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DEBT VULNERABILITIES AND FINANCING CHALLENGES IN EMERGING MARKETS AND DEVELOPING ECONOMIES—AN OVERVIEW OF KEY DATA

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DEBT VULNERABILITIES AND FINANCING CHALLENGES IN EMERGING MARKETS AND DEVELOPING ECONOMIES—AN OVERVIEW OF KEY DATA

Approved By
Guillaume Chabert (SPR)

Prepared by Karim Foda under the overall guidance of Karina Garcia. Data analytics and visualization support was provided by Joyce Saito and Chen Chen. Administrative assistance was provided by Claudia Isern and Eiman Afshar (all SPR).

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INTRODUCTION

Many emerging markets and developing economies face elevated debt vulnerabilities and financing needs. Following the 2020-21 surge in debt levels associated with the COVID-19 shock, and the subsequent tightening in global financial conditions, many emerging markets and developing economies (EMDEs)[1] are grappling with rising debt service burdens that squeeze the space available for development spending. Pandemic-induced deficits have declined, and debt levels have stabilized and are projected to remain stable or slightly decline under staff's baseline assumptions. However, many EMDEs are confronting high costs of financing, large external refinancing needs, and a decline in net external flows amid important investment and social spending needs. To help address these challenges, countries would benefit from actions, both at domestic and international level, to proactively expand their capacity to finance development spending. There are also important risks to the baseline that will require careful monitoring. This paper aims to help inform the international debate on these issues by providing factual data and insight on the debt vulnerabilities and financing pressures facing EMDEs.

EVOLUTION OF DEBT VULNERABILITIES

Debt Vulnerabilities and Financing Needs Remain Elevated in EMDEs

1. Public debt levels in EMDEs remain elevated, though they have stabilized post-pandemic and are expected to remain stable or decline slightly over the medium-term. Public debt in EMDEs was already high and on an increasing trend before the COVID-19 pandemic, following a steady increase through the 2010s. The COVID-19 shock in 2020 led to steeper increases in debt-to-GDP levels as public spending ramped up to support the policy response and recovery, and GDP declined. In the post-pandemic period, countries have sought to restore fiscal sustainability and primary fiscal deficits have mostly narrowed. For the median low-income country (LIC), the primary fiscal deficit has narrowed to about 1 percent of GDP, around its pre-pandemic levels. For the median emerging market economy (EM), primary deficits have narrowed significantly and are close to balance. Therefore, post-pandemic public debt levels have now stabilized (Figure 1).

2. While elevated, public debt levels in EMDEs remain well below historical highs. This is particularly true for LICs with debt burdens much lower today than in the period leading up to the HIPC Debt relief Initiative,[2] with the debt-to-GDP of the median LIC at about 55 percent today compared to the peak of about 70 percent in 1994. Furthermore, even for countries currently assessed at high risk or in debt distress, their current median debt to GDP ratio of 57 percent is still markedly lower than their peak at the eve of the HIPC Initiative (67 percent) and much lower than the median of the 39 HIPC countries at that time (that peaked at just below 90 percent of GDP). (Figure 1).

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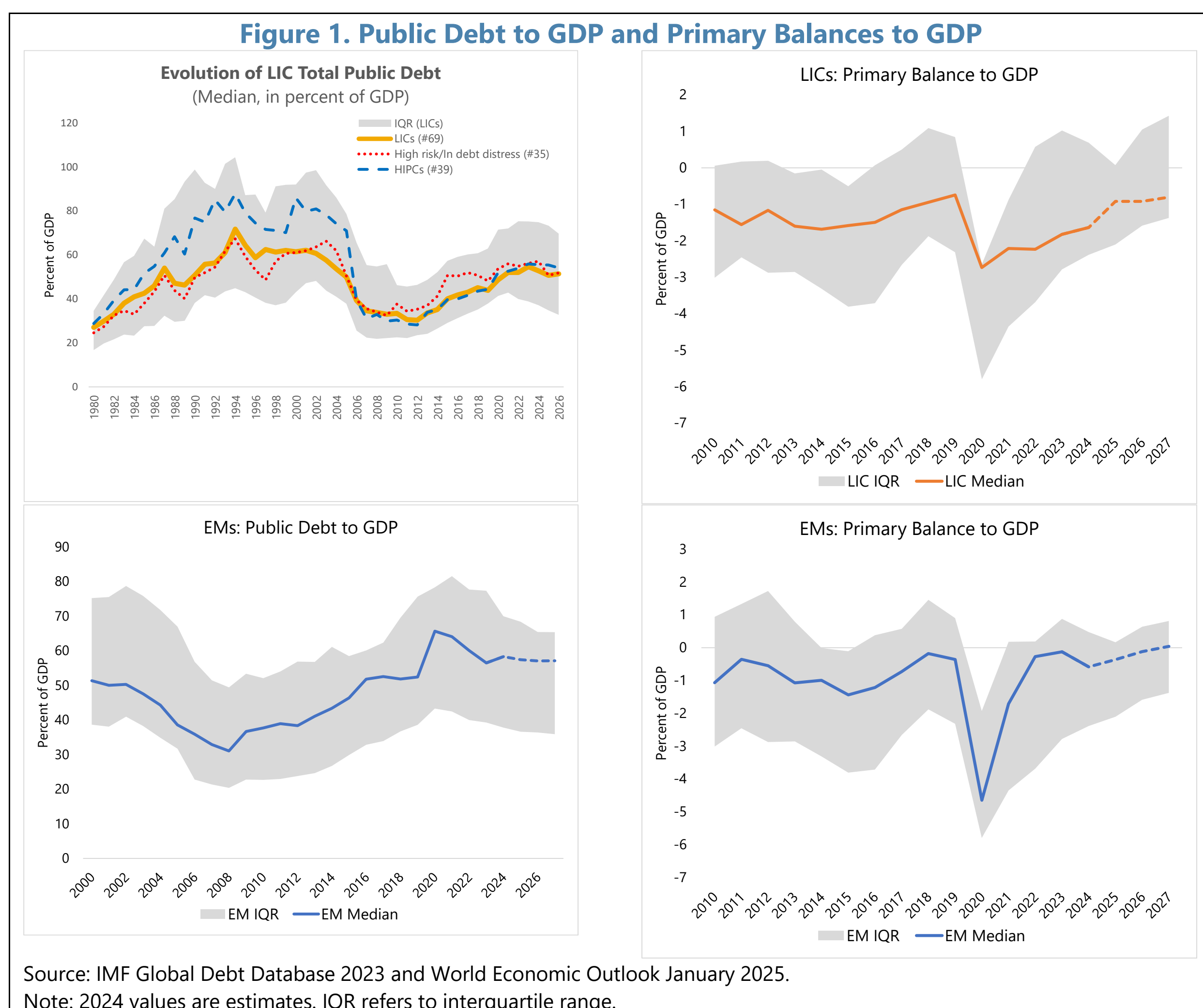
[1] Encompasses all countries which are not classified as high-income countries by the World Bank, excluding China and India due to their economic size and specific situations, plus all countries classified as Small Developing States by the IMF. Within this group, LICs refer to PRGT-eligible countries.

[2] The HIPC initiative was launched in 1996.

Figure 1. Public Debt to GDP and Primary Balances to GDP



Source: IMF Global Debt Database 2023 and World Economic Outlook January 2025.
Note: 2024 values are estimates. IQR refers to interquartile range.

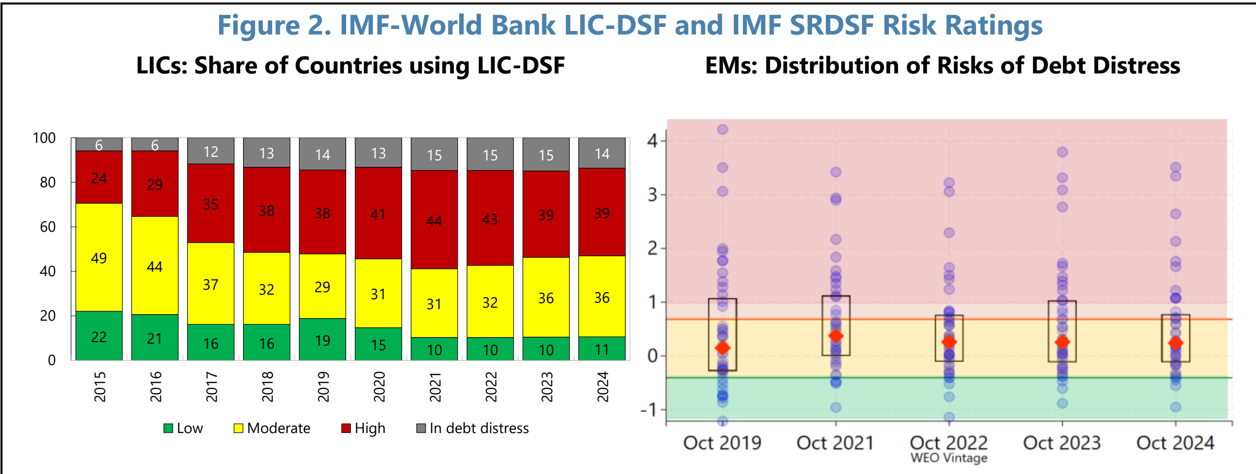
3. **Under baseline assumptions, the risk of a systemic debt crisis appears broadly contained.** The number of countries with unsustainable public debt, in debt distress based on DSA assessments, and/or are engaged in debt restructurings remains contained; out of 136 EMDE countries in this note's perimeter, only 12 LICs are in debt distress or have unsustainable public debt,[3] and 2 EMs are undergoing debt restructurings. Among LICs, while the share of countries assessed at high risk of external debt distress briefly increased at the onset of the pandemic, the situation has improved since 2021, with the share now seven percentage points lower (Figure 2). It is also important to note that a high-risk rating does not necessarily signal a risk of debt distress in the near term. Based on the latest LIC-DSAs through 2023, nearly 30 percent of high-risk ratings were driven predominantly by long-term breaches in solvency indicators (for which corrective adjustments could be made over a sufficient period of time before risks materialize) or the application of judgment to reflect longer-term considerations, rather than near-term breaches. Furthermore, the share of countries at low and moderate risk

[3] Based on LIC-DSF risk ratings available as of December 2024.

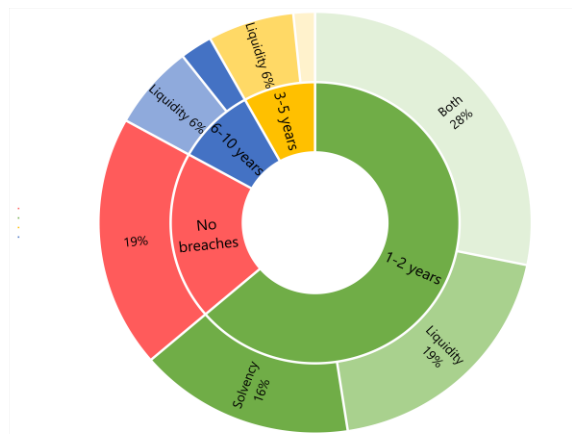
(whose debt is deemed sustainable with a high probability for IMF policies) has returned to pre-pandemic levels, another signal that risks of a systemic debt crisis is declining. Among EMs, medium-term debt distress risks remain stable, but some remain vulnerable with risks at the tail-end of the distribution (Figure 2).

