81.7	91.6	31.3	100.0	87.6	57.3
97	Cambodia	**75.7**	97.9	80.9	0.0	100.0	35.0	100.0	91.8	100.0
98	Afghanistan	**77.1**	100.0	89.0	0.0	100.0	85.6	100.0	100.0	41.9
99	Congo DR	**80.5**	100.0	78.3	0.0	100.0	81.4	100.0	84.1	100.0
100	Russia	**80.7**	100.0	63.0	61.3	93.2	99.4	100.0	73.4	55.1
101	Bulgaria	**84.9**	100.0	68.0	18.8	92.4	100.0	100.0	100.0	100.0

Note: To make the underlying data comparable across indicators, each of them was rescaled from 0 to 100, with 0 denoting the highest risk and 100 the lowest. Then the PDSRS was calculated as the average of the indicators, thus also ranging between 0 and 100.

Source: Euler Hermes, Allianz Research

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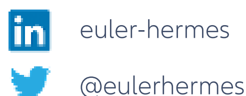
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FORWARD-LOOKING STATEMENTS

The statements contained herein may include prospects, statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties. Actual results, performance or events may differ materially from those expressed or implied in such forward-looking statements.

Such deviations may arise due to, without limitation, (i) changes of the general economic conditions and competitive situation, particularly in the Allianz Group's core business and core markets, (ii) performance of financial markets (particularly market volatility, liquidity and credit events), (iii) frequency and severity of insured loss events, including from natural catastrophes, and the development of loss expenses, (iv) mortality and morbidity levels and trends, (v) persistency levels, (vi) particularly in the banking business, the extent of credit defaults, (vii) interest rate levels, (viii) currency exchange rates including the EUR/USD exchange rate, (ix) changes in laws and regulations, including tax regulations, (x) the impact of acquisitions, including related integration issues, and reorganization measures, and (xi) general competitive factors, in each case on a local, regional, national and/or global basis. Many of these factors may be more likely to occur, or more pronounced, as a result of terrorist activities and their consequences.

NO DUTY TO UPDATE

The company assumes no obligation to update any information or forward-looking statement contained herein, save for any information required to be disclosed by law.