REUTERS
BREAKINGVIEWS

Breakingviews - Guest view:
Debt crisis redux

4 Feb 2022 By William Rhodes and Stuart Mackintosh

The U.S. Federal Reserve is belatedly reacting to high inflation. Whether or not Chair Jerome Powell manages to tame worrying price pressures, his rhetoric and actions are pushing up interest rates in poorer countries at a speed not seen in more than a decade. That spells real trouble for emerging markets and lower-income countries, which are already groaning under the weight of large sovereign debts.

The 1980s debt crisis in Latin America played out in the same manner. The Fed took robust and necessary action that ended up triggering debt crises in emerging economies overburdened with debts. In 2022, emerging economies face a quadruple hit. These countries are grappling with the pandemic with lower vaccine access and take-up rates, and very high mortality rates, exacerbated by the Delta and Omicron variants. They are experiencing a slower economic rebound. At the same time, many have debt loads at distress levels and are confronting rising inflation. This puts their central banks in a terrible bind: These rate-setters must tighten monetary policy, even though they face ongoing health, economic and debt-driven dynamics.

How big a problem is this debt distress and fiscal shock? The International Monetary Fund has warned of economic collapse in some low-income countries. This affects huge numbers of people across the globe. 60% of the world’s poorest countries are either at high risk of, or already in, debt distress, double the share in 2015, according to IMF Managing Director Kristalina Georgieva. The countries affected range from Chad, Ethiopia, Gambia, Kenya and Zambia to Afghanistan and Tajikistan. Lives are at stake.

The IMF expects that central banks in emerging economies will need to let currencies depreciate and raise benchmark interest rates. It is a matter of degree – not whether this occurs. Meanwhile, sovereign and many private sector debts are held in foreign currencies, resulting in higher and higher payments, just as resource constraints bite.

A debt service suspension initiative that was designed to offer a temporary freeze in payments to low-income countries expired at the end of 2021. What these nations now need is rapid action by the G20 countries, with accelerated debt restructuring talks involving public and private creditors. Such talks are never easy, and all sides must come to the table willing to be flexible and face some pain to get deals that are manageable and acceptable to everyone.
Creditors should not wait for disaster to act, for the real human cost is too high. And lenders should be willing to renegotiate. Private creditors must engage and face reality, while sovereign lenders, such as China, must step forward. If large players in either of these two groups refuse to deal with the debt distress, the outcomes will be worse for all concerned.

For instance, Sri Lankan authorities have appealed to China for a debt restructuring deal. It is in China's interests to find a way forward. Sri Lanka has real debt distress. Its government revenues were estimated at $9.4 billion in 2019, while its scheduled debt repayments, to lenders around the world, amounted to on average $4.4 billion per year. These levels of debts, seen across many low-income countries, are crippling as they face slower growth and rising interest costs.
The IMF, meanwhile, must address countries' concern that applications for multilateral relief might result in stigma and ratings downgrades. This almost always happens: A responsible country approaches the IMF for help, only to find that doing so negatively affects their market access and costs. Greater efforts are required by the fund and others to correct this corrosive dynamic, which deters countries from seeking much-needed assistance. The fund has the money it needs. In 2022, the IMF has an enlarged $650 billion pot of funds to assist debt distressed countries, if only governments would apply.

We all need to recognize the responsibility that advanced economy creditors have to their stressed borrowers. Without workable solutions we risk making matters worse and more enduring, to our collective detriment.