4. However, there are important uncertainties around the baseline. While the risk of a broad-based debt crisis has diminished compared to the assessment at the time of COVID-19, there are significant risks to the baseline, including on global growth, international financial conditions, exchange rate movements, weaker than anticipated macro-structural policies, or the risk of a combination of -or successive- shocks. If these risks were to materialize, current financing challenges could evolve into a broad debt crisis. An additional caveat is that staff's assessment is based on available data such that debt data limitations could result in some underestimation of the scale of these challenges.

Figure 2. IMF-World Bank LIC-DSF and IMF SRDSF Risk Ratings



LIC-DSAs with High External Debt Risk Rating: Pattern of First-Time Breaches of Debt Indicators Thresholds over Time and by Time of Risk, 2018-23
(Share, in percent of total)

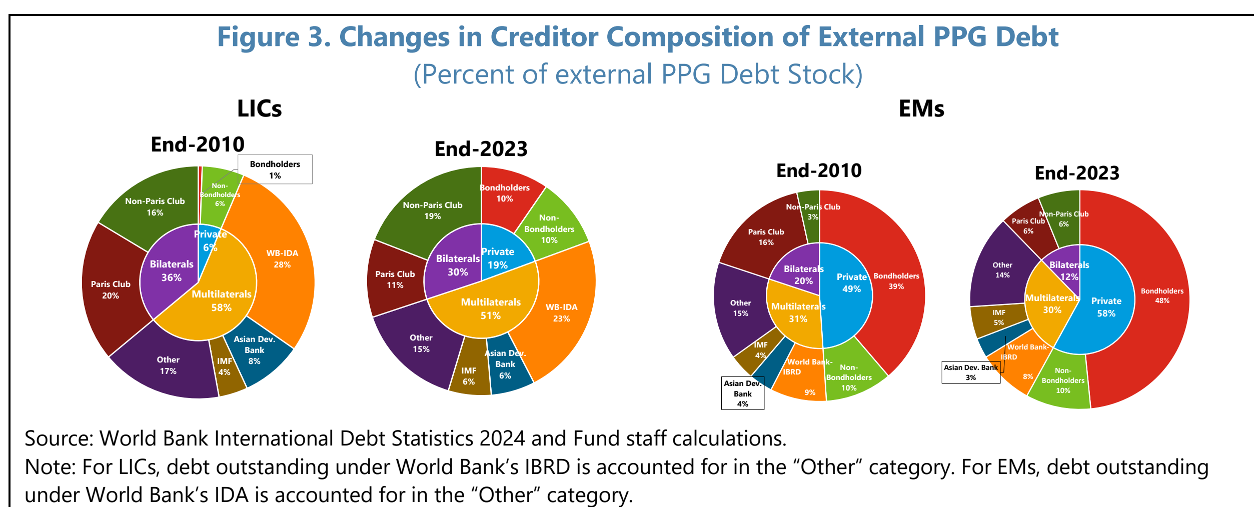


Sources: IMF-World Bank LIC-DSF database and IMF SRDSF database.
Note: For LICs (left chart), based on final external risk ratings. For EMs (right chart), risks based on SR DSF medium-term fan chart z-scores: Green area = Low risk (Crisis probability<9%, Missed crisis probability=10%); Yellow area = Moderate risks (Crisis probability>9%, <20%); Light Pink = High risk (Crisis probability>20%, =10%); Dark Pink area = Crisis probability > 40%.

The Nature of Debt Vulnerabilities Has Evolved Significantly Over the Last Decade

5. The composition of public external debt has changed significantly over the last two decades (Figure 3). Both private and non-Paris Club creditors increased their exposure, particularly in LICs**.** The shares of external public debt held by commercial creditors –including bondholders and other private creditors—and non-Paris Club official creditors almost doubled since 2010, from 22 percent to 38 percent at end-2023, with the share of Paris Club creditors declining significantly during the same period and a marginal decline in the share of multilateral creditors (Figure 3). For EMs, there has been a similar increase in private and non-Paris Club bilateral financing although from a higher starting point, with the share going from 52 to 64 percent over the same period. While the broader shift of the financing mix towards private creditors and non-Paris Club creditors has led to greater access to finance, it has also been accompanied by greater -and costlier- debt service burdens. Furthermore, the increased exposure to private creditors has been particularly pronounced for frontier markets, whose debt profile has evolved closer to that of EMs.

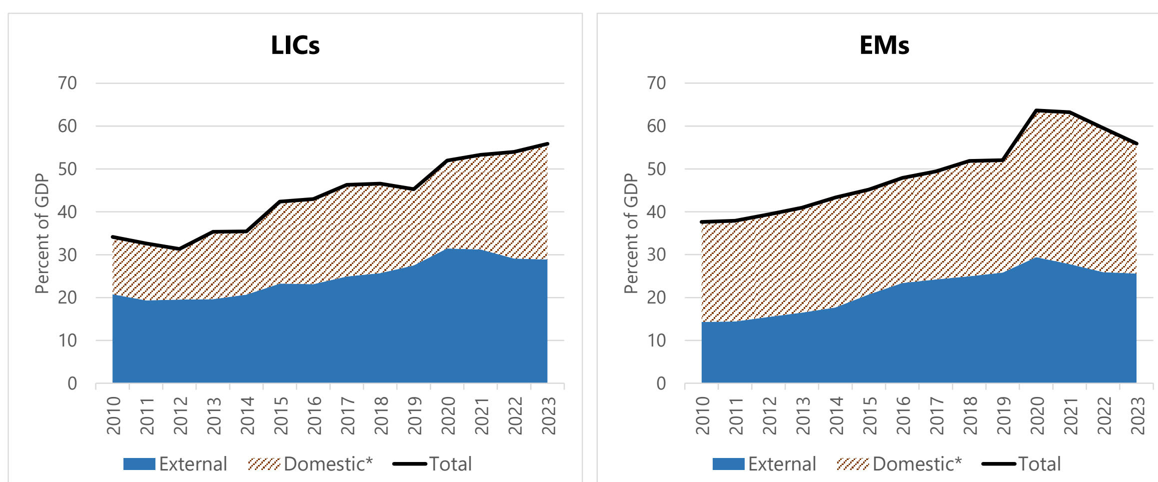
Figure 3. Changes in Creditor Composition of External PPG Debt
(Percent of external PPG Debt Stock)



Source: World Bank International Debt Statistics 2024 and Fund staff calculations.
Note: For LICs, debt outstanding under World Bank's IBRD is accounted for in the "Other" category. For EMs, debt outstanding under World Bank's IDA is accounted for in the "Other" category.

6. Reliance on domestic debt has also increased (Figure 4). Since 2010, the median LIC has increased its share of domestic public debt (proxied as total public debt less external public debt) by nearly 9 percentage points. After the onset of the pandemic, this trend accelerated given the unanticipated need for funding and limited access to international markets, with the share of domestic debt increasing by another 9 percentage points (or 6.5 percentage points of GDP) for the median LIC. For the median EM, access to deeper domestic financial systems proved an important source of financing at the onset of the pandemic in 2020, when domestic public debt increased by 8 percentage points of GDP, compared to a 3.6 percentage points of GDP increase in external public debt.

Figure 4. Composition of Public and Publicly Guaranteed Debt



Source: IMF World Economic Outlook October 2024 and January 2025, World Bank International Debt Statistics 2024, and Fund staff calculations.

Notes: Domestic* debt proxied as the difference between total and external public debt. Sample includes EMDE countries for which data is available for both total and external public debt.

7. New debt instruments have also been increasingly used by LICs, which tend to be riskier and harder to restructure.[4] Guaranteed, securitized, and collateralized debt contracts linked to public-private partnerships (PPPs), state-owned enterprises (SOEs), and pension funds/social security funds, among others, have gained broader usage among LICs in recent years. Total investments in PPPs in LICs rose about 17-fold from US$0.3 billion in 1994 to US$5.9 billion in 2021, while the number of PPP projects within the same period more than doubled from 11 to 26, most of which involve sovereign guarantees. These instruments do not reflect immediately in the debt burden indicators; however, they could give rise to a sudden increase in debt vulnerabilities at a time when public guarantees or collaterals are called.

CHALLENGES AHEAD

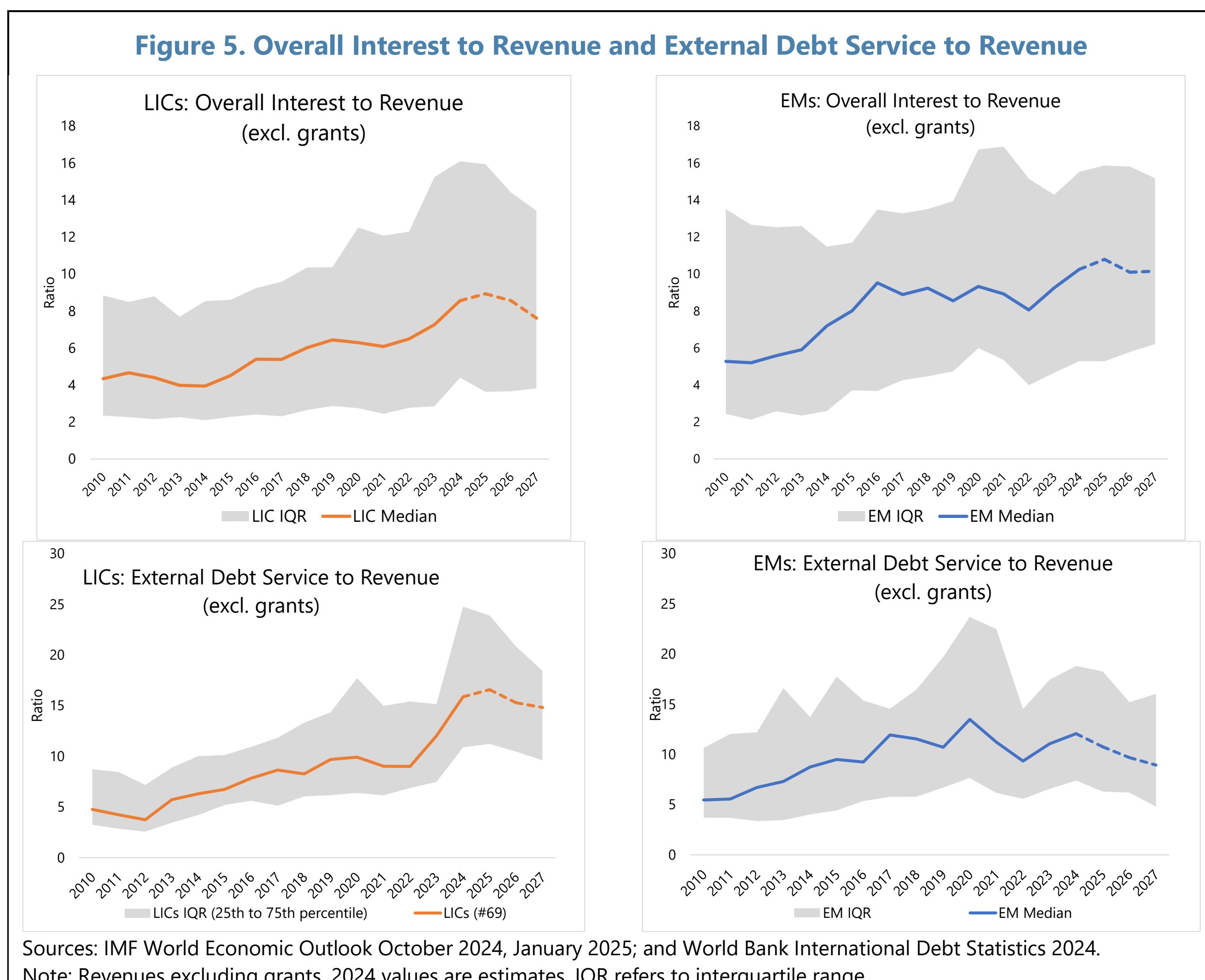
Debt Challenges Look to Remain Difficult Amid Elevated Debt Service Obligations, Growing Financing Needs and Declining Net Flows

