United Nations

High-Level Event on Financing for Development in the Era of COVID-19 and Beyond

Convened by Canada, Jamaica and the Secretary-General

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Discussion Notes

1. **Global Liquidity and Financial Stability**
2. Debt Vulnerability
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Discussion Note

Global Liquidity and Financial Stability

1. Background

The global health crisis caused by COVID-19 has rapidly developed into a severe economic and financial crisis, posing especially grave challenges for emerging market and developing countries facing large financing needs - for testing, tracing, isolation and treatment, as well as supporting the most vulnerable, livelihoods and stimulating the economy - and increasing debt burdens. Most developing countries do not have sufficient domestic resources and fiscal space to fund adequate response and recovery measures. This makes international cooperation and external finance crucial to heal and prosper together.

Rising economic risks and the rush for US dollar liquidity have led to record capital outflows from developing countries. Non-resident portfolio outflows from emerging market countries were almost $100 billion between late January and the end of March, credit spreads on emerging market sovereign bonds widened to more than 600 basis points, and emerging market exchange rates came under pressure. While capital markets are not completely frozen and there is recognition of the very substantial heterogeneity among developing countries, reduced capital inflows, collapsing exports and tourism revenues and falling remittances are further weighing on countries' external balances.

Creative and decisive actions by central banks in major economies averted a full-fledged global financial crisis during the March selloff by putting a floor on falling asset prices and injecting much-needed liquidity. While there were renewed inflows to some emerging markets in April, most developing countries continue to experience severe liquidity shortages. The absence of timely support could magnify the scale of the financing challenges and potentially trigger a wave of debt and financial crises.

The IMF has implemented a bold crisis response package to (i) scale up and accelerate its emergency financing—over 100 countries have requested funding from the IMF's Rapid Credit Facility and Rapid Financing Instrument; (ii) set up a new short-term liquidity line for countries with very strong policies; and (iii) provide immediate debt relief to its poorest and most vulnerable members with grants to pay off any debt service falling due to the IMF from the IMF's Catastrophe Containment and Relief Trust and to help 34 of the poorest members free up resources for priority spending.

Poor and lower middle-income economies will also benefit from the G20 Debt Service Suspension Initiative (DSSI) to suspend debt service payments (of both principal and interest) to official bilateral creditors until the end of the year. Private sector creditors have been asked by the G20 to join on a voluntary basis to provide comparable terms. Countries considering to request forbearance from creditors are carefully assessing the impact such requests may have on their financing agreements, as bond contracts from official (and private) creditors may include provisions that trigger a default once a request for debt relief is made.

The IMF and World Bank staff are providing technical support to help implement the DSSI by informing countries about the initiative through country teams and supporting the provision of information requested by the G20, such as for monitoring the use of the resources released by the DSSI to address the pandemic shock. Regional financing arrangements are also supporting member countries through lending activities and technical support. UN Regional Economic Commissions are creating platforms for dialogue between member states and creditors, including the Africa Private Credit Working Group (APCWG)[1]. The IMF continues to monitor developments in global financial markets and in individual countries, as part of its regular country surveillance and multilateral surveillance.

2. Main challenges

Near-term challenges include:

- *Liquidity shortages and balance of payments difficulties* that restrict fiscal and monetary space and constrain developing countries' ability to import vital medical and other supplies, fight the pandemic, and contain its economic fallout.
- *Heightened levels of capital flow volatility* that can affect macroeconomic and financial stability.
- *Increasing debt risks*, as higher debt servicing costs of foreign currency-denominated debt are undermining debt sustainability in many countries.

As the world begins to emerge from the pandemic, central banks will face the challenge of unwinding the extreme stimulus and extraordinary measures, which may add to existing financial vulnerabilities in the medium term. In addition, this crisis highlights the importance of non-economic risks for economic and financial outcomes, strengthening the case for including climate risk in regulatory and policy considerations.

3. Next steps

Specific actions to address the near-term challenges could include:

- *Special Drawing Rights (SDRs)*: The IMF is exploring with its members additional tools that would meet the financing needs, including those that involve SDRs.
- *Debt sustainability*: The IMF and World Bank staff are collaborating on frameworks for monitoring the use of created fiscal space to increase social, health, or economic spending, and for disclosure of public debt according to international standards, with technical assistance being provided as appropriate. Together with the World Bank, the IMF will prepare a paper on DSSI for the G20 meeting in June, which will cover any issues impeding the effective implementation of the DSSI, and a report to assess whether an extension of the DSSI is needed by October. In addition, the

[1] The Africa PCWG provides African Governments, the UNECA, the G20, the IMF and other Multilateral Development Banks ("MDBs") a forum through which all stakeholders can engage transparently and constructively with different categories of private international investors in African sovereign and corporate debt to coordinate the resolution of broad issues arising due to the COVID-19 crisis.

IMF, with the G20 International Financial Architecture (IFA) and the Paris Club, are stepping up work with official and private creditors to improve international mechanisms for debt resolution.

- *Management of capital flows*: The IMF is providing policy advice to member countries on managing capital flows, including insights from IMF work on developing an Integrated Policy Framework. Its advice covers a wide range of policies, including exchange rate adjustment, foreign exchange intervention, monetary policy, as well as sound financial supervision and regulation through macro-prudential measures. Temporary use of capital flow management measures on outflows may be needed to prevent full-blown crises, as part of a broader policy package that addresses underlying macroeconomic imbalances. The IMF is also reviewing its macroeconomic policy advice on external shocks through its Integrated Policy Framework (IPF) analytical workstream. The IMF will prepare a paper on the IPF likely by end-summer. The paper will jointly consider the role of monetary, exchange rate, macroprudential, and capital flow management policies, and their interactions with each other and with other policy levers, in response to volatile capital inflows.

4. Continued Collaboration

A. By mid- July 2020, at the margins of the High-Level Political Forum

- Reflection on recommendations from the paper on DSSI prepared for the G20 meeting in June.
- Reflection on possible avenues to advance the Secretary-General's Strategy and Roadmap for Financing the 2030 Agenda in support of the process.

B. By mid-September 2020, at the margins of the UN General Assembly

- Reflection on the implementation of the DSSI and other initiatives to address the crisis and maintain global liquidity and financial stability.
- Reflection and knowledge sharing regarding policy advice to cushion and build resilience to external shocks.

C. By mid-December 2020

- Stock-taking and placing progress in the context of our common ambition to deliver the 2030 promise—by mobilizing together around the Decade of Action, needed now more than ever to prevent losing decades of progress towards sustainable development.