8. Fiscal space has tightened amidst high interest costs and growing external debt service burdens (Figure 5). Countries' efforts to rebuild fiscal sustainability have led to a crowding out of critical growth-enhancing development spending and social priorities as an increasing share of revenues has had to be allocated to interest expenditures. Interest payments on total public debt (external and domestic) have increased significantly, particularly for LICs, where interest bills have increased by over two and a half times compared to a decade ago, from around $13 billion in 2014 to US$35 billion. The pace of increase has been more rapid since 2021, averaging about US$3 billion more per year, compared to US$1 billion more per year over 2014-16, and over US$2 billion per year

[4] See IMF WP/23/79.

over 2017-20. At the same time, LICs' external debt service (interest and principal) pressures have also intensified, rising by about two and a half times as much as a share of revenues (excluding grants) than a decade ago for the median LIC, from 6 to 16 percent between 2014 and 2024. While external debt service for EMs has generally eased in recent years (Figure 5), the median EM still spends over 12 percent of revenues (excluding grants) on servicing external debt (almost twice as high as a decade ago).

Figure 5. Overall Interest to Revenue and External Debt Service to Revenue



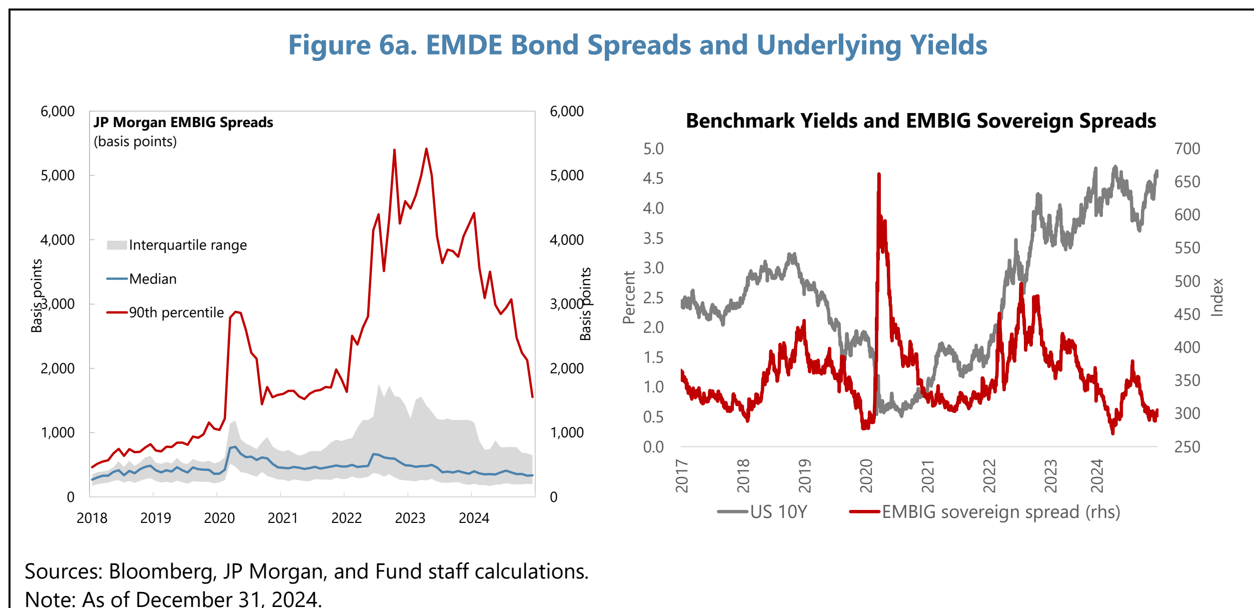
Sources: IMF World Economic Outlook October 2024, January 2025; and World Bank International Debt Statistics 2024.
Note: Revenues excluding grants. 2024 values are estimates. IQR refers to interquartile range.

9. Despite some easing in financing conditions, funding costs remain high. Global financial conditions began to tighten in 2022 as advanced economy central banks tightened monetary policy and EMDE bond spreads rose (Figure 6a). This implied a sharp rise in interest rates on new official and private external commitments for most EMDEs (Figure 6b). By 2024, spreads had generally declined to pre-pandemic levels for most countries,[5] which, coupled with some easing of monetary policy in advanced economies, facilitated a return by some LICs to international capital markets.

[5] In parallel, the share of countries trading at distressed levels (>1000 bps) declined significantly with several countries making progress resolving their debt restructuring (e.g., Ghana, Sri Lanka, Ukraine, Zambia), though some pockets of vulnerability remain, and a number of countries still trade at stressed levels (>700 bps).

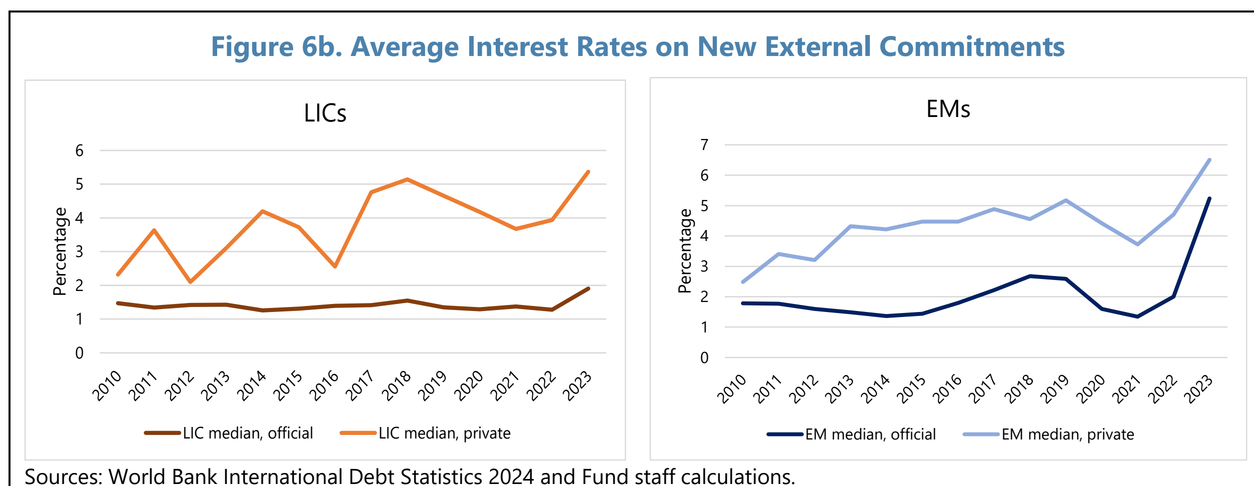
Nevertheless, funding costs remain well above pre-pandemic levels (Figure 6a), so interest burdens rates are likely to continue rising as debt contracted pre-pandemic needs to be refinanced.

Figure 6a. EMDE Bond Spreads and Underlying Yields



Sources: Bloomberg, JP Morgan, and Fund staff calculations.
Note: As of December 31, 2024.

Figure 6b. Average Interest Rates on New External Commitments



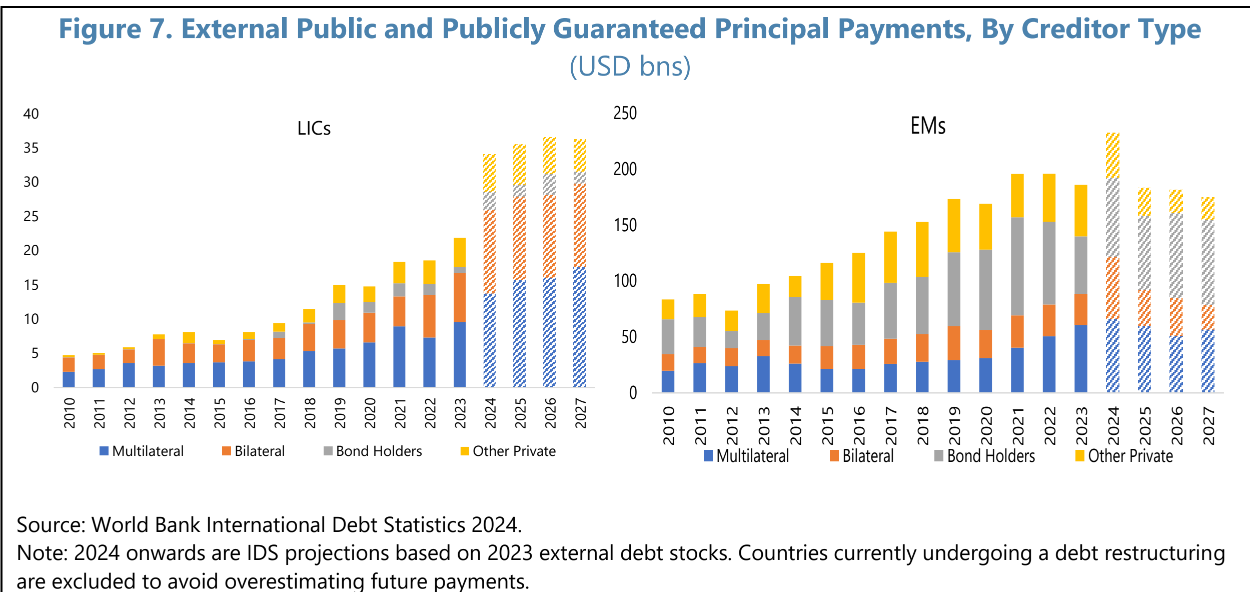
Sources: World Bank International Debt Statistics 2024 and Fund staff calculations.

10. Meeting refinancing needs in the coming years will be challenging, with external principal payments set to increase significantly (Figure 6). External principal payments exceeded US$20bn in LICs in 2023, more than three times higher than a decade ago. More than three-quarters of these payments were due to official creditors, with most of the remainder due to commercial lenders, reflecting the shift in creditor composition over the last decade. Looking ahead, LICs' external refinancing needs are set to exceed US$30 billion per year over 2025-27 based on existing stocks.[6] Among EMs, the pace of increase in external principal payments has been less rapid,

[6] Due to data constraints, this is based on debt contracted as of end-2023; it does not capture the impact of new financing raised in 2024. External refinancing needs estimate exclude countries currently undergoing a debt restructuring to avoid overestimating future payments.

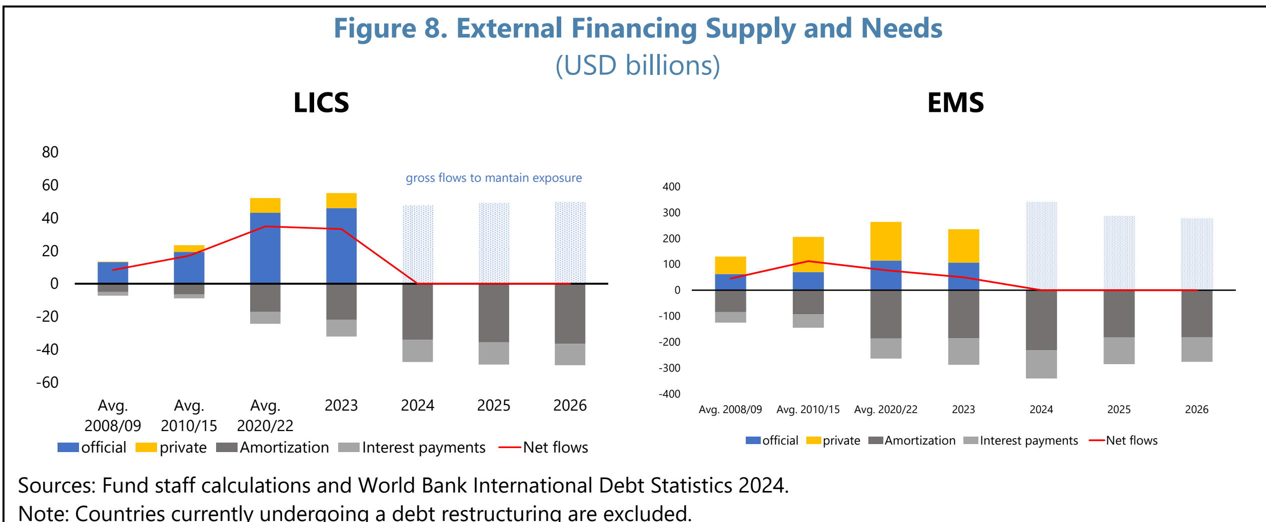
reaching USD$185bn in 2023. In the next few years, average annual gross flows of about US$350 billion per year to EMDEs will be needed just to maintain exposure to these countries (Figure 8). While this amount is broadly in line with flows observed during the COVID-19 crisis, these are notably above gross flows observed in the past, especially for LICs. And this does not take into account the net new financing that is needed to finance primary deficits.

Figure 7. External Public and Publicly Guaranteed Principal Payments, By Creditor Type
(USD bns)



Source: World Bank International Debt Statistics 2024.
Note: 2024 onwards are IDS projections based on 2023 external debt stocks. Countries currently undergoing a debt restructuring are excluded to avoid overestimating future payments.

Figure 8. External Financing Supply and Needs
(USD billions)

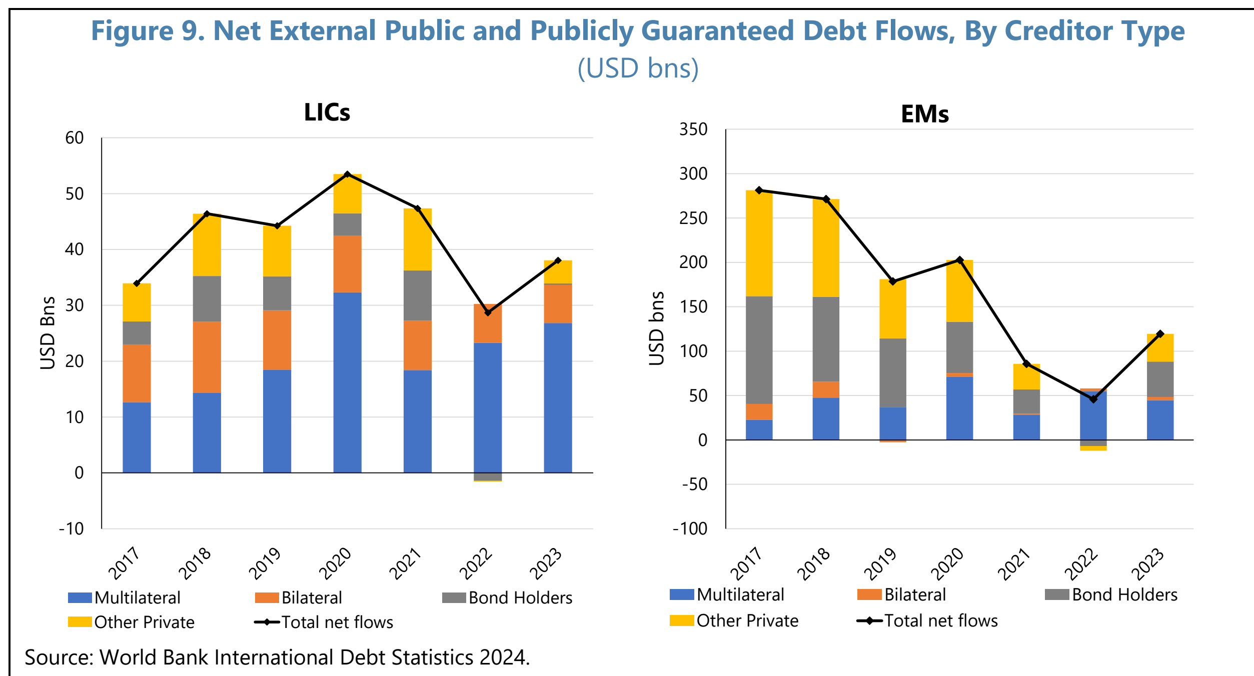


Sources: Fund staff calculations and World Bank International Debt Statistics 2024.
Note: Countries currently undergoing a debt restructuring are excluded.

11. Financing challenges are further aggravated by the sharp decline in net flows, limiting scope to meet the substantial investments needs to advance towards the Sustainable Development Goals (SDGs) and adapt to climate change (Figure 9). Net external PPG debt flows to LICs have stagnated in recent years (and even declined in 2021-22), as larger contributions from multilateral creditors failed to fully offset declines from private and bilateral creditors. Net external flows to EMs have also fallen as private flows scaled back and the smaller volumes of bilateral official support diminished. Competing demands for financing, including from advanced economies that

have also important financing needs, increases the risk of EMDEs failing to raise sufficient financing at an affordable cost, a situation that is further complicated by the important uncertainty and risks around the evolution of international financial conditions and exchange rate movements in 2025 and beyond.

Figure 9. Net External Public and Publicly Guaranteed Debt Flows, By Creditor Type
(USD bns)



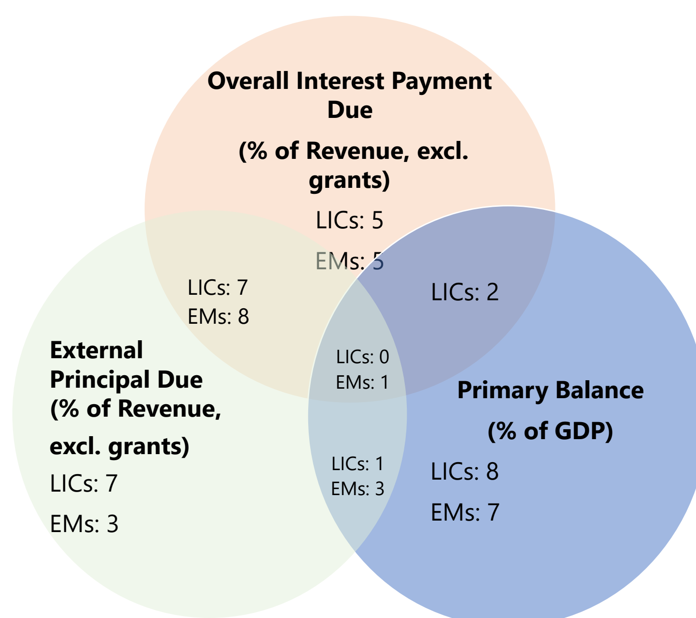
Source: World Bank International Debt Statistics 2024.

EMDEs Face Important Financing Challenges but the Type and Source Vary Across Countries

12. Focusing on countries with the largest interest burdens, principal repayments, and primary deficits helps identify key sources of financing challenges. This provides insight into drivers of debt vulnerabilities, including *cost* of financing, high *rollover risks*, and high *financing needs*. Figure 10 presents the countries in the top quartile of each of these key components over 2024-27—overall interest costs, external principal repayments, and primary deficits—relative to countries' revenues and GDP.[7] To sharpen this insight with a view to where to focus in order to *preempt* higher risks of debt distress, countries that are already in distress (countries currently undergoing or negotiating debt restructurings or countries with unsustainable debt as identified under the LIC-DSF or the SRDSF) are excluded from this analysis.

[7] Projections based on IMF World Economic Outlook October 2024, and World Bank International Debt Statistics 2024. To avoid skewing the distribution, countries with particularly high vulnerabilities are controlled for when establishing quartile cut-offs.

Figure 10. Countries with the Highest Relative Financing Challenges, 2024-27



Sources: IMF World Economic Outlook October 2024, World Bank International Debt Statistics 2024; and Fund staff calculations.
Note: Numbers refer to the number of LICs and EMs respectively failing in each category.

13. While the sources of financing challenges vary across countries, most countries face challenges around the volume of refinancing needs and costs of financing.

- ***Volume.*** These are countries with high external principal payments relative to their revenues (excluding grants) but without high overall interest burdens, reflecting greater pressures stemming for refinancing needs. Countries in this category are mostly smaller economies, consisting of eight LICs and six EMs that represent about 12 percent (USD$15 billion) of external principal payments coming due over 2024-27 among LICs and USD$27 billion among EMs).

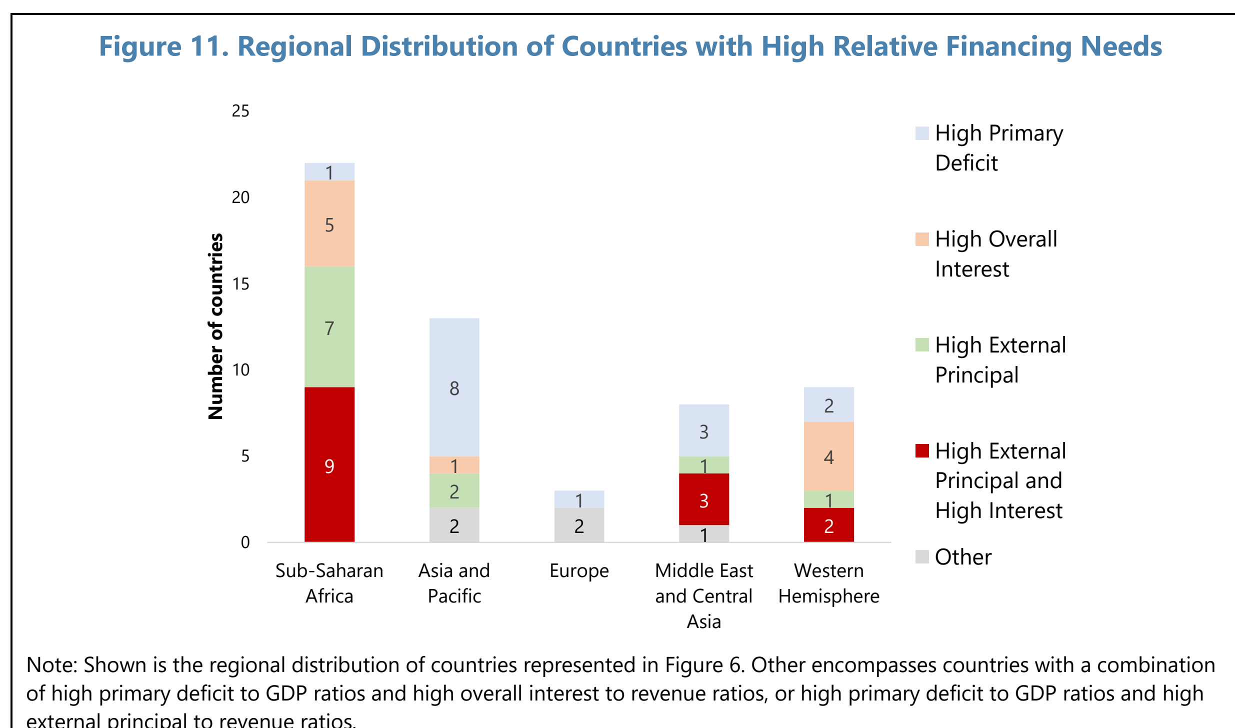
- ***Cost.*** Countries with high overall (domestic and external) interest burdens but without high external amortizations relative to revenues (excluding grants) in the near-term are mostly those with low revenue capacity and high domestic debt burdens with high average interest rates. External debt tends to be relatively low in these countries; but high reliance on domestic debt presents greater macro-financial risks through the sovereign-bank nexus and often leads to relatively higher overall debt service costs. A total of seven LICs and five EMs fall in this category.

- ***Volume and cost.*** These are countries most in need of accessing financing and at more affordable costs, consisting of seven LICs and nine EMs They have both high external principal and overall (domestic and external) interest payments relative to revenues (excluding grants). This group represents a combined 16 percent (USD$435 billion) of overall (external and

domestic) interest payments over 2024-27, and 25 percent (US$221 billion) of external principal payments. Most of these countries do not have especially large debt stocks but are constrained by combinations of low revenue generating capacity, high interest rates, and declining net flows. These constraints have forced these countries to tighten their fiscal positions by more than in other countries.

14. A large share of countries facing significant financing challenges are in Sub-Saharan Africa. Twenty-two Sub Saharan African countries are among the group of countries with the highest total interest to revenues, external principal to revenues, or both, and they account for 44 percent of total interest payments across LICs over 2024-27 and just 2 percent across EMs, respectively, and 46 percent total external principal payments across LICs and 7 percent across EMs, respectively. Latin American countries tend to have a higher relative concentration of countries with high overall interest burdens relative to revenues, with some smaller countries facing high external principal payments. Many Middle East and Central Asia countries, face high debt vulnerabilities. In Asia and the Pacific, many small island states account for a large share of countries with large primary deficits, while some others run high deficits alongside high domestic interest expenditures (Figure 11).

Figure 11. Regional Distribution of Countries with High Relative Financing Needs



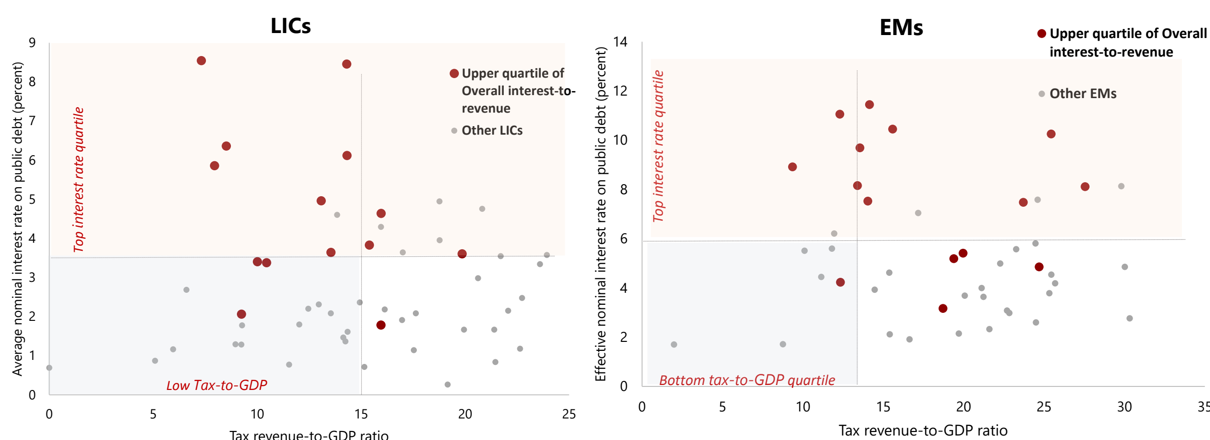
Note: Shown is the regional distribution of countries represented in Figure 6. Other encompasses countries with a combination of high primary deficit to GDP ratios and high overall interest to revenue ratios, or high primary deficit to GDP ratios and high external principal to revenue ratios.

High Borrowing Costs Are Driving Interest Burdens

15. Countries with the highest overall interest-to-revenue ratios tend to have the highest average interest rate costs, with many also among those with lowest domestic revenue capacity. Some are driven by high rates on domestic debt, reaching up to 17 percent in some cases, and others with relatively high average rates on external debt for LICs (around 3-4 percent)

compared to LICs where a larger share of external financing is concessional. At the same time, many of these countries also rank among the bottom quartile of tax-to-GDP ratios in LICs (well below 15 percent of GDP), thus facing challenges from relatively high cost of financing and low domestic revenue mobilization. Among EMs, some have high overall interest to revenue ratios on top of a large revenue base relative to GDP and include some large countries with deep financial markets, mitigating acute financing vulnerabilities but placing pressure on national budgets. Other EMs are more vulnerable to high interest burdens through both high costs of financing and low revenue capacity (Figure 12).

Figure 12. Average and Effective Interest Rates on Public Debt vs. Tax Revenue to GDP for Countries with High Overall Interest to Revenue Ratios

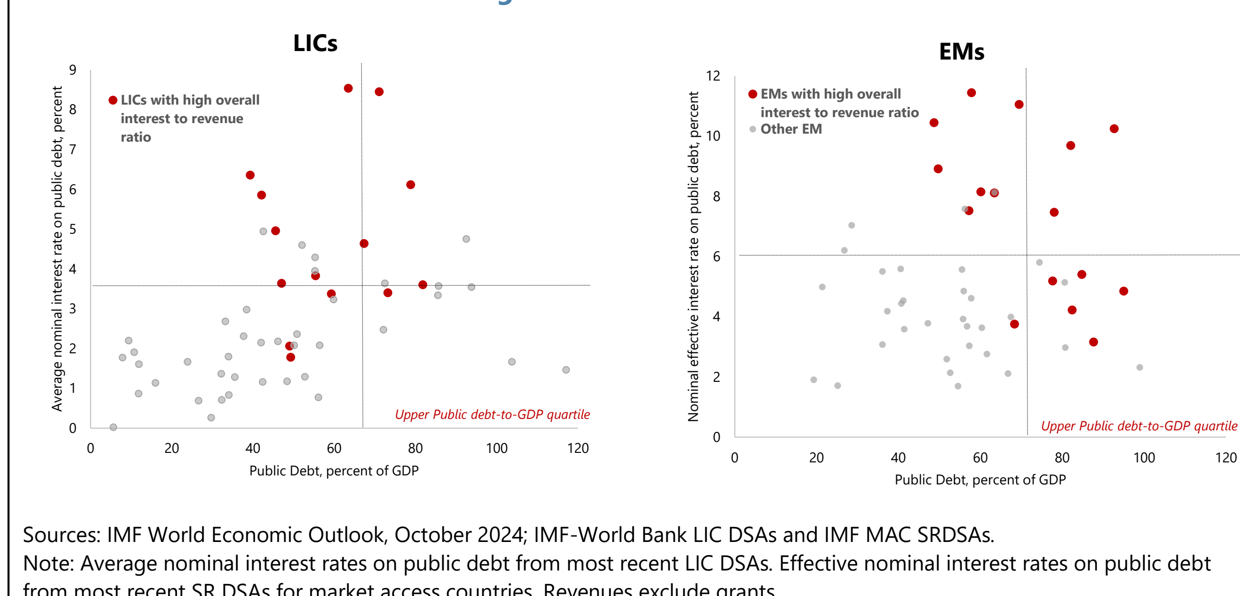


Sources: IMF World Economic Outlook October 2024, IMF-World Bank LIC DSAs, and IMF MAC SRDSAs.
Note: Average nominal interest rates on public debt from most recent LIC DSAs. Effective nominal interest rates on public debt from most recent SR DSAs for market access countries.

16. Some countries with the highest interest burdens also have relatively high overall public debt levels. As high average interest rates drive high interest burdens for the majority of LICs in this group, there are a handful who are also characterized as having relatively high stocks of overall public debt (external and domestic). Only four countries are among those with public debt to GDP ratios clearly in the upper quartile of LICs. For some LICs, domestic debt is twice as high as their external debt, reaching 40 percent of GDP in some cases, with the cost of domestic debt 2 to 3.5 times higher than on external debt. Among EMs, there is a larger occurrence of countries with the highest interest burdens that also have relatively high public debt, though many have relatively large revenue bases and deeper financial markets (in contrast, nearly all LICs with relatively high public debt have low revenue generating capacity with tax-to-GDP ratios around or below 15 percent).[8] Overall, only three EMs with high interest burdens have high debt levels and low revenue generating capacity.

[8] A 15 percent tax-to-GDP ratio is a minimum level typically associated with a significant acceleration in the process of growth and development.

Figure 13. Average Interest Rates on Public Debt vs. Public Debt-to-GDP
Countries with High Overall Interest to Revenue Ratios



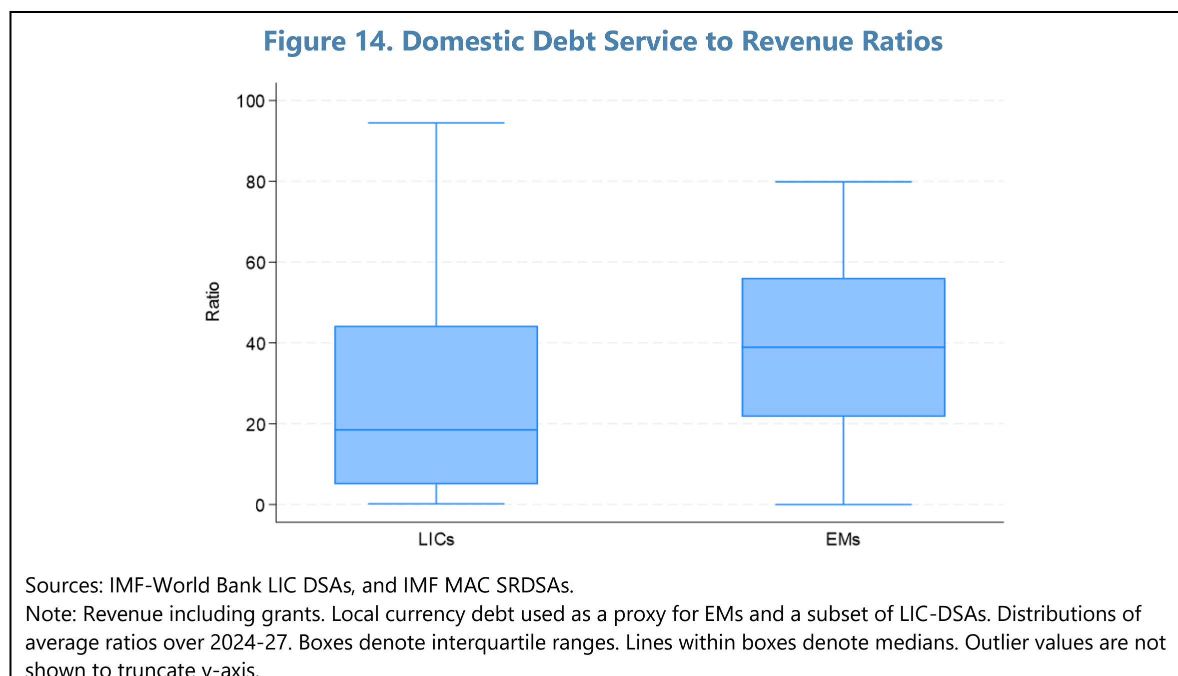
Sources: IMF World Economic Outlook, October 2024; IMF-World Bank LIC DSAs and IMF MAC SRDSAs.
Note: Average nominal interest rates on public debt from most recent LIC DSAs. Effective nominal interest rates on public debt from most recent SR DSAs for market access countries. Revenues exclude grants.

Domestic Debt Service Has Also Driven Financing Pressures

17. While domestic debt tends to be higher in EMs with deeper financial systems, some LICs' domestic debt service burdens exceed those of most EMs.[9] The median EM domestic debt service (interest and principal) to revenue ratio is about twice as high as the median LIC, which tends to have lower levels of domestic financial development and higher domestic financing costs. For some LICs, however, domestic debt service is considerably higher than the majority of EMs, reaching nearly 100 percent of revenues (including grants) in some cases. (Figure 14). Since the pandemic, diminished access to external and concessional financing pushed many LICs to more expensive domestic financing, which was especially costly for some countries and has heightened the sovereign-bank nexus, placed significant pressure on social spending, and in some cases resulted in notable domestic payments arrears accumulation.

[9] Overall, EMs, tend to carry higher debt to GDP ratios given deeper domestic financial systems.

Figure 14. Domestic Debt Service to Revenue Ratios

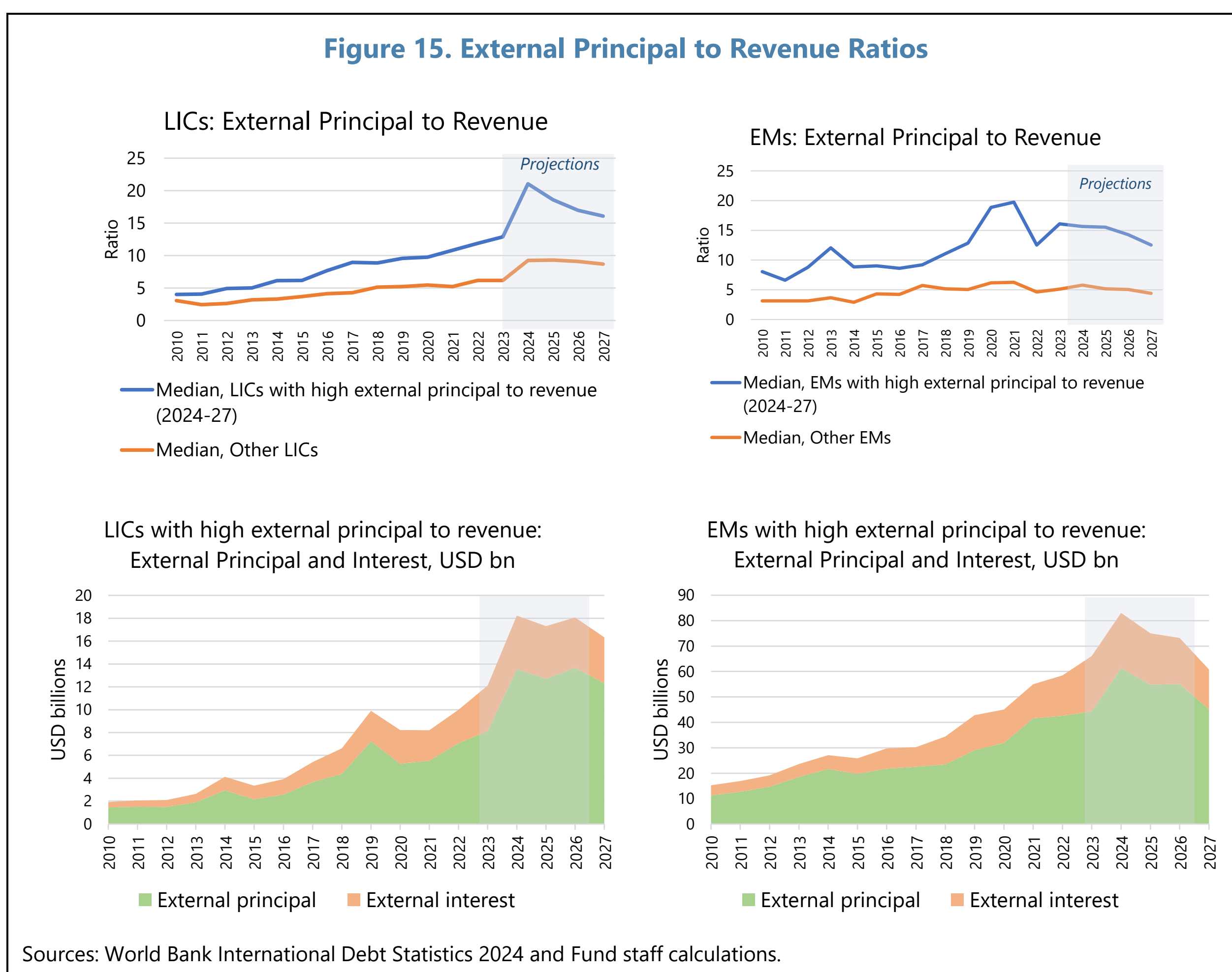


Sources: IMF-World Bank LIC DSAs, and IMF MAC SRDSAs.
Note: Revenue including grants. Local currency debt used as a proxy for EMs and a subset of LIC-DSAs. Distributions of average ratios over 2024-27. Boxes denote interquartile ranges. Lines within boxes denote medians. Outlier values are not shown to truncate y-axis.

Rollover Pressures Have Built-Up Significantly Over Recent Years

18. External principal payment burdens have grown significantly faster for some countries over the last decade, particularly among LICs (Figure 15). The median LIC with high external principal payments (relative to revenues) coming due over 2024-27 has already seen its principal payments to revenue ratio more than double since 2010 to about 13 percent in 2023; and this is set to further increase by about 5 percentage points on average over 2024-27 on average. This is a significantly faster build-up in external amortizations than the median among other LICs whose ratio of external amortization to revenues doubled between 2010 and 2023, and which is expected to rise by almost a further 3 percentage points over 2024-27. Among EMs, the rate of increase in external principal payments has not been as divergent between those with the highest refinancing burdens and other EMs, with the ratio to revenue for the median in both groups increasing by more than 1.5 times since 2010. A notable acceleration occurred for the more vulnerable EM group in the pre-pandemic period before falling again, potentially explained by currency appreciation relative to the dollar as EMs tightened monetary policy sooner than advanced economies.

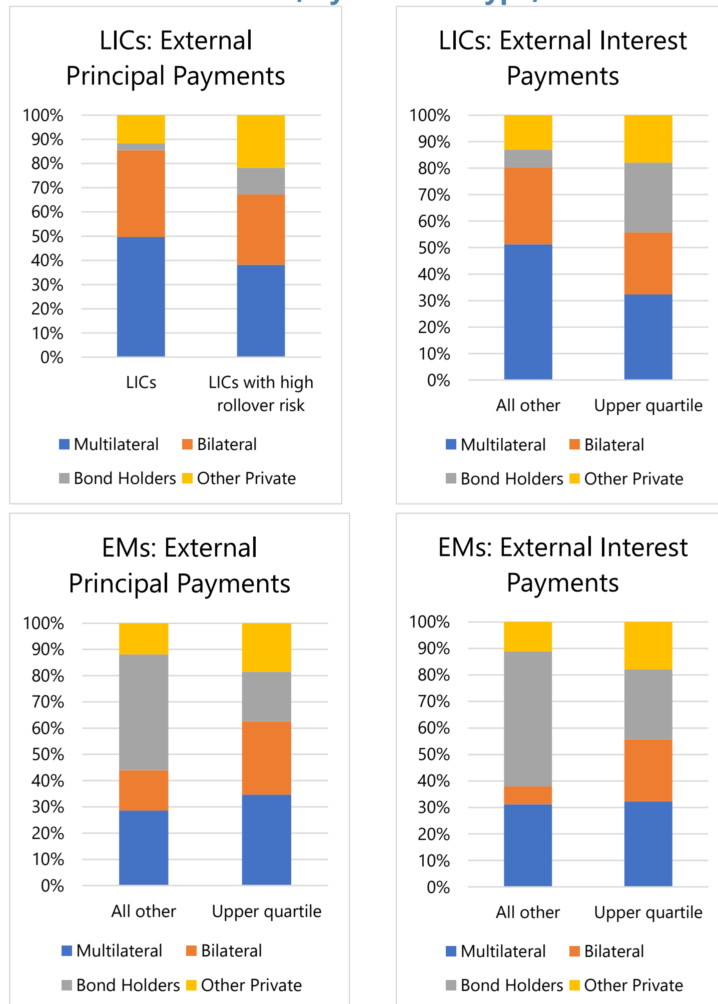
Figure 15. External Principal to Revenue Ratios



Sources: World Bank International Debt Statistics 2024 and Fund staff calculations.

19. LICs with the highest external principal repayment burdens owe most of these payments to private creditors; while for EMs, most of these payments are due to bilateral official creditors. LICs with the highest external debt service relative to revenues owe about one third of their principal payments over 2024-27 to private creditors, compared to 15 percent for all other LICs (Figure 16). At the same time, they owe close to half of their external interest payments to private creditors (compared to about 20 percent in other LICs), highlighting the significant cost of external private financing among this group of LICs. On the other hand, EMs with the highest external debt service to revenue owe over half of both their principal and interest to official creditors, compared to about 40 percent for median EMs. In particular, nearly 30 percent of their principal payments are due to bilateral official creditors, compared to 15 percent for other EMs. However, this situation is very concentrated: a handful of EMs account for most of the volumes.

Figure 16. Shares of External Principal and Interest Payments on PPG Debt, by Creditor Type, 2024-27



Sources: World Bank International Debt Statistics 2024 and Fund staff calculations.

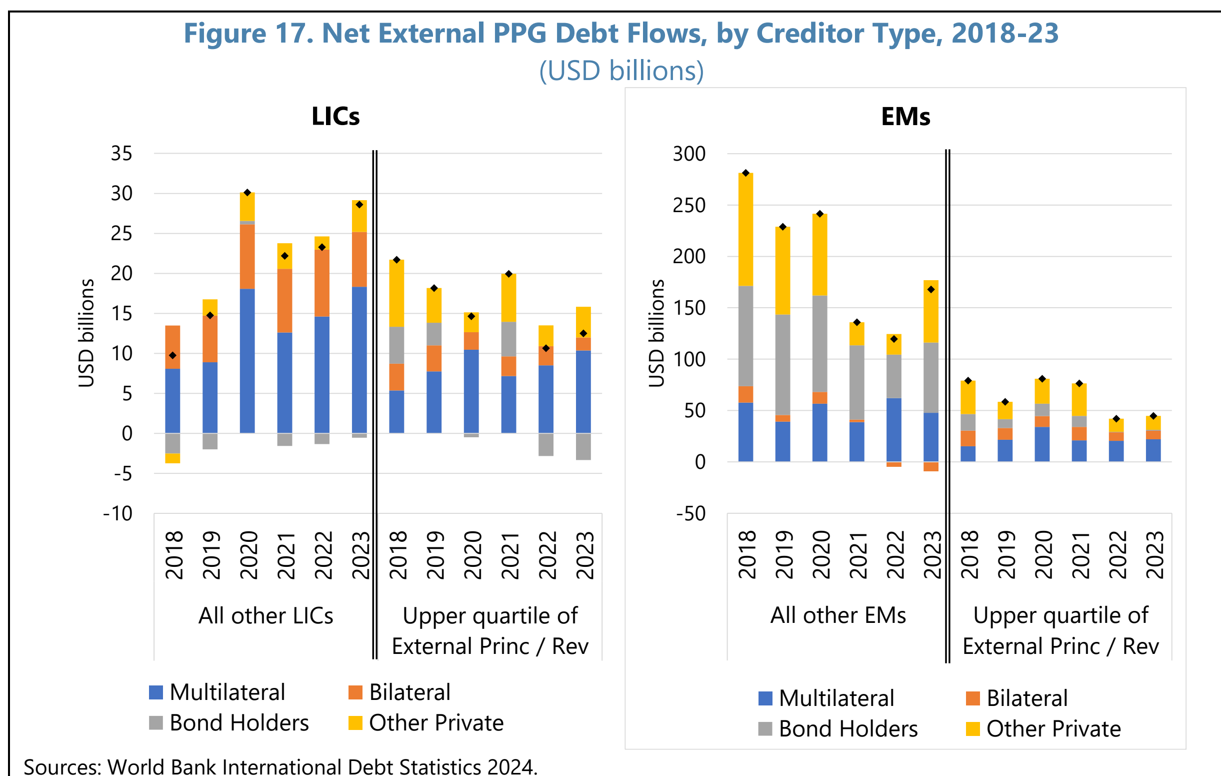
A Decline in Net Flows Aggravates Rollover Risks

20. Countries facing high external amortization pressures have seen a decline in external net flows, particularly among EMs (Figure 17). As noted above, LICs with high external principal payments relative to revenues have relied more on private external financing than other LICs. Over 2018-23, net flows from private commercial creditors to this set of LICs exceeded that of all other LICs, at around USD$28 billion compared to USD$13 billion, respectively.[10] In recent years, private net flows, for this group has declined, partly offset by an increase in net flows from multilateral creditors. Meanwhile, net flows from bilateral official creditors have also declined for this group and is generally relatively lower than for other LICs. Among EMs with high external principal to revenue ratios, total net flows have declined by about 40 percent since 2021, largely driven by private

[10] In line with this, these LICs have accessed more private bond financing over this period than other LICs.

creditors. During this period, official creditors account for nearly 60 percent of net positive flows to these EMs, compared to around 35 percent of net flows to other EMs.

Figure 17. Net External PPG Debt Flows, by Creditor Type, 2018-23
(USD billions)

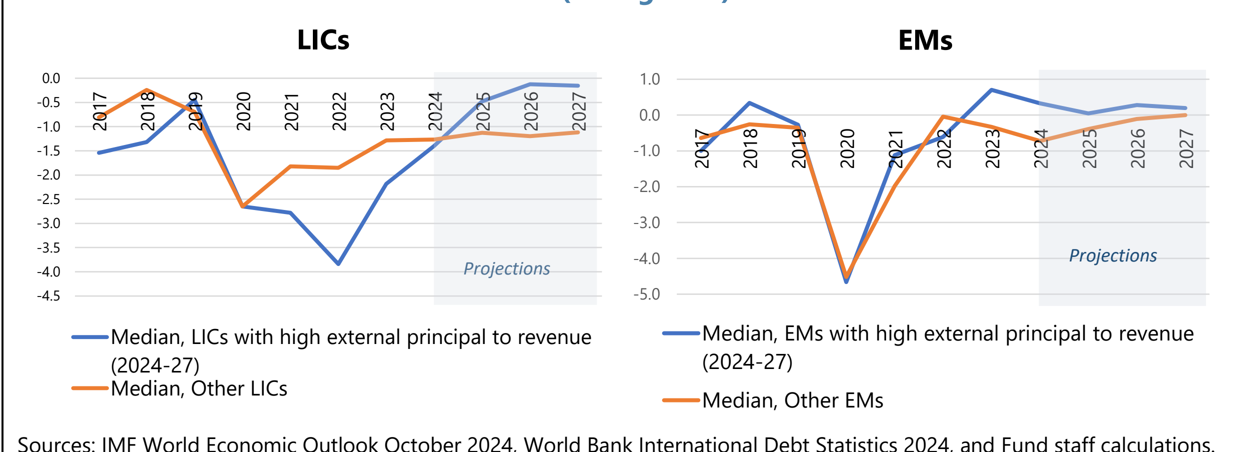


Sources: World Bank International Debt Statistics 2024.

To Mitigate Risks from Large External Amortizations, EMDEs Have Tightened Their Fiscal Stance

21. Countries with the highest principal payment burdens have been tightening their fiscal positions to anchor debt levels and manage financing needs, particularly among LICs. Compared to other LICs, those with high external principal payments relative to revenues (excl. grants) have undergone larger fiscal consolidations in recent years (Figure 18). Still, as of 2024 estimates, the primary deficit to GDP ratio for the median LIC in this group remains larger than its pre-pandemic level, with some variation. Many of these countries are still undergoing consolidations, with primary balances projected to reach near balance in coming years. Among EMs, those with high external principal payments relative to revenues (excl. grants) have adjusted their post-COVID fiscal positions at a faster rate than other EMs, with the median country reaching a primary surplus by 2023.

Figure 18. Primary Balance to GDP Ratios in Countries with High External Principal to Revenue (excl. grants) Ratios

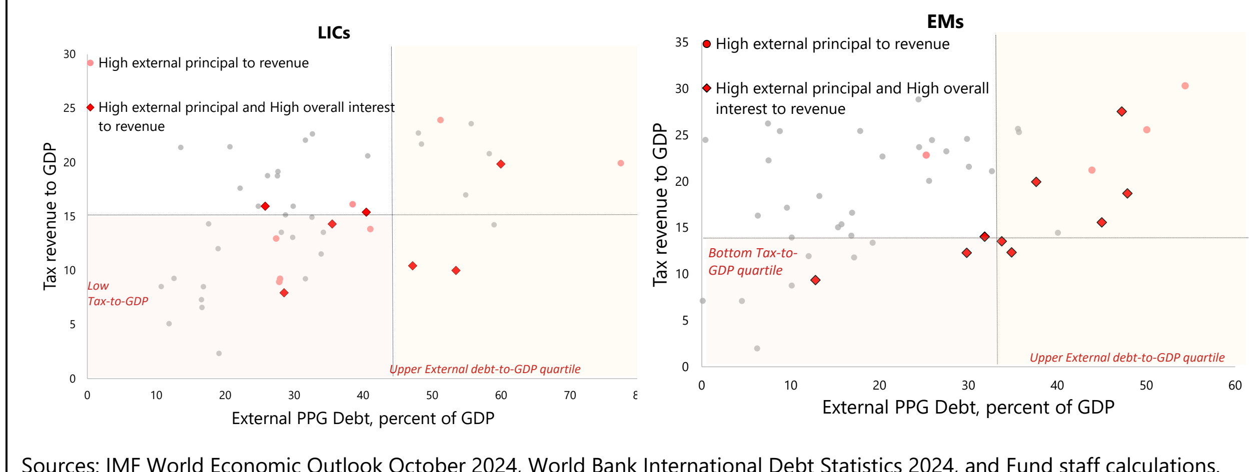


Sources: IMF World Economic Outlook October 2024, World Bank International Debt Statistics 2024, and Fund staff calculations.

A Handful of Countries are Facing Heightened Debt Service Pressures

22. High cost of financing and revenue challenges are exacerbating pressures for some countries with large rollover needs. Countries that rank among the highest in both external principal payments and overall interest payments relative to their revenues (excluding grants) face a combination of pressures from their refinancing needs and high average costs of financing (Figure 6). However, external debt levels are not relatively high for many, falling below the upper quartiles of LICs and EMs, respectively, and fiscal adjustments have narrowed primary deficits to their pre-pandemic levels. Low revenue generating capacity is a challenge particularly among LICs in this group. Among LICs, about 40 percent of high external principal to revenue countries have high overall interest-to-revenue ratios, tax-to-GDP ratios below 15 percent, and do not have relatively high external debt levels. These countries account for about one fifth of total LIC external principal payments and nearly one quarter of total overall interest payments. Among EMs, there is a higher tendency for countries with high external amortization burdens to have high external debt levels, yet on top of relatively high revenue bases and financing capacity. However, about one third of EMs who have both high external amortization and have high overall interest burdens also face low tax revenue generating capacity (Figure 19).

Figure 19. Countries with High External Principal and High Overall Interest to Revenue (excl. grants) Ratios: Tax Revenues and External PPG Debt

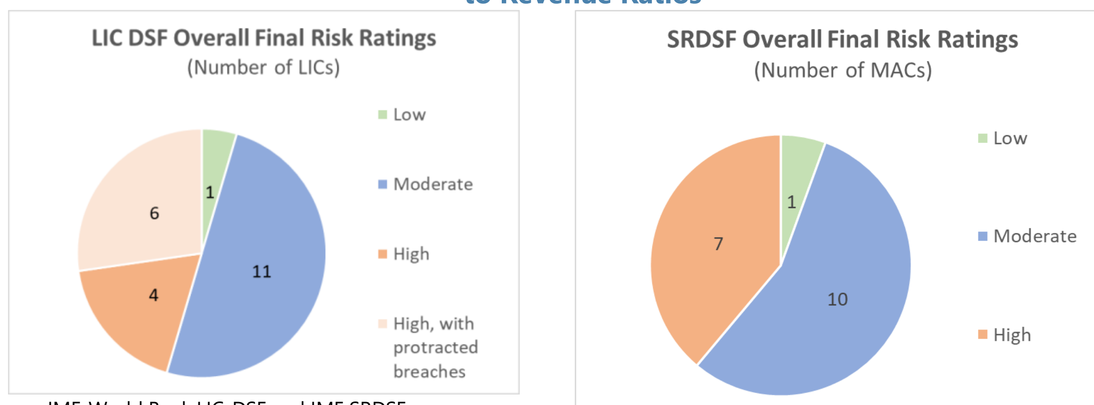


Sources: IMF World Economic Outlook October 2024, World Bank International Debt Statistics 2024, and Fund staff calculations.

THE ROAD AHEAD

23. While most countries with heightened debt vulnerabilities have so far navigated these challenges, pressures are building. The majority of countries with the largest financing needs are assessed as having moderate risks of debt distress (based on either LIC-DSF or SRDSF recent assessments) (Figure 20). Among low-income countries with the relatively highest debt service burdens, nearly 60 percent (12 countries) are assessed as having low or moderate risk of overall debt distress (1 is low risk) and 20 percent (4 countries) are high risk but without protracted or near-term breaches of debt burden indicators, indicating their debt service burdens remain contained. Among EMs with the highest debt service burdens, over half (10 out of 18) are assessed at overall moderate risk of sovereign stress, while 7 countries are assessed at high-risk with varying degrees of liquidity and solvency risks. Overall, countries have been able to manage debt vulnerabilities so far, but often at the expense of large fiscal adjustments and resorting to more expensive sources of financing.

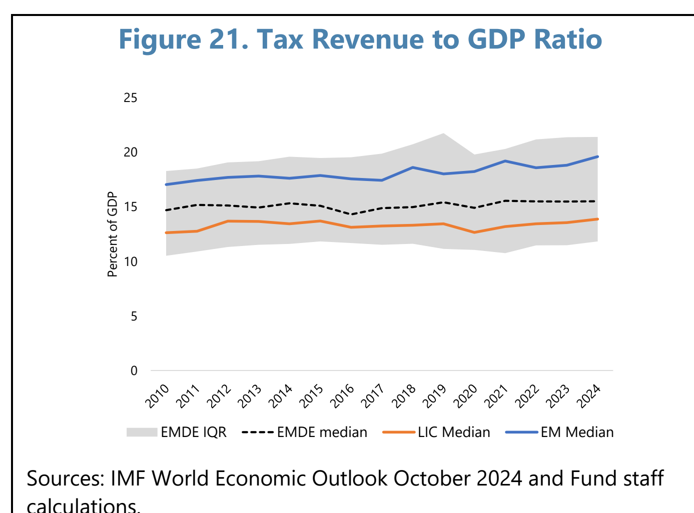
Figure 20. DSA Risk Ratings of Countries with High External Principal or High Overall Interest to Revenue Ratios



Sources: IMF-World Bank LIC-DSF and IMF SRDSF.
Note: Based on latest DSAs. High-risk LICs with protracted breaches are those in which the duration of threshold breaches for external debt burden indicators last five years or more and the first year of the breach starts within the first three years of the projection period.

24. There remains scope for countries to do more themselves to create more fiscal space. Many countries still have significant untapped potential to increase domestic resources to help address debt challenges from within. Just over half of the 136 EMDEs (or 69 countries) have tax-to-GDP ratios below 15 percent. Around 60 percent of these are LICs (41 countries), and the rest are EMs (28 countries), highlighting the widespread nature of this structural weakness (Figure 21). As highlighted above, among countries with low tax-to-GDP ratios, nearly 40 percent (27 countries) are EMDEs with high overall (domestic + external) interest burdens, high external principal repayment burdens, or both.

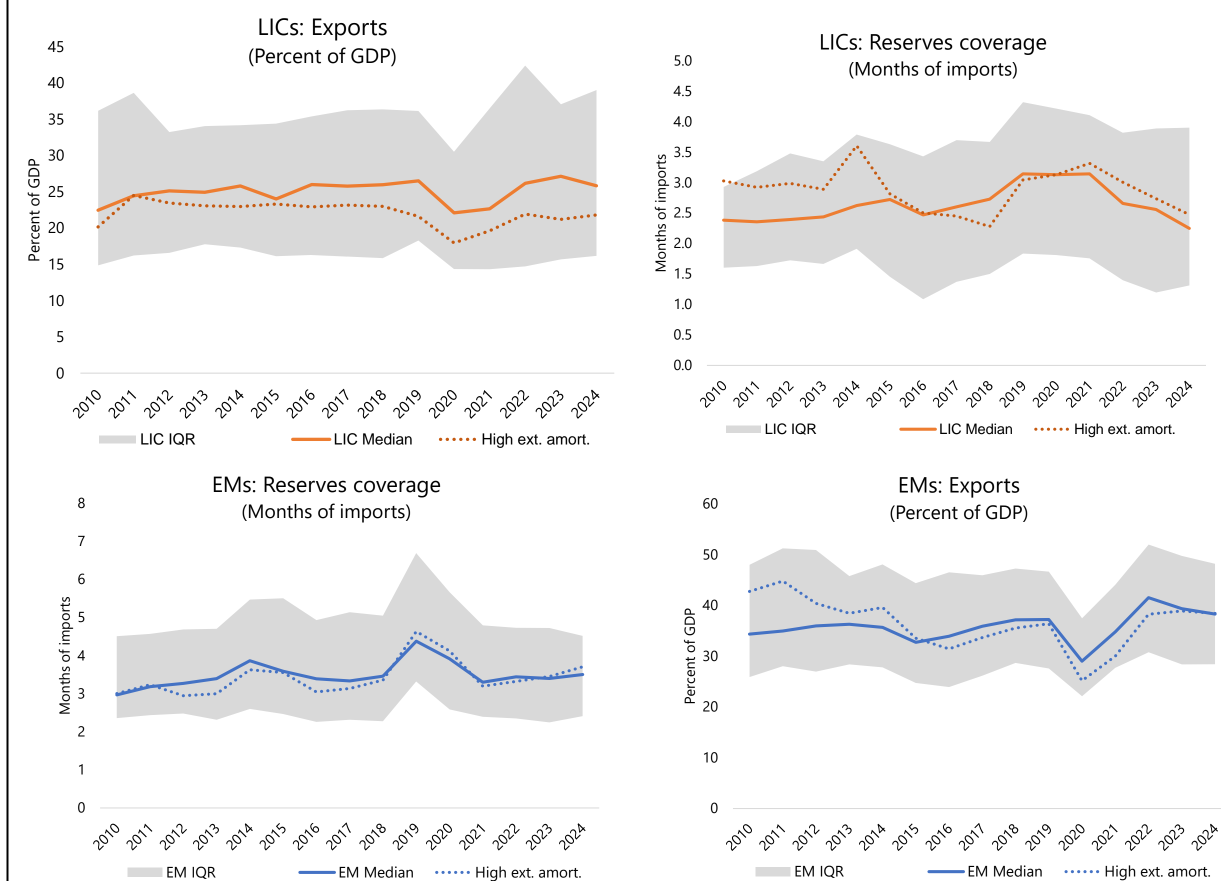
Figure 21. Tax Revenue to GDP Ratio



Sources: IMF World Economic Outlook October 2024 and Fund staff calculations.

25. Actions to improve underlying economic fundamentals and improve the capacity to repay are more urgent for those countries with the highest debt servicing burdens. For instance, structural reforms to boost growth and exports would significantly improve resilience for these countries. This is particularly relevant for LICs with high external amortization obligations relative to revenues as the median export base in this group has fallen below the median for all LICs over time, and despite having higher international reserve coverage than the full LIC sample, it has deteriorated faster than other LICs over the last decade. (Figure 22).

Figure 22. Exports and International Reserves Coverage in EMDEs



Sources: IMF World Economic Outlook October 2024 and Fund staff calculations.
Note: High Ext/Prin. refers to countries in the upper quartile of LICs and EMs, respectively, in external principal payments relative to revenues (excluding grants) over 2024-27.

26. **These efforts take time to bear fruit, however, and could be enabled with increased financing support from creditors and international partners.** Helping countries that are undertaking serious reform efforts meet their financing needs would help offer needed fiscal space and avert broad distress events (see the “3-pillar approach” proposed by the IMF and World Bank). In parallel, further progress on restructuring mechanisms should be achieved to ensure that, if needed, countries have access to timely, reliable, and predictable restructuring processes.